

1 for the benefit of customers. Unfortunately, due to its financial constraints, GSU could
2 not purchase and construct the gas storage facility. It contracted with Sabine Gas
3 Transportation Company ("SGT") to construct the facility and utilize it at the direction of
4 GSU. GSU retained control of construction, modifications, and operation of the facility.
5 In addition, the operating agreement included an option to purchase the facility from SGT
6 at a "Payoff Amount". The "Payoff Amount" reflected a reduced net cost in association
7 with the level of "Credit Payments" made by the Company.¹⁵⁸ The "Credit Payments"
8 were costs the Commission allowed the Company to pass on to customers. In 2004, the
9 Company exercised its purchase option and became the owner of the gas storage facility
10 for a \$1.00 payment.

11
12 **Q. HAVE SGSF CAPITAL COSTS BEEN INCLUDED IN ELIGIBLE FUEL SINCE**
13 **ITS INCEPTION?**

14 A. Yes. In Docket No. 10894, the Commission found that the "Credit Payments" to SGT for
15 capital reduction were costs that were passed on to customers.¹⁵⁹

16
17 **Q. WHAT IS THE VALUE OF THE FACILITY?**

18 A. Recently, the Company has appraised the value of the gas storage facility at \$100
19 million.¹⁶⁰ In other words, the current best estimate of the value of SGSF is
20 \$100,000,000 less the \$1 it paid for the facility.

21
22 **Q. ARE THERE OTHER EVENTS CURRENTLY TRANSPIRING THAT IMPACT**
23 **THIS PARTICULAR ISSUE?**

24 A. Yes. As part the electric deregulation process in Texas, a jurisdictional separation has
25 been completed. The Company is now a distinct corporate entity, separate from Entergy
26 Gulf States Louisiana. While the ownership of SGSF remains with ETI, the completion
27 of the separation process may result in the sale of the Texas system. In fact, Entergy
28 Corporation chairman and Chief Executive Officer J. Wayne Leonard told shareholders
29 in November 2007 that he might sell the Texas operations if the jurisdictional split were

¹⁵⁸ PUCT Docket No. 10894, Examiners' Report pages 106-110.

¹⁵⁹ PUCT Docket No. 10894 Finding of Fact 288.

¹⁶⁰ October 18, 2004 Hadco International Appraisal & Consulting Services.

1 approved by the Louisiana Public Service Commission. If this were to occur, or if
2 deregulation is eventually implemented for the Company, Texas retail customers stand to
3 lose the value of the facility they have already paid for and were previously promised.
4 Thus, Texas retail customers may lose their share of the current \$100 million gross
5 salvage attributable to the SGSF unless action is taken.
6

7 **Q. WHY IS IT APPROPRIATE TO TAKE ACTION IN THIS PROCEEDING?**

8 A. In Docket No. 10894, this Commission specifically afforded the Company recovery for
9 the *capital* costs of constructing the gas storage facility even though it did not own the
10 facility.¹⁶¹ This action was taken in spite of the Company's admission that if it had
11 constructed the facility itself it would have been subject to base rate treatment.¹⁶² The
12 Company could not build the facility itself due to budgetary constraints at the time the
13 project to construct the gas storage facility became available. The Commission granted
14 the Company special treatment based in part on the fact that customers were expected to
15 benefit from the facility. The Commission also allowed the pass through of capital costs
16 (i.e., depreciation) on an accelerated basis. The Commission allowed the financing of the
17 facility to be paid within a 10-year period rather than the then-estimated 30-year useful
18 life of the facility.¹⁶³ Now, in recognition of the changed circumstances, and the drastic
19 intergenerational inequity that occurred for customers, it is only fair and equitable to level
20 the field for current and future customers due to prior significant overpayment.

21
22 **Q. WHAT DO YOU RECOMMEND?**

23 A. I recommend that with the changed circumstances associated with the purchase of the
24 facility for \$1.00 by the Company that: (1) Texas retail customers be credited for their
25 allocable portion of the current \$100 million valuation or net salvage, and (2) Texas retail
26 customers be given credit in the APFD for prior payments for the return of capital (i.e.,
27 depreciation). These recommendations are conservative in favor of the Company, given
28 that the gas storage facility may very well continue to increase in value.

¹⁶¹ PUC Docket 10894.

¹⁶² Id., at Finding of Fact 308.

¹⁶³ Id., at Finding of Fact 310.

1 **Q. WHY DO YOU BELIEVE THAT THE VALUE OF THE FACILITIES WILL**
2 **INCREASE IN THE FUTURE?**

3 A. First and foremost, the value of the facilities increased by a factor of 2.5 times its original
4 \$40 million cost in a little over a decade ($\$100 \text{ million} \div \$40 \text{ million} = 2.5$). This increase
5 in value has occurred in large part due to the change in the natural gas industry and the
6 resulting prices that suppliers have and can demand for their product. The price of gas has
7 reached all-time highs in the last several years and the fact that the gas market is unstable,
8 coupled with the concern for air quality associated with coal-fired generation and
9 consideration of a return to a more robust economic market, results in the conclusion that
10 the future for gas prices will continue to be volatile and most likely be at a higher level
11 than experienced during the 1990s and early 2000s. As gas prices increase in cost over
12 time, the value of the gas storage facility further increases. Thus, in another 5 or 10 years
13 the gas storage facility may actually be valued at something much higher than the recent
14 estimate of \$100 million to another entity. In the event the Commission opts to retain the
15 SGSF regulated service, the value should be revisited in future rate cases like other net
16 salvage values are expected to be revisited.
17

18 **Q. FROM AN EQUITY STANDPOINT, ARE TEXAS RETAIL CUSTOMERS**
19 **ENTITLED TO THE VALUE OF THIS FACILITY?**

20 A. Yes. There can be no doubt that Texas retail customers have paid their proportionate
21 share of basically all costs associated with this facility. Had GSU not been in a budgetary
22 constraint position when the opportunity arose to acquire the rights to build the gas
23 storage facility customers would have paid significantly lower fuel costs and base rate
24 charges. Historical fuel costs would have been lower since there would have been no
25 "Credit Payments" made to SGT. Moreover, base rates would not have increased on a
26 comparable basis if the original costs had been included in rate base. This result would
27 have occurred since the effective depreciation component of revenue requirements would
28 have essentially been minimal or even a negative value given the estimated gross salvage
29 for the value of the facility would have been subtracted from the original cost. This is
30 standard industry practice since the useful life of the facility would extend beyond the
31 estimated life of the generating facilities that it serves (Sabine and Lewis Creek

1 generating stations). The last unit at the Sabine station is scheduled to retire no sooner
2 than 2029.¹⁶⁴ Thus, the gas storage facility could be sold at a substantial value above cost.

3
4 In addition, in compliance with the benefits-follows-burdens concept adopted by the
5 Texas Supreme Court, the fact that customers have in fact paid for capital costs, operating
6 costs, property taxes, and basically every other cost associated with the facility, entitles
7 any gain on sale to be assignable to customers.¹⁶⁵
8

9 **Q. WHAT IS YOUR UNDERSTANDING OF THE DIRECTION THE COURTS**
10 **HAVE PROVIDED TO THE COMMISSION REGARDING WHO IS ENTITLED**
11 **TO THE GAIN IN VALUE OF THE SGSF?**

12 A. I have been advised by counsel that the Texas Supreme Court recognized that “the proper
13 allocation is a complicated one that cannot be resolved simply by reference to who paid
14 for the property.”¹⁶⁶ The court relied in part on the benefits-follows-burdens principal
15 established in the Democratic Central Committee case.¹⁶⁷
16

17 The Court, while not requiring the Commission to consider all of the standards set forth
18 in its ruling, nor forbidding it from considering others, listed a number of factors. The
19 Court noted:

20
21 *In the general case, the gain should be allocated to that group (as*
22 *between shareholders and ratepayers) that has borne the financial*
23 *burdens (e.g., depreciation, maintenance, taxes) and risks of the asset*
24 *sold. In addition to these two general equitable factors, courts have*
25 *also considered numerous other factors, including whether the asset*
26 *had been included in the rate base over the years, whether the*
27 *asset was depreciable property, non depreciable property, or a*
28 *combination of the two types, the impact of the proposed allocation on*
29 *the financial strength of the utility, the reason for the asset's*
30 *appreciation (e.g., inflation, a general increase in property values in*
31 *the area), any advantages enjoyed by the shareholders because of*
32 *favorable treatment accorded the asset, the dividends paid out to the*

¹⁶⁴ Response to Rose City 1-16.

¹⁶⁵ 798 S.W. 2d 560.

¹⁶⁶ Id.

¹⁶⁷ Id.

1 *shareholders over the years, and any extraordinary burdens borne by*
2 *the ratepayers in connection with that asset.*
3

4 **Q. DID YOU CONSIDER VARIOUS FACTORS?**

5 A. I have considered numerous factors. First while ETI did not own the plant prior to
6 January 2005 and thus it was obviously not included in rate base, the treatment afforded
7 the Company by the Commission was in fact superior to rate base treatment. As
8 previously noted, the Commission granted the Company the right to recognize all
9 construction costs and operating costs as reconcilable fuel. By doing so, it allowed the
10 Company to pass basically all financial burdens on to customers and without the normal
11 regulatory lag and guaranteed cost recovery. In addition, the costs incurred by SGT for
12 property taxes, operation and maintenance expenses, etc. were also passed on to the
13 Company. The Company in turn included such costs as reconcilable fuel costs, which
14 were then passed on to customers. Once again, customers paid all operating and tax
15 impacts of the facility.
16

17 **Q. WERE CUSTOMERS RESPONSIBLE FOR DEPRECIATION?**

18 A. In effect, yes. While the amounts paid to SGT did not specifically identify depreciation, it
19 is an undeniable fact that the "Credit Payments" were for debt service requirements. The
20 principal and interest components of debt service requirements are the equivalent of
21 depreciation and return, respectively for plant afforded base rate treatment. Thus, the
22 principal payment is the equivalent of depreciation, and the interest portion of the debt
23 service payment is the equivalent of return. Therefore, while not identified specifically as
24 depreciation, customers did pay the equivalent of depreciation for the investment. This
25 fact also demonstrates that the regulatory treatment afforded the Company was more than
26 the equivalent of providing rate base treatment over the entire operating life of the
27 facility. This represents yet another burden carried by customers, not the Company.

1
2 **Q. DOES YOUR RECOMMENDED 100% ALLOCATION OF GAIN TO**
3 **CUSTOMERS TAKE INTO ACCOUNT THE FINANCIAL STRENGTH OF THE**
4 **COMPANY?**

5 A. Yes. While GSU was not in a financial position to construct the facility back in the early
6 1990s, that situation was rectified when GSU merged with Entergy. In fact one of the
7 benefits touted by Entergy in association with its proposed merger at that time was the
8 financial strength that it brought to the GSU system. Moreover, the financial strength of
9 the utility has been enhanced by normal regulatory treatment in rate proceedings as well
10 as very unique and special legislative treatments realized by the Company over the last
11 several years as it pertains to recovery of capacity charges and hurricane damage costs
12 during the period when the Company had been in a base rate freeze. In addition, when
13 the Company was granted fuel reconciliation treatment for the cost associated with the
14 SGSF it was granted favorable rate treatment for this particular asset. Had the Company
15 been required to place the asset into base rates rather than receiving reconcilable fuel
16 treatment it would have experienced a regulatory lag in recovery of funds and would not
17 have been guaranteed recovery. This regulatory lag was eliminated by the Commission
18 for the Company's use of the SGSF.
19

20 **Q. IS THE COMPANY RESPONSIBLE FOR THE INCREASE IN VALUE OF THE**
21 **FACILITY OVER THE YEARS?**

22 A. No. The value of the asset has increased due to market forces, not anything implemented
23 by the Company.
24

25 **Q. IN SUMMARY, IS THERE ANY FACTOR THAT YOU'VE IDENTIFIED**
26 **WHICH WOULD INDICATE THAT THE COMPANY'S SHAREHOLDERS**
27 **WERE ENTITLED TO SOME PORTION OF THE GAIN TO BE OBTAINED**
28 **FROM THE ULTIMATE DISPOSITION OF THIS FACILITY?**

29 A. No. Based on every meaningful factor I have been able to identify associated with the
30 construction, financing, operations, etc. of this facility, it has been customers who are
31 responsible for each component. As such, in my opinion it would clearly be in violation

1 of the principals set forth by the Supreme Court of Texas if the Company were to be
2 afforded any portion of the gain in value of this facility. Moreover, in Docket No. 10894,
3 Company witness Mr. Harrington stated that the savings of the project were for
4 customers, not shareholders.¹⁶⁸
5

6 **Q. HOW DO YOU PROPOSE TO RECOGNIZE THE \$100 MILLION VALUE FOR**
7 **TEXAS RETAIL CUSTOMERS?**

8 A. As of January 2005, the Company took ownership of the facility after purchasing the
9 facility for \$1.00. Texas retail customers should be credited with their allocable portion
10 of the \$100 million value as of that point in time. As shown on Schedule (JP-3) this
11 results in a \$42.5 million credit to the Texas retail jurisdiction. I recommend that the
12 amount be returned to customers over the 35.5-year remaining life I recommended for
13 Sabine 5, or \$1,197,183 annually. This amount should be credited whether Mr. Nalepa's
14 recommendation is adopted.
15

16 **Q. WHY IS IT APPROPRIATE TO CREDIT CUSTOMERS FOR THE SGSF NET**
17 **SALVAGE VALUE WHETHER THE PUC ADOPTS MR. NALEPA'S**
18 **RECOMMENDATION?**

19 A. Mr. Nalepa's recommendation reflects a prudent business decision regarding the annual
20 benefits versus costs for the SGSF. My recommendation relates to the value that a
21 different owner with a different operating philosophy might have regarding the facility. It
22 is my understanding that Mr. Nalepa's recommendation is based on the changed
23 circumstances relating to reliability issues and annual costs of operation. ETI no longer
24 needs the facility, but that fact does not change the value of the facility to a new owner.
25 By analogy, this is no different than a family no longer needing a two-seat sports car once
26 they have children. The fact that a two-seat sports car no longer fit one family's situation
27 does not diminish the value of the car.

¹⁶⁸ Mr. Harrington's rebuttal testimony at WEH-7 in Docket No. 10894.

1 **Q. TURNING TO YOUR SECOND ISSUE RELATING TO**
2 **INTERGENERATIONAL INEQUITY, WHAT DO YOU RECOMMEND?**

3 A. I recommend correcting the significant level of intergenerational inequity that currently
4 exists by amortizing the future service value over a four-year period in conjunction with
5 corresponding depreciation treatment of the estimated remaining life of the facility. This
6 treatment will eliminate the “free ride” future customers will enjoy given the full, but
7 accelerated, depreciation realized for the initial capital costs.
8

9 **Q. WHY ARE CUSTOMERS ENTITLED TO A CREDIT FOR PRIOR**
10 **ACCELERATED RETURN OF CAPITAL OR DEPRECIATION PAYMENTS?**

11 A. Had the SGSF been afforded normal base rate treatment rather than the superior fuel
12 treatment, the Company’s books would already reflect the “Credit Payments” in the
13 APFD (Account 108) as a credit to rate base. Given that customers were required to pay
14 off the facility on an accelerated basis to meet the construction related finance
15 requirements, it is only equitable to recognize such accelerated payments now that the
16 Company has taken formal ownership of the facility. The Texas retail jurisdiction should
17 be allocated its proportional share of the prior accelerated depreciation payments. This
18 results in a \$17 million adjustment to rate base.¹⁶⁹ In conjunction with this credit to rate
19 base, I also recommend a four-year amortization in order to correct the substantial level
20 of intergenerational inequity. This will result in a net \$3.8 million annual credit.¹⁷⁰

21 **Q. HAVE OTHER REGULATORS ADOPTED THE CORRECTION OF**
22 **INTERGENERATIONAL INEQUITY AS YOU ARE RECOMMENDING IN**
23 **THIS CASE?**

24 A. Yes. The FPSC within the past year ordered precisely this treatment I recommend in this
25 case. In fact, the FPSC ordered that state’s two largest electric utilities to credit their

¹⁶⁹ Production demand allocation factor of 42.5% as noted in response to Rose City 2-6(c) times the \$40 million initial cost.

¹⁷⁰ \$17 million amortized over 4 years equals \$\$4,250,000, less \$17 million depreciated over 35 years equals \$485,714.

1 retail customers with approximately \$1 billion of excess or prior accelerated depreciation
2 over a four-year period.¹⁷¹

3
4 **Q. WHAT ANNUAL LEVEL OF DEPRECIATION WILL CUSTOMERS BE**
5 **REQUIRED TO INCUR ASSOCIATED WITH YOUR RECOMMENDATION?**

6 A. As part of my recommendation customers will be required to pay \$485,714 of annual
7 depreciation expense in order to extinguish the \$17 million rate base credit over the 35-
8 year remaining life I am recommending.

9
10 **Q. WILL FUTURE CUSTOMERS HAVE TO PAY FOR A PORTION OF YOUR**
11 **RECOMMENDATIONS?**

12 A. Yes. After the proposed 4-year amortization is over and the Company files for a change
13 in base rates, future customers will begin paying a return and depreciation on the
14 \$17million portion of my recommendation for the remaining life of the facility. This
15 future payment will better meet the regulatory matching principle tying the payment by
16 those customers to the benefit of the storage facility being used to provide that generation
17 of customer's electric service. There will be no need for future customers to pay for the
18 \$42.5 million portion of my recommendation given that value will be provided through
19 the sale of the facility after it is retired from utility service.

20 **SECTION V: STORM INSURANCE RESERVE**

21 **1. General**
22

23 **Q. WHAT IS THE ISSUE IN THIS PORTION OF YOUR TESTIMONY?**

24 A. The Company requests an insurance reserve storm cost accrual of \$9,450,000.¹⁷² This
25 request is comprised of two components. The first component of \$4,180,000 relates to
26 recovering the Company's claimed \$64.4 million deficit in its insurance reserve, plus
27 building the storm reserve to a positive \$19.3 million target.¹⁷³ The Company proposes to

¹⁷¹ FPSC Docket Nos. 080677-EI and 090079-EI, a FP&L and Progress Energy Florida case, respectively.

¹⁷² Direct testimony of Mr. Wilson at page 4.

¹⁷³ Id.

amortize this claimed \$83.7 million (\$64.4 million + \$19.3 million) change in reserve position over a 20-year period, for a \$4.18 million annual expense. The second component of the Company's proposed annual accrual is \$5,270,000, which represents the Company's estimated annual ongoing storm losses.¹⁷⁴ In addition to these two components, ETI also requests \$25,278,210 in rate base, to be amortized over 5 years at an annual rate of \$5,055,642, associated with a proforma adjustment for hurricane securitization cost that were removed from the storm reserve.¹⁷⁵ This portion of my testimony addresses my recommendations to eliminate significant portions of the claimed historical reserve deficit, reduce the projected reserve target level, reduce the annual estimated storm loss expense, and assign storm reserve treatment to the proposed hurricane securitization proforma adjustment. As summarized in the table below, the combined impact of my recommendations reduces the Company's requested \$9.45 million annual revenue requirement by \$7,703,810 and also reduces rate base by \$45,867,967. I also recommend increasing the storm threshold level from \$50,000 per storm to \$500,000 per storm.

Rate Base Impact			
	<u>ETI</u>	<u>Cities</u>	<u>Adjustment</u>
Reserve Deficiency	\$64,355,152	\$47,497,395	(\$16,857,757)
Reserve Target	<u>\$19,304,000</u>	<u>\$15,572,000</u>	<u>(\$3,732,000)</u>
Subtotal	\$83,659,152	\$63,069,395	(\$20,589,757)
Hurricane Proforma	<u>\$25,278,210</u>	<u>\$0</u>	<u>(\$25,278,210)</u>
Total Rate Base	\$108,937,362	\$63,069,395	(\$45,867,967)
<u>Annual Accrual Impact</u>			
Rate Base Amortization	\$4,182,958	\$3,153,470	(\$1,029,488)
Annual Loss Accrual	\$5,270,000	\$3,651,320	(\$1,618,680)
Hurricane Proforma	<u>\$5,055,642</u>	<u>\$0</u>	<u>(\$5,055,642)</u>
Total Annual Expense	\$14,508,600	\$6,804,790	(\$7,703,810)

¹⁷⁴ Id., at page 5.

¹⁷⁵ Testimony of Mr. Wright at pages 19-20 and ETI Adjustment AJ15.10.

1 **Q. DOES THE COMMISSION PERMIT SELF-INSURANCE BY UTILITIES?**

2 A. Yes. The Commission has implemented Substantive Rule 25.231(b)(1)(G) relating to a
3 self-insurance plan for storm damages. The establishment and operation of the insurance
4 reserve is intended to produce a less costly approach to dealing with storm damage,
5 which could not have been reasonably anticipated, than would be the case if the
6 Company purchased commercial insurance.

7
8 **Q. DOES THE COMPANY CURRENTLY HAVE A SELF-INSURANCE**
9 **PROGRAM?**

10 A. Yes. In fact, the issues addressed in this proceeding cover the changes in the Company's
11 self-insurance reserve subsequent to the settlement in Docket No. 34800 and in the
12 Company's last fully litigated rate case, Docket No. 16705.

13
14 **Q. WHAT DID THE COMMISSION ADOPT REGARDING THE COMPANY'S**
15 **SELF-INSURANCE EXPENSE IN DOCKET NO. 16705?**

16 A. The Commission granted the Company \$1,651,320 per year for current losses and noted
17 the amount should accrue only enough each year to cover typical storm damage.¹⁷⁶ In
18 addition, the Commission did not set a storm reserve balance. The reason the
19 Commission did not set a storm reserve balance is because the Company did not provide
20 a reasonable post test-year level for its then existing reserve fund and because the
21 Company did not prove that the amounts expended in 1997 associated with an ice storm
22 were prudent or appropriate.¹⁷⁷

23
24 **Q. WAS THE ANNUAL STORM LOSS LEVEL MODIFIED RECENTLY?**

25 A. Yes. The Commission recently adopted a settlement in Docket No. 34800 that increased
26 the annual storm loss accrual to \$3,651,320 effective January 1, 2009.¹⁷⁸

¹⁷⁶ Docket No. 16705 FOF 146.

¹⁷⁷ Id., at FOF 147.

¹⁷⁸ Docket No. 34800 Settlement Term Sheet Item 8.

1 **Q. WHAT DOES THE COMPANY CLAIM HAS TRANSPIRED TO THE STORM**
2 **RESERVE SUBSEQUENT TO DOCKET NO. 16705?**

3 A. The Company claims that it has incurred storm losses from 155 different storms, each of
4 which exceeded \$50,000 of charges in aggregate.¹⁷⁹ In addition, the Company increased
5 the reserve on an annual basis for the \$1.651 million annual insurance accrual through
6 2008, and then by \$3.651 million annually beginning in 2009.

7
8 **Q. WHAT ARE THE VARIOUS COMPONENTS OF THE SELF-INSURANCE**
9 **RESERVE EXPENSE THAT REQUIRE INVESTIGATION?**

10 A. The Commission has identified the annual level of contributions until the amount was
11 increased effective January 1, 2009 in association with Docket No. 34800. All other
12 components that affect the insurance reserve level and annual expense are subject to
13 review and justification.

14 **2. Storm Reserve Deficit**
15

16 **Q. WHAT DOES THE COMPANY CLAIM AS ITS STORM RESERVE DEFICIT?**

17 A. The Company claims a \$64 million deficit or negative reserve currently.¹⁸⁰
18

19 **Q. WHAT IS INCLUDED IN THIS RESERVE THAT CAUSES IT TO BE SO**
20 **NEGATIVE?**

21 A. The Company has included all storm-related costs that in aggregate exceeded \$50,000 per
22 storm. Some of the costs recognized by the Company included incentive compensation,
23 fire and property insurance premiums, safety training expenses, computer hardware
24 acquisitions, and, in effect, anything else the Company deems appropriate.
25

26 **Q. DID MR. WILSON DEVELOP THE \$64 MILLION RESERVE DEFICIT**
27 **VALUE?**

28 A. No. This amount was provided to him by the Company.¹⁸¹

¹⁷⁹ Response to Rose City 5-1.

¹⁸⁰ Direct Testimony of Mr. Wilson at page 5. The precise claimed deficit is \$64,355,152.

¹⁸¹ Deposition of Mr. Wilson on April 22, 2010 at TR 12.

1 **Q. DID MR. WILSON INVESTIGATE THE REASONABLENESS OR NECESSITY**
2 **OF ANY OF THE EXPENSES THAT WERE INCLUDED IN THE CLAIMED \$64**
3 **MILLION RESERVE DEFICIT?**

4 A. No.¹⁸²
5

6 **Q. DID THE COMPANY PRESENT ANY DETAILED ANALYSES**
7 **DEMONSTRATING THE VALIDITY OF THE COSTS REFLECTED IN ITS**
8 **STORM RESERVE?**

9 A. No. There was no presentation by the Company that demonstrates it has only included
10 prudent, reasonable and necessary costs in its storm reserve. In fact, the loss-run data
11 supporting the costs included in the storm reserve for the periods prior to 1996 were not
12 retained.¹⁸³ Moreover, the Company did not provide any documentation that
13 demonstrates that the labor charges reflected in the storm reserve are not already being
14 recovered through base rate charges and thus may represent a double recovery of
15 expense.
16

17 **Q. AFTER REVIEW OF ALL THE DOCUMENTATION PRESENTED BY THE**
18 **COMPANY ASSOCIATED WITH ITS STORM RESERVE, DO YOU BELIEVE**
19 **ADJUSTMENTS ARE NECESSARY?**

20 A. Yes. In my opinion, the Company's claimed \$64 million current storm reserve deficiency
21 is quite excessive. In fact, I recommend adjustments to remove the impact of: (1) the
22 major 1997 ice storm; (2) the first \$50,000 of each storm corresponding to a deductible
23 that would be in place by standard insurance practices; (3) miscellaneous expenses not
24 appropriately included in the reserve; (4) a proposed situs based adjustment addressed in
25 Docket No. 34800; and (5) additional insurance proceeds associated with securitized
26 storms that have been received or estimated, but which are not reflected in the
27 securitization process or the current filing.

¹⁸² Id., at TR 12 and 13.

¹⁸³ Response to Cities 30-1 in Docket No. 34800.

1 **Q. PLEASE DISCUSS YOUR FIRST ADJUSTMENT RELATING TO THE 1997 ICE**
2 **STORM.**

3 A. Included in the insurance reserve is a charge of \$13,014,379 associated with the January
4 13, 1997 ice storm.¹⁸⁴ This particular storm resulted in a separate docket before the
5 Commission in which the Company's actions were investigated. That proceeding was
6 Docket No. 18249. The Order on Rehearing identified the following critical issues or
7 problems associated with the Company's actions that led, in part, to the significant cost
8 associated with storm restoration efforts:

- 9
- 10 • The Company conceded that it did not have a traditional pole inspection program.
- 11 With the Entergy-GSU merger, the Company reduced the number of inspections
- 12 for poles. The Company's pole inspection and work cycles were not sufficiently
- 13 rigorous, continuous or frequent to maintain all of its facilities in the condition
- 14 required to meet its reliability and service obligations under PURA.¹⁸⁵
- 15 • The Company's line maintenance and vegetation control were reactive in nature
- 16 and lacked written and specific preventative maintenance policies. Moreover,
- 17 priority was not given to capital additions to the detriment of adequate
- 18 maintenance practices.¹⁸⁶
- 19 • While the Company claimed that its vegetation management was adequate and
- 20 consistent with industry practices, extensive evidence was provided to document
- 21 serious neglect of vegetation management. Such serious neglect resulted in
- 22 heightened risk to the distribution system associated with the ice storm. "The
- 23 Commission concludes that the level of the Company's vegetation management is
- 24 unacceptable and has significantly affected the reliability of the distribution
- 25 system in recent years."¹⁸⁷
- 26 • The Company itself found it necessary to hire 30 new vegetation clearance crews
- 27 subsequent to the ice storm, which only confirmed the existence of an
- 28 unacceptable backlog in vegetation control prior to the ice storm.¹⁸⁸
- 29 • "The January 1997 ice storm was certainly a severe storm that would have
- 30 diversely affected the best-maintained distribution system. EGS' distribution
- 31 system, however, is not the best-maintained. A major cause of the outages during
- 32 the storm was broken or bowed ice-laden tree limbs overhanging the wires. Tree
- 33 limbs in ROW overhanging distribution lines pose a threat to system reliability
- 34 and are largely within EGS' control. The Company's failure to clear the limbs
- 35 before the storm was a major factor in the number and duration of outages
- 36 experienced by customers. While the Company's initial efforts to mobilize and

¹⁸⁴ Response to Rose City 5-2.

¹⁸⁵ Docket No. 18249 Order on Rehearing page 9.

¹⁸⁶ Id., at pages 9 and 10.

¹⁸⁷ Id., at page 15.

¹⁸⁸ Id.

1 deploy non-EGS personnel were slow and caused concern, vegetation
2 management failures greatly aggravated the situation.”¹⁸⁹

- 3 • The Company’s management structure is ill-suited to assure best supervision of
4 the T&D System in the Texas territory.¹⁹⁰
- 5 • The inspection program carried out by the Company was not sufficiently
6 extensive or adequate to fulfill its proposed purpose of securing reliable
7 service.¹⁹¹
- 8 • The Company’s distribution system maintenance practices fail to assure
9 continuance and adequate service to customers.¹⁹²
- 10 • “Negligent and backlog of vegetation management projects has posed
11 unacceptable risk of increasing and recurrent service outages, especially during
12 major storms.”¹⁹³

13
14 Moreover, the Proposal for Decision in Docket No. 16705 stated the following regarding
15 the 1997 ice storm:

16
17 First, the ALJs recommend the Commission ignore the \$13 million in this
18 case. EGS did not meet its burden to prove that the \$13 million
19 expenditure was prudent and reasonable, or even that it was necessary.
20 Cities point out in their Brief that EGS did not inform the other parties that
21 further charges were made to the fund, and EGS did not update discovery
22 requests advising that the reserve was at a level different from the \$11.4
23 million. Tr. 6928; 6744-6745 (Lawton). The only information concerning
24 post-test-year charges to the reserve appeared in Mr. Wilson’s rebuttal. Tr.
25 8136. On cross-examination, Mr. Wilson testified that he did not know
26 when he first learned that the insurance reserve has been reduced. And he
27 did not review or evaluate the expenditures to determine whether they
28 were prudently incurred, or whether they had been properly expensed and
29 capitalized. Tr. 8800-8803. He did not know if any of the damage could
30 have been avoided by better tree trimming of maintenance of poles. Cities,
31 OPC, and General Counsel suggest, and the ALJs agree, that this issue can
32 be addressed in the 1998 rate filing when all parties will have the
33 opportunity to evaluate the reasonableness of the changes to the insurance
34 reserve fund.¹⁹⁴ (Emphasis added).

35
36 The above noted items, along with other items set forth in Docket No. 18249, clearly
37 establish that the Company did not perform adequately or prudently and incurred
38 excessive costs associated with the January 1997 ice storm. Therefore, I recommend that

¹⁸⁹ Id., at pages 17-18.

¹⁹⁰ Id., at FOF 26.

¹⁹¹ Id., at FOF 45.

¹⁹² Id., at FOF 46.

¹⁹³ Id., at FOF 82.

¹⁹⁴ Docket No. 16705 PFD at page 186.

1 the Commission exclude the \$13 million of ice storm related charges from the
2 Company's insurance reserve.

3
4 **Q. PLEASE DISCUSS YOUR SECOND ADJUSTMENT TO THE COMPANY'S**
5 **INSURANCE RESERVE ASSOCIATED WITH DEDUCTIBLE LEVELS.**

6 A. The Company's self-insurance program fails to comply with standard insurance practices
7 and in fact, creates a perverse incentive. The issue is the Company's failure to treat the
8 lower \$50,000 threshold as a deductible event. Indeed, with normal insurance policies, an
9 incentive is provided to the party purchasing insurance to not make unreasonable or
10 frivolous claims. Part of that deterrent is the requirement of a deductible. In this case, the
11 \$50,000 minimum threshold employed by the Company should serve the purpose of
12 being the deductible in the insurance process.

13 **Q. HOW SHOULD THE DEDUCTIBLE WORK AS IT RELATES TO THE**
14 **INSURANCE RESERVE?**

15 A. If the Company incurred \$49,999 of expense associated with the storm, it would absorb
16 the entire amount as O&M expenditures. However, if the Company captures one
17 additional dollar of expense, then it converts the process to insurance reserve treatment
18 and includes all expenditures associated with such storm in the insurance reserve, rather
19 than only those amounts in excess of the first \$50,000. Regulation must provide
20 reasonable and appropriate incentives in order to minimize costs. The failure to recognize
21 a deductible only encourages the occurrence of costs and provides no incentive to act
22 prudently and in the best interest of customers.

23
24 **Q. IS THERE ANY REASON TO TREAT THE FIRST \$50,000 OF STORM COSTS**
25 **INCURRED AS INSURANCE RESERVE COSTS?**

26 A. No. Failure to treat the first \$50,000 of O&M expense related storm expenditures as a
27 deductible insurance practice is inappropriate and must be denied.

1 **Q. WHAT IS THE IMPACT OF THIS RECOMMENDATION?**

2 A. The Company's insurance reserve reflects 155 different storms since Docket No.
3 16705.¹⁹⁵ Therefore, after removal of the ice storm previously discussed, I recommend a
4 reduction to the insurance reserve in the amount of \$7,700,000, or 154 times \$50,000 per
5 storm.

6
7 **Q. PLEASE ADDRESS THE THIRD AREA OF ADJUSTMENT ASSOCIATED**
8 **WITH MISCELLANEOUS INAPPROPRIATE CHARGES.**

9 A. As set forth in the table below, the Company has included numerous charges in its storm
10 reserve that do not comply with the Commission's rule. One of the Commission's rules
11 requires charges only for "property and liability losses which occur, and which could not
12 have been reasonable anticipated and included in operating and maintenance expense."¹⁹⁶

Description	Amount ¹⁹⁷
Incentive Compensation	\$1,002,104
Non-Productive Loading	\$1,586,480
Fire & Property Insurance	\$3,555,179
Computer Hardware Acquisitions	\$487,727
Safety Training Loader	\$722,796
Total	\$7,354,286

13 Items such as incentive compensation are not appropriate. Incentive compensation, to the
14 extent that is allowed in base rates in the first place, will not vary depending on whether
15 an employee's time is expended performing normal services or storm reserve related
16 activity. Thus, such charges easily can be anticipated and reflected in O&M expense.

17
18 **Q. IS THE SAME SITUATION TRUE FOR NON-PRODUCTIVE AND SAFETY**
19 **TRAINING LOADERS AS IS THE CASE FOR INCENTIVE COMPENSATION?**

20 A. Yes. The same is true for non-productive loaders and safety training loaders reflected in
21 the reserve.

22

¹⁹⁵ Response to Rose City 5-1, including the ice storm.

¹⁹⁶ P.U.C. Subst. Rule 25.231(b)(1)(G).

¹⁹⁷ Response to Rose City 20-6 and Response to Cities 30-4 in Docket No. 34800.

1 **Q. CAN THE COMPANY PROVIDE ANY DOCUMENTATION OR SUPPORT FOR**
2 **ITS INCLUSION OF HARDWARE ACQUISITION IN THE PROPERTY**
3 **INSURANCE RESERVE?**

4 A. No. The Company was specifically requested to explain in detail and justify the inclusion
5 of costs associated with computer hardware acquisitions into the property insurance
6 reserve. The Company's entire response to the request for "all support" was that "these
7 charges were related to and deemed necessary for storm restoration."¹⁹⁸ (Emphasis
8 added). The word "deemed" does not rise to the level of credible support for the inclusion
9 of computer hardware costs into the storm reserve.

10
11 **Q. DO EXPENDITURES FOR FIRE AND PROPERTY INSURANCE PREMIUMS**
12 **QUALIFY FOR STORM INSURANCE RESERVE TREATMENT?**

13 A. No. There is no credible claim that premiums for fire and property insurance are not
14 reasonably anticipated and includable in operations and maintenance expenses as noted in
15 the Commission's substantive rules. Indeed, beginning in December of 2007 the
16 Company no longer charged fire and property insurance premiums to its insurance
17 reserve.¹⁹⁹

18
19 **Q. WHAT DO YOU RECOMMEND REGARDING THE COMPANY'S PRACTICE?**

20 A. I recommend that the \$3,555,179 of fire and property insurance premium charges be
21 removed from the claimed insurance reserve deficit.

22
23 **Q. PLEASE DISCUSS YOUR NEXT ADJUSTMENT TO THE INSURANCE**
24 **RESERVE BALANCE ASSOCIATED WITH THE COMPANY'S PROPOSED**
25 **SITUS ADJUSTMENT.**

26 A. As part of the Company's presentation of its current storm reserve deficiency, it identifies
27 a reapportionment of jurisdictional reserve balances due to an analysis during the
28 Jurisdictional Separation Plan split.²⁰⁰ As part of this analysis, the Company attempted to

¹⁹⁸ Response to Rose City 21-33.

¹⁹⁹ Response to Rose City 21-22.

²⁰⁰ Response to Rose City 5-1 Attachment 1, footnote 2.

1 shift \$12,498,325 of charges previously recorded as Louisiana costs to the Texas
2 jurisdiction.²⁰¹

3
4 **Q. HAS THE COMPANY DEMONSTRATED THAT ITS PROPOSED**
5 **ADJUSTMENT IS APPROPRIATE?**

6 A. No. In fact, the Company's presentation is an after the fact attempt to change the
7 historical allocation process.

8
9 **Q. HAS THE COMMISSION PREVIOUSLY RECOGNIZED POTENTIAL**
10 **PROBLEMS WITH THE COMPANY'S AFTER THE FACT POLICY CHANGES**
11 **AS IT RELATES TO ALLOCATION OF COSTS BETWEEN JURISDICTIONS?**

12 A. Yes. In Docket No. 34800, the Commission stated the change in the way that the
13 Company allocated its transmission costs is "a policy decision that should be made by the
14 Commission upon consideration of the facts and circumstances that necessitate such a
15 change."²⁰² The Commission further stated that without "detailed analysis and findings of
16 fact, the Commission finds it inappropriate to change Entergy's transmission cost
17 allocation methodology as part of this case."²⁰³ In other words, the Company must make
18 a strong showing that its policy changes are appropriate before the Commission will
19 permit a shifting of cost previously charged to Louisiana to be reassigned to Texas
20 customers.

21
22 **Q. HAS THE COMPANY PRESENTED A FULL AND COMPLETE ANALYSIS OF**
23 **ALL JURISDICTIONAL SEPARATION ISSUES IN THIS PROCEEDING?**

24 A. No. Indeed, prior to allowing a change in the historical allocation of costs between
25 jurisdictions for the storm reserve, it is incumbent upon the Company to present and
26 justify that all historical jurisdictional charges are appropriately reflected in the
27 Jurisdictional Separation Plan. Failure to do so could and undoubtedly has resulted in
28 Texas retail customers already paying more than their fair share in comparison to
29 Louisiana ratepayers. Therefore, I recommend that the historical allocation of costs

²⁰¹ Response to Rose City 17-26.

²⁰² Docket No. 34800 Order on Remand page 10.

²⁰³ Id.

1 between Texas and Louisiana reflected in the storm reserve be retained. This
2 recommendation reverses the Company's proposed reassignment of costs.

3
4 **Q. PLEASE DISCUSS YOUR NEXT ADJUSTMENT TO THE INSURANCE**
5 **RESERVE DEFICIT BALANCE.**

6 A. In association with the securitization process relating to Hurricanes Rita and Katrina, the
7 Company has received insurance proceeds or has revised its insurance estimates
8 subsequent to the analysis reflected in Adjustment 15 to the Company's filing.²⁰⁴ The
9 Company states there have been two additional changes that impact the insurance related
10 amount reflected in the Company's filing. First, the actual proceeds for Hurricane Katrina
11 received in December 2009 exceeded the estimated proceeds by \$7,290. Second, the
12 Company revised the estimated proceeds for Hurricane Rita that exceeded the previous
13 estimate by \$1,511,688.²⁰⁵ Therefore, the combined total of these two insurance proceed
14 related adjustments total \$1,518,978 and should be recognized in this case.

15
16 **Q. PLEASE DISCUSS YOUR LAST ADJUSTMENT TO THE INSURANCE**
17 **RESERVE DEFICIT BALANCE.**

18 A. I recommend reversal of Company proposed Adjustment 15. This proposed adjustment
19 attempts to remove from the insurance reserve the unrecovered hurricane insurance
20 proceeds, insurance proceeds in excess of insurance proceeds included in the
21 securitization process and carrying costs.²⁰⁶ ETI proposes to carve \$25 million out of the
22 insurance reserve and establish a separate regulatory component for which it also
23 proposes a 5-year amortization. There is no valid basis for this proposed separate and
24 unique treatment. Therefore, ETI's proposed Adjustment 15, Hurricane Securitization,
25 should be eliminated by returning the \$25 million amount to the insurance reserve. This
26 recommendation does not impact rate base, but does reduce the net annual amortization
27 by \$3,791,732 due to the differing amortization periods (5 years for Adjustment 15
28 versus 20 years for storm insurance reserve).

29

²⁰⁴ Response to Rose City 23-21.

²⁰⁵ Id.

²⁰⁶ Testimony of Mr. Wright at page 20.

1 **Q. WHAT DO YOU RECOMMEND?**

2 A. I recommend that the storm reserve deficit balance be adjusted upward (less negative) by
3 \$1,518,978 to reflect the additional funds received, or increased estimates by the
4 Company, for insurance proceeds relating to Hurricanes Katrina and Rita and by
5 \$3,791,732 for reversal of ETI proposed Adjustment 15.
6

7 **Q. WHAT IS THE IMPACT OF YOUR VARIOUS RECOMMENDATIONS TO THE**
8 **COMPANY'S CLAIMED CURRENT LEVEL OF STORM RESERVE**
9 **DEFICIENCY?**

10 A. The Company claims a \$64,355,152 current deficiency in its storm insurance reserve.
11 The adjustments previously discussed total \$16,857,757, and reduce the Company's
12 claimed storm insurance reserve deficit to a deficit of \$47,497,395.

13 **3. Target Reserve**
14

15 **Q. WHAT TARGET RESERVE DOES THE COMPANY REQUEST IN THIS**
16 **PROCEEDING?**

17 A. The Company proposes to increase the current \$15,572,000 target storm reserve to
18 \$19,304,000. This represents an increase of \$3,732,000 or 24% above the current target.
19

20 **Q. IS THE PROPOSED TARGET SIGNIFICANTLY DIFFERENT FROM THE**
21 **TARGET LEVEL PROPOSED IN DOCKET NO. 34800?**

22 A. Yes. In Docket No. 34800, Mr. Wilson proposed a \$37,110,000 total target amount to the
23 reserve.²⁰⁷ While, the Company's proposed target level in this proceeding is noticeably
24 less than what was proposed approximately 2 years earlier, it is still excessive.
25

26 **Q. HOW DID THE COMPANY DEVELOP ITS PROPOSED TARGET IN THIS**
27 **PROCEEDING?**

28 A. Mr. Wilson ran a Monte Carlo simulation on Company loss history. Mr. Wilson
29 performed 5,000 iterations of simulated experience. Based on this simulation, Mr. Wilson

²⁰⁷ Direct Testimony of Mr. Wilson page 9 of 18 in Docket No. 34800, but included the anticipated impact of major hurricanes.

1 claims that in any 25-year period, the largest annual expected storm loss totaling less than
2 a \$100 million is approximately \$19.3 million.²⁰⁸
3

4 **Q. DID MR. WILSON RELY ON THE MONTE CARLO ANALYSIS FOR THE**
5 **ESTABLISHMENT FOR THE TARGET RESERVE LEVEL IN THE LAST**
6 **CASE?**

7 A. No. Mr. Wilson admitted that he did not use a Monte Carlo analysis in the last
8 proceeding.²⁰⁹
9

10 **Q. DOES MR. WILSON'S MONTE CARLO SIMULATION INCLUDE THE**
11 **IMPACT OF THE PREVIOUSLY DISCUSSED 1997 ICE STORM?**

12 A. Yes.²¹⁰
13

14 **Q. DID MR. WILSON INVESTIGATE ANY OF THE HISTORICAL LOSS DATA**
15 **REFLECTED IN THE MONTE CARLO SIMULATION?**

16 A. No. Therefore, Mr. Wilson cannot attest to the validity of his database as being
17 reasonable and necessary for ratemaking purposes. As previously discussed, the historical
18 analysis includes charges that are inappropriate for ratemaking purposes and thus,
19 overstates the target level even if it were to be appropriately based on a Monte Carlo
20 simulation.
21

22 **Q. DO THE AMOUNTS REFLECTED IN MR. WILSON'S MONTE CARLO**
23 **SIMULATION ALSO INCLUDE HURRICANE RELATED COSTS?**

24 A. Yes. While the Company has excluded the majority of hurricane related costs, it has still
25 included over \$40 million of hurricane related costs that were not securitized in its
26 analysis.²¹¹

²⁰⁸ Direct Testimony of Mr. Wilson at page 10.

²⁰⁹ Deposition of Mr. Wilson on April 22, 2010 at TR 30.

²¹⁰ Id., at TR 28.

²¹¹ Response to OPC 20-10(b).

1 **Q. DID MR. WILSON NORMALIZE HIS DATABASE PRIOR TO PERFORMING**
2 **THE MONTE CARLO SIMULATION?**

3 A. No. While Mr. Wilson trended his historical loss data based on inflation considerations,
4 he failed to normalize for any other factors. Other factors include items such as
5 vegetation maintenance that the Company implemented after the 1997 ice storm, any
6 process improvements developed as part of planning for storm recovery activities, better
7 software mapping systems of the Company's service territory or other factors that would
8 change the resulting costs if the same storm were to occur in the future.

9
10 **Q. IN YOUR OPINION, IS THE HISTORICAL DATABASE ARTIFICIALLY**
11 **SKEWED TO PRODUCE HIGH-SIDE COST ESTIMATES?**

12 A. Yes. Mr. Wilson's sole efforts associated with attempting to recognize inflation and
13 failing to recognize any other factors that would offset costs results in a skewed database
14 that produces artificially excessive cost estimates.

15
16 **Q. WHAT DO YOU RECOMMEND REGARDING THE TARGET STORM**
17 **RESERVE LEVEL?**

18 A. I recommend retaining the existing target reserve level. The existing target better
19 represents the historical data after adjustment for identifiable excesses reflected in the
20 losses (e.g., the 1997 ice storm). Further, retention of existing target level also recognizes
21 that other factors (e.g., a more storm hardened system, computerized mapping systems,
22 etc.) other than inflation have changed from historical time periods that should result in
23 lower storm losses even if the same event were to transpire in the future.

24
25 **Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?**

26 A. My recommendation results in a \$2,732,000 reduction in the target level reserve. When
27 this amount is amortized over the same 20-year period proposed by Mr. Wilson, it
28 reduces the Company's storm insurance related revenue requirement by \$186,600.

1 **4. Annual Expected Losses**

2
3 **Q. WHAT DOES THE COMPANY REQUEST FOR ITS EXPECTED ANNUAL**
4 **STORM LOSSES?**

5 A. The Company proposes to accrue \$5,270,000 annually in the self-insurance reserve to
6 cover expected losses for storms each year.²¹² This amount reflects Mr. Wilson's
7 expectation for annual storm losses, except for those storms over \$100 million adjusted to
8 reflect current loss levels.²¹³

9 **Q. WHAT LEVEL OF ANNUAL EXPECTED STORM LOSSES DID MR. WILSON**
10 **PROPOSE IN DOCKET NO. 34800?**

11 A. Mr. Wilson proposed an annual accrual of \$13,840,000 for expected annual storm
12 losses.²¹⁴

13
14 **Q. HOW DID MR. WILSON DETERMINE HIS CURRENT \$5.27 MILLION**
15 **ANNUAL STORM LOSS PROPOSAL?**

16 A. Mr. Wilson again relied on the previously noted Monte Carlo simulation of the
17 Company's loss history.²¹⁵

18
19 **Q. HOW DOES MR. WILSON'S CURRENT PROPOSAL COMPARE TO WHAT**
20 **THE COMMISSION HAS PREVIOUSLY ACCEPTED OR ADOPTED FOR**
21 **ANNUAL STORM LOSS LEVELS?**

22 A. In Docket No. 16705, the Commission adopted a \$1,651,320 annual storm loss level.
23 This amount was in place until 2009 when, based on the settlement adopted by the
24 Commission in Docket No. 34800, the annual amount was raised to \$3,651,320 annually.
25 Thus, the parties and the Commission believed that a \$3.65 million annual storm loss
26 level was reasonable and acceptable as recently as 1 year before the Company filed its
27 current case.

²¹² Direct Testimony of Mr. Wilson at page 7.

²¹³ Id.

²¹⁴ Direct Testimony of Mr. Wilson in Docket No. 34800 at page 5.

²¹⁵ Mr. Wilson's Direct Testimony at page 7.

1 **Q. HAVE YOU REVIEWED MR. WILSON'S MONTE CARLO SIMULATION,**
2 **WHICH FORMS THE BASIS FOR HIS PROPOSAL?**

3 A. Yes. As previously discussed, the Monte Carlo simulation is a new process employed by
4 Mr. Wilson. As previously noted, the database relied upon for simulation purposes
5 includes many significant levels of cost that are inappropriate for ratemaking purposes
6 and for purposes of predicting reasonable future expectations. In addition, the Company's
7 analysis fails to recognize any factor other than inflation that can and will impact the
8 severity of costs incurred in future storms. In addition, Mr. Wilson's simulation over
9 estimates the number of storms eligible for inclusion in the storm reserve, thereby
10 increasing the projected annual total of storm related O&M expense of reach of his 5,000
11 iterations in his Monte Carlo simulation.
12

13 **Q. HAS THE COMPANY PROVIDED ANY VALID BASIS ON WHICH TO ADOPT**
14 **MR. WILSON'S FLAWED MONTE CARLO SIMULATION?**

15 A. No.
16

17 **Q. HAS THE COMMISSION RECOGNIZED THE VALIDITY OF RELYING ON**
18 **HISTORICAL AVERAGES AS A REASONABLE APPROACH TO**
19 **ESTABLISHING EXPECTED ANNUAL STORM LOSSES?**

20 A. Yes. In Docket No. 35717, an Oncor Delivery case, the Commission accepted an annual
21 storm loss expectation based in part on a 10-year average of storm cost values.²¹⁶
22

23 **Q. IS RELIANCE ON A 10-YEAR HISTORICAL AVERAGE REASONABLE IN**
24 **THIS CASE?**

25 A. No. Given the significant spike of hurricane activity during the last 5 years, reliance on
26 too short of a historical average skews the reasonably expected results associated with
27 long-term weather conditions. Indeed, just the 2007 value, which includes approximately
28 \$25 million of costs associated with Hurricane Humberto, noticeably skews any average
29 that relies on too short of a timeframe to an excessive level for purposes of future
30 projections. The 2007 level associated with Hurricane Humberto is more than 80%

²¹⁶ Docket No. 35717 Final Order at FOF 100 and page 111 of the Proposal for Decision.

1 greater than the next highest value reported in the Company's database, that being 1997.
2 As previously noted, the 1997 value includes over \$13 million associated with the most
3 severe ice storm the Company has ever experienced and which reflects excessive cost
4 levels due to inappropriate actions by the Company. Removing the 1997 storm-related
5 activity renders the 2007 Humberto related value at over 150% greater than the next
6 highest value reflected in the Company's 20 plus year historical database. Therefore,
7 reliance on a 10-year historical period only serves to artificially inflate the expected
8 annual storm loss level.
9

10 **Q. HAVE YOU ANALYZED THE HISTORICAL DATA FROM THE STANDPOINT**
11 **OF ESTABLISHING A REASONABLE ANNUAL STORM LOSS?**

12 A. Yes. Review of the historical data, even on a trended loss basis, but absent the impact of
13 the category 1 Hurricane Humberto, indicates that the current existing \$3.651 million
14 annual storm loss accrual would be both reasonable and adequate level for annual storm
15 loss accruals. The reasonableness of the existing annual storm loss level is especially true
16 taking into considerations that the historical data still contains inappropriate storm loss
17 charges for ratemaking purposes. Indeed, both the 10-year and 20-year average of the
18 trended annual storm loss levels, excluding Hurricane Humberto and the 1997 ice storm
19 costs, each yield approximately the existing \$3.651 million annual storm loss expected
20 cost approved by the Commission and agreed to by all parties in Docket No. 34800.²¹⁷
21

22 **Q. IS THERE ANOTHER CONSIDERATION THAT MUST BE RECOGNIZED IN**
23 **ESTABLISHING THE ANNUAL STORM LOSS VALUE?**

24 A. Yes. The way the process works is that the annual accrual remains constant until the next
25 rate proceeding. Therefore, the storm loss reserve was only increased by the \$1.651
26 million annual accrual adopted in Docket No. 16705. However, the collection of that
27 amount through base rates is predominantly based on energy charges. Given that there
28 has been growth on the system since 1996, the Company's actually collected through
29 base rates much more than the \$1.651 million annual accrual. However, customers have
30 not received the benefit of the annual additional amount that the Company has recovered

²¹⁷ The 10-year average trended loss value is \$3.8 million, while the 20-year average is \$3.6 million.

1 through base rates for the insurance reserve annual storm amounts. Therefore, the higher
2 the annual storm reserve amount set, the greater amount the Company actually recovers
3 from customers over time, but for which it does not credit customers. Such amounts
4 become additional return for the Company, rather than a credit to the insurance reserve.
5

6 **Q. WHAT DO YOU RECOMMEND?**

7 A. Based on the approaches discussed above, I recommend retention of the recently adopted
8 \$3,651,320 annual storm loss value. This results in a \$1,618,680 reduction to the
9 Company's request.

10 **5. Minimum Storm Reserve Threshold**
11

12 **Q. WHAT IS THE CURRENT STORM RESERVE THRESHOLD?**

13 A. Any storm-related property loss of at least \$50,000 is accounted for in the storm
14 reserve.²¹⁸
15

16 **Q. WHAT IS THE BASIS FOR THE \$50,000 MINIMUM THRESHOLD LEVEL?**

17 A. Other than having been approved prior to Docket No. 16705, the Company could not
18 provide any narrative explanation on how the \$50,000 level was determined.²¹⁹
19

20 **Q. HOW OFTEN HAS THE COMPANY REVIEWED THE \$50,000 THRESHOLD**
21 **FOR REASONABLENESS?**

22 A. The Company could not identify a single instance in which it has reviewed the \$50,000
23 minimum threshold for reasonableness.²²⁰

²¹⁸ Response to Rose City 9-2.

²¹⁹ Response to Rose City 9-3.

²²⁰ Id.

1 **Q. HAS THE COMPANY COMPARED ITS \$50,000 MINIMUM THRESHOLD TO**
2 **ANY OTHER UTILITIES FOR PURPOSES OF DETERMINING**
3 **REASONABLENESS?**

4 A. No. The Company states that it “has not compared its storm reserve policies with any
5 other utility.”²²¹
6

7 **Q. IS THE \$50,000 MINIMUM THRESHOLD REASONABLE?**

8 A. No. The Company has incurred 155 storms that it claims qualify for storm reserve
9 treatment subsequent to Docket No. 16705.²²² This represents in excess of 10 storms per
10 year, not counting Hurricane Rita and Hurricane Ike. Occurrences of this frequency on an
11 annual basis cannot credibly be claimed to comply with the Commission’s rules that are
12 intended to allow for storms, “which could not have been reasonably anticipated.”²²³
13 Moreover, the threshold only encourages the Company to accumulate as many charges as
14 possible associated with, or around, a storm in order to reach the low \$50,000 threshold.
15 By reaching such threshold and attempting to employ storm reserve treatment, the
16 Company can inappropriately manipulate its annual earnings.
17

18 **Q. DOES THE MINIMUM \$50,000 THRESHOLD COMPORT WITH THE**
19 **COMMISSION RULE AS IT APPLIES TO THE COMPARISON TO**
20 **COMMERCIAL INSURANCE?**

21 A. No. Indeed, during Mr. Wilson’s deposition, he stated that the “deductibles are extremely
22 high” when discussing how insurance companies would set the deductible for the same
23 service.²²⁴ Mr. Wilson’s statement was made with knowledge of the \$50,000 lower
24 threshold for the Company’s insurance storm reserve. Therefore, Mr. Wilson recognizes
25 that insurance companies would set a deductible level far in excess of the current \$50,000
26 level employed by the Company.

²²¹ Id.

²²² Response to Rose City 5-1.

²²³ P.U.C. Subst. Rule 25.231(b)(1)(G).

²²⁴ Mr. Wilson’s deposition on April 22, 2010 at TR 11.

1 **Q. HAS THE COMMISSION RECENTLY RULED ON THE ISSUE OF WHAT**
2 **CONSTITUTES A REASONABLE MINIMUM INSURANCE THRESHOLD**
3 **DEDUCTIBLE LEVEL?**

4 A. Yes. In Docket No. 35717, an Oncor Delivery case, the issue as to whether to increase the
5 minimum threshold level to \$10 million was raised. Oncor's witness stated that the
6 "demarcation point at \$500,000 is the hallmark in risk management because losses under
7 \$500,000 are considered routine and predictable. Anything over that loss cannot be
8 predicted."²²⁵ The Commission in Docket No. 35717 accepted the \$500,000 minimum
9 threshold for storm reserve treatment.²²⁶

10
11 **Q. WHAT DO YOU RECOMMEND?**

12 A. I recommend increasing the minimum threshold level from \$50,000 per storm to
13 \$500,000 per storm and treating the threshold as a deductible. This level complies with
14 the Commission's rule as it relates to storms that could not have been reasonably
15 anticipated and is equivalent to what the Commission recently adopted when this issue
16 was contested in Docket No. 35717. This level will further eliminate any unreasonable
17 efforts by the Company to aggregate charges so as to meet the low threshold currently in
18 place and thus remove any incentive for manipulating reasonably predictable O&M
19 expense.

20
21 **Q. WHAT IS THE COMBINED IMPACT OF YOUR VARIOUS**
22 **RECOMMENDATIONS?**

23 A. My various recommendations would result in a \$3.9 million reduction to the Company's
24 expense request for storm damage reserve and a \$45.868 million reduction to rate base.

²²⁵ Docket No. 35717 Proposal for Decision at page 106.

²²⁶ Docket No. 35717 Final Order FOFs 98-101.

1 **SECTION VI: CASH WORKING CAPITAL**

2 **1. Introduction**

4 **Q. WHAT IS THE ISSUE IN THIS PORTION OF YOUR TESTIMONY?**

5 A. This portion of my testimony deals with CWC. CWC is a component of rate base and
6 represents the amount of funds supplied by either the shareholders or others, such as
7 customers, to fund the day-to-day operations of the Company.

9 **Q. HOW DID THE COMPANY ARRIVE AT ITS PROPOSED CWC?**

10 A. The Company has attempted to perform a lead-lag study in its efforts to quantify its CWC
11 requirements. The type of study is a cash lead-lag study as required by P.U.C. Subst. R.
12 25.231(c)(2)(B)(iii)(IV).

14 **Q. WHAT HAS THE COMPANY PROPOSED FOR CWC?**

15 A. The Company has proposed a negative \$1,979,613 of CWC.²²⁷ However, the Company
16 has also admitted to two errors relating to state and local franchise fees.²²⁸ The correction
17 for those two errors yields a negative \$4,869,630 CWC requirement.

19 **Q. WHAT LEVEL OF CASH WORKING CAPITAL DID THE COMMISSION FIND
20 APPROPRIATE FOR THE COMPANY IN ITS LAST FULLY LITIGATED
21 RATE CASE?**

22 A. In Docket No. 16705, the Commission ordered a negative \$36,016,000 CWC compared
23 to the Company's request for a negative \$8,053,000 CWC in that case²²⁹ In other words,
24 the Commission found errors and made adjustments that more than quadrupled the
25 negative level of CWC requested by the Company. My testimony in that case, upon
26 which the Commission relied in part, also addressed various errors and inappropriate
27 positions taken by the Company.

²²⁷ Schedule E-4 page 2.

²²⁸ Response to State of Texas 8-9.

²²⁹ Docket No. 16705 Final Order Schedules IV and VI.

1 Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS PROCEEDING
2 AS IT RELATES TO YOUR REVIEW OF THE COMPANY'S CWC REQUEST.

3 A. The Company's negative CWC estimate is again substantially inadequate (i.e. too little
4 level of negative CWC). A more appropriate level of CWC is a negative \$45.7 million or
5 \$43.7 million more negative than the Company's original request as set forth on Schedule
6 (JP-4). While, again in this case, there are many problems associated with the
7 Company's lead-lag study, I have attempted to correct mainly the major components and
8 make adjustments to comport with Commission precedent. A summary of the specific
9 areas and issues follows.

- 10
- 11 • **Meter-To-Billing Revenue Lag.** In spite of expenditures for electronic meter
12 reading equipment, new computer hardware and software, the Company proposes
13 a longer period of time necessary to read a meter and issue a bill than in the past.
14 This attempt to rely on a longer period of time signifies that the Company
15 believes it has become less efficient. The regulatory principle that customers
16 should not shoulder the burden of the Company's inefficiencies must be
17 recognized in the lead-lag study. Relying on a meter-to-billing period previously
18 achieved by the Company results in \$4,973,701 more negative CWC.
 - 19 • **Billing-To-Payment Revenue Lag.** The Company relies upon an inappropriate
20 methodology to estimate the time period between when it bills a customer and
21 when a customer pays their bill. Moreover, Company's estimation process
22 reflects the unusual affect of the worldwide financial meltdown that began in the
23 last quarter of 2008. In addition, the Company proposes a 60-day lag for its MSS-
24 4 affiliate transaction. My recommended methodology relies on a previously
25 accepted approach, with a modification that will eliminate a concern raised by the
26 Commission in Docket No. 16705, and removal of the MSS-4 affiliate transaction
27 results in \$26.2 million more negative CWC.
 - 28 • **Customer Float Revenue Lag.** The Company proposed a customer float revenue
29 lag of 0.95 days for its retail revenues based on an estimation it believes to be
30 reasonable. The Company's *estimation* is based on customer count rather than
31 revenues. When revenues are used for the calculation, the float days decline to
32 0.49 days. The adjustment to the Company's proposed customer float results in
33 \$1.6 million more negative CWC.
 - 34 • **Payroll Expense Lead.** The Company's proposed lead-lag study does not
35 conform to Commission precedent in Docket No. 16705 as it relates to the service
36 period associated with vacation pay. The Company's attempt to ignore the
37 Commission's decision in Docket No. 16705 stems from its illogical and
38 inappropriate attempt to inconsistently measure the service period for expenses as
39
40
41

1 a period *when the expense is recorded rather than when the product or service is*
2 *provided*. In addition, the Company also failed to properly recognize the deferred
3 compensation aspect associated with incentive compensation. Reversal of the
4 Company's attempt to not follow the Commission's previous order relating to
5 vacation pay and proper treatment of incentive pay results in \$6.3 million more
6 negative CWC.
7

- 8 • **FAS 106 Expense Lead.** In Docket No. 16705, the Commission adopted a
9 312.55 day expense lead for FAS 106 expenses. The Company again ignores that
10 decision by excluding the expense. This is another instance where the Company
11 attempts to employ an illogical and inconsistent approach in order to artificially
12 increase revenue requirements. Complying with Commission precedent on this
13 issue results in \$2.2 million more negative CWC.
14
- 15 • **Entergy Services, Inc. Expense Lead.** The Company has proposed 38.04 lead
16 days for this category of CWC. The Company bases its lead day proposal on its
17 operating agreement with Entergy Service, Inc. That agreement permits payment
18 no later than the 25th of the following month. The major problem with the
19 Company's analysis is its failure to recognize that a substantial component of the
20 amount at issue is associated with incentive compensation. Proper recognition of
21 the extended lead days associated with incentive compensation results in \$5.6
22 million of more negative CWC.
23
- 24 • **Other O&M Expense Leads.** As was the case in prior dockets, the Company
25 has made errors in its stratified sample of invoices used to determine the
26 appropriate expense leads for other O&M. Correction of certain problems in the
27 Company's current stratified sample analysis increases the expense lead days by
28 15.52 days resulting in \$3.6 million of more negative CWC.

29 Due to the interactive nature between revenue lags and expense leads, the combined
30 impact of the above various adjustments is not simply the addition of each individual
31 component. Rather, the combined impact is \$45.7 million, or \$43.7 million more
32 negative CWC as set forth on Schedule (JP-4).
33

34 2. General

36 Q. WHAT IS A LEAD-LAG STUDY?

37 A. A lead-lag study is an attempt to measure the value of the difference between the time the
38 Company provides services to its customers and the time it receives payment for such
39 services, compared to the time the Company receives a product or service and the time it

1 pays for such product or service. As part of the lead-lag study, an attempt is made to
2 measure the revenue lag and compare it to an expense lead.²³⁰
3

4 **Q. WHAT ARE THE COMPONENTS OF THE REVENUE LAG?**

5 A. Within the revenue lag component of a lead-lag study there are four components: the
6 service period, the billing lag, the collection lag, and the financial or customer lag. The
7 service period normally represents the mid-point of the month in which service is
8 provided. The billing lag represents the time period between the date a meter reading is
9 taken and a bill is issued to the customer. The collection lag is the period between the
10 time the Company issues a bill to the customer and the date the customer pays the
11 Company. Finally, in instances where the Company receives payment in a form other
12 than cash or electronically, it is considered a financial lag until funds become available.
13

14 **Q. WHAT ARE THE COMPONENTS OF THE EXPENSE LEAD?**

15 A. Normally for an electric company, the largest single component of expense leads is its
16 cost of energy, whether it is through self generation (e.g., coal, oil, gas, or nuclear) or
17 through purchase power costs. Other components are labor, other O&M, property taxes,
18 etc. The Company has identified many categories as set forth on Schedule E.
19

20 **Q. IS THERE A MAJOR ISSUE REFLECTED IN THE COMPANY'S CONCEPT OF**
21 **A LEAD-LAG STUDY THAT IS CONTRARY TO COMMISSION PRECEDENT?**

22 A. Yes. Company witness Mr. Gallagher states that "a central issue in the measurement of
23 both revenue and expense payment lags is a consistent definition of the Service Period –
24 i.e., the date the utility provides services to its customers for which it incurs costs and
25 accrues revenues and expenses."²³¹ (Emphasis added). Unfortunately, while Mr.
26 Gallagher desires consistency, the Company's practice, with his oversight, is anything but
27 consistent.
28

²³⁰ The revenue lag represents the claimed time period between date(s) the Company provides service to customers and the date(s) the Company receives funds from the customer for such service. An expense lead is the time period between the date(s) the Company receives a product or service and the date(s) it pays for such product or service.

²³¹ Direct Testimony of Mr. Gallagher at page 8.

1 Mr. Gallagher's discussion of service period between expenses and revenues violates
2 prior Commission decisions as well as logic and consistency. In particular, Mr.
3 Gallagher would have the Commission believe that it is logical and consistent to measure
4 the revenue lag as the time period during which customers receive service. For example,
5 if a customer's meter readings occur on April and May 1st, the service period is one
6 month or 30 days. On average, the customer will have received the service 15 days into
7 the 30-day period. This concept of service period has nothing to do with the fact that the
8 recording of the actual revenues that will be charged to the customer do not occur until
9 later in May when the billing process is completed. Alternatively, Mr. Gallagher would
10 have the Commission believe that the service period associated with expenses occurs
11 only when the *recording* of labor, materials or other costs occur. In other words, he
12 would have the Commission believe that the Company has not received a product or
13 service until it accrues or books the expense not when it receives a product or service.
14 This inconsistent logic between revenue and expense service periods must be recognized
15 for what it is, a direct attack on the Commission's prior decisions and a clear indication
16 of the Company's desire to artificially minimize the negative level of CWC that should
17 be reflected in rate base.

18 3. Revenue Lag

19 A. Meter Reading To Billing

21 Q. WHAT HAS THE COMPANY PROPOSED FOR ITS METER READING TO 22 BILLING REVENUE LAG?

23 A. The Company proposes 3.63 days associated with its Customer Information System
24 ("CIS") related customers and 3.72 days for large power customers.²³²

26 Q. ARE THESE REASONABLE LEVELS?

27 A. No. The Company has invested money into electronic meter reading devices and
28 expensive computer systems that incorporate billing systems. One would hope that the
29 expenditures of large amounts of capital on such equipment and software would result in

²³² Company Workpaper WP/E-4 page 3.

1 recognizable benefits for customers given that customers must pay a return of and a
2 return on such investments. Unfortunately in this area, the Company has become *less*
3 *efficient* in the billing process in spite of such substantial capital expenditures.
4

5 **Q. HAVE OTHER REGULATORY BODIES RECOGNIZED THE MORE**
6 **EFFICIENT BILLING PROCESS ASSOCIATED WITH MORE MODERN**
7 **ELECTRONIC METER READING DEVICES AND BILLING SYSTEMS?**

8 A. Yes. The Railroad Commission of Texas ("RCT"), the regulator of gas utilities in Texas,
9 has adopted a *1-day* meter reading to billing lag for the largest gas utility in the state.²³³
10 Moreover, the RCT adopted such shorter period of time in spite of the gas utility's
11 request to increase the number of days so as to permit verification of potential erroneous
12 billings.²³⁴ The adoption of that position was based, in part, on my testimony in those
13 proceedings. The guiding principle for the RCT decision was that customers "should not
14 be punished if a utility decides to manage the business process and payment less
15 efficiently."²³⁵
16

17 **Q. IS THE RCT'S GUIDING PRINCIPLE A REASONABLE AND APPROPRIATE**
18 **STANDARD?**

19 A. Yes. If the Company elects to allow inefficiencies in the billing process that results in
20 higher cost to customers, then such costs should be borne by shareholders, not customers.
21 As previously noted, the customers are already paying for equipment and software that
22 provide the capability of performing the billing process in a much more efficient manner.
23 Moreover, this Company has demonstrated that it can and has completed the meter
24 reading-to-billing process in as little as 1.46 days for the equivalent to the CIS customer
25 class which comprises the majority of customers and revenues.²³⁶

²³³ RCT GUD 9869, Atmos Gas Company.

²³⁴ RCT GUD No. 9670 Final Order FOF 126, and GUD No. 9902.

²³⁵ RCT GUD No. 9670 Final Order at FOF 148.

²³⁶ Company Workpaper WP/E-4 page 26 of 47 in Docket No. 12852 also set forth as Exhibit (JP-16) in Mr. Pous' Testimony in Docket No. 16705.

1 **Q. WHEN YOU STATE THAT THE METER READING-TO-BILLING PERIOD**
2 **HAS INCREASED RATHER THAN DECREASED, ARE YOU JUST**
3 **REFERRING TO THE 1.46 DAY PERIOD PREVIOUSLY REFERENCED?**

4 A. No. While it obviously has increased from Docket No. 12852, it has also increased from
5 Docket No. 16705 where the Company proposed a 3.61-day meter reading-to-billing lag.
6 It is apparent that the Company, absent proper direction from this Commission to
7 demonstrate that it will not tolerate inefficiencies in the billing process, will have a
8 perverse incentive to perform in a manner that is detrimental to customers. In fact, the
9 Company has every incentive to be inefficient in this particular area because it earns a
10 full rate of return on the higher level of cash working capital due to its own inefficiencies.
11 The continuation of this situation is neither reasonable nor equitable.
12

13 **Q. WHAT DO YOU RECOMMEND?**

14 A. I recommend that the Commission follow the lead of the RCT and adopt a principle that
15 customers "should not be punished if the utility decides to manage the business process
16 and payment less efficiently." The Company's incentive to operate inefficiently by
17 earning a higher return is neither reasonable nor appropriate. The Company has
18 demonstrated that it can issue a CIS bill within 1.46 days after reading meters. The
19 largest gas utility in the state has demonstrated that it can read meters and bill either on
20 the same day or within one day and has its base rate set on a 1-day meter reading to
21 billing period. Customers are paying for investment in meter reading devices, computers,
22 and software that make it possible to perform the meter reading process in a more
23 efficient manner. Customers are entitled to the benefit of the bargain associated with
24 such expenditures. Based on the various items noted above, I conservatively recommend
25 that a 1.46 day meter reading-to-billing lag for CIS related customers be adopted. This is
26 a level that the Company has demonstrated that it can achieve even prior to its investment
27 in the newer meter reading devices, computers, and software.

1 **Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?**

2 A. My recommendation on a standalone basis would result in a \$4,973,701 more negative
3 CWC requirement than what the Company proposed.²³⁷

4 **B. Billing-To-Payment Revenue Lag**
5

6 **Q. WHAT HAS THE COMPANY PROPOSED FOR THE REVENUE LAG DAYS**
7 **ASSOCIATED WITH THE PERIOD BETWEEN ISSUING BILLS AND**
8 **RECEIVING PAYMENT FROM CUSTOMERS?**

9 A. The Company has identified 4 separate revenue lag periods for this component of the
10 lead-lag study. The Company has proposed 22.26 days for its CIS customers, 16.21 days
11 for its large power customers, 60 days for MSS-4 sales, and 20 days for its other affiliated
12 sales.²³⁸
13

14 **Q. DO YOU TAKE ISSUE WITH ANY OF THE COMPANY'S PROPOSALS?**

15 A. Yes. I take issue with the Company's proposed 21.80 days for its CIS customers which
16 comprise approximately 53% of the entire revenues, and the 60-day lag proposed for
17 MSS-4 affiliate revenues.²³⁹
18

19 **Q. WHAT IS THE COMPANY'S BASIS FOR ITS PROPOSED 21.80 REVENUE**
20 **LAG DAYS FOR ITS CIS CUSTOMERS?**

21 A. The Company relies on an inconsistent accounts receivable turnover method.²⁴⁰ As will
22 be discussed later, the Company attempts to relate an end of month amount of accounts
23 receivable to daily average revenues.
24

25 **Q. IS THE COMPANY'S OVERALL APPROACH TO THE BILLING TO**
26 **COLLECTION REVENUE LAG DAYS APPROPRIATE?**

27 A. No. While the Company's actual mechanics has problems, the overall process employed
28 by the Company is inaccurate. The Company relies on an *end of month* accounts

²³⁷ Schedule E-4 page 2 of 2 average daily amount of \$4,324,957 times 1.15 days (3.63-1.46) X .528732.

²³⁸ Company Workpaper WP/E-4 page 3.

²³⁹ Company Workpaper WP/E-4 page 3.

²⁴⁰ *Id.*, at page 17.

1 receivable balance and compares that to the average *daily* revenues. The problem with
2 this approach rests on the premise that the end of month accounts receivable balance is
3 equivalent to the individual daily accounts receivable balances throughout the month.
4 Given that the Company has 21 different billing cycles throughout the month, the
5 accounts receivable monthly ending balance is skewed towards customers billed in the
6 later billing cycles and does not reflect the relationship experienced by those customers
7 billed in the early billing cycles of the month who have already paid their bill and are no
8 longer reflected in accounts receivable at the end of the month.

9
10 **Q. HAS THE COMPANY'S APPROACH RECENTLY BEEN TESTED IN TEXAS?**

11 A. Yes. In RCT Docket No. 9670, Atmos Energy, the state's largest gas company, proposed
12 the same approach. The RCT found that such approach was unacceptable based in part
13 on my testimony. Distortions can occur due to the difference between daily accounts
14 receivable balances compared to a month end accounts receivable balance in a turnover
15 analysis. This problem can result in several revenue lag days of difference in the
16 Company's billing-to-collection lag.

17
18 **Q. HAS THE COMPANY'S BILLING-TO-COLLECTION LAG CHANGED OVER**
19 **TIME?**

20 A. Yes. While the Company proposes 21.80 days in this proceeding for its CIS customers, it
21 proposed only 19.02 days in Docket No. 30123.²⁴¹ Moreover, in Docket No. 16705 the
22 Company proposed 21.63 days and in Docket No. 12852 the Company proposed 19.6
23 days.²⁴² It also proposed 19.67 days in Docket No. 20150 and 22.26 days in Docket No.
24 34800.²⁴³ Therefore, the Company's proposal in this proceeding represents its second
25 highest requested value over the past numerous rate proceedings and is 1.48 days greater
26 than the level in place during Docket No. 12852 and 1.41 days greater than the 19.67
27 billing-to-payment revenue lag in Docket No. 20150.

²⁴¹ Docket No. 30123 Company Workpaper WP/E-4 page 2.

²⁴² Docket No. 12852 Company Workpaper WP/E-4 page 26 of 47.

²⁴³ Workpaper WP/1-A-1-1/1.1 AJ12-1 in Volume 40-VL at page 838 in Docket No. 22356 and Workpaper WP/E-4 page 4 in Docket No 34800.

1 **Q. DID YOU SEEK INFORMATION NECESSARY TO QUANTIFY A MORE**
2 **ACCURATE BILLING-TO-COLLECTION REVENUE LAG FOR THE**
3 **COMPANY IN THIS CASE?**

4 A. Yes. I sought the Company's daily accounts receivable balances for retail sales, the
5 aging of accounts receivable reports for each month of the test year, and the daily revenue
6 receipts during the test year. The Company does not maintain all such information.²⁴⁴
7

8 **Q. IS THERE AN ADDITIONAL PROBLEM WITH RELYING ON THE**
9 **ACCOUNTS RECEIVABLE DATA EMPLOYED BY THE COMPANY?**

10 A. Yes. The test year data includes the period during which this country, if not the world,
11 experienced a financial meltdown and was on the brink of financial collapse. Credit dried
12 up for both individuals and companies. Reliance on this period, August 2008 and for an
13 extended period thereafter, unrealistically skews the revenue lag upward. Therefore, even
14 if the Company's proposed approach were relied on, which it should not be, it is
15 excessively high due to the period contained in the analysis.
16

17 **Q. CAN YOU PROVIDE AN EXAMPLE OF THE DISTORTION CAUSED BY**
18 **RELYING ON DATA CORRESPONDING TO THE PERIOD OF ECONOMIC**
19 **TURMOIL?**

20 A. Yes. A proxy for the impact can be seen from the month end accounts receivable reports
21 for October 2008 and 2009. The October 2008 report identified \$1,353,134 of arrears for
22 the 90-day category, while the same value for October 2009 was only \$200,111. The 90
23 days in arrears level of accounts receivable during the thick of the financial meltdown
24 was almost 7 times the level one year later.²⁴⁵ There were similar situations in other
25 arrears categories.

²⁴⁴ Response to Cities 9-18.

²⁴⁵ Response to Cities 9-6.

1 **Q. GIVEN THE CIRCUMSTANCES THE COMPANY HAS PRESENTED, WHAT**
2 **DO YOU RECOMMEND?**

3 A. The Company's current request is obviously incorrect and cannot be relied upon.
4 Unfortunately, the Company was unable to provide necessary information associated
5 with the current test year as it pertains to daily accounts receivable balances or even daily
6 revenues. Therefore, I recommend a modified aging of accounts receivable approach
7 adopted in Docket No. 16705.

8
9 In Docket No. 16705, the Company provided aging of accounts receivable information.²⁴⁶
10 I recommended an adjustment in that proceeding relying on that information, with one
11 assumption not adopted by the Commission. That assumption was that for those
12 customers under the current pay category, I assumed a conservative 14-day period while
13 the Commission rules allow up to 16 days.²⁴⁷ The examiners denied this approach since
14 they could "find no reason to justify changing the Commission-required 16-day paid
15 schedule."²⁴⁸ However, the examiners did say they questioned "whether the disconnects
16 really tipped the balance to 16."²⁴⁹ While I still believe that the 14-day assumption was
17 conservative given that all customers who are current do not pay on the very last day
18 possible, I base my recommendation in this case on adopting the full 16-day payment
19 period allotted by the Commission. In other words, I modified the values set forth on
20 Schedule (JP-17) page 1 of 2 in Docket No. 16705 and increased the revenue lag days for
21 the current balances from 14 to 16 days. Increasing the payment period assumption to the
22 *absolute maximum* permitted by the Commission rules would increase my previously
23 proposed 18.66 revenue lag days to 20.38 days (an additional 1.72 days to reflect 2
24 additional days time for 85.97 % of customers that pay currently).

²⁴⁶ Docket No. 16705 Company response to Cities 97 – 1 as shown on Schedule (JP-17) in that case.

²⁴⁷ PUC Subst. R. 25.28.

²⁴⁸ Docket No. 16705, PFD at Section F 2 (a).

²⁴⁹ *Id.*

1 **Q. DO YOU BELIEVE THIS APPROACH IS MORE REPRESENTATIVE THAN**
2 **THE COMPANY'S PRESENTATION?**

3 A. Yes, and for the various reasons noted above, the Company's position is in error. The
4 Company's position is not only excessive but unsupportable. The Company has elected
5 not to maintain the type of data that would permit a more accurate current calculation.
6 Moreover, the Company's proposal is approximately 2.5 days greater than what it has
7 proposed in several prior proceedings. In comparison, my proposed 20.38 days is less
8 than half the difference between what the Company has previously proposed and what it
9 currently proposes and is based on real Company data associated with aging of accounts
10 receivable information utilizing the most conservative assumption for current billings.
11

12 **Q. DO YOU BELIEVE YOUR ESTIMATE IS TOO CONSERVATIVE?**

13 A. Yes I do. However, given the examiners concerns in Docket No. 16705 and the current
14 situation that the Company has placed both the interveners and Commission in, I find that
15 this conservative approach should cure any concern the Commission previously had in
16 Docket No. 16705 on this issue. Moreover, to the extent the Commission was so inclined
17 and elects to adopt my previous position based on an average 14-day payment period
18 versus the full 16 days permitted under the rule, then the revenue lag would need to be
19 reduced by an additional 1.72 days, or \$3,933,198.
20

21 **Q. WHAT IS THE IMPACT OF YOU RECOMMENDATION?**

22 A. My recommendation of a 20.38 bill-to-payment revenue lag for the CIS class results in a
23 \$3,243,718 reduction to rate base (1.42 days x \$4,324,957 x 52.8732%).
24

25 **Q. WHAT IS THE ISSUE WITH THE COMPANY'S PROPOSED 60-DAY BILLING**
26 **TO PAYMENT PERIOD FOR MSS-4 SALES?**

27 A. Cities' witness Mr. Garrett recommends the removal of the EGSL Sabine and Lewis
28 Creek MSS-4 sales transactions from the Texas retail cost of service. Therefore, I have
29 removed this component from the revenue lag.

1 Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

2 A. My recommendation results in a \$14.4 million reduction to CWC requirements.²⁵⁰

3 C. Customer Float

4
5 Q. WHAT HAS THE COMPANY REQUESTED FOR THE REVENUE LAG DAYS
6 ASSOCIATED WITH THE CUSTOMER FLOAT CATEGORY?

7 A. The Company has proposed a lag of 0.95 days for the CIS and Large Power categories.²⁵¹

8
9 Q. WHAT DOES THIS AMOUNT REPRESENT?

10 A. The Company states this amount represents the check float corresponding to the period
11 that funds from payment by customers are not available to the Company because checks
12 for payments have not cleared from the customers accounts to the Company's account.²⁵²

13
14 Q. WHAT IS THE COMPANY'S BASIS FOR THE 0.95 DAY REQUEST?

15 A. Mr. Gallagher states that "it appears that after taking into account immediate cash
16 available from electronic funds transfer" that a 0.95 weighted lag days for retail sales is
17 appropriate.²⁵³ (Emphasis added).

18
19 Q. HAS THE COMPANY JUSTIFIED ITS REQUESTED CUSTOMER FLOAT?

20 A. No. First, the Company's proposal is based on customer *count* and not *dollars*.²⁵⁴

21
22 Q. IS IT APPROPRIATE TO RELY ON A CUSTOMER COUNT RATHER THAN
23 ON THE CORRESPONDING REVENUES?

24 A. No. Indeed, the revenue float is quite different from what Mr. Gallagher proposes. The
25 Company admits that at least 51% of its revenues were received in the form of cash, wire

²⁵⁰ Total revenue lag days decline to 39.84 if MSS-4 revenues are removed. This represents a 3.33 reduction in revenue lag days from ETI's proposed level of 43.17 days ($3.33 \times \$4,324,957 = \$14,408,915$).

²⁵¹ Company Workpaper WP/E-4 page 3.

²⁵² Mr. Gallagher's Direct Testimony at page 13.

²⁵³ Company Workpaper WP/E-4 pages 14-16.

²⁵⁴ Company Workpaper WP/E-4 page 7.

transfer or other electronic manners.²⁵⁵ Recognition of cash and electronic payments by dollar amount rather than by count reduces the 0.95 check float to 0.49.

Q. WHAT DO YOU RECOMMEND?

A. I recommend the Company's request for a 0.95-day customer float be denied. The Company's request is based on the wrong factor (customer count rather than revenues). Therefore, I recommend a 0.49-day check float lag for the CIS and Large Power classes.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation for a 0.49-day customer float reduces rate base by \$1,612,822 $((0.95-0.49) \times \$4,324,957 \times 81.06753\%)$.

Q. WHAT IS THE NET IMPACT OF YOUR VARIOUS REVENUE LAG RECOMMENDATIONS?

A. The adoptions of the revenue lag adjustments that I have recommended would reduce the Company's overall revenue lag days from 43.17 days to 37.12 days or 6.05 less revenue lag days. A 6.05 reduction in revenue lag days would result in a reduction to rate base of \$26,169,306 based on the Company's requested level of expenses.

4. Expense Leads

A. Payroll

Q. WHAT HAS THE COMPANY PROPOSED FOR EXPENSE LEAD DAYS ASSOCIATED WITH PAYROLL?

A. The Company proposes 14.55 lead days for the expense lead.²⁵⁶

²⁵⁵ Response to Rose City 9-12.

²⁵⁶ Company Workpaper WP/E-4 page 2.

1 **Q. IS THE COMPANY'S PROPOSED PAYROLL EXPENSE LEAD DAYS IN**
2 **COMPLIANCE WITH THE COMMISSION'S ORDER IN DOCKET NO. 16705?**

3 A. No. In Docket No. 16705 at FOF 114, the Commission adopted the position I sponsored
4 in that case. In doing so the Commission stated that "recognizing vacation time as a
5 separate component of payroll to account for the lag between when the employee earns
6 vacation time and when the Company pays for it in salary expense" is reasonable.
7 Unfortunately the Company's calculation in this case fails to recognize the significant
8 incremental time period associated with vacation pay.²⁵⁷
9

10 **Q. DOES THE COMPANY IDENTIFY ANY CHANGED CIRCUMSTANCES THAT**
11 **WARRANT THE REVERSAL OF THE COMMISSION'S PRECEDENT ON**
12 **THIS ISSUE?**

13 A. No.
14

15 **Q. WHAT DID YOU RECOMMEND FOR THE EXPENSE LEAD ASSOCIATED**
16 **WITH VACATION THAT WAS ADOPTED BY THE COMMISSION IN**
17 **DOCKET NO. 16705?**

18 A. As set forth in my testimony in Docket No. 16705 at page 99, I recommended a 210.67
19 day period as the appropriate expense lead days for vacation pay.
20

21 **Q. DO YOU STILL BELIEVE THIS LEVEL IS REASONABLE AND**
22 **APPROPRIATE?**

23 A. Due to the change in relationship of vacation pay to total payroll, I am of the opinion the
24 recommended level is conservative.
25

26 **Q. WHAT LEVEL OF VACATION PAY DID THE COMPANY INCUR DURING**
27 **THE TEST YEAR IN THIS PROCEEDING?**

28 A. The Company incurred \$3,842,535 of vacation pay for the test year.²⁵⁸

²⁵⁷ Company Workpaper WP/E-4 page 164.

²⁵⁸ Response to Rose City 9-16 .

1 **Q. HOW DID YOU ADJUST THE COMPANY'S PROPOSED PAYROLL EXPENSE**
2 **LEAD DAYS FOR THE PROPER RECOGNITION OF VACATION PAY?**

3 A. I began with the Company's payroll of \$35,210,377.²⁵⁹ I then subtracted the test year
4 vacation pay amount of \$3,842,535.²⁶⁰ Next, I applied a 210.67 lead day period to
5 vacation pay. I then applied the Company proposed 13 day payroll lead period to the
6 remaining payroll. I then added the Company proposed 1.23 lag days for the withholding
7 lag. This results in 35.81 lag days for payroll, or an adjustment of 21.57 days and a
8 reduction to rate base of \$2,080,974.
9

10 **Q. IS THERE A SECOND ISSUE RELATING TO THE PAYROLL EXPENSE LEAD**
11 **DAYS?**

12 A. Yes. The second issue deals with incentive compensation.
13

14 **Q. IS THERE A DEFERRED PAYMENT ASSOCIATED WITH INCENTIVE**
15 **COMPENSATION?**

16 A. Yes. Just as the situation for vacation pay there is also a deferred payment associated
17 with incentive compensation.
18

19 **Q. WHAT IS THE DEFERRED PERIOD OF TIME ASSOCIATED WITH**
20 **PAYMENT OF INCENTIVE COMPENSATION?**

21 A. The Company paid its annual incentives on March 12, 2009 for calendar 2008 services.²⁶¹
22

23 **Q. WHAT LEVEL OF LEAD DAYS DID THE COMPANY ASSIGN TO INCENTIVE**
24 **COMPENSATION?**

25 A. The Company assigned the same 13 day lead it assigned to all other payroll, prior to the
26 impact of withholding items.²⁶²

²⁵⁹ Company Workpaper WP/E-4 page 294.

²⁶⁰ Response to Rose City 9-16.

²⁶¹ Response to Rose City 7-1(E).

²⁶² Company Workpaper WP/E page 164.

1 **Q. IS THERE ANY REASON NOT TO RECOGNIZE THE MARCH 12TH OF THE**
2 **FOLLOWING YEAR AS THE APPROPRIATE DEFERRED PAYMENT DATE?**

3 A. No. The Company's action is based on the same illogical and inconsistent opinion of Mr.
4 Gallagher that assumes that the service period for expenses begins when an expense is
5 recorded. This false opinion must be corrected.
6

7 **Q. WHAT IS THE APPROPRIATE NUMBER OF LEAD DAYS FOR INCENTIVE**
8 **COMPENSATION?**

9 A. The appropriate number of lead days for incentive pay is 253.5 days. This level of lead
10 days is based on the average service period of the prior year (365/2) plus 71 days
11 corresponding to January 1 through March 12 of the following year.
12

13 **Q. HOW DID YOU CALCULATE THE IMPACT OF THIS ADJUSTMENT?**

14 A. I employed the same methodology that I discussed for vacation payroll. The only
15 difference is that I use \$3,688,868 corresponding to the level of incentive
16 compensation.²⁶³ This process resulted in a 39.43-day increase in the payroll lead days.
17 This incremental addition is additive to the vacation payroll adjustment.
18

19 **Q. WHAT IS THE IMPACT OF THIS ADJUSTMENT?**

20 A. Increasing the overall net payroll lead days from 14.23 days to 25.20 days results in more
21 negative working capital of \$2,430,616.

22 **B. FAS 106**
23

24 **Q. WHAT DOES THE COMPANY PROPOSE FOR LEAD DAYS ASSOCIATED**
25 **WITH FAS 106 EXPENSES?**

26 A. The Company proposes to exclude this expense from its analyses.²⁶⁴ It should be noted
27 that the Company also claims it reflected the impact in the "Other O&M" expense
28 category.²⁶⁵

²⁶³ Response to Rose City 7-1(E)..

²⁶⁴ Direct Testimony of Mr. Gallagher at page 18.

²⁶⁵ Response to Rose City 24-55.

1
2 **Q. IS THE ELIMINATION OF FAS 106 IN COMPLIANCE WITH THE**
3 **PRECEDENT SET IN THE COMPANY'S LAST FULLY LITIGATED RATE**
4 **CASE?**

5 A. No. The Commission's order in Docket No. 16705 found that FAS 106 expense is a form
6 of deferred compensation and should have a 312.55 day lead assigned to it.

7
8 **Q. WHAT ARE FAS 106 EXPENSES?**

9 A. FAS 106 expenses represent post retirement benefits other than pensions. In other words,
10 these amounts represent an employee benefit provided as part of an overall compensation
11 package. FAS 106 costs are deferred compensation.

12
13 **Q. DO YOU AGREE WITH THE COMPANY'S DECISION TO EXCLUDE FAS 106**
14 **EXPENSE FROM THE ANALYSIS?**

15 A. Of course not, and neither did the Commission in Docket No. 16705. Mr. Gallagher's
16 presentation in this proceeding is anything but clear or logical. First, he testifies that FAS
17 106 expenses are not cash expenditures and excluded from his analysis, but then claims
18 that they are treated as "Other O&M" expense. Mr. Gallagher also fails to even reference
19 the fact that FAS 106 expenses are deferred compensation. Thus, just as this
20 Commission has recognized vacation pay as deferred compensation requiring extended
21 number of lead days in comparison to normal payroll days, the same is true for FAS 106
22 expenses. There is no reason to vacate the Commission's precedent on this matter,
23 especially given the Company's presentation in this proceeding. There are no changed
24 circumstances. There is no underlying support or logic to conclude anything other than
25 cash payments are being made for FAS 106 expenses, that they are a component of
26 CWC, and that they represent deferred compensation.

27
28 **Q. WHAT DO YOU RECOMMEND?**

29 A. I recommend following the Commission's precedent on this matter. In Docket No.
30 16705 the Commission recognized that such costs are deferred compensation and adopted
31 my recommended 312.55 expense lag days for this category of expense.²⁶⁶

²⁶⁶ Schedule (JP-15) page 2 of 2 in Docket No. 16705.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. Given that the Company has proposed \$2,522,308 of FAS 106 expense for the test year, in conjunction with the 312.55 expense lead days I am recommending, results in a standalone impact of \$2,159,856 of more negative CWC requirement.²⁶⁷

C. Entergy Services Inc. ("ESI") Expense Lead

Q. WHAT LEVEL OF LEAD DAYS DID THE COMPANY PROPOSE FOR ENTERGY SERVICE EXPENSES?

A. The Company proposes an expense lead of 39.30 days for expenses associated with Entergy Services, Inc. expense.²⁶⁸

Q. WHAT IS THE COMPANY'S BASIS FOR ITS PROPOSED 39.30 LEAD DAYS?

A. Mr. Gallagher at page 17 of his direct testimony states that the ETI/ESI Service Agreement requires payments for ESI services to be made in the month after the expenses are booked. The payment of these costs occur between the 20th and 25th of the month following the provision of service. The actual calculation of the proposed lead days is set forth in the Company's workpapers.²⁶⁹

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. A substantial portion of the Company's charges from Entergy Services, Inc. is associated with incentive compensation. In fact, during the test year, \$9,481,590 of ESI charges were attributable to incentive compensation.²⁷⁰ As previously noted, incentive compensation represents a form of deferred compensation. Therefore, the incremental lead days associated with incentive compensation must be added to the portion of ESI charges that are incentive compensation related. The Company pays its incentive compensation on or about March 15th of the year following the period used to determine whether incentive compensation has been earned. A March 12th payment yields 253.5 lead days compared to the standard payroll levels reflected in the ESI charges of 13 days.

²⁶⁷ Response to Rose City 24-55.

²⁶⁸ Company Workpaper WP/E-4 page 2.

²⁶⁹ Company Workpaper WP/E-4 page 764.

²⁷⁰ Response to Rose City 6-4 through 6-10.

1 Therefore, an incremental 241.5 days must be recognized for the incentive compensation
2 portion of the ESI charges.

3
4 **Q. WHAT IS THE STANDALONE IMPACT OF YOUR RECOMMENDATION?**

5 A. Segregation of the ESI related incentive compensation charges from the total ESI
6 expenses reflected in the CWC analysis, along with the application of a 253.5 lead day
7 period for such incentive compensation results in an incremental negative working capital
8 of \$5,564,276.

9 **D. Other O&M Expense Lead**

10
11 **Q. WHAT DID THE COMPANY PROPOSE FOR OTHER O&M EXPENSE LEAD**
12 **DAYS?**

13 A. The Company proposed 28.55 days plus 3.84 days for check float, or a total of 32.39
14 days.²⁷¹ This level is 11.75 shorter than the 44.14 expense lag days Mr. Gallagher
15 supported in Docket No. 34800.²⁷² In other words, the value in the last case was 36%
16 higher than the current proposed value.

17
18 **Q. HOW DID THE COMPANY ESTABLISH ITS OTHER O&M LEAD DAY**
19 **PROPOSAL?**

20 A. The Company performed a stratified random sample process of 140 invoices.²⁷³

21
22 **Q. WHAT IS A STRATIFIED SAMPLE?**

23 A. A stratified sample represents a situation where the variance in a population is recognized
24 by segregating the individual sample items into various strata or categories that
25 represent different size intervals. In this case the Company recognized that the dollar
26 level of its invoices range from a few dollars to over \$240,000. Therefore, it elected to
27 establish different dollar ranges with the highest stratum for invoices over \$100,000 and
28 the lowest stratum for invoice amounts less than \$250.

²⁷¹ Company Workpaper WP/E-4 page 2.

²⁷² Id., in Docket No. 34800.

²⁷³ Testimony of Mr. Gallagher at page 19.

1 **Q. HAVE YOU REVIEWED THE SAMPLE AND THE COMPANY'S PROPOSED**
2 **RESULTS FROM SUCH SAMPLE?**

3 A. Yes. As was the situation in prior cases, the Company has made several errors in
4 performing its sample analysis for the other O&M category.
5

6 **Q. WHAT TYPE OF ERRORS DOES THE COMPANY'S PROPOSAL REFLECT?**

7 A. The Company incorporated prepayments in its sample. Prepayments are already or should
8 be reflected in rate base in the prepayment category of rate base. The Company also paid
9 invoices early in order to capture a discount. Unfortunately, the discount taken was so
10 small that the Company's actions actually cost customers more than the discount, if not
11 corrected. Customers should not pay for imprudent financial decisions. There are also
12 instances where Mr. Gallagher did not capture the correct service period reflected on the
13 invoice in his sample.
14

15 **Q. CAN YOU PROVIDE AN EXAMPLE OF EACH TYPE OF ERROR?**

16 A. Yes. For sample item number 8 in the greater than \$100,000 stratum, the Company
17 incurred an invoice with a September 1, 2008 through August 31, 2009 service period.
18 The Company paid that invoice on November 13, 2008 and attempts to claim a negative
19 99-day lead.²⁷⁴ The payment represents a prepayment and should be excluded from the
20 CWC analyses.
21

22 An example of the Company's inefficient financial actions can be seen on sample item 9
23 in the greater than \$100,000 stratum. This particular vendor offers a 0.7% discount if the
24 invoice is paid within 15 days. The vendor also provides for no discount or penalty if
25 payment is made within 45 days, or 30 more days. The invoice was for \$126,190 and by
26 paying early the Company received an \$883.33 discount. Unfortunately, by paying early
27 the Company now wants customers to incur a loss of 1.45 lead days for the greater than
28 \$100,000 stratum.²⁷⁵ Since the greater than \$100,000 stratum represents 32.59% of the
29 total stratums, the failure to take full advantage of the 45 day net terms for this single

²⁷⁴ Company Workpaper WP/E-4 pages 828 and 878-880.

²⁷⁵ $\$126,190 \times .993 / \$2,599,973.62 \times 30 \text{ days} = 1.45 \text{ days}$.