Entergy

Entergy Arkansas, Inc.
Regulatory Affairs
425 West Capitol Avenue
P. O. Box 551
Little Rock, AR 72203-0551
Tel 501 377 4000

RECEIVED
2014 OCT 16 AM 8:39
T.R.A. DOCKET ROOM

VIA OVERNIGHT MAIL

October 15, 2014

Chairman James M. Allison
Tennessee Regulatory Authority
Attn. Sharla Dillon, Docket Manager
Tennessee Regulatory Authority
502 Deaderick Street, 4th Fl
Nashville, TN 37243

Re: In the Matter of the Application of Entergy Arkansas, Inc. for Approval of Changes in Rates for Retail Electric Service
TRA Docket No. 13-00114

Dear Mr. Allison:

On March 1, 2013, Entergy Arkansas, Inc. (EAI), filed with the Arkansas Public Service Commission (APSC), an Application for Approval of Changes in Rates for Retail Electric Service in APSC Docket No. 13-028-U. On August 21, 2013, EAI filed the same Application and supporting documents with the Tennessee Regulatory Authority (TRA) to initiate a docket for a general change in rates for EAI's Tennessee customers. In its March 20, 2014 transmittal letter, EAI supplemented its TRA filing with the APSC's Order No. 21 issued on December 30, 2013, reflecting its final decision in the APSC docket and the resulting compliance tariffs subsequently approved by the APSC in its Order No. 24 issued on February 20, 2014. Pursuant to correspondence from the TRA on May 6, 2014, EAI's tariffs were approved by the TRA to become effective April 30, 2014.

On January 29, 2014, EAI filed its Petition for Clarification and/or Rehearing of Order No. 21 with the APSC, and on August 15, 2014, the APSC issued its Order No. 35, approving modifications to Order No. 21.

The purpose of this letter is to file one original and four hard copies as well as an enclosed CD with an electronic copy of each of the following items that have been filed in APSC Docket No. 13-028-U, each of which is attached hereto:

1. EAI's Petition for Clarification and/or Rehearing filed on January 29, 2014;
2. EAI's Supplement to Petition for Clarification and/or Rehearing filed on February 3, 2014;
3. Order No. 25, issued on February 24, 2014;
4. Amended Order No. 25, issued on February 26, 2014;

ARK. PUBLIC SERV. COMM.

CM

2014 FEB 24 P 2:05

FILED

ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF ENTERGY ARKANSAS, INC. FOR APPROVAL OF CHANGES IN RATES FOR RETAIL ELECTRIC SERVICE	))))	DOCKET NO. 13-028-U ORDER NO. 25

ORDER

On March 1, 2013, Entergy Arkansas, Inc. (EAI) filed an application with the Arkansas Public Service Commission (Commission) seeking an increase in its rates for providing electric service to retail customers. The Commission held a hearing on the proposed rate increase beginning on October 22, 2013, and concluding on October 30, 2013. On December 30, 2013, the Commission entered Order No. 21 in this Docket, denying EAI's proposed rate increase and approving a revised revenue requirement to be calculated by Staff in accordance with the provisions of Order No. 21.

On January 29, 2014, EAI filed a *Petition for Rehearing and Clarification* (Petition) and on February 3, 2014, EAI filed a *Supplement to Petition For Rehearing and Clarification* (Supplement). In its Petition and Supplement, EAI seeks rehearing on several issues and asks the Commission to allow it to introduce new evidence in support of the Petition and Supplement.

On February 7, 2014, the Consumer Utilities Rate Advocacy Division of the Arkansas Attorney General's Office (CURAD), filed a response to EAI's Petition asking that rehearing be denied on most issues, but not objecting to EAI's request for clarification regarding the timing of its dismantlement study. On February 10, 2014, responses to EAI's Petition were filed by the General Staff of the

455

Commission (Staff), Arkansas Electric Energy Consumers, Inc. (AEEC), the Federal Executive Agencies (FEA) and the Hospitals and Higher Education Group (HHEG). Staff's response states that rehearing should be denied on most issues, except that rehearing should be granted on the issue of the exclusion of certain wholesale accounts receivable from working capital, and that clarification of the Commission's Order is warranted on the timing of EAI's dismantlement study and whether EAI is permitted to report a regulatory asset for rate case expense on its financial reports. AEEC's response states that EAI's Petition should be denied, except that AEEC does not object to clarification of the Commission's Order with respect to the exclusion of certain wholesale accounts receivable from working capital and the timing of EAI's dismantlement study. FEA's response states that EAI's Petition should be denied. HHEG's response states that EAI's Petition should be denied, except that HHEG does not object to clarification of the Commission's Order with respect to the exclusion of certain wholesale accounts receivable from working capital, the timing of EAI's dismantlement study, and allowing a regulatory asset on EAI"s financial reports for rate case expense.

Under Ark. Code Ann. § 23-2-422 the Commission is authorized to take appropriate action on a rehearing petition, including granting or denying rehearing, affirming or modifying its order, or reopening the record for the purpose of receiving additional evidence:

> "(a) Any party to a proceeding before the Arkansas Public Service Commission aggrieved by an order issued by the commission may apply for a rehearing within thirty (30) days . . .

> (b) The application for rehearing shall set forth specifically the grounds upon which the application is based.
>
> (c) Upon receiving the application, the commission shall have power to grant or deny rehearing, to abrogate or modify its order without further hearing, or to reopen the record for the purpose of receiving and considering additional evidence."

Ark. Code Ann. § 23-2-422. The Commission's Rules of Practice and Procedure (RPPs) further provide that:

> "(d) In response to an application for rehearing, the Commission may:
>
> (1) uphold the order without modification;
> (2) modify or clarify the order without further hearing based upon the existing record;
> (3) upon notice to the Parties, reopen the Docket for the receipt of further evidence on particular issues;
> (4)reverse the order in whole or in part;
> (5) issue an order granting rehearing solely for the purpose of further consideration; or
> (5) take any other action it deems appropriate."

RPPs, Rule 4.14 (d).

Pursuant to EAI's request, the Commission hereby grants rehearing for the purpose of considering the additional evidence identified by EAI. In particular, EAI is authorized to introduce the following evidence and testimony related thereto: (1) the Regulatory Research Associates *Major Rate Case Decisions -- Calendar 2013 Report* issued on January 15, 2014, as discussed by EAI on page 11 of its petition, at note 21; (2) the January 2014 investment reports of Deutsche Bank, Credit Suisse, International Strategy & Investment Group, and UBS, identified by EAI on page 12 of its petition; and (3) the Moody's Investor Service reports released on January 30 and 31, 2014, as identified by EAI on page 2 of the supplement to its petition.

In order to ensure prompt and fair review of EAI's additional evidence and the responses, if any, filed by other parties to this Docket, the Commission hereby sets the following procedural schedule for further proceedings:

(1) EAI shall file the additional evidence identified above, along with any supporting testimony regarding such evidence, no later than 2 p.m. on March 14, 2014;

(2) Staff and Intervenors shall file responsive testimony, if any, to EAI's testimony and evidence no later than 2 p.m. on April 4, 2014; and

(3) EAI shall file its reply, if any, no later than 2 p.m. on April 11, 2014.

Accordingly, EAI's petition for rehearing is hereby granted for the purpose of considering the additional evidence identified by EAI, subject to the conditions and procedural schedule set forth in this Order.

BY ORDER OF THE COMMISSION,

This 24th day of February, 2014.

I hereby certify that this order, issued by the Arkansas Public Service Commission, has been served on all parties of record on this date by the following method:

X U.S. mail with postage prepaid using the mailing address of each party as indicated in the official docket file, or
____Electronic mail using the email address of each party as indicated in the official docket file.

Colette D. Honorable

Colette D. Honorable, Chairman

Olan W. Reeves

Olan W. Reeves, Commissioner

Elana Wills

Elana C. Wills, Commissioner

Cynthia Mayweather (acting)

Dallas W. Heltz, Secretary of the Commission

ARK PUBLIC SERVICE CM

ARKANSAS PUBLIC SERVICE COMMISSION FEB 26 P 3:57

FILED

IN THE MATTER OF THE APPLICATION OF ENTERGY ARKANSAS, INC. FOR APPROVAL OF CHANGES IN RATES FOR RETAIL ELECTRIC SERVICE)

DOCKET NO. 13-028-U
AMENDED ORDER NO. 25

AMENDED ORDER NO. 25

In order to clarify its ruling, the Commission hereby enters this Amended Order No. 25 entirely to replace, and substitute for, Order No. 25 as entered on February 24, 2014.

On March 1, 2013, Entergy Arkansas, Inc. (EAI) filed an application with the Arkansas Public Service Commission (Commission) seeking an increase in its rates for providing electric service to retail customers. The Commission held a hearing on the proposed rate increase beginning on October 22, 2013, and concluding on October 30, 2013. On December 30, 2013, the Commission entered Order No. 21 in this Docket, denying EAI's proposed rate increase and approving a revised revenue requirement to be calculated by Staff in accordance with the provisions of Order No. 21.

On January 29, 2014, EAI filed a *Petition for Rehearing and Clarification* (Petition) and on February 3, 2014, EAI filed a *Supplement to Petition For Rehearing and Clarification* (Supplement). In its Petition and Supplement, EAI seeks rehearing on several issues and asks the Commission to allow it to introduce additional evidence on one issue.

On February 7, 2014, the Consumer Utilities Rate Advocacy Division of the Arkansas Attorney General's Office (CURAD), filed a response to EAI's Petition asking that rehearing be denied on most issues, but not objecting to EAI's request for clarification regarding the timing of its dismantlement study. On February 10, 2014, responses to EAI's Petition were filed by the General Staff of the Commission (Staff), Arkansas Electric Energy Consumers, Inc. (AEEC), the Federal Executive Agencies (FEA) and the Hospitals and Higher Education Group (HHEG). Staff's response states that rehearing should be denied on most issues, except that rehearing should be granted on the issue of the exclusion of certain wholesale accounts receivable from working capital, and that clarification of the Commission's Order is warranted on the timing of EAI's dismantlement study and whether EAI is permitted to report a regulatory asset for rate case expense on its financial reports. AEEC's response states that EAI's Petition should be denied, except that AEEC does not object to clarification of the Commission's Order with respect to the exclusion of certain wholesale accounts receivable from working capital and the timing of EAI's dismantlement study. FEA's response states that EAI's Petition should be denied. HHEG's response states that EAI's Petition should be denied, except that HHEG does not object to clarification of the Commission's Order with respect to the exclusion of certain wholesale accounts receivable from working capital, the timing of EAI's dismantlement study, and allowing a regulatory asset on EAI"s financial reports for rate case expense.

Under Ark. Code Ann. § 23-2-422 the Commission is authorized to take appropriate action on a rehearing petition, including granting or denying rehearing, affirming or modifying its order, or reopening the record for the purpose of receiving additional evidence:

> "(a) Any party to a proceeding before the Arkansas Public Service Commission aggrieved by an order issued by the commission may apply for a rehearing within thirty (30) days . . .
>
> (b) The application for rehearing shall set forth specifically the grounds upon which the application is based.
>
> (c) Upon receiving the application, the commission shall have power to grant or deny rehearing, to abrogate or modify its order without further hearing, or to reopen the record for the purpose of receiving and considering additional evidence."

Ark. Code Ann. § 23-2-422. The Commission's Rules of Practice and Procedure (RPPs) further provide that:

> "(d) In response to an application for rehearing, the Commission may:
>
> (1) uphold the order without modification;
> (2) modify or clarify the order without further hearing based upon the existing record;
> (3) upon notice to the Parties, reopen the Docket for the receipt of further evidence on particular issues;
> (4)reverse the order in whole or in part;
> (5) issue an order granting rehearing solely for the purpose of further consideration; or
> (6) take any other action it deems appropriate."

RPPs, Rule 4.14 (d).

Pursuant to EAI's request, the Commission hereby grants rehearing on all the issues raised in the Petition and Supplement. EAI is authorized to introduce the following additional evidence on the return on equity issue, and testimony related solely to the following additional evidence on that issue: (1) the Regulatory Research Associates *Major Rate Case Decisions -- Calendar 2013 Report* issued on January 15, 2014, as discussed by EAI on page 11 of its Petition, at note 21; (2) the January 2014 investment reports of Deutsche Bank, Credit Suisse, International Strategy & Investment Group, and UBS, identified by EAI on page 12 of its Petition; and (3) the Moody's Investor Service reports released on January 30 and 31, 2014, as identified by EAI on page 2 of the Supplement to its Petition. Neither EAI nor any other party is authorized to submit any evidence other than that specified above; and neither EAI nor any other party is authorized to submit any testimony other than testimony relating solely to the additional evidence specified above.

In order to ensure prompt and fair review of EAI's additional evidence and the responses, if any, filed by other parties to this Docket, the Commission hereby sets the following procedural schedule for further proceedings:

(1) EAI shall file the additional evidence identified herein, along with any supporting testimony limited solely to the additional evidence identified herein, no later than 2 p.m. on March 14, 2014;

(2) Staff and Intervenors shall file responsive testimony, if any, limited solely to addressing EAI's additional evidence and supporting testimony, no later than 2 p.m. on April 4, 2014; and

(3) EAI shall file its reply, if any, to the responsive testimony of Staff and Intervenors on the additional evidence, no later than 2 p.m. on April 11, 2014.

Accordingly, EAI's petition for rehearing is hereby granted, including consideration of the additional evidence identified herein, subject to the conditions and procedural schedule set forth in this Order. Because the

Entergy

Entergy Arkansas, Inc.
Regulatory Affairs
425 West Capitol Avenue
P. O. Box 551
Little Rock, AR 72203-0551
Tel 501 377 4000

VIA OVERNIGHT MAIL

October 15, 2014

Chairman James M. Allison
Tennessee Regulatory Authority
Attn. Sharla Dillon, Docket Manager
Tennessee Regulatory Authority
502 Deaderick Street, 4th Fl
Nashville, TN 37243

Re: In the Matter of the Application of Entergy Arkansas, Inc. for Approval of Changes in Rates for Retail Electric Service
TRA Docket No. 13-00114

Dear Mr. Allison:

On March 1, 2013, Entergy Arkansas, Inc. (EAI), filed with the Arkansas Public Service Commission (APSC), an Application for Approval of Changes in Rates for Retail Electric Service in APSC Docket No. 13-028-U. On August 21, 2013, EAI filed the same Application and supporting documents with the Tennessee Regulatory Authority (TRA) to initiate a docket for a general change in rates for EAI's Tennessee customers. In its March 20, 2014 transmittal letter, EAI supplemented its TRA filing with the APSC's Order No. 21 issued on December 30, 2013, reflecting its final decision in the APSC docket and the resulting compliance tariffs subsequently approved by the APSC in its Order No. 24 issued on February 20, 2014. Pursuant to correspondence from the TRA on May 6, 2014, EAI's tariffs were approved by the TRA to become effective April 30, 2014.

On January 29, 2014, EAI filed its Petition for Clarification and/or Rehearing of Order No. 21 with the APSC, and on August 15, 2014, the APSC issued its Order No. 35, approving modifications to Order No. 21.

The purpose of this letter is to file one original and four hard copies as well as an enclosed CD with an electronic copy of each of the following items that have been filed in APSC Docket No. 13-028-U, each of which is attached hereto:

1. EAI's Petition for Clarification and/or Rehearing filed on January 29, 2014;
2. EAI's Supplement to Petition for Clarification and/or Rehearing filed on February 3, 2014;
3. Order No. 25, issued on February 24, 2014;
4. Amended Order No. 25, issued on February 26, 2014;

5. EAI's Rehearing Direct Testimony filed on March 14, 2014;
6. EAI's Rehearing Reply Testimony filed on April 11, 2014;
7. Order No. 35, issued on August 15, 2014;
8. EAI's Revised Tariffs Pursuant to Order No. 35 filed on September 17, 2014;
9. EAI's Errata to Revised Tariffs Pursuant to Order No. 35 filed on September 18, 2014;
10. Order No. 37, issued on September 24, 2014, approving the compliance tariffs filed by EAI on September 17, 2014, as amended by EAI on September 18, 2014.

In addition, EAI's compliance tariffs for filing with TRA with requested effective date of November 28, 2014 (first billing cycle of December 2014) are attached to this transmittal letter. The attachment includes only those tariff sheets that are revised pursuant to APSC Order No. 35 that are applicable to Tennessee. The base rate increase approved by the APSC in Order No. 35 results in the following changes to rates previously approved in Order No. 21:

Class	Order No. 21 $ Increase	Order No. 35 $ Increase	$ Difference
Residential	28,995,695	30,771,546	1,775,851
Small General Service	19,782,751	20,994,283	1,211,532
Large General Service	31,941,173	33,873,850	1,932,677
Lighting	0	(4,216)	(4,216)
Total	80,719,619	85,635,463	4,915,844

EAI respectfully requests that the TRA include consideration of these revised tariffs in TRA Docket No. 13-00114 on its next Conference Agenda scheduled November 3, 2014.

EAI also requests that the 30 day notice required in TRA Rule 1220-4-1-.04 be waived to allow EAI to place its compliance tariffs in effect with the first billing cycle of December 2014 (which begins November 28, 2014) for its retail customers residing in Tennessee.

If you have any questions, please do not hesitate to call me at 501-377-3571.

Sincerely,

David Palmer
Manager, Regulatory Affairs

Attachments

BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF ENTERGY ARKANSAS, INC. FOR APPROVAL OF CHANGES IN RATES FOR RETAIL ELECTRIC SERVICE	))))	DOCKET NO. 13-028-U

PETITION FOR REHEARING AND CLARIFICATION
OF ENTERGY ARKANSAS, INC.

Comes Entergy Arkansas, Inc. ("EAI" or the "Company"), pursuant to Rule 4.14 of the Rules of Practice and Procedure of the Arkansas Public Service Commission ("APSC" or the "Commission") and Ark. Code Ann. § 23-2-422, and for its Petition for Rehearing and Clarification ("Petition") of Order No. 21 (the "Order") entered December 30, 2013 and Order No. 22[1] entered January 16, 2014, states as follows:[2]

[1] Through this Petition, EAI seeks rehearing of Order No. 22 to the extent that it is based on Order No. 21 and affirms a revenue requirement and deficiency based on the determinations in Order No. 21.
[2] Citations to the live testimony presented at hearing use "T" followed by the page number, e.g., "T. 243." Citations to the prefiled testimony are referenced as documents filed with the Commission in this docket, e.g., McDonald Direct Testimony at 1. Citations to the exhibits use "T" followed by the page number beginning with "E," e.g., "T. E243."

TABLE OF CONTENTS

1. A required showing of ratepayer benefit or material ratepayer benefit is not consistent with the accepted standard for utility cost recovery.
2. The Order erred in applying a ratepayer benefit standard and in applying it arbitrarily.
3. Even if a ratepayer benefit standard was proper, evidence demonstrates that EAI met this standard.
4. Prior Commission action supports a recovery of reasonable incentive compensation.
5. Incentive compensation measures aimed at controlling spending are operational in nature and not financial.
6. Conclusion

V. FACTUAL FINDINGS AND CONCLUSIONS AS TO SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN ("SERP")

1. SERP is not incentive compensation.
2. The Order does not define the standard for review or apply the facts in reaching its finding.

VI. WHOLESALE ACCOUNTS RECEIVABLE

1. All "wholesale revenues" are not excluded from retail, and retail customers are receiving the benefit of the "wholesale revenues" reflected in the Wholesale Accounts Receivable.
2. Allowing a revenue credit for wholesale revenues but not allowing a return on the receivable asset violates the matching principle of matching costs and revenues in the same period.

VII. REGULATORY ASSET FOR RATE CASE EXPENSES

1. Staff provides no basis or support for disallowing the establishment of a regulatory asset for deferred rate case expenses.
2. The Arkla Order does not address the establishment of a regulatory asset for rate case expenses.
3. The Arkla Order does not provide a basis or factual support for rejecting EAI's proposal to create a regulatory asset for rate case expenses.

VIII. ACCUMULATED DEFERRED INCOME TAX

A. ADIT on the Regulatory Asset for Rate Case Expense
    1. If the Commission continues its denial of the regulatory asset, then a corresponding adjustment to the $1.4 million of ADIT associated with that asset is warranted.

B. FIN 48 Balances Are Not Sources of Zero Cost Capital.
   1. Evidence shows that FIN 48 ADIT balances are not sources of zero cost capital.
   2. Evidence shows that EAI will not "ultimately prevail" in these positions.
   3. Conclusion.

IX. REVENUE CONVERSION FACTOR/MANUFACTURERS' TAX DEDUCTION

1. EAI is not eligible for the Manufacturers' Tax Deduction, and there is no basis for inclusion in the Revenue Conversion Factor.
2. The Revenue Conversion Factor should not be confused with normalization accounting.

X. DISMANTLEMENT STUDY REPORTING

1. The intent of EAI and Staff was to propose a dismantlement study at the time EAI proposes new depreciation rates if the existing study was greater than 10 years old and not to require a dismantlement study automatically every 10 years.
2. The Order contains an illogical date for provision of dismantlement information.

XI. CONCLUSION

I. INTRODUCTION

EAI initiated this case in March 2013 to address many critical issues that would directly affect its future operations as part of the Midcontinent Independent System Operator, Inc. ("MISO") and the Company's ability to overcome significant challenges to continuing to provide safe and reliable services to its customers at a reasonable cost, primarily by making significant capital investment to address aging infrastructure, resource adequacy requirements, environmental regulations, and technology upgrades. Based in many instances on the recommendations of Staff witnesses, the Order authorized many of the required tariff changes and the use of critical tools for EAI's operation in MISO, including the MISO Rider and a limited scope Capacity Cost Recovery Rider. However, the Order also presented significant obstacles to the Company's ability to attract needed capital for required investments in infrastructure, as well as discretionary capital needed for the Company to promote economic development in the state; through a combination of specific disallowances and findings that result in inconsistent accounting methods, the Order prohibits the Company from earning a sufficient rate of return on its investments, further hindering its ability to attract capital. The Order does not position EAI for the future envisioned for its customers following EAI's successful exit from the System Agreement and its entry into MISO.

This petition seeks clarification of and/or rehearing in a number of areas, including whether the Order, when viewed objectively, properly balanced the interests of the Company and its customers and whether specific decisions on issues were supported by meaningful analysis or substantial evidence that set forth findings that were not arbitrary or unreasonable. The petition also seeks clarification and/or rehearing on the Order's adherence to past practice, for example, in part relying on prior negotiated, non-precedential settlements. The cumulative effect of the individual findings and conclusions of the Order is to frustrate rather than facilitate EAI's operations in the new, post-System Agreement environment, deny recovery of reasonable levels of incurred costs, and exacerbate an already stressed financial outlook for the Company.[3] Therefore, the Company seeks clarification of and/or rehearing on several issues given their significance at this critical time.

II. ISSUES ADVERSELY AFFECTING EAI'S ABILITY TO INVEST IN INFRASTRUCTURE

EAI established that certain tools were essential to address the looming investment the Company faces to serve its customers, which investment is projected at $3.4 billion over the period 2012 – 2018.[4] The Order failed to address this undisputed challenge in the context of setting the Return on Equity

[3] In its November 8, 2013 release, Moody's Investor Service ("Moody's") placed the ratings of most regulated utilities and utility holding companies on review for upgrade due to Moody's more favorable view of the relative credit supportiveness of the nation's regulatory environment. Moody's considered improving regulatory trends, including better cost recovery provisions and reduced regulatory lag, but indicated there may be instances where ratings will not be upgraded following its review. Moody's expected to have its review completed within 90 days from the release. EAI will supplement this Petition regarding the release by Moody's to the extent the release contains relevant information that may be considered as new evidence in support hereof.

[4] Lewis Direct Testimony at 5.

("ROE") and establishing the formula to be used to calculate financing costs during construction of those investments.

A. Return On Equity

Setting the allowed investment return for shareholders who provide capital to a regulated utility is a critical responsibility of a regulatory commission in any general rate proceeding. These facts are amplified today at a time when economic uncertainty is a major factor in most investors' decisions and while, contemporaneously, utilities are confronted with increased expectations to make investments in infrastructure and to meet ever-changing environmental regulations. Utility commissions must exercise careful and thoughtful discretion, within constitutional requirements, in setting a reasonable rate of return that assures confidence in the financial soundness of the utility while also ensuring that the outcome supports public policy goals.

To that end, an ROE of 9.6 percent as recommended by the APSC General Staff ("Staff") should have formed the baseline as the Commission considered evidence supporting a higher ROE given current market conditions and investment need. Recognizing that the Commission historically has relied upon the Discounted Cash Flow ("DCF") methodology,[5] Staff witness Robert Daniel provided the Commission with such an analysis and recommended an ROE of 9.6 percent, the upper end of his DCF range.[6] In his recommendation,

[5] Daniel Direct Testimony at 21.
[6] *Id.* at 38.

Mr. Daniel acknowledged that current economic and market conditions are not fully comprehended in a traditional DCF analysis, which indicates that sole reliance upon the results of a DCF analysis was not appropriate and that all of the facts presented on this issue should be considered.[7]

The APSC, however, determined that there was "no compelling evidence to justify a return on equity above the approximate mid-point of the Staff's range" and that "a return on equity of 9.3 percent is reasonable."[8] EAI respectfully disagrees. Such a determination overlooks the evidence presented that current market conditions support the use and consideration of other econometric models, as well as consideration of public policy goals.[9] The consideration of all relevant facts and evidence supports a higher ROE than the 9.6 percent recommended by Staff, and certainly not one lower. In fact, the Order ignored the current trend in investments made by the Company, which increased more than 60 percent between 2009 and 2011[10] as well as the projected $3.4 billion in investment projected to take place in the immediate future. The ROE awarded by the Commission in this case is unjust, unreasonable, and inconsistent with landmark U.S. Supreme Court cases because the APSC's ROE determination unsettles, rather than assures, confidence in the financial soundness of EAI. In addition, the APSC's decision on ROE should be revised because it is based in part on contradictory evidence. Finally, an ROE that is the second lowest non-

---

[7] *Id.* at 37-38
[8] Order No. 21 at 109.
[9] Hadaway Direct Testimony at 51-52; Hadaway Rebuttal Testimony at 6-12, 44-45; Hadaway Sur-Surrebuttal Testimony at 3-7; *see also* Daniel Direct Testimony at 35-38.
[10] Marcus Direct Testimony at 16-17.

penalty ROE granted to a vertically integrated electric utility in recent decades[11] is counter to reasoned public policy that should encourage, not discourage, utility investment required to support economic development.

The U.S. Supreme Court in *Bluefield Waterworks & Improvement Co. v. Public Service Commission Of West Virginia*[12] and *Federal Power Commission v. Hope Natural Gas Co.*[13] set three overriding principles for rate of return determinations:

1. Comparable earnings – "commensurate with returns on investments in other enterprises having corresponding risks."[14]

2. Attraction of capital – "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[15]

3. End result doctrine – "the end result...cannot be condemned under the Act as unjust and unreasonable from the investor or company viewpoint."[16]

The APSC's 9.3 percent ROE determination in this case violates each of these principles, as described below, and additionally, the 9.3 percent ROE hinders EAI's role in economic development in the state because such an inferior ROE discourages discretionary capital allocations to the Company. Therefore, the Company respectfully requests rehearing on this issue.

[11] Regulatory Research Associates Rate Case History Database; the database is a frequently updated online resources available at the following link: www.snl.com.
[12] *Bluefield Water Works & Imp. Co. v. Public Service Comm'n*, 262 U.S 679 (1923).
[13] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1942).
[14] *Id.* at 603; *see Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 48-49 (1909).
[15] *Hope*, 262 U.S. at 603.
[16] *Id.* at 602, 604-605.

1. A 9.3 percent ROE does not allow EAI an opportunity to achieve earnings comparable with other utilities.

A utility has a constitutionally protected right to a fair return on its equity investment, one commensurate with that paid by firms of similar risk.[17] The 9.3 percent ROE is out of line with recent decisions by other utility commissions. Regulatory Research Associates reports[18] a 10.02 percent average ROE for the 48 electric utility ROE determinations in 2013 and a 9.89 percent average ROE for the 19 observations in the fourth quarter of 2013.[19] An independent analysis of the vertically-integrated utilities included among the 48 total observations yields an even more stark result and provides new evidence[20] that the APSC's 9.3 percent is substandard and at the extreme low end of all ROE determinations for firms with similar risks. The Commission's 9.3 percent ROE was the lowest non-penalty ROE awarded to a vertically-integrated electric utility in 2013, and of

[17] *Bluefield,* 262 U.S. at 692.

[18] Regulatory Research Associates, *Major Rate Case Decisions—Calendar 2013*, January 15, 2014. If requested to produce this new evidence, EAI will do so pursuant to Protective Order No. 2.

[19] *Id.*

[20] Commission Rule of Practice and Procedure 4.14 (Rehearing) provides in part that "[i]f any party applies for a rehearing based in whole or in part on additional evidence which was not a part of the original record, the party shall provide good cause for omitting the evidence from the original record, show that such evidence will not be merely cumulative;" and "state the subject matter if the new evidence is proposed as testimony and a description of any proposed exhibits…." EAI provides herein descriptions of the new evidence it proposes to offer through testimony in support of this petition. EAI states that the evidence is not merely cumulative and further could not reasonably have been offered as part of the original record. For example, in the case of certain analyst reports, those were not available until after the issuance of the Order; likewise, new testimony regarding economic development and ROE comparisons only became pertinent after the Commission's determination of a 9.3 percent ROE in the Order.

the other 30 ROEs determined by state regulators for vertically-integrated utilities in 2013, only three fall below Staff's recommended 9.6 percent ROE.[21]

2. The 9.3 percent ROE is not adequate to attract capital needed to address aging infrastructure, resource adequacy requirements, environmental regulations, and technology upgrades.

This Commission's selection of an ROE 90 basis points lower than EAI's currently authorized ROE of 10.2 percent, more than 70 basis points lower than the 2013 national average allowed ROE of 10.02 percent,[22] and 30 basis points lower than Staff's recommended 9.6 percent is inadequate to support EAI's anticipated capital investment and inconsistent with the ROEs awarded to other comparable-risk, vertically-integrated electric utilities in 2013. To put this in context, 90 basis points is approximately $24 million dollars of EAI's revenue requirement, 70 basis points is approximately $19 million, and 30 basis points is approximately $8 million, and these are current values that will increase over time. The APSC's decision frustrates the Company's ability to maintain its creditworthiness and jeopardizes EAI's ability to (a) attract the capital necessary to operate its business on reasonable terms compared to firms of similar risk and (b) make the necessary investments to prepare EAI for the future.

[21] EAI has analyzed the Regulatory Research Associates, *Major Rate Case Decisions—Calendar 2013* report issued January 15, 2014, and identified the ROEs awarded to vertically integrated utilities in 2013. EAI will provide this analysis as new evidence if the Commission grants rehearing on this issue.
[22] Regulatory Research Associates, *Major Rate Case Decisions—Calendar 2013*, January 15, 2014.

The investment community reacted immediately in assessing the impact of the order on EAI's equity investor, its parent company Entergy Corporation. The Markets Research arm of Deutsche Bank reported, "We viewed the order negatively for ETR [Entergy Corporation], particularly since the commission has recommended additional cost disallowances versus Staff's recommendation and a lower ROE."[23] In another equity research report, Credit Suisse, labeled the decision "disappointing" in light of an assumed 10 percent result and Staff's support of a 9.6 percent ROE.[24] As a result, International Strategy & Investment Group lowered the Company's earnings estimates to reflect the outcome of this case.[25] In a research report, UBS stated that it thought that the rate case decision, specifically the 9.3 percent authorized ROE, would provide for a slight net income decline vs. prior rates.[26] These reports and statements provide new evidence[27] that the 9.3 percent ROE awarded by the Commission is insufficient to assure confidence in the financial soundness of EAI sufficient to allow it to attract necessary capital.

3. **The end result of the Order is unjust and unreasonable.**

The end-result of a 9.3 percent ROE is unjust and unreasonable in light of all the evidence presented. Regulatory consistency, stability, and certainty are

[23] Deutsche Bank Markets Research, DB Utility Spotlight (#144) at 7 (January 3, 2014).
[24] Credit Suisse, Utility ROE Trends In 2013 (January 2, 2014).
[25] International Strategy & Investment Group LLC, Power and Utilities Research, Diversified Utilities, AR Rate Order Grants a 9.3% ROE; Our Genco Numbers Are Lower; Tgt $60/shr (January 3, 2014).
[26] US IPP Weekly Power Points at 6-7 (January 17, 2014).
[27] If subsequently produced, this new evidence would be submitted consistent with the provisions of Protective Order No. 2 in this proceeding.

important to investors, and a reduction in EAI's currently allowed ROE of 10.2 percent by 90 basis points to 9.3 percent is inconsistent with these factors. The end result doctrine does not support an ROE at the extreme low end of all ROEs awarded to comparable utilities in 2013 and near the bottom of all ROE awards in recent decades. Rather, the APSC must determine what ROE is adequate to assure confidence in the financial soundness of EAI, to maintain its credit, and to enable it to attract the capital necessary to operate its business on reasonable terms compared to firms of similar risk. As was addressed in the *Bluefield* and *Hope* decisions, adhering to these tenets provides constructive, policy-making guidance in determining an ROE.

In the most fundamental sense, regulation is the direct result of balancing the public and private interest factors. The importance of using judgment in the balancing of all relevant factors is underpinned by the law governing regulatory bodies and the determination of a utility's proper rate of return. Thirteen years prior to the landmark *Bluefield* case, U.S. Supreme Court Justice Oliver Wendell Holmes discussed the idea that rate regulation involved a middle course determined by judgment and fairness:

> On the one side, if the franchise is taken to mean that the most profitable return that could be got, free from competition, is protected by the Fourteenth Amendment, then the power to regulate is null. On the other hand if the power to regulate withdraws the protection of the Amendment altogether, then the property is naught. This is not a matter of economic theory, but of fair interpretation of a bargain. Neither extreme can have been meant. A midway between them must be hit.[28]

[28] *Cedar Rapids Gas Light Co. v. Cedar Rapids*, 223 U.S. 655, 669 (1912).

The determination of allowable rates of return based on a balanced position of all evidence is illustrative of a state public service commission's general duty to consider and balance all relevant factors when exercising its regulatory functions, which is not evident in the 9.3 percent ROE result. In *Bluefield*, the U.S. Supreme Court held that "[w]hat annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts."[29] The court continued, describing the necessity of being allowed a return sufficient to enable the discharge of a utility's public duties:

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain its credit and enable it to raise the money necessary for the proper discharge of its public duties.[30]

The ability of a utility to attract and compensate investors, therefore, directly correlates to the discharge of its public duties. As stated by the Court in *Hope*, the rate making process "involves a balancing of the investor and the consumer interests."[31] And in a restatement of the principles listed by the Court in *Bluefield*, the Court held that "[f]rom the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business."[32]

---

[29] *Bluefield,* 262 U.S. at 692-693.
[30] *Id.*
[31] *Hope,* 320 U.S. at 603.
[32] *Id.*

Equity, like debt, has a cost. For EAI, whose common stock is not publicly traded, the cost of equity can only be determined indirectly. The field of finance has three generally accepted ways of going about that determination: the Capital Asset Pricing Model, the Risk Premium Method, and the DCF formula. The APSC relied solely on the DCF model to derive the cost of equity for EAI in this case, as it has in other utility cases in recent years. It was not always so and should not be so here.

Mechanical application of a single methodology and selection of the midpoint of an ROE range that results from Staff's DCF model violates each of the *Bluefield* and *Hope* principles and implicitly ignores much of the evidence presented in this case by failing to explain how the Commission balanced all relevant factors. Moreover, in *United Railways & Electric Company v. West*,[33] the U.S. Supreme Court asserted that "[w]hat will constitute a fair return in a given case is not capable of exact mathematical demonstration…."[34] Considering the extreme, low-end result achieved by adhering strictly to a DCF analysis in this case, it is apparent that the industry standard calls for more analyses, both quantitative and qualitative, in making an ROE determination. Given the unobservable nature of the cost of equity and its critical importance to setting rates, this is a subject about which a regulator should want more information, not less, and would use all evidence at its disposal. The Company submits under the circumstances that singular reliance on the DCF methodology

[33] *United Railways & Electric Company v. West,* 280 U.S. 234 (1930).
[34] *Id.* at 249, 251.

is in error and counter to *United Railways, Bluefield,* and *Hope*, and its end result, 9.3 percent, is unjust and unreasonable.

The APSC previously has approved as fair and reasonable ROEs reflecting the high-end of Staff's recommended ROE range, as was the case with the 9.6 percent recommended by Staff in this proceeding.[35] In doing so the Commission cited to *Bluefield* and *Hope*, describing the need to balance the interests of ratepayers and investors:

> [T]he Commission must grant a utility the opportunity to earn a fair return which is reasonably sufficient to attract capital. In the monopoly utility setting, utility regulation simulates the competitive market by setting an allowed return on equity equal to the required return such that stockholders experience neither long-run monopoly profits nor erosion of financial position.[36]

Applying the principles of *Bluefield* and *Hope* to all the evidence presented and considering the current circumstances will ensure the ROE determination is comparable with other utilities, adequate to attract capital, and reasonable when comparing the end-result to the industry. This is not a circular analysis as often suggested by other parties but is merely a practical reasonableness check. The ROE established in the Order cannot withstand scrutiny in light of the overwhelming evidence and policy considerations that require its revision.

[35] APSC Docket No. 93-081-U, Order No. 13 at 80 (February 9, 1994), wherein the APSC approved a 10.7 percent ROE based on the upper bound of Staff witness' ROE range.
[36] *Id.* at 67.

4. The Commission's 9.3 percent ROE is based in part on discredited evidence, and new evidence undermines the Commission's conclusion that EAI's requested ROE was an outlier.

The Order cites to the various parties' ROE analyses and recommendations, including Arkansas Electric Energy Consumers ("AEEC") witness David Parcell's "cost of equity range of 9.0% to 9.5% with a point recommendation of 9.25%."[37] In summarizing the evidence presented, the Order states:

> Of the five ROE recommendations made by the Parties, including EAI, four of the recommendations are clustered in the range of ***9.25%*** to 9.6%, while the outlier is the Company's recommendation of 10.4%. If the Staff's recommendation were the midpoint of its range, or 9.3%, the four non-EAI Parties' recommendations would be clustered in the range ***9.25%*** - 9.4% with a midpoint of approximately 9.3%.[38]

The Commission's finding of a clustered ROE range of non-EAI parties with a 9.3 percent midpoint and finding that EAI's 10.4 percent ROE recommendation is an outlier was not informed by the testimony of Mr. Parcell recommending 10.0 percent for a comparable utility at roughly the same time he recommended a 9.25 percent ROE for EAI. Mr. Parcell's direct testimony filed August 2, 2013 in EAI's case states:

> My three analyses produce the following results:

DCF	8.4-9.1 %	(8.75% mid-point)
CAPM	6.3-6.7%	(6.50% mid-point)

[37] Order No. 21 at 97.
[38] *Id.* at 106 (emphasis added).

CE	9.0-10.0%	(9.50% mid-point)

> These results indicate an overall broad range of 6.3 percent to 10.0 percent, which focuses on the respective ranges of my individual model results. Focusing on the respective midpoints, the range is 6.5 percent to 9.5 percent. I recommend a COE range 9.0 percent to 9.5 percent for EAI. Though this recommendation is higher than my CAPM findings, it includes the upper-end of my DCF range (9.0 percent) and the mid-point of my CE range (9.5 percent). For the purposes of this proceeding, I recommend the mid-point of this range, which is 9.25 percent. I note that my 9.25 percent recommendation exceeds the mid-point of my DCF analyses, which in turn, essentially incorporates only the highest of the growth rates.[39]

Mr. Parcell also filed direct testimony on October 18, 2013 before the Georgia Public Service Commission ("GPSC") to offer his recommendation of the appropriate ROE for Georgia Power Company ("Georgia Power"). Georgia Power is a vertically integrated electric utility and subsidiary of a holding company with a comparable risk profile to that of EAI. However, in the case of Georgia Power, Mr. Parcell's testimony stated:

> My three analyses produce the following:

DCF	8.4-9.2 %	(8.80% mid-point)
CAPM	7.0-7.5%	(7.25% mid-point)
CE	9.0-10.0%	(9.50% mid-point)

> These results indicate an overall broad range of 7.0 percent to 10.0 percent, which focuses on the respective ranges of my individual model results. Focusing on the respective midpoints, the range is 7.25 percent to 9.5 percent. I recommend a COE range of 9.0 percent to 10.0 percent for Georgia Power. Though this recommendation is higher than my CAPM findings, it includes the upper-end of my DCF range (9.2 percent) and the upper-end point of my CE range (10.0 percent). For the purposes of this proceeding, I recommend the upper-end of this range, which is 10.0 percent. I note that by focusing on the highest point of my cost of

[39] Parcell Direct Testimony at 35.

equity range, I am making a very conservative recommendation in this proceeding.[40]

The remarkably similar analyses that produced almost identical ranges for Mr. Parcell's three analytical methods are even more remarkable because of the different conclusions, or appropriate end result, that he draws for these two similarly situated utilities. Mr. Parcell's 10.0 percent ROE recommendation, which he labels conservative from the view of a consumer advocate, indicates that EAI's 10.4 percent recommendation, and certainly Staff's 9.6 percent recommendation, is not an outlier as argued by other parties in EAI's case and as restated in the Order. Further, the 10.0 percent ROE recommendation further demonstrates that the Commission's belief that a 9.3 percent ROE was representative of a reasonable result is not supported by credible evidence.

5. A 9.3 percent ROE discourages economic development in the state and is counter to state goals and customers' long-term interests.

The APSC's 9.3 percent ROE strains EAI's ability to satisfy its obligation to provide service, which requires capital investment, and discourages discretionary capital allocations to the Company by its parent corporation, which has a fiduciary duty to its investors. In order to meet its requirement as a public utility, EAI must provide electric service to all customers within its designated service territory. That obligation carries with it the need to make capital

[40] GPSC Docket No. 36989, Direct Testimony and Exhibits of David C. Parcell at 32 (Oct. 18, 2013).

investment to install the facilities required to provide that service. A practical reality of setting EAI's ROE at 9.3 percent is the inherent difficulty posed by needing to secure capital to meet obligations as a public utility but requiring investors to forego the opportunity for higher returns from utilities with comparable risks. Sound public policy does not create this untenable situation.

The capital that EAI is allocated first goes to meet the requirements of existing customers and needed upgrades to comply with state and federal regulations, *e.g.*, National Electric Reliability Council electric reliability standards. But constraints such as the 9.3 percent ROE established in the Order are very likely to result in less allocation of capital to EAI for incremental, discretionary projects, thereby hindering the role of EAI in economic development in Arkansas. EAI will meet its obligation to provide required service for customers locating in its service territory, but all other things being equal, the Order's ROE determination jeopardizes a continuation of the Company's historical efforts to recruit potential opportunities to its territory. The cumulative effect of the Order exacerbates such adverse effects. The Order's ROE determination will have a very real, and adverse, impact on economic development prospects requiring significant capital that now would rationally be directed outside of Arkansas. For example, moving forward EAI will not be as well positioned to compete for projects like Big River Steel because a 9.3 percent ROE is insufficient for the rational investor. After all, there was at the time a competing site for the project in the territory of Entergy Mississippi, Inc., which is allowed a materially higher ROE than 9.3 percent. All other things being equal, no rational investor using an objective view, especially when constrained by a fiduciary obligation to shareholders, would choose the materially lower rate of return for its discretionary capital, much less devote vigorous efforts toward securing an industrial prospect that would require significant investment. This is an economic reality that must be recognized and reckoned with in order to achieve the public interest.

EAI management, executives, and the Company's Business and Economic Development team would testify as to the adverse impacts associated with the Commission's 9.3 percent ROE determination in the area of economic development, including the reduced incentive for EAI to employ its resources and to take risks that are necessary to site projects and bring new customers in the State. If provided the opportunity, Company representatives would describe the efforts and accomplishments of EAI's economic development program, which works in conjunction with state agencies and the Office of the Governor, to aggressively pursue leads and bring new business to the state. Finally, Company representatives are prepared to provide testimony addressing the adverse effects on EAI of an assumed reduction in discretionary capital and how the Order discourages Arkansas economic development efforts, especially those involving prospects considering multiple jurisdictions, such as Big River Steel.

6. Conclusion

The ROE awarded by the Commission is unjust, unreasonable, inconsistent with the overriding principles set forth in *Bluefield and Hope,* and unsupported by substantial evidence. The 9.3 percent ROE is at the extreme low end of all ROE determinations during 2013, is 30 basis points lower than Staff's recommended 9.6 percent ROE, is inconsistent with the ROEs awarded in 2013 to other comparable-risk, vertically-integrated utilities, and will constrain the Company's ability to achieve earnings comparable to that of other firms. The Company submits that singular reliance on the DCF methodology produced a result that is counter to the holdings of *Bluefield* and *Hope*, and the end-result, a 9.3 percent ROE, is unjust and unreasonable. In addition, as supported by the initial and continuing feedback received from the investment community and rating agencies, the APSC's ROE determination in this case has already begun to erode confidence in the financial soundness of EAI, including the Company's ability to attract the capital necessary for its imminent investment needs and for potential economic development projects, which is counter to sound public policy. Finally, the Commission's findings were based in part on testimony in this case that conflicts with the witness's testimony in another regulatory proceeding despite similar facts. Therefore, for all the foregoing reasons, the ROE determination deserves rehearing. EAI respectfully requests rehearing on the 9.3 percent ROE set by the Commission in the Order.

B. <u>Allowance For Funds Used During Construction ("AFUDC")</u>

There are two regulatory approaches to recovering the cost of funding utility Construction Work In Progress ("CWIP"). One is to include CWIP in rate base, in which case CWIP financing costs are recovered through current charges to customers during the construction period. The other approach is to exclude CWIP from rate base and to record AFUDC to capture the costs of financing CWIP. These financing costs are then recovered from customers as the assets are depreciated over their useful lives.

AFUDC is the cost of money invested during the construction phase of a project. AFUDC is capitalized to projects in the same manner as construction labor and materials cost and simply recognizes that financing costs are a component of construction costs when CWIP is excluded from rate base. At issue in this case is how that cost of money should be measured: whether by the Company's overall rate of return on its rate base ("RORB") or by the Federal Energy Regulatory Commission ("FERC") AFUDC formula calculation. As a result of the Commission's use of the Modified Balance Sheet Approach, Accumulated Deferred Income Taxes ("ADIT") (and other low cost / no cost components) are included in the calculation of the RORB.[41] By contrast, the FERC formula rate does not include ADIT and other low cost / no cost components.[42]

In the Order, the Commission determined that the overall rate of return, including the zero cost capital that results from ADIT, should serve as the AFUDC rate because of the principle of fungibility and because "it is consistent with AFUDC treatment by this Commission since Docket No. 09-084-U."[43] The

[41] Because there is a level of income tax deferred into the future, ADIT is essentially a zero cost loan from the federal government resulting from the difference in time between when income is earned and recognized for accounting, but not tax, purposes.
[42] The FERC formula's components are short term debt incurred, existing long-term debt, preferred stock, and common stock at the latest return on equity allowed by the Commission.
[43] Order No. 21 at 118.

facts do not support the bases for Commission's decision, nor is the decision supported by genuine precedent or by public policy considerations. Therefore, the Company respectfully requests rehearing on this issue.

1. The fungibility principle is not applicable to the calculation of AFUDC.

Citing fungibility of dollars, the Commission adopted Staff's proposal to set the accrual rate for the AFUDC at EAI's RORB. The Order states, "The Commission has long accepted that all sources of funds are fungible, and are equally used to finance CWIP as well as rate base. Given the fungibility of the funds available to EAI, it is impossible to determine which specific source is financing any particular asset."[44]

The first problem with this approach is that the CWIP being funded is not in rate base and, accordingly, is not earning a return in current rates charged to customers. As the Arkansas Court of Appeals described the operation of AFUDC:

> AFUDC is recorded part as current income, part as an offset to interest expenses, but no cash payments are made by ratepayers during construction. The payments from ratepayers to recover the carrying charges begin when the completed plant [is in service]. The entire cost of the plant (including AFUDC) is added to rate base and it earns a rate of return on investment and is depreciated over the life of that plant.[45]

---

[44] *Id.*

[45] *Ark. La. Gas Co. v. Ark. Pub. Serv. Comm'n.,* 50 Ark.App. 213, 225, 907 S.W.2d 140, 146 (Ark. Ct. App. 1995), *quoting* James C. Bonbright, Albert L. Danielson, David R. Kamerschen, *Principles of Public Utility Rates*, 246 (2d ed. 1988).

RORB has no demonstrable connection with a non-rate-base item like CWIP, as neither return nor rate base is implicated in the establishment of an AFUDC rate.[46]

One of the tenets of the fungibility doctrine is that it is impossible to know which liabilities are funding which assets. The Company submits, however, in this case, it is possible to know which liabilities are ***not*** funding certain assets. A major component of the capital structure committed to EAI's rate base is ADIT. CWIP does not generate ADIT, and ADIT does not arise under the tax laws until a project is placed in service and is no longer under construction (notably, the time at which AFUDC no longer accrues).[47] An asset is not depreciated, and therefore not eligible for accelerated depreciation under the tax laws that create ADIT, until it is in operation.[48]

The RORB cap approach necessarily assumes that EAI creates ADIT to fund CWIP some other way, and that it coincidentally does so in the same proportion as existing ADIT is committed to rate base and reflected in RORB. A proposition that bold, when confronted with the fact that CWIP itself does not give rise to ADIT, begs for some evidence. No party provided sufficient evidence to support this proposition, leaving the Commission without a sound basis for its decision. As the State Court of Appeals expressed it, "we cannot accept the argument that the concept of fungibility should be recognized in this particular

[46] Indeed, if RORB and AFUDC were the same thing, they would not have different names. AFUDC involves neither "R" nor "RB", but rather, it is a utility's real cost of financing construction.
[47] Staff witness Daniel agrees that "ADIT related to depreciation expense is generated when plant is placed in service and not during the construction phase." Daniel Surrebuttal Testimony at 18-19.
[48] Lewis Rebuttal Testimony at 4-7.

case because doing so would be absolute fiction."[49] That statement applies equally well here. Fungibility is no valid basis to limit the AFUDC rate at EAI's RORB.

2. Orders in contested cases establish the FERC formula as precedent.

The Order states that its decision on this issue is "consistent with AFUDC treatment by this Commission since Docket No. 09-084-U."[50] However, the APSC has not established a consistent principle on the calculation of AFUDC since Docket No. 09-084-U. The APSC has issued orders resolving seven general rate proceedings of electric and gas utilities including and since that docket. As clearly documented in EAI Exhibit JAL-5, attached to the Rebuttal Testimony of Jay A. Lewis, each of those orders approved a negotiated settlement, not a contested proceeding in which parties debated the issue and the APSC issued a policy decision on the issue of the appropriate method to calculate AFUDC. The Commission acknowledged elsewhere in the Order that Docket No. 09-084-U provides no precedent for issues in the current case because of the give and take among parties required to achieve a settlement of all issues:

> As to EAI's contention that its proposed treatment is consistent with the Commission's approval of the Settlement in Docket No. 09-084-U, the Commission notes that, in its Order No. 15 in that docket, the

---

[49] *Associated Natural Gas Co. v. Ark. Pub. Serv. Comm'n.*, 25 Ark.App. 115, 121, 752 S.W.2d 766, 769 (Ark.Ct.App. 1988).
[50] Order No. 21 at 118.

> Commission specifically advised that, in its approval of a settlement, it "acknowledges that parties make concessions during settlement negotiations."[51]

Clearly, such settlements should not serve as a basis to approve a course of action here because compromises struck in pursuit of reaching settlements can contain conflicting outcomes and are routinely recognized not to set precedents. For example, months before the settlement in Docket No. 09-084-U was approved, the Commission approved a negotiated settlement in Docket No. 09-008-U, Southwest Electric Power Company's ("SWEPCO") general rate proceeding.[52] Unlike Docket No. 09-084-U, however, the SWEPCO settlement remained silent on the AFUDC formula, resulting in two very different outcomes.[53]

If the Commission looks to precedent on this issue, prior Commission rulings in contested cases favor adoption of the FERC AFUDC formula. Prior to the settlement in Docket No. 09-084-U, the APSC approved the FERC formula (prescribed in FPC Order 561 in 1977 following an extensive rulemaking) for determining the AFUDC rate.[54] In addition, the Commission approved the use of the FERC formula for AFUDC in three EAI general rate proceedings prior to Docket No. 09-084-U: Docket Nos. 84-199-U, 96-360-U, and 06-101-U, with Docket No. 96-360-U resolved by settlement. Of these three, AFUDC was a contested issue in only the 1984 case. In that proceeding, the Commission stated in Order No. 7:

---

[51] Order No. 21 at 39.
[52] See Docket No. 09-008-U, Order No. 12 (Nov. 24, 2009).
[53] *Id.*
[54] Docket No. 84-199-U, Order No. 7 at 13.

> We would note that while this Commission has accepted the FERC AFUDC calculation for AP&L at the present time, we are convinced by the testimony of Mr. Sullins that further research should be done to determine if this Commission should adopt a new AFUDC calculation methodology that recognizes ALL sources of capital available to the Company to fund CWIP, and hereby direct Staff to do so and call for a generic docket.[55]

This most recent policy statement of the Commission is to use the FERC AFUDC formula until such time as Staff completes its investigation and the Commission has completed a generic docket focused on that issue. EAI cannot find that such investigation has been conducted or that a generic docket has been initiated. If the Commission's intent is to remain consistent with established policy on an AFUDC calculation, then the FERC formula should be used until the Staff has investigated the options and a generic docket is completed. The Commission's reliance on settlements as consistent with the Order's direction to cap the AFUDC rate is not a reasoned basis for the Commission's decision in this case on this issue.

3. Public policy favors utilizing the FERC formula.

Public policy supports a finding that AFUDC should be set using the FERC formula and not capped at EAI's RORB. EAI witness Jay Lewis explained in his direct testimony that EAI expects the need to finance new capital expenditures in excess of nearly $3.4 billion from 2012 through 2018, which represents more than 86 percent of the Company's 2011 total aggregate rate base.[56] Said

---

[55] *Id.* (emphasis in original).
[56] Lewis Direct Testimony at 5.

differently, over a 7-year period that is currently underway, EAI expects to invest almost as much in its asset base as it has, in net, invested over the first 100 years of its existence. These necessary investments will place pressure on the financial strength of EAI as it undertakes increasing levels of debt financing to support the investment. Public policy should support mechanisms that facilitate a utility's ability to attract capital needed to construct facilities to provide service to its customers. Restricting the AFUDC rate to a level that is below the utility's true cost of financing construction discourages investment and supports rehearing on this issue.

III. <u>PAYROLL EXPENSE</u>

Establishing an appropriate level of payroll expense in this case involved several complex issues, particularly given the reorganization of EAI, Entergy Operations, Inc. ("EOI"), and Entergy Services, Inc. ("ESI") organizational structures that occurred during the case due to the Human Capital Management ("HCM") initiative. The payroll adjustment annualizes test year operation and maintenance ("O&M") payroll expense to reflect changes in headcount and salary increases that occurred during the test year at EAI, ESI, and EOI.[57] Test year payroll costs are included in rates as either O&M expense or capital costs (*e.g.*, payroll costs could be 45 percent O&M expense and 55 percent capital). The costs charged to capital are included in rates as capital projects when completed and closed to plant. All plant costs, which include capitalized payroll costs, will

[57] Zakrzewski Direct Testimony at 8, 11.

eventually end up in rates as new base rate cases are filed. O&M expense payroll levels included in rates are based on the known and measurable changes[58] when the rate case is filed. Changes in payroll O&M expense between rate cases are not trued up in the next rate case, so it is important to set the appropriate expense level during a given rate case.

As discussed above, the payroll adjustment is made to annualize the impact of headcount changes and salary increases on only the test year level of payroll O&M expense. The payroll adjustment is calculated on test year total Company payroll and allocated between O&M expense and capital based on the actual test year O&M and capital payroll percentages. The Staff and EAI agreed to use head count changes that had occurred as of the end of December 2012 for EAI, ESI and EOI to derive an annual payroll cost for the adjustment. In the past, Staff has updated this adjustment to reflect headcount changes that occurred during the pro-forma year.[59] In this case, however, Staff and EAI agreed not to update the December 2012 headcount to avoid double-counting headcount changes that were captured in the separate HCM adjustment. However, Staff also chose to average, or normalize,[60] payroll costs for ESI and EOI over a historical five-year period, in addition to annualizing these costs. Staff did not normalize the payroll costs for EAI direct payroll. The Order adopted Staff's recommendation. EAI respectfully seeks rehearing on this issue.

---

[58] *Id.* at 11.
[59] *Id.*
[60] *Id.*

A. ESI and EOI Payroll

The APSC concluded that EOI and ESI payroll costs should be normalized using a five-year average O&M expense while adopting the 2012 test year O&M percentage as the normal level for EAI direct payroll costs.[61] The Company seeks clarification of the basis for the Commission's use of inconsistent and selectively applied payroll adjustments based on different accounting periods for different categories of payroll costs. To the extent that no reasonable basis underlies this decision, the Company respectfully requests rehearing on this issue.

1. Payroll costs should be calculated consistently to achieve a reasonable result.

The Company calculated its original payroll adjustment in this case using test year components for EAI, EOI, and ESI consistent with its calculation in its last two rate cases, Docket Nos. 09-084-U and 06-101-U. EAI witness Gregory R. Zakrzewski addressed a number of issues in his rebuttal testimony associated with Staff witness Bill Taylor's payroll calculation, and Mr. Taylor incorporated some of those changes into his calculation. However, Mr. Taylor did not accept Mr. Zakrzewski's recommendation that a normalization adjustment for ESI and EOI payroll costs was not appropriate. As a result, the Company recalculated all its payroll adjustment to conform to Staff's five-year normalization methodology

[61] Order No. 21 at 47-48.

for all three companies (EAI, EOI, and ESI) not just EOI and ESI as Staff had done.

Despite EAI's recalculation and agreement to apply Staff's five-year normalization methodology in the present case, Staff still did not agree to apply this methodology consistently to all three companies (EAI, EOI and ESI). Staff calculated an EAI direct payroll adjustment using the 2012 test year O&M percentage but used a five-year average O&M percentage to calculate the payroll adjustment for EOI and ESI payroll costs. Mr. Taylor testified that "it is more representative to use five-year average O&M expense ratios to normalize payroll expense for ESI and ANO and the test year O&M ratio for EAI, especially in light of EAI's [Human Capital Management] HCM initiative." [62] However, he presented no analysis or explanation to support this selective application other than a vague reference to certain adjustments made to payroll costs related to the recent reorganization, which is addressed in the next section.

The allocation of payroll costs between O&M expense and capital will vary from year to year for each company depending on the types of capital projects that are taking place and which company employees are working on these capital projects. Using five-year averages or test year values can achieve a reasonable result if consistently applied to all categories of payroll costs.[63] However, the result of the selective application of Staff's methodology, on which the Order

[62] Taylor Surrebuttal Testimony at 2.

[63] Attorney General ("AG") witness William B. Marcus agrees that EAI's alternative recommendation to normalize these costs using a five- year average is appropriate. *See* Marcus Surrebuttal Testimony at 6, 43.

relies, is to lower the calculation of costs for EOI and ESI payroll by $5.6 million.[64] A consistent application of this methodology to all three categories of payroll costs results in an increase of $0.5 million to test year values. The net result is a $6.1 million difference when comparing EAI's calculation to Staff's calculation. These calculations are also shown on EAI Exhibit GRZ-8.[65]

The Commission's treatment of payroll expense is inconsistent with the treatment of such costs in the Company's previous two cases; its adoption of Staff's internally inconsistent methodology is unsupported by substantial evidence; and the resulting adjustment is unreasonable in that EAI's payroll is undercounted by approximately $6 million. Because the HCM savings were calculated based on EAI, ESI, and EOI payroll as of December 2012, test year payroll for 2012 should be consistently used for all of the companies (EAI, ESI, and EOI), and EAI's payroll adjustment for all of the companies should be based on the most recent available year, 2012. Stated another way, because HCM savings were calculated based on payroll at the end of 2012, the payroll level determined for the case must be based on the 2012 level to be consistent. The Order results in approximately $6 million of payroll costs – real people and real salaries disallowed in rates.

2. The HCM initiative provides no reasonable basis to use inconsistent methods to calculate payroll costs.

[64] Zakrewski Sur-Surrebuttal at 22, EAI Exhibit GRZ-8.
[65] *Id.* at 22.

Staff' reference to the HCM initiative as the explanation for its selective application of its normalization methodology lacks any rational basis. As described by EAI witness Hugh T. McDonald,[66] the HCM initiative was an Entergy Corporation initiative that impacted all Entergy companies, including EAI, EOI, and ESI. As a result, all categories of payroll costs, including ESI payroll, EOI payroll, and EAI direct payroll were affected by the initiative. Using the HCM initiative as a basis for normalizing payroll costs at EOI and ESI and not normalizing costs at EAI is therefore unfounded.

The Order contains no explanation for adopting differing treatment in adjusting payroll expense, except to say that the method chosen for EAI was appropriate because the HCM savings were determined based on payroll as of 2012.[67] Yet, if that is the case according to the Order, then it is illogical that the Order does not consistently apply all payroll expense for EAI, ESI, and EOI based on payroll as of 2012. Nothing in the HCM initiative provides a rational basis for adopting different methods to derive the payroll adjustment. EAI seeks clarification of the basis on which the APSC adopted the Staff method for adjusting EAI, ESI, and EOI payroll, and to the extent that basis has no reasonable support, the Company seeks rehearing on this issue.

[66] McDonald Rebuttal Testimony at 10.
[67] Order No. 21 at 47.

IV. INCENTIVE COMPENSATION

The Order determined that EAI should not be allowed to recover all the costs it incurred for certain incentive compensation programs, finding that "EAI and Staff have failed to show that EAI's short-term, long-term and stock based incentive compensation ***provide ratepayer benefits*** to justify 100% inclusion in rates."[68] Moreover, the Order found that EAI's stock-based and long-term incentive costs "... do not provide material ratepayer benefits, or align the interest of shareholders and ratepayers ... and are based entirely on the financial performance of EAI and therefore entirely benefit shareholders, rather than ratepayers."[69] Finally, the Order held that "... the short-term incentive costs are indirectly tied to financial performance through the [Entergy Achievement Multiplier] EAM funding mechanism and, therefore, the Commission finds that ratepayers should bear no more than 50% of the costs."[70]

The Order failed to adopt and apply a standard for cost recovery or disallowance that is supported by substantial evidence, and in fact the standards suggested in the Order are inconsistent, ill-defined, and incompatible with the standard used to approve cost recovery for all other types of expenses. These factors, along with flawed and incomplete factual findings and conclusions, render the Order's $17.8 million disallowance of certain incentive compensation costs arbitrary and unreasonable. Thus, EAI seeks rehearing on this issue as no

[68] *Id.* at 4 (emphasis added).
[69] As a result of these findings, the Order disallows recovery of $8,087,877 in annual short-term incentive compensation costs and $7,036,188 in long-term and stock-based incentive compensation costs. Order No. 21 at 54-55.
[70] *Id.* at 54.

rationally-based standard, applied objectively to the evidence in this case, could produce the result reached in the Order.

In addition, the Company seeks clarification as to what is a financial based measure, and to the extent the decision is inconsistent with that definition, seeks rehearing on this issue.

1. A required showing of ratepayer benefit or material ratepayer benefit is not consistent with the accepted standard for utility cost recovery.

The Order reasons, in part, that disallowance of certain incentive compensation is justified because evidence does not demonstrate ratepayer benefit or material ratepayer benefit. EAI asserts that a proper cost recovery standard for expenses does not require a showing of ratepayer benefit or material ratepayer benefit. Staff legal counsel asserted the same regulatory principle advanced by EAI in this case:

> As a general rule, reasonable expenses of the utility which are necessary for the provision of utility service are allowed in rates. Consistent with the treatment of other operating expenses, it is appropriate to evaluate whether the overall level of EAI's compensation cost is reasonable and not subject the individual components to a benefits test. ... ***In this docket, EAI has presented substantial evidence demonstrating the reasonableness of its overall level and the structure of its compensation.*** ... In addition, EAI witness Hartzell supported the company's use of financial or cost containment incentives and stock based compensation as beneficial to ratepayers, which further supported inclusion of the full level of cost for its employees. ... The intervenors' piecemeal attack on incentive and stock based

> compensation merely results in denying EAI recovery of a total compensation level, which has been proven reasonable.[71]

Staff witness Bill Taylor advocated that reasonable expenses of the Company which are necessary for the provision of utility service should be allowed in rates.[72] Staff, as it does with all other expenses, reviewed the overall employee compensation levels and then determined that EAI's compensation amounts were reasonable, including incentive and stock-based compensation. Thus, Staff did not recommend an adjustment to the incentive and stock-based compensation included in EAI's cost-of-service study.[73] No party offered proof that EAI's overall compensation levels, including incentive compensation, are unreasonable. The Order is flawed in its failure to (a) acknowledge that no party rebutted that EAI's overall compensation levels, including incentive compensation, are reasonable and (b) demonstrate how those facts are applied to a reasonable and clearly articulated standard to determine cost recovery.

2. The Order erred in applying a ratepayer benefit standard and in applying it arbitrarily.

The Commission applied a ratepayer benefits test only to the expense of incentive compensation and not to all other utility expenses. Staff witness Bill Taylor testified that applying a ratepayer benefits test to one set of reasonable expenses and not to other utility costs was inconsistent and inappropriate.[74] Mr.

---

[71] T. 94-96 (emphasis added).
[72] Taylor Direct Testimony at 7.
[73] *Id.* at 6-7.
[74] T. 876.

Taylor explained that "if these are the type of expenses that are an ordinary component of a compensation plan, that would be something that should be allowable, not subject to a benefits test."[75] Moreover, two Commissioners at the hearing questioned the origin of the benefits test, stating in one instance that "this is the first I have learned of some requirement for a benefits test"[76] and in another instance asking Mr. Taylor "from where do you derive the requirement that we use a benefits test?"[77] Yet, that is exactly what the Order does – applies an arbitrary ratepayer benefits test to incentive compensation as the alleged standard for cost recovery.

The arbitrary nature of a ratepayer benefits test is apparent because it cannot be applied uniformly to reach a reasonable result. Many utilities, including EAI, are structured as a corporation because this form of business lends itself to raising the large amounts of capital needed to supply utility service. A corporate structure, by definition, includes shareholders, which the courts recognize must be fairly compensated for the investment they make in the corporation. Recognizing that principle, the Commission in this case, and in all of EAI's prior base rate proceedings, has allowed rate recovery of the ROE provided by those shareholders, which is a cost element that solely benefits shareholders and which would not be allowed for recovery under a test requiring a showing of ratepayer benefit. The selective application of a customer benefit test to a limited set of costs is arbitrary.

[75] *Id.*
[76] T. 876-77.
[77] T. 881.

3. Even if a ratepayer benefit standard was proper, evidence demonstrates that EAI met this standard.

Even if a ratepayer benefit standard was an accepted standard, evidence demonstrates that EAI's incentive compensation programs produce reasonable levels of compensation costs and their design is consistent with the industry to attract and retain qualified employees, which benefits the Company's customers. EAI witness Kevin Gardner testified that equity-based, long-term incentive programs are commonly used tools.[78] To make sure that total compensation levels, including incentives, are at reasonable market levels, EAI employs an independent consultant to benchmark total compensation to ensure they are competitive and reasonable in comparison with the electric utility industry and general industry.[79] The design of EAI's total compensation program results in achieving cost levels at the market median.[80]

EAI's principal witness supporting incentive compensation as necessary to attract and retain qualified employees, Dr. Jay Hartzell, presented empirical studies to support his opinions, and he was not cross examined or questioned by Commissioners. Staff agreed with Dr. Hartzell that:

> [the Company] competes with other employers in the marketplace for qualified and competent employees. Attracting and retaining qualified and competent employees is beneficial to ratepayers, because it improves the quality of service and reduces the cost of electric utility service, because of the costs associated with hiring and training employees. Failure to retain qualified and competent employees elevates the cost of service due to the cost of hiring and

[78] Gardner Direct Testimony at 19-20.
[79] *Id.* at 20-21.
[80] *Id.* at 22-24.

training employees. Therefore, better employee retention results in lower costs to ratepayers.[81]

The Order is flawed in its failure to (a) acknowledge that no party to this proceeding rebutted these facts and (b) demonstrate how those facts are applied to a reasonable and clearly articulated standard to determine cost recovery. EAI respectfully submits that the Commission has failed to articulate a lawful standard for disapproving EAI's requested recovery herein. In any event, no rationally based standard, applied objectively to the evidence in this case, could produce the result reached in the Order, thus EAI respectfully seeks rehearing.

4. Prior Commission action supports a recovery of reasonable incentive compensation.

The Order's requirement of a showing of ratepayer benefits in the face of evidence that the payroll expense is reasonable also departs from prior Commission precedent. In Docket No. 93-081-U, the Commission allowed incentive compensation award payments when the undisputed evidence demonstrated the utility's total employee cash compensation was within the range of peer group studies.[82] The Commission's determination in that proceeding was upheld by the Arkansas Court of Appeals, rejecting the AG's assertion that the Commission erred in allowing incentive award payments to be included in rates.[83] Mr. Taylor testified in this case that the Company provided evidence that supported the total level of compensation as reasonable, which is

[81] Taylor Direct Testimony at 6.
[82] Docket No. 93-081-U, Order No. 13 at 25 (February 9, 1994).
[83] Ark. La. Gas Co. v. Ark. Pub. Serv. Comm'n, 50 Ark.App. at 227-28, 907 S.W.2d at 148-149.

consistent with the Commission's finding in Docket No. 93-081-U. No party asserted that EAI's total level of compensation was unreasonable. EAI seeks clarification of the basis for the APSC's finding that incentive compensation whose costs are reasonable should not be fully recovered in rates in contrast with a prior Commission decision reaching a contrary decision on similar facts, and to the extent there is no reasonable basis to support the current finding, seeks rehearing on this issue.

5. Incentive compensation measures aimed at controlling spending are operational in nature and not financial.

The Order cites AG witness William Marcus' explanation that EAI's short-term incentive programs "...are based on five types of goals - which include cost control, operational, safety, and financial. He states the goals related to cost control are also at least in part financially-related, as the Commission has found previously."[84] In reaching its finding that the cost of short-term incentive programs should not be fully recovered, the Order apparently lumps cost control measures in with financial measures that the Order concluded should not be allowed full cost recovery. EAI seeks clarification of the Commission's decision on what is a financial measure, and based upon that definition, rehearing in that the cost control measures used in EAI's incentive compensation programs are not financial measures that render the underlying costs ineligible for cost recovery.

[84] Order No. 21 at 50.

EAI witness Kevin Gardner testified that EAI modified its incentive compensation program in response to the Commission's order in Docket No. 06-101-U to focus the measures more on operational factors, including controlling costs.[85] Cost control measures, essentially staying within budget, are a common management tool not limited to utilities structured as an Investor Owned Utility. EAI's cost containment and spending measures pertain to completing projects in a cost effective manner and controlling the rate of growth of expenditures.[86] This is a prudent management practice that is expected by regulators.

Mr. Marcus testified EAI's goals listed as "cost-control" measures are "at least in part" financially related, as previously found by the Commission.[87] In making this assertion, however, Mr. Marcus provided no support for his conclusion. Mr. Marcus' reference to Docket No. 06-101-U for support is unpersuasive given that the cost-control goals were developed after and in response to Order No. 10 in that docket,[88] so the Commission has not had an opportunity to make a finding as to whether cost containment measures are financially related and did not do so in the Order in this docket. EAI seeks clarification of the basis on which the Commission determined that short-term financial incentives based on cost control measures should be treated the same as those based on financial measures, and to the extent no reasonable basis exists, then the Company seeks rehearing on this issue.

[85] Gardner Direct Testimony at 17-18.
[86] *Id.* at 19.
[87] Marcus Direct Testimony at 57.
[88] Gardner Direct Testimony at 17.

6. Conclusion

The Order's holdings that disallow all or a portion of payroll costs related to incentive compensation are in error for the following reasons:

(a) The Order failed to discuss whether the appropriate standard for cost recovery, as advocated by Staff and EAI, is as follows: reasonable expenses of the Company which are necessary for the provision of utility service should be allowed in rates.[89]

(b) the Order erred by not deciding if EAI and Staff showed that EAI's incentive compensation programs are necessary to attract and retain qualified employees and thus necessary for the provision of utility service.

(c) the Order neither defined nor provided a rationale or justification for its adherence to a cost recovery standard that requires proof of ratepayer benefit or material ratepayer benefit, nor did it define the difference between ratepayer benefit versus material ratepayer benefit, nor did it provide a rationale or justification for rejecting the cost recovery standard advocated by Staff and EAI, which is the standard applied to cost recovery for all other categories of costs and which does not require a finding of ratepayer benefit;

---

[89] It is worth noting that at page 186 of the Order, the Commission adopted the suggestion of AG witness William Marcus to limit the increase in customer fees to the consumer price index ("CPI") noting, "The Commission agrees with AG witness Marcus and adopts the AG's recommendation to limit the increase in these fees to no more than the CPI, as a form of mitigation similar to that which both EAI and Staff recommend for the LGS for base rates. The result of this mitigation is an increase of $517,000 to EAI's revenue requirement." Significantly, Mr. Marcus did not demonstrate that such costs were "unreasonable" but merely asserted that to the extent such fees are based on the costs the activities cause then they should be constrained by the CPI to protect cost-sensitive customers. Marcus Direct Testimony at 7-8. This determination in the Order is yet another example of the Order's failure to define a consistent cost recovery standard.

(d) the Order did not provide a rationale or justification for concluding that incentive compensation tied to financial performance (budget cost controls) cannot provide benefits to ratepayers;

(e) the Order did not provide a rationale or justification for concluding that changes to application of the EAM (which altered the Company's measures for determining annual incentives to further reinforce the link between incentive compensation and the control employees have over the achievement of incentive goals, such as safety, customer service, operational performance, and cost control measures) are tied to financial performance and thus warrant a 50 percent, or any other, cost disallowance, and

(f) the Order did not provide evidentiary justification for the 50 percent split of ratepayer and shareholder sharing of costs, except to recite that the AG proposed it.

As a result, EAI seeks rehearing on this issue.

V. FACTUAL FINDINGS AND CONCLUSIONS AS TO SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN ("SERP")

The SERP provides retirement benefits for employees with salary levels that exceed $255,000 in order to provide a compensation package competitive with the market.[90] The Order held that such costs are not necessary to provide utility service, after framing the question on this issue as "whether the Commission should force captive customers to fund extra benefits for highly

[90] Order No. 21 at 2, 55.

compensated employees."[91] The Order applied a standard of cost recovery that differs from the customer benefit standard apparently adopted with respect to incentive compensation but failed to provide a rationale or justification for that variance. EAI seeks clarification as to the standard that the Commission applied to this expense, and how the facts in this case were applied based upon that standard in order to reach the Commission's decision on this issue. EAI respectfully submits that the Order failed to articulate a lawful standard for disapproving EAI's requested recovery herein. In any event, no rationally-based standard, applied objectively to the evidence in this case, could produce the result reached in the Order, thus EAI respectfully seeks rehearing and clarification of the standard and its application.

To the extent that the standard is not appropriate, is unreasonable, or is applied arbitrarily, and the facts do not support the conclusion reached in the Order based upon that standard, EAI seeks rehearing on this issue.

1. SERP is not incentive compensation.

EAI witness Kevin Gardner addressed criticism of the SERP from the only party contesting these costs, HHEG:

> First, [HHEG witness] Mr. Garrett confuses the issue in his surrebuttal testimony by co-mingling non-qualified pension plan costs with incentive-based compensation. While addressing the non-qualified pension plan costs, he refers to "removing incentive-based compensation elements." Clearly, non-qualified pension plans are not considered an element of incentive–based compensation. Mr. Garrett then introduces a term "extra benefits"

[91] Order No. 21 at 57.

> with no definition. He fails to address the core benefits design principle noted in my rebuttal testimony, differentiating qualified and non-qualified benefits under the tax code. Mr. Garrett then simply asserts that these benefit plan costs should be borne by shareholders and not ratepayers. Clearly, these non-qualified pension benefits have no direct alignment to the shareholder; rather, they are reasonably designed benefits, necessary to attract and retain the talent needed for EAI.[92]

While the Order does not dispute Mr. Gardner's unrebutted testimony that the challenged SERP benefit is not a form of incentive compensation,[93] the Order fails to acknowledge Mr. Gardner's unrebutted statements that these non-qualified pension plans have no direct alignment to shareholders.

2. The Order does not define the standard for review or apply the facts in reaching its finding.

The Commission has not disallowed recovery of SERP costs in prior proceedings and did not set forth a standard in this case for aligning the interests of shareholders and ratepayers and thus offers the Company a moving target as to which cost recovery standard will be followed depending on which type of compensation or retirement benefit is under scrutiny. The Order imposes the challenged costs on shareholders by describing them as "extra benefits for highly compensated employees ... that are not necessary to provide utility service ... [and] discretionary costs implemented by EAI ...."[94] These conclusions are flawed in that the Order did not articulate a standard for cost recovery as to why a given cost is considered "extra" and "discretionary," or what makes them so,

---

[92] Gardner Sur-Surrebuttal Testimony at 16-17 (footnotes omitted).
[93] Order No. 21 at 56-57.
[94] *Id.* at 57.

and there exists no evidence in the record to rebut Mr. Gardner's testimony that the SERP costs are necessary to attract and retain talent needed for EAI. Moreover, there is no evidentiary justification for disallowing the SERP retirement benefit for salary levels which exceed $255,000 versus any other level. The Order acknowledges Mr. Gardner's testimony that the salary level in question is an Internal Revenue Code limit,[95] but the Order does not provide any rationale to support a conclusion that reference to that Code limit to structure the retirement plan is improper or unreasonable or that the level of SERP benefit is otherwise unreasonable to attract and retain talent needed for EAI and thus is not necessary for the provision of utility service.

As noted above, EAI seeks clarification as to the standard that the Order applied to this expense, and how the facts in this case were applied based upon that standard to reach the Order's disallowance of $4.4 million on this issue. EAI respectfully submits that the Order did not articulate a lawful standard for disapproving EAI's requested recovery herein. In any event, no rationally based standard, applied objectively to the evidence in this case, could produce the result reached by the Commission, thus EAI respectfully seeks rehearing.

VI. WHOLESALE ACCOUNTS RECEIVABLE

The Order excluded Wholesale Accounts Receivable from EAI's working capital assets on the recommendation of Staff, whose position was based upon its assertion that retail customers should not pay a return on a wholesale asset.

[95] *Id.* at 56.

However, Staff's recommendation and the Order's adoption of that recommendation are based on a fundamental misunderstanding of the nature of the "wholesale" revenues and the manner in which these wholesale revenues are treated for retail ratemaking purposes. In fact, while Staff's approach is correct in that EAI actually has wholesale customers that are excluded from the cost of service for purposes of setting retail rates, the revenues reflected in the Wholesale Accounts Receivable are assigned to retail customers who have received a credit for these revenues as an offset to EAI's revenue requirement in this and prior base rate proceedings and who will continue to receive this credit through the MISO Rider.

1. All "wholesale revenues" are not excluded from retail, and retail customers are receiving the benefit of the "wholesale revenues" reflected in the Wholesale Accounts Receivable.

The Commission's decision on this issue reflects a fundamental misapplication of a long-standing APSC principle regarding the treatment, for ratemaking purposes, of assets that are devoted to wholesale business. Where assets are devoted to the wholesale business, the APSC, as well as Staff and the Company, generally agree to a principle that those costs, and the associated revenues, are to be excluded for retail ratemaking purposes. Consistent with this principle, the Commission adopted in Docket No. 96-360-U a specific retail/wholesale allocation for generation assets that had been devoted to serving EAI's wholesale loads (e.g., municipalities that had power purchase agreements with EAI) to ensure that ratepayers were protected "from rate changes caused by wholesale customer load loss by EAI." In addition, EAI's transmission service provided to the Arkansas Electric Cooperative Corporation ("AECC") has been treated as wholesale in nature, with allocation factors applied to exclude the costs and revenues associated with AECC load from retail rates.

On the other hand, there are other parties who take transmission service, now under the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff ("MISO Tariff"), from which EAI will receive revenue from sales of transmission service (e.g., the municipal authorities for the cities of West Memphis and Conway). While these revenues may be described as "wholesale sales" because they are derived from sales that are not APSC-jurisdictional, those sales, and the assets supporting them, are not excluded from retail rates based upon application of the retail/wholesale allocation methodologies just discussed. Specifically, EAI historically has credited retail customers for revenues associated with sales of transmission service to parties taking transmission service under the Entergy Open Access Transmission Tariff ("Entergy OATT") and the transmission assets used to provide that service were included in retail rate base. Unlike the allocation methods applied with respect to AECC's transmission service, the costs associated with such sales of transmission are not allocated to EAI's wholesale business, and neither are the revenues. The Company's retail customers receive credit for Wholesale Accounts Receivable revenues as an offset to the retail revenue requirement.

2. Allowing a revenue credit for wholesale revenues but not allowing a return on the receivable asset violates the matching principle of matching costs and revenues in the same period.

The Company's retail customers receive credit for Wholesale Accounts Receivable revenues as an offset to retail revenue requirement. Consistent with a principle as ancient and enduring as *cui bono*, as the customers receive the benefit it is fair they bear the cost. One of the costs of producing the wholesale revenues is the carrying cost of the receivables. Excluding that cost while retaining the benefit of the associated revenues results in unjust enrichment, contrary to long-standing equitable principles.

Alternatively, the Commission could treat cost and benefit consistently by excluding Entergy OATT revenue from the Company's cost of service equal to the carrying cost on the receivables. EAI has no preference for either approach, although it respectfully submits that customers would be better served by the more practical approach of including costs and a revenue credit. In any case, the Order arbitrarily excludes one item and includes the other, and the Company therefore seeks rehearing on this issue.

VII. REGULATORY ASSET FOR RATE CASE EXPENSES

EAI seeks rehearing on the Order's determination to reject EAI's proposal to create a regulatory asset for deferred rate case expenses. EAI proposed to create a regulatory asset for rate case expenses included in working capital assets ("WCA") amortized over a three-year period. Staff proposed a normalized level of rate case expense in base rates over a 3.5-year period,[96] and recommended against establishing a regulatory asset.[97] The Order adopted Staff's proposal to use a 3.5-year amortization period, to exclude the regulatory asset from WCA, and to not allow the Company to establish a regulatory asset for rate case expenses.

As a consequence of the Order, without the regulatory asset, EAI was required to write off approximately $3.2 million of rate case expense incurred as of December 31, 2013.[98] This write-off of rate case expenses in 2013 creates a mismatch between revenues and expenses going forward because all of the expense was recognized in 2013 while all of the revenues associated with these expenses will be recognized in future periods. This violates the matching principle which requires that expenses incurred by an organization be charged to the income statement in the accounting period in which the revenue, to which those expenses relate, is earned.

1. Staff provides no basis or support for disallowing the establishment of a regulatory asset for deferred rate case expenses.

Staff witness Rick Dunn testified, "With the inclusion of rate case expense at a normal level, it is not necessary or appropriate to also establish a regulatory asset. This is consistent with the Commission's long-standing treatment of this

[96] Johnson Surrebuttal Testimony at 4.
[97] Dunn Direct Testimony at 7.
[98] If granted rehearing on this issue and the decision reversed, the write-off can be reversed.

cost in prior rate cases."[99] Mr. Dunn does not explicitly affirm to what he is referring when he states that this is consistent with the Commission's long-standing treatment of this cost in prior rate cases, nor does he provide a cite to a specific Commission docket which supports this statement in his direct testimony. He does, however, cite to a specific Commission order in his surrebuttal testimony to support his position: "The Commission has previously rejected including unamortized rate case expense in rate base in its Order No. 16 in CenterPoint Energy Arkla ("Arkla") Docket 04-121-U."[100]

Order No. 16 in Docket 04-121-U (the "Arkla Order") supports the Staff's position for a normalized level of rate case expenses and not including the regulatory asset in WCA. The Arkla Order does not, however, support Mr. Dunn's assertion that it is not necessary or appropriate to establish a regulatory asset and forms no reasonable basis to support the Commission's decision on this issue.

2. The Arkla Order does not address the establishment of a regulatory asset for rate case expenses.

In the above referenced docket, Staff and Arkla agreed on the level of rate case expense to be allowed in rates so this issue was not specifically addressed in the Arkla Order. The Arkla Order does explicitly hold that this deferred asset

---

[99] Dunn Direct Testimony at 7.
[100] Dunn Surrebuttal Testimony at 5.

for rate case expenses should not be included in rate base as a part of WCA.[101] However, it does not address the establishment of a regulatory asset for rate case expenses. Upon review of Staff witness L.A. Richmond's surrebuttal testimony in the Arkla docket, it is clear that Mr. Richmond recognized that Arkla had established accounting deferrals on its books for rate case expenses, and it was his recommendation that the deferred asset not be included in rate base. He did not recommend the write-off of the deferred asset as evidenced by his surrebuttal testimony: "Therefore, despite Mr. Harder's rebuttal recommendation that Staff's MBSA working capital assets be increased by $703,897 to reflect Arkla's deferred debit from Docket No. 01-243-U, my recommendation is to only include the $512,081 of rate case expense and any existing accounting deferrals will not be recognized in rate base."[102] Based on Mr. Richmond's testimony and the Arkla Order, it is clear that prior Commission treatment has allowed the establishment of a regulatory asset by a utility for rate case expenses which are included in rates at a normalized level.

3. The Order does not provide a basis or factual support for rejecting EAI's proposal to create a regulatory asset for rate case expenses.

The Order relies on no asserted precedent for rejecting the Company's proposal to create a regulatory asset for these costs. The Order cites instead to

[101] Docket No. 04-121-U, Order No. 16 at 8–10. Rate case expenses are referred to as "Deferred Arkansas Rate Case Expense."
[102] Docket No. 04-121-U, Richmond Surrebuttal Testimony at 33.

prior Commission treatment for including a normal level of these expenses in the revenue requirement. The cited Arkla Order supports the Commission's decision to include a normalized level of rate case expenses in the revenue requirement and the decision to not include the regulatory asset for rate case expenses in WCA. It does not, however, support the Commission's rejection of EAI's proposal to create a regulatory asset. The facts associated with the Arkla Order in Docket No. 04-121-U support EAI's proposal in this case to create a regulatory asset. EAI asks the Commission to reconsider and reverse its decision denying the regulatory asset for rate case expense or, at the very least, provide the basis for maintaining this denial.

VIII. ACCUMULATED DEFERRED INCOME TAX

EAI seeks rehearing on the Order's determinations with respect to ADIT associated with the regulatory asset for rate case expenses and FIN 48.

A. ADIT on the Regulatory Asset for Rate Case Expense

1. If the Commission continues its denial of the regulatory asset, then a corresponding adjustment to the $1.4 million of ADIT associated with that asset is warranted.

As discussed earlier the Company had recorded a regulatory asset on its books for rate case expenses. In conjunction with recording this regulatory asset, the Company also recorded associated ADIT of $1.4 million. This ADIT was included in both the Company's and Staff's cost of capital ("COC") calculation as a zero cost source of funds. The Order explicitly rejected EAI's proposal to create a regulatory asset for these costs. However, the Order did not address the ADIT associated with the regulatory asset; it should logically follow that if there is no regulatory asset, then there will be no associated ADIT, and that this ADIT should be removed from the COC calculation. Staff, however, failed to make this adjustment in the COC calculation when it made its compliance filing on January 9, 2014.

With respect to rate case expense, EAI seeks rehearing regarding the ADIT associated with this regulatory asset for rate case expenses as described above. Staff did not follow through on its rejection of the regulatory asset by also removing the associated ADIT. Because the latter cannot exist without the former, EAI's ADIT in this case is now overstated by $1.4 million, which should be removed in order to reflect the Commission's ruling against the regulatory asset.

EAI requests rehearing on the proposed regulatory asset associated with rate case expenses. However, if the Commission denies EAI's rehearing request for a regulatory asset, then the Company requests that the Commission order that the ADIT associated with this rejected regulatory asset also be removed from the COC calculation.

B. FIN 48 Balances Are Not Sources of Zero Cost Capital

FIN 48 prohibits the recognition of deferred income tax on a taxpayer's books unless it is objectively "more likely than not" that the position will be sustained by the taxing authority.[103] Thus, the Company's FIN 48 ADIT balances are associated with underlying tax positions which the Company and its auditors have determined it will most likely be unable to sustain upon review by the Internal Revenue Service ("IRS"). At such time, the Company will be required to pay the taxes with interest. Therefore, EAI seeks rehearing on this issue.

1. Evidence shows that FIN 48 ADIT balances are not sources of zero cost capital.

FIN 48 balances, as described by FASB, are associated with underlying tax positions that have a greater than 50 percent chance of disallowance by the IRS and once disallowed will be paid with interest. FASB guidance, as indicated by HHEG witness Mark Garrett, requires that FIN 48 balances be segregated and identified for financial reporting purposes.[104] Mr. Garrett also noted that the Public Utility Commission of Texas ("PUCT") required that Entergy Texas, Inc. ("ETI") include FIN 48 balances in base rates.[105] However, the PUCT allowed ETI to track its FIN 48 positions and established a rider to make ETI whole for tax

[103] Financial Accounting Standards Board ("FASB") Interpretation No. 48 states, "An enterprise shall initially recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. As used in this Interpretation, the term ***more likely than not*** means a likelihood of more than 50 percent; the terms ***examined*** and ***upon examination*** also include resolution of the related appeals or litigation processes, if any."

[104] Garrett Direct Testimony at 5.

[105] *Id.* at 6.

positions ultimately lost with the IRS.[106] The evidence shows that FIN 48 ADIT balances are distinguishable from other sources of ADIT and represent a liability for which the Company will most likely have to pay the IRS, with interest, and thus are not a zero cost source of capital.[107]

2. Evidence shows that EAI will not "ultimately prevail" in these positions.

EAI has approximately $346 million in ADIT related to FIN 48 balances.[108] Consistent with the standard and the evidence presented in this case, EAI excluded FIN 48 ADIT balances from ADIT, as well as the portion of the Net Operating Loss ("NOL") attributable to these positions, netting the impact to the Company's cost of capital to zero. Conversely, Staff included both, and the Commission adopted Staff's approach, with the Order saying in part, "Nor is there evidence that EAI will not 'ultimately prevail'"[109] in its FIN 48 positions. However, a FIN 48 designation is effectively not a designation any taxpayer would want to claim unless it was required to, and the fact that EAI is carrying a FIN 48 balance is evidence that EAI will not "ultimately prevail," and certainly more convincing than any speculation to the contrary. In other words, much like a statement against self-interest, the fact that EAI has stated that it is not likely to prevail on the tax position is itself substantial evidence that should have been

[106] Zakrzewski Rebuttal at 75.
[107] Zakrzewski Direct Testimony at 6; Zakrzewski Rebuttal Testimony at 70-76, Zakrzewski Sur-Surrebuttal at 37.
[108] T. 201-202.
[109] Order No. 21 at 38.

considered and credited by the Commission. As explained, a FIN 48 tax position is a tax position that has a greater likelihood than not (greater than 50 percent) that it will be disallowed by the IRS. The simple fact that EAI has characterized certain tax positions as FIN 48 tax positions is substantial evidence that EAI will not sustain these positions.

3. Conclusion.

A FIN 48 tax position, as described by FASB Interpretation No. 48, is a tax position which more likely than not is going to be disallowed by the IRS. The Company has approximately $346 million in FIN 48 balances. When FIN 48 positions are disallowed, the amounts are paid, with interest, to the IRS. Therefore, these balances do not represent a source of zero cost capital to the Company. For these reasons, the Company respectfully requests rehearing on this issue and requests the Commission consider treatment consistent with the negotiated settlement approved in Docket No. 09-084-U or in the alternative, treatment consistent with that of the PUCT, where a tracking mechanism was instituted to ensure that the Company is made whole on its liabilities. Otherwise, there is no means whereby the Company will be able to recover its costs associated with the amount of ADIT that was classified as a zero cost source of funds.

IX. <u>REVENUE CONVERSION FACTOR / MANUFACTURERS' TAX DEDUCTION</u>

EAI respectfully requests the Commission to reconsider its decision to include the Manufacturers' Tax Deduction, 26 U.S.C. § 199, in the revenue conversion factor. The Commission's basis for its decision is succinctly *stated in* the Order: "The deduction is directly tied to taxable income resulting from the jurisdictional revenue requirement and would be treated similarly to that of the state income tax rate."[110] However, the Order is based upon incorrect assumptions that render the decision unreasonable.

1. EAI is not eligible for the Manufacturers' Tax Deduction, and there is no basis for inclusion in the Revenue Conversion Factor.

Even after the increase in base rates in this docket, EAI will still have net operating losses to offset future taxable income. The undisputed evidence is that EAI was not eligible for the Manufacturers' Tax Deduction during the test year and pro-forma year and will not be eligible for the deduction for the foreseeable future because of its net operating loss position.[111] Consequently, based on the determinations in the Order, the Commission effectively has ordered EAI to reflect in its rates the effects of a tax deduction EAI consistently has not taken,[112] is not entitled to take now, and will not be able to take in the foreseeable future. It is a factual and legal impossibility.

---

[110] Order No. 21 at 44.
[111] *See* EAI Exhibit DEH-2; T. 45.
[112] T. 45.

Nor is a tax deduction appropriate to treat as a tax rate in the calculation of the Revenue Conversion Factor. There is no factual basis in the record (or otherwise) for the Commission's conclusion that the Manufacturers' Tax Deduction "would be treated similarly to that of the state income tax rate."[113] The deduction has no analog in Arkansas income tax and, moreover, it is a deduction, not a tax rate. Tax rates are properly comprehended in the revenue conversion factor, but tax deductions are not, and, most certainly, non-existent tax deductions are not.

EAI seeks rehearing on this issue because the revenue conversion factor adopted by the Commission is without support in any evidence, lacks a rational basis, and is arbitrary and capricious.

2. The Revenue Conversion Factor should not be confused with normalization accounting.

EAI recognizes that it is possible that the Commission may have been led into error by the rate-making effects of normalization accounting for deferred taxes. One of those effects is the inclusion in current rates (via the revenue conversion factor) of federal income taxes that will not be paid until later. Nevertheless, those taxes will be paid, and in the meantime, EAI's customers receive the benefit of a significant amount of zero-cost capital (ADIT) in rates. The fact that those taxes are recovered presently, however, has no bearing on whether there is presently any taxable income that would allow EAI to take the

[113] Order No. 21 at 44.

Manufacturers' Tax Deduction. To the extent the Commission may have believed or reasoned otherwise, EAI respectfully requests it reconsider.

X. DISMANTLEMENT STUDY REPORTING

EAI respectfully requests clarification from the Commission on its ordered reporting requirements for EAI's dismantlement studies.

1. The intent of EAI and Staff was to propose a dismantlement study at the time EAI proposes new depreciation rates if the existing study was greater than 10 years old and not to require a dismantlement study automatically every 10 years.

In the Order, the Commission adopted the reporting requirements proposed in the surrebuttal testimony of Staff witness Ron Garner.[114] During the public hearing on October 23, 2013, EAI witness Kurtis W. Castleberry acknowledged the Company's agreement with Mr. Garner's recommendations.[115] However, it is the Company's (and Mr. Castleberry's) understanding that Mr. Garner's surrebuttal testimony was intended to agree with Mr. Castleberry's proposed modification to the reporting requirements that would require EAI to provide a dismantlement study at the time it proposes new depreciation rates if the previous study was greater than 10 years old, not necessarily to require a new dismantlement study every 10 years.[116] To the extent the Commission

[114] Order No. 21 at 78.
[115] T. 365.
[116] Castleberry Sur-Surrebuttal Testimony at 37.

intended that the Order reflect the intended recommendations of Mr. Garner, EAI requests that this requirement be amended to reflect this language.

2. The Order contains an illogical date for provision of dismantlement information.

By adopting Mr. Garner's recommendations at face value, the Order requires that EAI submit to the Commission the anticipated start date for dismantlement of each of the units that the Company plans to retire by the end of 2013 by the effective date of the depreciation rates approved in this docket. However, because the Order approved the depreciation rates and the reporting requirements in the same instance, it is impossible for EAI to comply with this requirement. As such, EAI requests that the Commission clarify the date certain for which EAI should provide this information is no later than the first billing cycle of March 2014, the effective date of compliance rates resulting from this docket.

XI. CONCLUSION

As set forth above, EAI initiated this docket to address critical issues directly affecting its successful future operations, including its ability to make significant capital investment to address aging infrastructure, resource adequacy requirements, environmental regulations, and technology upgrades. However, the Order in several key respects hinders the Company's ability to meet such challenges. Most notably, the Order precludes EAI from earning a sufficient rate of return to attract needed capital for required investments in infrastructure. As demonstrated herein, the Order's establishment of a grievously low 9.3 percent ROE creates tension in EAI's ability to attract capital and its obligation to serve, future success all on its own, and when coupled with disallowances in the order, it cements EAI's inability to earn its allowed return. For instance, disallowance of $6 million of payroll expenses, $17.8 million of incentive compensation expenses, and $4.4 million of SERP expenses alone effectively reduces EAI's ROE to about 8.09 percent.[117] In summary, the cumulative effect of the Order is to frustrate EAI's operations in the new post-System Agreement environment, deny recovery of reasonable levels of incurred costs that are necessary to provide electric service, and exacerbate an already stressed financial outlook for the Company. Clarification of and/or rehearing on the issues presented in the Petition is not only warranted but essential.

[117] The reduced ROE was calculated as follows: $28.2 million in disallowances x 98% O&M retail allocation x (1 – 38.225% tax rate) = $17.1 million operating income reduction ($206 million allowed operating income - $17.1 million operating income reduction) / $4,797 million retail rate base = 3.94% realized return on rate base (RORB) 3.94% realized RORB – 4.29% allowed RORB = -0.35% RORB deficiency -0.35% RORB deficiency / 28.98% common equity ratio = -1.21% ROE deficiency. The 9.3% allowed ROE – 1.21% ROE deficiency = 8.09% realized ROE.

Respectfully submitted,

ENTERGY ARKANSAS, INC.

By /s/ Tucker Raney

Tucker Raney
Assistant General Counsel

Matthew R. Suffern
Assistant General Counsel

N. Wesley Hunt
Counsel

Kimberly K. Bennett
Senior Counsel

Entergy Services, Inc.
P. O. Box 551
Little Rock, AR 72203
Telephone: (501) 377-3500

Scott C. Trotter
Trotter Law Firm, PLLC
425 W. Capitol, Suite 216
Little Rock, Arkansas 72201
Telephone: (501) 353-1069

N. M. Norton
Wright, Lindsey & Jennings
200 West Capitol Avenue, Suite 2200
Little Rock, Arkansas 72201
Telephone: (501) 371-0808

ATTORNEYS FOR ENTERGY ARKANSAS, INC.

CERTIFICATE OF SERVICE

I, Tucker Raney, do hereby certify that a copy of the foregoing has been served upon all parties of record by forwarding the same by electronic mail and/or first class mail, postage prepaid, this 29th day of January, 2014.

/s/ Tucker Raney
Tucker Raney

BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF ENTERGY ARKANSAS, INC. FOR APPROVAL OF CHANGES IN RATES FOR RETAIL ELECTRIC SERVICE	))))	DOCKET NO. 13-028-U

ENTERGY ARKANSAS, INC.'S SUPPLEMENT
TO PETITION FOR REHEARING AND CLARIFICATION

COMES NOW Entergy Arkansas, Inc. ("EAI" or the "Company"), and for its Supplement to Petition for Rehearing and Clarification, states:

1. On January 29, 2014, EAI filed its Petition for Rehearing and Clarification ("Petition") with respect to Arkansas Public Service Commission ("APSC" or the "Commission") Order No. 21 (the "Order") issued on December 30, 2013 in this docket.

2. At footnote 3 on page 6 of EAI's Petition, the Company explained:

> In its November 8, 2013 release, Moody's Investor Service ("Moody's") placed the ratings of most regulated utilities and utility holding companies on review for upgrade due to Moody's more favorable view of the relative credit supportiveness of the nation's regulatory environment. Moody's considered improving regulatory trends, including better cost recovery provisions and reduced regulatory lag, but indicated there may be instances where ratings will not be upgraded following its review. Moody's expected to have its review completed within 90 days from the release. EAI will supplement this Petition regarding the release by Moody's to the

extent the release contains relevant information that may be considered as new evidence in support hereof.

3. Moody's released the reports on January 30 and 31, 2014, and EAI hereby supplements its Petition to identify the reports that may be introduced as new evidence in support of several aspects of EAI's Petition.[1] In addition to upgrading many utilities throughout the industry, approximately $11 billion of debt securities were upgraded for all of the other Entergy Operating Companies, except Entergy New Orleans, Inc.[2] EAI was not among those utilities upgraded by Moody's. With respect to EAI, Moody's noted the Company's "disappointing" rate case outcome and confirmed EAI's current ratings based on the "less than favorable rate case outcomes in May 2010 and December 2013."[3]

Moody's advised that EAI's ratings "could be upgraded if there were improvement in the credit supportiveness of the regulatory environment in Arkansas..." or "downgraded if there were continuous adverse regulatory developments, if there were a termination or any changes to the utility's rate riders that would prevent full and timely recovery of prudently incurred costs, or if there is not an improvement in cash flow coverage metrics from unusually low 2012 and 2013 levels...."[4]

[1] If allowed to introduce this new evidence, which is not cumulative and was not available until after the closing of the record in this case, EAI would produce the reports along with supporting testimony.
[2] These other Entergy Operating Companies include Entergy Gulf States Louisiana, L.L.C.; Entergy Louisiana, LLC; Entergy Mississippi, Inc.; and Entergy Texas, Inc.
[3] Moody's Investor Service, "Rating Action: Moody's upgrades certain Entergy subsidiaries, outlooks stable" (Jan. 31, 2014).
[4] *Id.*

WHEREFORE, EAI respectfully requests that the Commission grant the Company's Petition for Rehearing and Clarification, allow it to introduce new evidence in support thereof as described in the Petition and this supplement, and grant all other necessary and proper relief.

Respectfully submitted,
ENTERGY ARKANSAS, INC.

By: /s/Kimberly Bennett
Senior Counsel

Tucker Raney
Assistant General Counsel

Matthew R. Suffern
Assistant General Counsel

N. Wesley Hunt
Counsel

Entergy Services, Inc.
P. O. Box 551
Little Rock, AR 72203
Telephone: (501) 377-3500

Trotter Law Firm PLLC
425 W. Capitol Ave, Suite 216
Little Rock, AR 72201
Office: 501-353-1069
Fax: 501-353-1715

N. M. Norton
Wright, Lindsey & Jennings
200 West Capitol Avenue, Suite 2200
Little Rock, Arkansas 72201
Telephone: (501) 371-0808

ATTORNEYS FOR ENTERGY ARKANSAS, INC.

CERTIFICATE OF SERVICE

I, Steven K. Strickland, do hereby certify that a copy of the foregoing has been served upon all parties of record by forwarding the same by electronic mail and/or first class mail, postage prepaid, this 3rd day of February 2014.

/s/Steven K. Strickland
Steven K. Strickland

Commission is allowing the introduction of additional evidence and setting a procedural schedule, this is not a Limited Rehearing Order "*solely* for the purpose of further consideration" under Rule 4.14(e), and the sixty (60) day provision in that Rule does not apply.

BY ORDER OF THE COMMISSION,

This 26th day of February, 2014.

Colette D. Honorable

Colette D. Honorable, Chairman

I hereby certify that this order, issued by the Arkansas Public Service Commission, has been served on all parties of record on this date by the following method:

___U.S. mail with postage prepaid using the mailing address of each party as indicated in the official docket file, or

✓ Electronic mail using the email address of each party as indicated in the official docket file.

Olan W. Reeves

Olan W. Reeves, Commissioner

Elana Wills

Elana C. Wills, Commissioner

Cynthia Magwood L. (acting)

Dallas W. Heltz, Secretary of the Commission

5. EAI's Rehearing Direct Testimony filed on March 14, 2014;
6. EAI's Rehearing Reply Testimony filed on April 11, 2014;
7. Order No. 35, issued on August 15, 2014;
8. EAI's Revised Tariffs Pursuant to Order No. 35 filed on September 17, 2014;
9. EAI's Errata to Revised Tariffs Pursuant to Order No. 35 filed on September 18, 2014;
10. Order No. 37, issued on September 24, 2014, approving the compliance tariffs filed by EAI on September 17, 2014, as amended by EAI on September 18, 2014.

In addition, EAI's compliance tariffs for filing with TRA with requested effective date of November 28, 2014 (first billing cycle of December 2014) are attached to this transmittal letter. The attachment includes only those tariff sheets that are revised pursuant to APSC Order No. 35 that are applicable to Tennessee. The base rate increase approved by the APSC in Order No. 35 results in the following changes to rates previously approved in Order No. 21:

Class	**Order No. 21 $ Increase**	**Order No. 35 $ Increase**	**$ Difference**
Residential	28,995,695	30,771,546	1,775,851
Small General Service	19,782,751	20,994,283	1,211,532
Large General Service	31,941,173	33,873,850	1,932,677
Lighting	0	(4,216)	(4,216)
Total	80,719,619	85,635,463	4,915,844

EAI respectfully requests that the TRA include consideration of these revised tariffs in TRA Docket No. 13-00114 on its next Conference Agenda scheduled November 3, 2014.

EAI also requests that the 30 day notice required in TRA Rule 1220-4-1-.04 be waived to allow EAI to place its compliance tariffs in effect with the first billing cycle of December 2014 (which begins November 28, 2014) for its retail customers residing in Tennessee.

If you have any questions, please do not hesitate to call me at 501-377-3571.

Sincerely,

David Palmer
Manager, Regulatory Affairs

Attachments