

LOUISIANA PUBLIC SERVICE COMMISSION

ORDER NO. U-25533

**LOUISIANA PUBLIC SERVICE COMMISSION,
EX PARTE**

DOCKET NO. U-25533 - IN RE: JOINT APPLICATION OF ENTERGY
LOUISIANA, INC. AND ENTERGY GULF STATES, INC. FOR AUTHORIZATION
TO PARTICIPATE IN CONTRACTS FOR THE PURCHASE OF CAPACITY AND
ELECTRIC POWER

INTRODUCTION

On March 6, 2001, Entergy Louisiana, Inc. ("ELI") and Entergy Gulf States, Inc. ("EGSI") filed an application to participate in purchase contracts entered by the Entergy System to serve the Summer peak and energy requirements of its operating companies. Recognizing that certain preliminary determinations regarding the Summer Purchase program are appropriate for ratemaking purposes, the Commission, at its April 18 Business and Executive Session, directed the Staff to report at the May Business and Executive Session on a) appropriate allocations between capacity and energy of the purchases, both at retail and under the System Agreement; and b) whether the Commission should issue economic criteria or a ratemaking order to apply to Entergy's purchases for interruptible customers. A hearing was noticed for May 7, 2001 in this docket. Testimony was filed by ELI and EGSI (collectively, "Entergy"), the Commission Staff, the Louisiana Energy Users Group ("LEUG"), and Occidental Chemical Corp. ("Occidental"). The Staff's report and the parties' briefs were filed on May 11, 2001. The matter was considered at the May 16, 2001 Business and Executive Session and extensive oral argument was permitted.

DISCUSSION

Entergy plans to supply its incremental needs for capacity through a portfolio of agreements, including a purchase that includes a nominal capacity payment and separate energy charge, a number of firm contracts in which the entire price is specified as an energy charge (in other words, a charge per MWH), a number of "call options" to acquire energy at specified "strike" prices, and short-term or "spot" purchases in the Summer energy markets. The Staff witness, Matthew I. Kahal, testified that the cost of firm energy purchases should be allocated between capacity and energy based on Entergy's incremental cost of generating the energy. Based on an alternate method, he indicated that at least 40 percent of the cost of the purchases

should be treated as capacity. He also testified that purchases by Entergy to avoid interruptions to customers on interruptible or curtailable tariffs ("interruptible tariffs") should not be made when the price of energy exceeds \$200 per MWH. To permit interruptible customers to avoid service interruptions, he recommended that Entergy provide them the option of obtaining electricity when Entergy faces a shortage of supply and the market price exceeds \$200, by paying any incremental cost above \$200 per MWH.

Entergy's witness, Bruce Louiselle, reported that the Entergy System Operating Committee decided in April, 2001 to allocate 24 percent of the on-peak prices for firm energy purchases to capacity. He also defended the basis for this allocation. Kenneth Turner of Entergy testified concerning Entergy's planning process and policy for purchasing energy to serve interruptible customers. The LEUG witness, Maurice Brubaker, and the Occidental witness, Whitfield Russell, argued against establishing a presumptive "strike" price for interruptions at this time. They relied primarily on an alleged historic practice of interrupting for reliability purposes only, asserted inadequacy of notice, and asserted difficulties in implementing a program to permit purchases above the strike price for interruptible customers. LEUG and Occidental also asserted due process objections to the Commission's notice and procedure.

A. Allocation of Purchases Between Capacity and Energy.

There can be little question that Entergy's portfolio of purchases, including the firm energy purchases, should be assigned a capacity component. As Mr. Turner testified, the purchases are made to meet the peak requirements of the System. Firm energy is required because the load is near the peak in many hours and the exact time of the peak is difficult to predict. Entergy's owned resources would not be sufficient to provide adequate reliability in many of the Summer hours.

Although the market price for power in most of Entergy's purchase contracts is expressed solely as an energy price (dollars per MWH) rather than reflecting both a demand charge (dollars per megawatt) and an energy charge, this marketing approach does not determine the appropriate allocation of the cost. In today's tight power markets, much of the energy purchased by utilities is acquired because the companies have inadequate capacity of their own. In Entergy's case, the computer modeling performed by the Company establishes that its owned capacity is insufficient to meet the peak demand with adequate reliability. The alternative method of meeting the peak would be to build capacity. As Mr. Kahal testified, "Entergy needs these contracts in order to ensure that it can provide reliable service to its system native load customers this summer." [Dir. Test. of Kahal at 8 (citing Turner studies)]. Further, the General Order issued by the Commission in 1997 regarding fuel cost recovery recognizes that a capacity charge may be "subsumed within an energy charge" and this implicit capacity charge should be excluded from costs passed through a utility's fuel clause.

Capacity charges in a purchase contract should not be collected through the fuel clause. If a utility built rather than purchased capacity, its costs would be subjected to base ratemaking treatment and considered along with all other base rate costs in establishing rates. In ELI's case, the costs would be subjected to the sharing formula established as part of its Formula Rate Plan. Fuel clause treatment of the implicit capacity costs inappropriately avoids the ratemaking analysis and, potentially, the sharing established for base rate costs. Further, fuel clause treatment of high-cost purchases may harm ratepayers by concentrating the billing of costs in a few months, rather than over the entire year.

Additionally, treating capacity-related purchase contracts as entirely energy-related causes misallocations of costs within the Entergy System. Entergy purchases power to serve the needs of all its operating companies and allocates the purchases according to the load ratios of the companies. When all the costs are

treated as energy-related, however, they may be included in the cost of energy exchanges among the companies pursuant to the Entergy System Agreement. As a result, a company that often buys energy pursuant to "economic dispatch" to promote energy efficiency for the System may be misallocated capacity costs incurred for another company.

Mr. Kahal testified that the energy portion of the firm energy contracts should be established through a projection of Entergy's marginal energy costs for the Summer peak hours using Entergy's PROMOD computer model. He further testified that the capacity portion is at least \$43 to \$58 per megawatt hour, based on the equivalent cost of peaking capacity to generate the energy required to serve the load in the peak hours. He recommended a capacity allocation of the purchases for the following reasons: a) the Commission's General Order requires it when appropriate; b) there is a potential double recovery if base rates already provide sufficient revenues for capacity charges and they are nevertheless flowed through the fuel clause; and c) fuel clause treatment may distort the utility's planning process by making purchases more attractive than capacity additions. [Dir. Test. of Kahal at 10-11].

Bruce Louiselle, an Entergy witness, testified that the Operating Committee had allocated 24 percent of firm energy purchases to capacity. The company used the same conceptual approach as Mr. Kahal, but came to different conclusions. With respect to the incremental energy cost approach, Mr. Louiselle focused on the energy costs for certain small peaking units and previously mothballed units with high heat rates, most of which previously were held in mothballs. This approach indicated that about 23 percent of the purchase costs should be allocated to energy. [Dir. Test. of Louiselle, Ex. BML-4, p.1].

With respect to the "peaker" approach, Mr. Louiselle generally agreed with Mr. Kahal on the annualized cost for a combustion turbine, but proposed to assign only a portion of the costs – about 60 percent – to the Summer Purchases. [Dir. Test. of Louiselle at 6, 8]. Mr. Louiselle asserted that a seller who owned a combustion turbine would collect capacity costs over five months rather than the three month Summer Purchase period. In this case Entergy's purchases are being made for three months, as an alternative to constructing peaking capacity, because the firm energy is only needed for three months. Allocating the capacity cost over five months would suggest that 25 percent of the purchase costs in the three month purchase period are attributable to capacity. Mr. Louiselle also testified that the market is in disequilibrium, with no clear "capacity" or "energy" rationale for

above-cost prices. If the capacity costs he estimated for a new combustion turbine were added to the energy costs, the sum would be less than market prices. [Cross-exam. and redirect exam. of Louiselle].

The Commission determines that the correct capacity allocation need not be resolved in this Order. At this time, the Commission need only deal with Entergy's request to establish a regulatory deferral to preserve its opportunity to collect the portion of purchase costs attributable to capacity. Entergy has agreed to allocate 24 percent of its firm purchase costs and 100 percent of its payments for call options to capacity, but requires the opportunity to defer those costs for reflection in base rate cases. Any after-the-fact adjustment to the allocation proposed by Entergy may be made at a later time. As occurred in 2000, any excess amount flowed through the fuel clause may be refunded and a regulatory asset established for the refund amount.

For the capacity portion of purchases allocated directly to ELI and EGSI, the Commission will grant the companies' request to establish provisional deferrals to preserve the opportunity to recover the costs in ensuing base rate cases. The deferrals should be subject to the Commission's review of the prudence of the costs in this docket. The Commission will attempt to issue a decision on the prudence of each deferred asset in time to permit its reflection on each Company's books for 2001.

B. Economic Criterion for Purchases to Avoid Interrupting Customers Served Under Interruptible Tariffs.

Mr. Kahal recommended that Entergy enforce the terms of its interruptible and curtailable tariffs when its own resources are inadequate and the price of energy in the market exceeds \$200 per megawatt hour. His reasons include: a) the interruptible customers enjoy very large discounts and contribute little to the cost of service, b) market prices in excess of \$200 reflect shortage conditions, and c) other customers should not be forced to subsidize interruptible customers through the fuel clause, which averages the costs of purchases with other energy costs and distributes them to all customers. [Dir. Test. of Kahal at 14-16].

The LEUG and Occidental witnesses opposed the establishment of an economic criterion for interruptions, arguing that the criterion would depart from the alleged historic practice under the tariffs without adequate notice and disrupt the operations of customers served under interruptible tariffs. [Dir. Test. of Brubaker; Dir. Test. of Russell]. The notice issue is discussed in connection with the due process objections raised by these parties. Additionally, the objections are not meritorious in light of the evidence.

First, the interruptible tariffs do not limit the reasons for which customers on the tariffs may be interrupted. So long as Entergy complies with the notice and time limitations in the tariffs, it may interrupt customers largely at its discretion. [Cross-exam. of Kahal]. Mr. Brubaker and Mr. Russell, who testified that interruptions should occur only for reliability reasons, admitted that they could find no language in any tariff that supported their position. They conceded that they were relying on an unstated understanding that is not reflected in any writing. Additionally, they both admitted they were not personally involved in any discussions leading to the purported understanding. [Cross-exam. of Brubaker; cross-exam. of Russell].

Second, the interruptible tariffs were established, and contracts negotiated, before the recent escalation in incremental energy costs. These costs are now far higher than the average. The interruptible contracts were justified on the ground that they would preserve some contribution to the System's cost of service, compared to the customer's potential alternatives of self-generation or shutting down operations. It was not expected that the utility might be purchasing energy at some multiple of its average fuel cost for interruptible customers, where other customers would be forced to share the costs of the purchases. The spectre of cross-subsidization requires the Commission to limit the extent to which firm customers should bear the costs of serving interruptibles.

In this connection, the evidence indicates that interruptible customers today may provide a negative contribution to the cost of service even if energy is purchased for them at prices no higher than the firm energy prices negotiated by Entergy. As Mr. Russell conceded using hypothetical numbers slightly different from the actual purchase prices, Occidental would provide a negative contribution for its interruptible load if energy were purchased for it in all the Summer peak hours. [Cross-exam. of Russell]. In other words, the incremental cost above the average fuel cost paid by Occidental would be greater than the contribution to the cost of service realized through the discounted demand charge. To impose further costs on firm retail customers to keep interruptible customers on line would be discriminatory.

Third, Entergy already employs economic criteria in deciding when to interrupt the interruptible customers and the criteria change with changing market conditions. Entergy provides no notice to the Commission or its customers of its internal criteria. [Cross-exam. of Turner]. Entergy uses a price that is too high, however, causing a discriminatory impact on firm retail customers. The establishment of a more reasonable criterion is a change in implementation, not procedure.

Fourth, Entergy does not have sufficient capacity of its own to serve the interruptible customers in the Summer peak hours. When price in the market exceeds the strike price identified by Mr. Kahal, demand far exceeds supply, indicating a market shortage. These are precisely the conditions under which interruptible customers should be interrupted.

To ameliorate the possible unanticipated effect on industrial customers of the new economic criterion, they should be given the opportunity to purchase power at the incremental prices incurred by the utility to serve interruptible loads in any hour. Mr. Kahal proposed a Voluntary Curtailment Mitigation Pilot Program to permit this practice. [Dir. Test. of Kahal, Sched. MIK-1, attached to this Order]. Entergy will be required to implement this or a substantially similar program. Entergy suggested that some refinements may be necessary to protect reliability and avoid practical difficulties. The Commission will require Entergy to work with the Staff and report on any necessary refinements in managing the program. The Commission will permit additional comments on the program and reconsider its decision at the June business meeting.

C. Due Process.

LEUG and Occidental argued that their due process rights would be violated by the adoption of the Staff's proposal regarding short term power purchases for interruptibles. They assert that the proposal constitutes a change in the interruptible tariffs without adequate notice of this purported change. LEUG's and Occidental's due process argument is baseless and should be rejected because Staff's proposal does not constitute a change in the interruptible tariffs and does not threaten a protectable, individual property interest that would trigger the necessity of procedural due process. Furthermore, even if procedural due process were required, LEUG and Occidental received both adequate notice and an opportunity to be heard.

The requirement of procedural due process in administrative proceedings is triggered only when two elements are present. First, the administrative action must constitute individualized decision-making. Procedural due process does not apply when the Commission makes a policy decision that has an impact on an entire class of individuals or entities. *See Tafari's Investment Co. v. Division of Housing Improvement*, 259 So. 2d 57, 60 (La. 1972), *Gulf States Utilities Co. v. Louisiana Public Service Com'n*, 578 So. 2d 71, 78-80 (La.), *cert.*

denied, 502 U.S. 1004, 112 St. Ct. 637 116 L. Ed. 2d 655 (1991). Second, the administrative action must threaten to deprive an individual of a concrete property interest. *See id.* Neither of these elements is present here.

The Staff's proposal regarding short term power purchases for interruptible customers would apply to all customers who subscribe to interruptible tariffs. If adopted, the proposal would not constitute individualized decision-making. The Commission is free to establish such a class-wide policy pursuant to its plenary authority over public utilities. La. Const. art. IV, § 21(B); *Gulf States Utilities Co. v. Louisiana Public Service Commission*, 92-1185 (La. 3/17/94), 633 So. 2d 1258, 1263-64.

The proposal also does not threaten to deprive any individual of a private property interest. Neither LEUG, Occidental, nor any other interruptible customer has a vested property interest in having its power supplied without interruption at any price. They especially have no entitlement to subsidies from firm industrial, commercial and residential customers. The interruptible tariffs grant Entergy wide discretion as to when to interrupt service. Provided it complies with the notice and time limitations provided in the tariffs, Entergy may interrupt its interruptible customers' service at any time for any reason. [See Interruptible Tariffs, LPSC Staff Ex. No. 2]. The tariffs thus do not vest the interruptible customers with a right to uninterrupted service regardless of market conditions.

LEUG and Occidental argued that, despite the written terms of the tariffs, their understanding has always been that Entergy would interrupt them only for reliability reasons. However, both LEUG's witness, Maurice Brubaker, and Occidental's witness, Whitfield Russell, admitted that this "understanding" is an unwritten, unmemorialized policy of unknown origin; they were not parties to the negotiations and had no firsthand knowledge of the asserted understanding.

Moreover, Entergy's witness, Kenneth Turner, testified that Entergy already interrupts for economic reasons. Mr. Turner testified that Entergy interrupts the service of interruptible customers rather than pay more than a certain pre-determined price on the spot market. Mr. Turner further testified that Entergy has never provided any notice to its interruptible customers of this practice or of its strike price for interruptions. And, according to Mr. Turner, Entergy reevaluates and changes the strike price depending on market conditions, without notice to the interruptible customers. Thus, Staff's recommendation is consistent with Entergy's existing policy regarding interruptibles and presents no procedural change. The Staff is merely recommending that the strike price be fixed at a lower price than that which Entergy has used. Indeed, the Commission has given the

interruptible customers more notice of the strike price criterion for interruptions than they ever previously received from Entergy.

Even if a reliability condition were read into the interruptible tariffs, short term power purchases above the strike price recommended by Staff reflect shortage conditions, giving rise to reliability concerns. [Dir. Test. of Kahal at 15.] Since there is a clear lack of reliability that gives rise to the need to purchase at exorbitant prices, Entergy's interruptible and curtailable customers could be interrupted via the unwritten reliability condition. Furthermore, with the proposed voluntary curtailment mitigation pilot program, Staff's recommendation gives the interruptible customers the option to continue service when curtailments might otherwise occur because of shortage power prices by agreeing to pay for the incremental cost of the power they consume above the strike price. The interruptibles thus need not experience any interruptions because of the strike price criterion; they merely have to pay their fair share of maintaining service when the market reaches exorbitant levels. In fact, this approach allows fewer interruptions than Entergy's current practice, which does not provide an option to pay the higher price.

Additionally, even if some form of procedural due process were required, those requirements were amply satisfied. Procedural due process in an administrative proceeding generally consists of notice and an opportunity to be heard. *See Trafaro's Investment Co. v. Division of Housing Improvement*, 259 So. 2d 57, 60 (La. 1972). The jurisprudence has emphasized that "[a]dministrative proceedings are not ordinarily governed by the strict rules of judicial proceedings. The key to pleading and procedure in that administrative process is the opportunity to prepare . . . Generally inadequacies in pleading and notice may be cured if the record establishes a full hearing was had after proper preparation." *White v. Louisiana Public Service Commission*, 250 So. 2d 368 (La. 1971) (internal citations omitted). More specifically, "[t]he requirement of notice in an administrative proceeding is not as strict or exacting as that in a judicial proceeding. The notice given must be reasonable under the circumstances of the particular case, and serves the primary function of allowing the plaintiff an opportunity to prepare for the hearing." *Buras v. Board of Trustees of Police Pension Fund of City of New Orleans*, 430 So. 2d 237, 238 (La. App. 4th Cir. 1983).

Under the circumstances here, the notice and opportunity for hearing that the Commission afforded LEUG and Occidental were more than adequate. In response to Entergy's application for authorization to enter into the summer contracts, the Commission directed at the April 18, 2000 Business and Executive Session

that the Staff address both the capacity/energy allocation and the interruptible issues. The interruptible issue is inextricably related to Entergy's request for authorization to purchase the Summer power because Entergy plans to make purchases on the spot market to avoid interruptions. The Commission gave official notice of the May 7, 2001 hearing both in the April 27, 2001 LPSC Bulletin and in a notice faxed to the official service list in docket number U-25533, which includes representatives of LEUG and Occidental, on April 24, 2001. These multiple forms of notice comply with Rule 19 of the LPSC's Rules of Practice and Procedure requiring hearings to be announced ten days in advance.

Additionally, the claim of inadequate notice is invalid because both LEUG and Occidental attended and participated in the May 7th hearing. They submitted pre-filed expert testimony, presented witnesses at the hearing, introduced exhibits, and had an opportunity to cross examine all witnesses who testified at the hearing. They presented extensive oral argument at the May Business and Executive Session. The notice obviously served its essential purpose of allowing the parties adequate time to prepare for the hearing.

LEUG and Occidental also argue that the interruptible issue is not properly included in this docket, in which Entergy seeks approval of its Summer Purchase Plan. As explained, since Entergy's plan includes purchasing on the spot market to serve interruptibles, the circumstances under which it does so must be addressed. Further, the ratemaking treatment of Summer Purchase costs – including cost assignments to interruptibles – is fairly encompassed by the docket. For clarity, the Commission expressly determines that the issues are to be considered in this docket.

CONCLUSION

Based on the foregoing discussion, IT IS HEREBY ORDERED that:

1. ELI and EGSI shall each be authorized to establish a provisional deferral of the capacity portion of costs directly assigned to ELI and EGSI, subject to the review in this docket related to the prudence of the costs. Entergy will be provided the opportunity to recover the directly assigned capacity costs, if prudent, in its annual base rate cases. The appropriate capacity/energy allocation of purchase costs shall be determined at a later time.
2. Entergy shall enforce the terms of its interruptible and curtailable tariffs to avoid, to the extent practicable, making spot purchases to serve interruptible and curtailable loads of ELI and EGSI at market prices exceeding \$200 per MWH, unless interruptible or curtailable customers agree to pay the costs in excess of \$200 per MWH that are incurred to serve them.
3. Entergy shall establish a protocol substantially similar to the attached Voluntary Curtailment Mitigation Pilot Program to permit interruptible and curtailable customers to avoid interruptions by agreeing to pay the costs in excess of \$200 per MWH incurred to serve them. Entergy shall consult with the Commission Staff in fashioning

the protocol, which shall be established by June 1, 2001 but reconsidered at the June 20, 2001 Business and Executive Session.

4. Consideration of the issue in this Order, after a hearing, and in this docket does not violate due process. The interruptible issues shall be deemed part of this docket. If parties attempt to intervene late, but on or before June 1, 2001, the interventions shall be granted. Interruptible customers shall be permitted to file comments related to this decision by June 1, 2001 and the matter will be reconsidered at the June 20, 2001 Business and Executive Session. Comments regarding the Voluntary Mitigation Pilot Program may be filed within 10 days after it is disseminated to the parties.

5. Upon implementation of the Voluntary Curtailment Pilot Program, the Commission finds that any Interruptible/Curtailable customers shall have an opportunity to switch to firm energy provided that ELI and EGSI are given appropriate notice. This issue will be reconsidered at the June 20, 2001 Business and Executive Session.

This Order will be effective upon its issuance.

**BY ORDER OF THE COMMISSION
BATON ROUGE, LOUISIANA**

May 25, 2001

/S/ JAMES M. FIELD
DISTRICT II
CHAIRMAN JAMES M. FIELD

/S/ JACK "JAY" A. BLOSSMAN, JR
DISTRICT I
VICE CHAIRMAN JACK "JAY" A. BLOSSMAN, JR

/S/ DON OWEN
DISTRICT V
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/S/ IRMA MUSE DIXON
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