ARK. PUBLIC SERV. COMM

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BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN INVESTIGATION OF ENTERGY ARKANSAS, INC.'S MARCH 2006 ENERGY COST RECOVERY RIDER ANNUAL UPDATE	)	DOCKET NO. 06-055-U -doc. 142
IN THE MATTER OF AN INVESTIGATION INTO ENTERGY ARKANSAS, INC.'S INTERIM REVISION TO ITS ENERGY COST RECOVERY RIDER	)	DOCKET NO. 05-116-U -doc. 220

PHASE II SURREBUTTAL TESTIMONY

OF

THOMAS D. CROWLEY

PRESIDENT

L. E. PEABODY & ASSOCIATES, INC.

ON BEHALF OF

ENTERGY ARKANSAS, INC.

AUGUST 31, 2010

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME.

A. My name is Thomas D. Crowley.

Q. ARE YOU THE SAME THOMAS D. CROWLEY WHO SUBMITTED PHASE II DIRECT TESTIMONY ON BEHALF OF ENTERGY ARKANSAS, INC. IN THIS PROCEEDING ON JUNE 15, 2010?

A. Yes, I am.

Q. ON WHOSE BEHALF ARE YOU OFFERING THIS PHASE II SURREBUTTAL TESTIMONY?

A. I am submitting this Phase II surrebuttal testimony to the Arkansas Public Service Commission ("APSC" or the "Commission") on behalf of Entergy Arkansas, Inc. ("EAI" or the "Company").

Q. WHAT IS THE PURPOSE OF YOUR PHASE II SURREBUTTAL TESTIMONY?

A. EAI requested that I provide surrebuttal testimony in response to the August 10, 2010 Phase II rebuttal testimony submitted by William N. D'Onofrio on behalf of the Attorney General.

II. RESPONSE TO ATTORNEY GENERAL REBUTTAL TESTIMONY

Q. HAVE YOU REVIEWED MR. D'ONOFRIO'S REBUTTAL TESTIMONY AS IT RELATES TO ISSUES ADDRESSED IN YOUR PHASE II DIRECT TESTIMONY?

A. Yes, I have. In particular, I have reviewed Mr. D'Onofrio's rebuttal testimony at pages 4 through 8, in which he addresses the calculation of damages for EAI's alleged failure to prudently manage its coal inventory.

Q. DO YOU AGREE WITH HIS CONCLUSIONS AND RECOMMENDATIONS WITH REGARD TO YOUR PHASE II DIRECT TESTIMONY AND EAI'S MANAGEMENT OF ITS COAL INVENTORY?

A. No, I do not.

Q. WHAT IS THE BASIS OF YOUR DISAGREEMENT WITH MR. D'ONOFRIO?

A. In criticizing my testimony, Mr. D'Onofrio relies upon the 45-day standard that the Commission established in 1996 relating to the Company's application to revise its base rates in Docket No. 96-360-U. This 45-day standard, as I previously explained, was not an operational based standard. Instead, it was a cost recovery standard designed to allow EAI to include in its rate base the level of coal inventory based on average daily fuel consumption at the White Bluff and Independence Steam Electric Stations ("White Bluff" and "ISES", respectively). The average daily burn rate used in 1996 to establish this 45-day standard was [redacted] tons per day, or [redacted] tons of total coal for White Bluff and ISES combined.

In responding to my testimony concerning the use of the Commission's cost-recovery standard to evaluate the operational prudency of EAI's inventory levels, Mr. D'Onofrio accepted the 45-day part of the Commission's 1996 standard, but concluded that the [redacted] tons per day burn portion of the Commission's standard should be modified to [redacted] tons per day.[1] Mr. D'Onofrio suggested that the [redacted] tons per day he used was based on the "actual burn rates at White Bluff and ISES leading up to the May 2005 coal delivery disruptions."[2]

Mr. D'Onofrio's approach results in an "apples-to-oranges" comparison. On the one hand, Mr. D'Onofrio accepts the 45-day part of a standard that was developed in 1996 as part of the working capital calculation, while on the other he rejects the burn rates that were actually used to calculate working capital for inventory that EAI included in its rate base. He then exacerbates this problem by substituting a [redacted] tons per day average burn rate that is based on a misunderstanding, and misstatement, of my prior testimony and the 2005 EAI inventory policy. As I explained in my prior testimony, the [redacted] tons per day assumption

[1] Mr. D'Onofrio confirmed this approach at his August 26, 2010 deposition. Phase II Deposition of William N. D'Onofrio at 49.
[2] D'Onofrio Phase 2 Rebuttal Testimony at 5.

in the 2005 inventory policy was based on a conservative burn rate that reflected the assumption of a burn rate for planning purposes that exceeded the actual average burn rate. There is no evidence in this record that supports the conclusion that the *average daily burn rates* at White Bluff and ISES have increased from the [redacted] tons per day assumed in 1995 to [redacted] tons per day in 2005.[3] In fact, EAI's 2005 inventory policy, which was produced in discovery in this Docket, confirms that the average burn rates at EAI were below [redacted] tons per day in every year from 1999 through 2004. The use of the [redacted] tons per day assumption for planning purposes was thus appropriate for EAI to use in setting an operational inventory level, in that it assumed a rate that was well above the average burn rates experienced by White Bluff and ISES in the study period leading to the development of the 2005 inventory plan.[4]

Q. DO YOU DISAGREE WITH ANY OTHER ASPECTS OF MR. D'ONOFRIO'S TESTIMONY?

A. Yes, Mr. D'Onofrio's testimony erroneously ascribed to me operational inventory standards that were in fact cost-recovery standards employed

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[3] Mr. D'Onofrio admitted at his deposition that he is unaware of any basis to assume that the average daily burn rates at EAI's coal plants had increased to [redacted] tons per day. Phase II Deposition of William N. D'Onofrio at 51.

[4] Coal Inventory Operating Committee Presentation, at 4 (November 18, 2005), a copy of which was provided to Staff in EAI's response to APSC Staff Request 16-3.

by the Commission, and incorrectly equated operational fuel inventory requirements with plant investment requirements.

Q. PLEASE EXPLAIN THESE ERRORS MADE BY MR. D'ONOFRIO REGARDING THE REQUIRED INVENTORY LEVELS.

A. Mr. D'Onofrio claims that my conclusions on operational inventory requirements are based in part on the proposition that the Commission in its 1996 order approving the Stipulation and Settlement Agreement in EAI's ratecase in Docket No. 96-360-U established an appropriate operating inventory level for EAI's generating plants, both in terms of the number of day's burn, i.e. 45-days, and the number of tons, i.e. [5] Contrary to Mr. D'Onofrio's claim, and as I indicated above, I have not testified that a 45-day standard is the appropriate standard for measuring the prudent level of inventory that should be held for operational purposes. Rather, it was APSC General Staff witness Richard McDowell who stated that the use of a 45-day inventory level at historic average burn rates is the acceptable amount of inventory for purposes of setting working capital: "I calculated the appropriate amounts of inventory at each location necessary to fuel the plants for 45 days,... which produces an acceptable inventory level."[6] The Commission's finding that EAI's inventory levels were not prudent was based on its acceptance of

[5] D'Onofrio Phase 2 Rebuttal Testimony at 7.
[6] Docket No. 96-360-U, McDowell Prepared Testimony at 6-7.

the concept that EAI should not be compensated for carrying 45 days of inventory, if it is actually carrying less than that amount.[7] The flaw in this finding, and in Mr. D'Onofrio's criticism of my testimony, is that it assumed that the Commission's 1996 cost-recovery standard did not include a quantifiable quantity of inventory that EAI was authorized to include in its rate base. It did. That amount was based on a burn rate of [redacted] tons per day and resulted in a 45-day volume of inventory equaling [redacted] tons. Any finding that linked the amount of inventory that EAI should have carried to be prudent to the amount that it was including in the rate base should have compared the same volume of coal inventory (i.e., [redacted] tons) that was used to calculate the amount that could be included in the rate base to the actual volume of coal in the inventory stockpile.

Q. DOES MR. D'ONOFRIO ASCRIBE ANY OTHER INCORRECT CLAIMS TO YOUR TESTIMONY?

A. Yes, he indicates that my conclusions are based on the premise that because the Commission allowed a certain level of cost recovery in rates for working capital relating to EAI's coal piles at White Bluff and ISES, EAI was only obligated to maintain a coal inventory of [redacted] tons. Instead, my point is that Mr. D'Onofrio's testimony improperly endorses the conclusion that EAI was required to carry substantially more inventory

[7] *See*, Docket Nos. 06-055-U and 05-116-U, Orders No. 10 and 14 (January 16, 2007).

than the APSC allowed it to include in its rate base. Mr. D'Onofrio's acceptance of the use of a cost recovery standard to impose an operational inventory requirement makes no sense from either a business or public policy perspective. EAI has a responsibility to maintain inventory levels at commercially reasonable levels while providing effective service to its customers. This is also consistent with the Commission's desire to limit inventory cost recovery levels to a specified level. Based on his testimony, however, Mr. D'Onofrio fails to recognize that the standard approved by the Commission was in fact based on a quantifiable level of inventory that was based on a specific average daily burn rate. Failure to recognize this fact would result in an anomaly where EAI would be required to carry substantially more coal than it is allowed to recover through its rate base.

[redacted]

WITH STAFF'S RECOMMENDATION TO ALLOW 45 DAYS inventory levels based on a 45-day inventory level using EAI's average coal burn during the test year. Because EAI in Docket No. 96-360-U sought changes in retail electric rates, all factors, including cost of electric production, property, plant and equipment items and inventory levels would be required to be converted to a dollar basis to conform with the ratemaking procedures. Simply stated, just because the Commission approved standard for cost recovery of coal inventory was presented on a monetary basis does not mean that there are not physical items underlying the costs.

Additionally, from a mathematical perspective, it is irrelevant whether the Staff calculated its 45-day level for cost recovery by first developing required inventory levels on a tonnage basis and then multiplying this by an average fuel cost per ton, or whether the Staff calculated an average cost per burn day and multiplied this average cost by 45 days. Either approach produces the same answer because the same base inputs are used in both calculations. For example, assume a utility burns 1 million tons of coal per year at a total delivered cost of $10 million. This means average daily coal burn on a tonnage basis equals approximately 2,740 tons per day.[8] Alternatively, average daily coal burn on a dollar basis is $27,400 per day.[9] If the Staff recommended a 45-day inventory standard for rate base purposes, one approach to developing

[8] 1 million tons divided by 365 days = 2,740 tons per day.
[9] $10 million in aggregate delivered costs divided by 365 days = $27,400 per day.

the working capital that could be included entails calculating the physical inventory required, or 123,300 tons,[10] and then multiplying the average physical inventory by the average cost of $10 per ton[11] to develop an inventory cost of $1,230,000.[12] In the alternative, one could, as the Staff did in Docket No. 96-360-U, multiply the average daily burn on a dollar basis of $27,400 by 45 days to develop an inventory cost of $1,230,000.[13]

Both approaches produce the exact same results because both use the same inputs, but just in a different order of operation. To claim that the inventory cost recovery standard was not expressed on a tonnage basis, and therefore there is no Commission approved standard is to ignore the basic mathematics underlying the Commission approved inventory calculations.

Mr. D'Onofrio also confuses the difference between the level of inventory for working capital that the Commission approved for cost recovery purposes and the amounts that the Company targeted in its real-world operating conditions. The fact that EAI was using a higher burn rate assumption for its internal inventory policy than the burn rate used to establish the cost recovery standard merely reflects that the Company's inventory policy was acting in a more conservative mode than if it had set an inventory policy based only on what the Commission had allowed it to

[10] 2,740 tons per day of coal burn multiplied by 45 days of required inventory = 123,300 tons in inventory.
[11] $10 million total delivered cost divided by 1 million tons = $10 per ton.
[12] 123,300 tons in inventory multiplied by an average cost of $10 per ton = $1,233,000.
[13] $27,400 per day of coal burn multiplied by 45 days = $1,233,000.

include as working capital. This approach does not contradict the prudence of EAI's actions. As I explained in my Phase II direct testimony, utilities do not always use average daily burn rates to set inventory levels. Many use other metrics, such as peak burn, to develop a conservative approach to inventory management.

Q. DID MR. D'ONOFRIO MAKE ANY OTHER FACTUAL ERRORS IN HIS TESTIMONY?

A. Yes. Mr. D'Onofrio also erred in his comparison of coal inventory to right-of-way clearing and plant investment. He asserts that there is no difference in fuel inventory from any other item of expense or plant investment. To support his position, he compares changes in fuel inventory with changes in right-of-way clearance and plant inventory.

His comparison of fuel inventory to "other item[s] of expense or plant investment" is erroneous because fuel inventory does not fall into either category.[14] Fuel inventory is a non-plant investment that is treated separately and distinctly from operating expenses and plant-assets. Specifically, it is a non-interest bearing, non-plant asset that is entitled to a return not applicable to operating expenses, and not accounted for in the return on plant equipment. Staff witness McDowell explained the use and derivation of these types of assets in his direct testimony in Docket No.

[14] FERC Form No. 1: Annual Report of Major Electric Utilities, Licensees and Others, at 110.

96-360-U.[15] To ignore the separate nature of inventory assets as compared to plant-assets and operating expenses is to ignore the nature of the separate accounting.

III. SUMMARY AND CONCLUSION

Q. WILL YOU PLEASE SUMMARIZE YOUR SURREBUTTAL TESTIMONY?

A. Yes. The key points of my surrebuttal testimony are as follows:

- As I testified in my Phase II direct testimony in this proceeding, EAI's inventory levels were above the Commission's 45-day standard when measured by the same burn rate assumptions that were used by the Commission in establishing that standard for cost recovery.[16]
- It is inconsistent to accept the 45-day part of the Commission approved standard for cost recovery while at the same time rejecting the daily burn rate assumption used by the Commission to calculate the amount of inventory that is prudent. To hold otherwise results in a situation where the Company would not be considered prudent unless it carries more inventory than the associated cost it is allowed to recover through its rate base.

[15] Docket No. 96-360-U, McDowell Prepared Testimony at 6.
[16] Crowley Phase II Direct Testimony at 8; Phase II Deposition of William N. D'Onofrio at 37 (Acknowledging the accuracy of my calculations I presented at page 8 of my Phase II direct testimony).

- There is no basis in this record to conclude that EAI managed its inventory imprudently from an operational standpoint. The only standard relied upon by the Commission and Mr. D'Onofrio has been the 45-day cost recovery standard. As Mr. D'Onofrio admits, this standard was not based on any operating study.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

CERTIFICATE OF SERVICE

I, Steven K. Strickland, do hereby certify that a copy of the foregoing has been served upon all parties of record this 31st day of August 2010.

Steven K. Strickland