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September 15, 2009

VIA EMAIL
Matthew Brown
Senior Counsel
Legal Services-Regulatory
Entergy Services, Inc.
639 Loyola Ave.
New Orleans, LA 70113

Re: Entergy Services, Inc. Request for Proposals for Long-Term Supply-Side Resources.

Dear Mr. Brown:

Attached are Staff's Comments regarding the above-referenced draft RFP. Please post on the RFP public website.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Melissa Watson
Staff Attorney

cc: Commissioners
Eve Gonzalez

ENTERGY SERVICES, INC.
2009 RFP FOR LONG-TERM CAPACITY

COMMENTS OF THE STAFF
OF THE LOUISIANA PUBLIC SERVICE COMMISSION

A. Background

Entergy Services, Inc. (ESI), serving as agent for the six Entergy Operating Companies (EOCs), issued an RFP in draft form on July 16, 2009. The purpose of the draft is to initiate a stakeholder process pursuant to the requirements of the Louisiana Public Service Commission (LPSC) Market Based Mechanisms (MBM) General Order. While the procedures employed by ESI are intended to comply with this order, the RFP is designed to be System-wide, i.e., meeting the supply needs of all six EOCs. The other regulatory jurisdictions do not have formal procurement rules analogous to the LPSC's MBM Order.

The RFP addresses two perceived capacity resource needs for the System. The first is to expand the installed capacity for the transmission-constrained Amite South region of the System, and in particular, the southeastern portion, referred to as "Downstream of Gypsy" (DSG). Due to a lack of existing, third-party capacity in that region, ESI has identified a self-build combined cycle project that it could construct at the Nine Mile station. Third-party development projects may bid in to the RFP to displace the need for this self-build project. In addition, existing (or even other developmental) projects physically located outside of Amite South may compete to serve this need, but would need to be made "electrically equivalent" to in-region capacity through accompanying transmission upgrades. In this respect, the identified self-build project should not be viewed as the "preferred" or the "incumbent utility" project, but rather should be

viewed as a "backstop" resource in the event that third-party bids from the market are judged not to be economically, financially or technically feasible.

In addition to the Amite South/DSG capacity, the RFP also seeks approximately 1,000 MW of additional capacity on a long-term basis in the form of peaking, load-following CCGT or baseload. The RFP emphasizes the System's need for flexible capacity. ESI has indicated that during the pendency of this RFP it is conducting other procurements, which may or may not impact this RFP. This includes its current "Western" RFP, which involves primarily Entergy Texas, the recently concluded three-year, 350 MW baseload RFP and ongoing bilateral negotiations with a project concerning an unsolicited bid.

ESI provided both Staff and the Independent Monitor (IM) with a preliminary draft of the RFP package in late June. At that time, Staff provided ESI with numerous suggested changes to the draft, and met with ESI in early July in New Orleans to discuss Staff's suggestions. Most of Staff's suggestions were incorporated in the July 16 draft posted to the RFP web site. ESI conducted a similar process to obtain advanced input from the IM, Potomac Economics.

After issuance of the draft RFP, ESI held a combined bidders conference on August 6, 2009 in Houston. Staff attended this conference and made a presentation. Potomac Economics representatives also attended. At this conference, ESI made a presentation of its RFP, including a session on electronic bidding procedures. The conference was well attended by potential bidders and other stakeholders, with an opportunity for raising questions and/or providing comments. All questions at the conference were later written down so that both the questions and ESI responses (after vetting the responses through the IM) could be posted to the public RFP

web site. This included questions submitted by LPSC Staff. To date, approximately 85 questions and answers have been posted to the RFP web site.

ESI also invited written comments on the draft RFP to be submitted by August 20, 2009, and one stakeholder (Calpine) has done so. LPSC Staff also has invited written comments (to be submitted by the end of August), and we have received such comments from four stakeholders (with one choosing to remain anonymous). This includes the Calpine comments, which were submitted to both ESI and Staff. In addition, we have met informally (telephonically or in-person) with some of the stakeholders to discuss RFP design issues. Staff also has discussed RFP-related issues informally with the IM on several occasions, and provided the IM with Staff's written comments on the preliminary draft.

The purpose of this document is to concisely summarize and discuss comments on the draft RFP submitted by stakeholders. Staff normally has extensive comments on the draft RFP beyond those issues raised by stakeholders. However, most of Staff's concerns already have been adequately resolved at the front end of this process prior to the public draft being issued in July. Staff's understanding is that ESI will post Staff's comments on its public website. Further, it is Staff's understanding that ESI respond in writing to comments submitted.

B. Summary of Stakeholder Comments

Staff has received written comments on the draft RFP from four potential bidders or other interested stakeholders, including:

- Calpine Corporation
- Cottonwood Energy
- The Louisiana Energy Users Group (LEUG)

- Other stakeholder (requesting identity not be made public)

Other than Calpine, the written comments were received by Staff in the first week in September.

All stakeholders submitting comments addressed one aspect of the RFP process – whether the Nine Mile self-build project should be subject to a cap on cost recovery equal to the submitted cost estimate. No such rate recovery cap is identified in the draft RFP. In addition to this self-build rate cap issue, stakeholders mentioned the following additional concerns.

- The RFP evaluation methodology should account for the ability of a project (and transmission upgrades associated with that project) to displace high-cost reliability must run (RMR) generation. (Cottonwood)
- Whether the transmission portion of the evaluation will be including the very latest Entergy Construction Plan and/or whether it should include the "Base Plan" developed by the Independent Coordinator of Transmission (ICT). A related issue is whether a major new transmission project under review (e.g., South Louisiana Reliability Loop) should be considered. (Other stakeholder, Calpine)
- ESI's use of capacity delisting as a means of obtaining transmission service (and presumably incorporation of that option in the bid evaluation process) for all bidders on a non-discriminatory basis. (Other stakeholder, Calpine)
- The evaluation methodology should properly account for locational attributes of a resource being bid when conducting bid ranking. (Cottonwood)

- Bids should not be disqualified on the basis of location as long as transmission facilities make it possible for that resource to meet the utility's defined needs. (Cottonwood)

- The costs of emission allowances (e.g., SO_2, NO_x and Co_2) should be reflected in the bid evaluation analysis. (Cottonwood)

- The benefits of dispatch flexibility, e.g., from automatic generation control (AGC) equipment, should be quantified, to the extent feasible. (Cottonwood)

- Comments indicate the need to clarify certain aspects of the RFP collateral requirements. (Calpine)

Staff's comments briefly discuss each of these areas, as appropriate, indicating Staff concurrence or disagreement. Most of these comments (other than the self-build cost recovery cap) require only clarification and perhaps some additional detail associated with the evaluation methodology, but no substantial change to the RFP itself is needed. Some of the comments are actually questions, and as such, they are best answered by ESI. Staff's understanding is that ESI will post Staff's comments to its website and shortly thereafter will provide a written response.

C. Staff Discussion of Stakeholder Issues

1. Recovery Cap on the Nine-Mile Self-Build CCGT

All stakeholder comments advocate that Entergy's regulatory cost recovery be limited to the submitted self-build construction cost. Commenters believe that such a requirement would provide a consumer protection benefit associated with potential construction-related cost-overruns. The concern for some Stakeholders is also one of basic fairness: the utility self-build

should play by the same rules as all third-party bids and should not be permitted to raise its "bid" after-the-fact. This would inhibit the utility from submitting a riskless "low-ball" cost estimate that might distort the selection process and thereby discourage participation. Some commenters cite to the recent experience from an Oklahoma RFP process that utilized such a cap, which they suggest contributed to its success. It should be noted that the Stakeholder comments are not specific concerning precisely what should be capped. Should it just be the unit's construction costs, or should it include its operating costs as well?

There is a short answer to the Stakeholder cost cap proposal. While Entergy may voluntarily agree to accept a cost cap for rate recovery purposes (and therefore use that cap amount as part of the bid evaluations), under the MBM General Order this cannot be required.[1] Entergy so far has indicated no interest in accepting a voluntary cost cap. This issue was explored at length in last year's MBM rulemaking process, in which the proposal for a cost cap rule for all self-builds was unanimously rejected by the Commission. Moreover, the MBM Order mandates that cost recovery of any self-build project prevailing in an RFP be no higher than actual cost. This means that a cost cap *cannot* be symmetric under the current rule. That is, with a cost cap the utility could not recover more than its actual cost, but it could recover less than actual cost if the after-the-fact actual cost exceeds the initial estimate. In addition, notwithstanding both actual cost and the cost submitted in the RFP, the utility remains subject to prudence disallowances for failing to construct the resource at lowest reasonable cost. Under the current rule and ratemaking practices, neither actual cost nor "bid" cost constitutes a "safe harbor" for ratemaking.

[1] Staff and other parties nonetheless retain their rights to propose a cost cap in a certification case, and under certain circumstances Staff believes this is appropriate.

Although the MBM rule precludes the cost cap recommended by commenters (absent voluntary utility consent), it is worth summarizing the safeguards currently required by the Rule to protect against inaccurate bids (intentional or otherwise). The utility has an obligation to promptly communicate to the IM and Staff any material change in project costs. Such a change must be incorporated into an updated re-ranking evaluation of the bids. Depending on circumstances, the IM and Staff could recommend reopening the bidding process. In addition, the bid evaluation process must assign an appropriate risk premium factor to the self-build project to reflect the potential for cost overruns (relative to the "evaluated cost") that could be charged to customers. Beyond these protections that are part of the MBM rule, the Commission retains authority to condition its certifications of a self-build, subject to cost caps, and the utility is subject to prudence reviews. These tools can both protect customers and incent the utility not to submit understated or incomplete cost estimates.

Despite these protections, that there is room for improvement in the process for evaluating the self-build project against the third-party bids. It is Staff understands that the self-build proposal will be prepared by ESI's self-build team that will be totally separate from the ESI RFP group. The submitted self-build will be modeled in the same manner as the third-party bids and subject to a detailed review by the Viability Assessment Team (VAT). It is Staff understands that the VAT will assess the reasonableness of a project's technical aspects and costs to ensure that any potentially attractive bid is also a viable project.

Staff suggests that ESI add an additional step to strengthen customer protection against an overly optimistic or incomplete self-build cost estimate. ESI should retain an outside, consulting engineer to evaluate the realism of the self-build construction cost estimates. The consulting engineer should have some hands-on experience with combined cycle construction

projects and be independent of ESI, i.e., an individual and/or firm with no ongoing or prospective business relationship with Entergy Corporation. This consultant would effectively serve as an additional IM resource focusing on this one, narrow task – thereby supplementing the capabilities of Potomac Economics. Staff has discussed this issue with Potomac, and they acknowledge that they do not have specialized expertise in power plant construction cost estimation. Despite Staff's enquiries, ESI has not adequately documented the expertise of its VAT in construction cost estimation. Moreover, even if one acknowledges that the VAT has such expertise, there is value to enhancing the integrity of the RFP process by having a disinterested and independent assessment.

The consulting engineer can serve two functions based on his or her costing review. First, the engineer could recommend (if warranted) that the RFP team use for evaluation purposes a construction cost estimate that differs from the self-build team's submittal. Second, as part of the review, the engineer would identify the principal cost uncertainties or escalation vulnerabilities. This can serve as a basis for costing sensitivities and the self-build risk premium analysis required under the MBM. Staff believes that an independent expert review would supplement Potomac's capabilities, provide another layer of consumer protection and provide reassurance to the market that ESI is using realistic self-build costs.

Staff's comments concerning the cost cap proposal have emphasized that imposing a cost cap is contrary to the MBM Rule, but that Rule includes important safeguards. Staff recommends strengthening those safeguards further through the use of an independent construction cost expert. It is also important to respond to certain comments suggesting the self-build be treated in a manner identical to third-party bids.

It should be noted that the self-build project plays a role that differs from third-party bids. In particular, unlike a third-party, the utility (a) has an obligation to serve, providing reliable service at lowest reasonable cost; and (b) the utility may not charge above cost of service. The third-party confronts neither of these obligations or restrictions. The third-party has no obligation to submit a bid at all, and is not required to price at cost.

Moreover, while third-parties in this RFP are expected to submit fixed-price bids, in practice this can be difficult to enforce. For example, if a development project submits a bid and subsequently discovers a large increase in cost (e.g., due to changed circumstances), one of two things must happen. Either the so-called "fixed price" is amended to account for the cost increase, or the party will simply cancel the project and withdraw the bid. It is very doubtful that the developer will simply absorb the large cost increase. This also can occur even with an existing project. For example, Entergy sought to proceed with an asset purchase of a third-party combined cycle unit in its 2006 RFP. Subsequent to the award, the third-party withdrew the offer after determining that market prices for assets had risen and its bid had become below-market.

2. The Inclusion of RMR-Reducing Benefits

Cottonwood's comments argue that the evaluation modeling should account for the ability of a unit submitted in the RFP to reduce or mitigate the RMR generation from Entergy's existing, high-cost legacy gas/oil units. This evaluation should include both the addition of the unit itself and the accompanying transmission upgrades that provide firm network service for that unit. A related comment is that Cottonwood argues that the evaluation methodology should take into account a unit's location.

Staff fully agrees with these comments, and Staff believes that it is the intention of both ESI and the IM to take both factors into account. It is a fundamental purpose of Entergy resource planning and this RFP to add generation resources that will significantly mitigate the operation of the legacy RMR units. As the cost of natural gas increases over time, the value of this mitigation will be substantial. Staff will help verify with ESI and the IM that RMR mitigation is being properly reflected.

ESI's Prosym model also accounts for the location of the proposed generating units through the inclusion in the model of the internal transmission interfaces. Thus, all else equal, a unit located with a constrained region will be modeled as providing greater energy savings than an identical unit located in the unconstrained region.

ESI may wish to review its methodology description in its draft RFP to determine whether any clarifying language is needed.

3. Transmission Facilities to be Included in the Evaluation Modeling.

Some commenters expressed concern that the evaluation methodology may be inadequate because it incorporates only those new facilities in Entergy's current "Construction Plan". The comments note that the Construction Plan differs from the ICT's Base Plan in significant ways. An additional comment suggested that ESI should consider including major new transmission projects such as the South Louisiana Reliability Loop.

The Stakeholder comments regarding the differences between the Construction Plan and ICT Base Plan may have been accurate at the time the draft RFP was issued in mid-July. However, in August, Entergy issued a revised Construction Plan that, in a fashion, substantially eliminates almost all differences. It is Staff's understanding that this updated set of projects will

be included in the evaluation process. This update eliminates this issue, and it would be helpful if the final RFP references the revised Construction Plan.

The additional suggestion concerning the inclusion of unapproved major transmission projects under consideration is more difficult to deal with since it is not known whether such a project actually will go forward. Staff intends to discuss this further with ESI and the IM at a later date. ESI may wish to reserve some flexibility in this issue in its final RFP. For example, if feasible, it may be worth the inclusion of a major new transmission project that is under study as a sensitivity case. Moreover, if a major new project (such as the South Louisiana Reliability Loop) is added to the Construction Plan prior to the conduct of the evaluations, then there is merit in including it in the transmission modeling.

4. Use the ICT to Perform the Transmission Assessments

Calpine cites to Oklahoma's use of the SPP to perform transmission assessments in its recent RFP as support for its position that the ICT should play a similar role for Entergy. Staff has no specific objection to the ICT providing such assistance, but the need does not seem compelling given Potomac's extensive expertise and oversight. Moreover, there may be a fundamental difference between the Oklahoma utility (i.e., PSO) and Entergy. In the Oklahoma RFP, presumably bidders could be anywhere in the SPP RTO footprint, making the SPP the most qualified entity to perform the transmission assessments.

In the Entergy RFP, the transmission assessments would be only for the Entergy grid, making both Entergy and the ICT fully qualified to perform these assessments. (It is our understanding that Entergy TBU normally prepares the detailed Facilities Studies.) Non-Entergy

transmission requirements are the bidder's responsibility in that the bidder must deliver to the Entergy grid.

In the past, ESI has had the ICT perform informational transmission analyses, but this will not be done in this RFP. It would be helpful if this change in practice could be explained by ESI.

5. The Use of Delisting

Commenters noted that ESI plans to use delisting of existing capacity as a potential tool for obtaining transmission service for its Nine Mile self-build. Delisting could provide substantial savings compared with undertaking expensive network upgrades. The concern is that the use of the delisting tool should be employed, as feasible, for both the self-build and third-party projects on a non-discriminatory basis, for purposes of evaluation and bid rankings. Staff is in full agreement, and it is our understanding that this is ESI's intention. It should be noted that the ability to use delisting for a given project is done on a case-by-case basis, and this should be reviewed by the IM since it can affect bid ranking results.

6. Disqualifications of Bids Due to Adverse Location

Cottonwood argues that no bid should be disqualified due to its location, as long as the proposed unit can meet System needs when accompanied by transmission upgrades. This issue would appear to apply only to the identified Amite South/DSG capacity need portion of the RFP. The draft RFP clarifies that while location within Amite South/DSY is considered desirable, it is not required, and bids will not be disqualified on that basis. Units outside that subregion can fill

that need with the appropriate transmission expansion that make it (more or less) equivalent to physically locating in that region.

7. Inclusion of Emission Allowances

Cottonwood advocates that the modeling of bids using Prosym include the cost of allowances for SO_2, NO_X and CO_2. In principal, Cottonwood's comment is valid since these allowances are, or are likely to be, part of the dispatch costs of System units. As a practical matter, this probably has a minimal effect on the bid rankings of competing CCGTs since all modern CCGTs are likely to have similar emissions profiles.

Nonetheless, there are two areas where emissions effects of the bids could differ materially. One case would be a comparison of a coal resource (if one bids) with a CCGT (for the baseload product). A second difference could arise if one CCGT (due to its location) had superior RMR energy displacement attributes. Since the Entergy legacy units have higher emission rates than newer units, this could affect System emissions.

8. Entergy Should Quantitatively Account for AGC.

Cottonwood encourages ESI to quantitatively account for the "flexibility" benefits of AGC, not just qualitatively. While this would be ideal, it is not clear that Prosym has this ability to explicitly model AGC. However, it seems likely that if Entergy were to "acquire" a CCGT unit (through asset purchase or long-term contract), it would want AGC to be installed. Thus, a more practical resolution might be to impute the cost of AGC, if a bidding unit lacks that equipment.

9. Questions Regarding Collateral

Calpine raised questions concerning collateral that ESI is best equipped to clarify. This concerns alternatives to cash collateral and whether the declining collateral is straight line.