



Hot Topics

Important issues for Entergy's customers, employees, investors and other stakeholders.

System Agreement

What Is The System Agreement?

The System Agreement is the contract that governs the interaction of the Entergy operating companies as one power pool. Entergy operating companies have operated as a pool utilizing some form of System Agreement since 1951. The current version of the System Agreement was approved by the Federal Energy Regulatory Commission (FERC) in 1985. Because this agreement governs the price for wholesale electricity used or exchanged by Entergy's operating companies, it must be approved by the FERC.

The System Agreement provides the contractual basis for the continued planning, construction and operation of the electric generation, transmission and other facilities to capture the economic efficiencies possible with a larger system.

A pooling arrangement is beneficial because it allows utilities in the pool to share generating capacity power reserves. The peak load of each operating company reflects the demands of its customers and is significantly influenced by weather. Because each Entergy operating company reaches its peak demand at a different time, the peak demand of Entergy at any given time will be smaller than the sum of the individual company peak levels. This means that the amount of generating capacity needed to serve the Entergy is less than would be needed to serve the sum of the peak demands of the individual companies. The System Agreement defines the pricing and allocation of the reserve capacity needed by the Entergy Operating Companies.

What Is The Issue?

Entergy Arkansas relies primarily on coal and nuclear generation. This has become a relatively inexpensive source of power now that the plants' construction costs have depreciated. Entergy Louisiana and Entergy Gulf

States rely more heavily on oil- and natural gas-fired generation. This has become more expensive as the costs of both commodities have soared in recent years.

In the 1985 Grand Gulf Nuclear Station rate case, the FERC interpreted the System Agreement as intending to achieve “rough equalization” of total production costs across all the Entergy operating companies. Total production costs are all the costs associated with generation – investment, operation and maintenance and fuel. The FERC assigned responsibility to the then four operating companies to purchase power from Grand Gulf in a way that, when coupled with the System Agreement allocations, the FERC determined achieved rough production cost equalization.

In 2000, natural gas prices shot up and have escalated significantly in the wake of hurricanes Katrina and Rita. Because Entergy Louisiana and Entergy Gulf States are more reliant on generation from natural gas than is Entergy Arkansas, total production costs went up for Entergy Louisiana and Entergy Gulf States, but not nearly so much for Entergy Arkansas.

The Louisiana Public Service Commission and the Council of the City of New Orleans filed a complaint in June 2001 with the FERC that the rough equalization standard set by FERC 15 years before was not being met. (The New Orleans City Council subsequently withdrew as a complainant in the case.) The LPSC complained that the System Agreement is not performing its function.

FERC Final Order

On December 19, 2005 the Federal Energy Regulatory Commission issued its order on rehearing in the System Agreement case that upholds all of the provisions of the order it issued in this case on June 1, 2005.

In order to reach rough production cost equalization, the FERC imposed a bandwidth remedy by which each operating company’s total annual production costs would have to be within plus/minus 11 percent of Entergy System average total annual production costs.

FERC’s remedy was effective based on calendar year 2006 production costs with first reallocation payments to be made in 2007.

In August 2006, Entergy Arkansas estimated that, in order to comply with the FERC order, the company will be required in July 2007 to begin making payments that will total \$284 million for the year. The amount would be adjusted in 2008 through 2013 due to changes in production costs outside the limits established by FERC.

Entergy Arkansas has provided notice to stop participating in the System Agreement no later than December 18, 2013.

Summary

- The FERC final order essentially upholds all of the provisions in its order of June 1, 2005.
- Natural gas prices increased so dramatically after June 2005, due in part to hurricanes Katrina and Rita, the final order will cause Entergy Arkansas customers to make substantial payments to customers of Entergy Louisiana and Entergy Gulf States.
- With the extraordinary escalation in the price of natural gas, the current interpretation of the System Agreement could result in an erosion of Entergy's ability to plan resources efficiently.
- The FERC order specifies first payments beginning in June 2007, based on actual costs during calendar year 2006.
- Entergy Arkansas has provided notice to terminate its participation in the System Agreement effective 96 months from December 19, 2005 or such earlier date as authorized by the FERC. However, Entergy Arkansas continues to believe that, if properly structured, a replacement agreement could allow the Entergy's operating companies, including Entergy Arkansas, to continue to achieve economies and efficiencies that result from joint operation of an integrated electric system.
- Entergy continues to work to identify alternative arrangements that could continue to facilitate the joint operation of all the Operating Companies.

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