



# Hot Topics

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

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## System Agreement

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### What Is The System Agreement?

The System Agreement is the contract that governs the operation 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 in 1985.

Because this agreement governs the price for wholesale electricity used or exchanged by Entergy's operating companies, it is a FERC-approved tariff subject to the exclusive jurisdiction of the FERC.

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

The System Agreement allows the operating companies 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 typically reaches its peak demand at a different time, the peak demand of the Entergy System 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 system load is less than would be needed to serve the sum of the peak demands of the individual operating companies. The System Agreement defines the pricing and allocation of the reserve capacity among 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 assets have depreciated. Entergy Louisiana and Entergy Gulf States rely more heavily on natural gas-fired generation. The cost of this type of generation has become more expensive as the cost of natural gas has increased and fluctuated in the last decade.

In the 1985 Grand Gulf Nuclear Station cost allocation case, 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 allocated responsibility to the then four operating companies for the Grand Gulf capacity costs 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 continued to escalate significantly in the wake of hurricanes Katrina and Rita. Because Entergy Louisiana and Entergy Gulf States are more dependent 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 FERC, which alleged 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.)

#### FERC Final Order

On Dec. 19, 2005, FERC issued its final order. In order to reach rough production cost equalization, 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 the 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 order to comply with the FERC order, in July 2007 Entergy Arkansas began making payments of \$284 million for the year. The requirement to make payments is evaluated each year until Entergy Arkansas' payment obligation, if any, ceases upon its exit from the System Agreement. In subsequent years Entergy Arkansas made payments of \$251.8 million, \$390 million and \$27 million in the years 2008, 2009 and 2010 respectively.

On Dec. 19, 2005 – the same day of the FERC order – Entergy Arkansas provided its 96-month notice to withdraw from the System Agreement by December 2013.

About two years later, Entergy Mississippi also provided its 96-month notice that it was terminating its participation in the System Agreement, with that exit to occur in November 2015.

## Summary

The FERC Dec. 19, 2005, 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, that as a result Entergy Arkansas customers were required to make substantial payments to customers of Entergy Louisiana and Entergy Gulf States.

The FERC order specified that first payments would begin in June 2007 based on actual costs during calendar year 2006 and be adjusted annually based on calendar year costs.

Entergy Arkansas provided notice to terminate its participation in the System Agreement effective 96 months from Dec. 19, 2005.

Entergy Arkansas has determined that its customers would receive the most benefit if it joined the Midwest Independent Transmission System Operator (MISO). Entergy Arkansas is working with MISO to integrate their operations by December 2013 when Entergy Arkansas' participation in the System Agreement ends. Entergy Arkansas is developing an option of operating temporarily as a separate utility if for any reason it is unable to integrate with MISO by that time.

Entergy Mississippi provided notice Nov. 7, 2007, that it was terminating its participation in the System Agreement, with that exit to occur in 2015.

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