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Re: Application of Entergy New Orleans, LLC for a change in Electric and Gas Rates Pursuant to Council Resolutions R-15-194 and R-17-504; Entergy New Orleans, LLC's Response to Proposed Resolution R-19-___ Council Docket No. UD-18-07

Dear Councilmembers:

As reflected in Entergy New Orleans, LLC's ("ENO" or the "Company") September 2018 Application and supporting testimony in the above-referenced docket, ENO has a bold strategy for the City of New Orleans' ("City") future and an aggressive plan to invest in New Orleans over the next five years to meet the New Orleans City Council's ("Council") and the Company's shared objectives. Some of these objectives include deploying Advanced Metering Infrastructure ("AMI"), expanding ENO's use of clean energy resources through renewables, increasing demand-side management alternatives (including stable funding), continuing to improve reliability of the electric grid and modernizing it to support the integration of distributed energy resources, electric vehicles, and Smart City objectives. These shared objectives must also be coupled with a plan that preserves ENO's financial health as it seeks to attract substantial capital investment necessary to make these goals a reality. ENO's ability to attract this investment capital to New Orleans is also a required precursor to executing on these objectives.

In sharp contrast to ENO's progressive strategy for the City, proposed Resolution R-19-XX (addressing Council Docket No. UD-18-07 ("Resolution")) will ultimately cost customers more over the long term and is contrary to the sound evidence offered in this case. The Resolution presented is neither fair nor balanced and is out of step with sound regulation rooted in Louisiana and federal law. More importantly, if adopted, the Resolution will undermine ENO's ability to deliver on the utility of the future for New Orleans. So, we take this opportunity to point out some of the more egregious components of the Resolution, in hopes that the parties can build on what has been presented to achieve a Council Resolution that is truly fair to all parties, and to avoid the lengthy and costly litigation and additional rate cases that will follow otherwise.

Return on Equity

On the surface, while it may seem attractive to reduce ENO's rate of return far below other utilities in the region, this short-term win is likely to yield longer-term increased costs for customers. ENO's ability to make the investments necessary to move the City forward depends upon its ability to compete with those less-risky utilities for capital from investors willing to lend money to or invest money in ENO. (In an effort to meet ENO's capital needs to support these investments, for several years, ENO has generally remitted minimal dividends to Entergy Corporation. In fact, because ENO's earnings are not sufficient by themselves to cover such investments, Entergy Corporation has continued to infuse equity into ENO. Entergy Corporation's equity investment in ENO should not mean that Entergy Corporation has the responsibility to take action to improve ENO's credit metrics simply because the regulator fails to approve a level of rates sufficient to provide for reasonable credit metrics.)

Moreover, in attempting to raise debt capital, recently, ENO's offering of long-term bonds initially was rejected by over 50 parties citing geographic risk factors, with one party also citing the uncertain regulatory environment—a first for any of the Entergy Operating Companies. Failing to set a ROE that appropriately reflects ENO's true risk profile will further undermine ENO's ability to attract capital on reasonable terms. In a time of crisis, such as following a major storm, difficulty raising capital could be catastrophic. Even a category 1 storm can be costly; Hurricane Isaac cost ENO just under $50 million to repair damage from that storm. (See Council Docket No. UD-14-01). Simply put, ENO needs to be able to borrow funds to serve customers, and it needs to do so on reasonable terms, including a reasonable interest rate, in order to avoid unnecessary rate increases. Setting a 9.35% ROE wholly fails to allow ENO to meet these objectives and undercuts the Company's ability to attract capital to fund projects that will have benefits for customers.

Without doubt, ENO is an above-average risk utility, as stated by one of the most credible credit rating agencies and publishers of risks, Moody's Investors Service ("Moody's"). This cannot reasonably be ignored by this Council. Tellingly, ENO is one of only a few utilities in the U.S. with a below-investment-grade credit rating, meaning that an independent party found that it is one of the riskiest utilities in the United States. Moody's rates ENO below investment-grade at Ba1. Standard & Poor's Financial Services, LLC ("S&P") rates ENO as BBB+ but notes that its rating for ENO reflects its affiliation with Entergy Corporation, its parent company, and does not reflect ENO's stand-alone risk profile, which S&P rates at the lowest investment-grade tier of BBB-. Moody's and S&P base these ratings and comments primarily on ENO's small size and location in a hurricane-prone area. Both Moody's and S&P refer to the Council's "historically supportive"[1] and "generally stable"[2] treatment as key/credit strengths. Moody's likewise points to Company's ability to "maintain strong regulatory support for investment and cost recovery" as reasons for a stable outlook for ENO's credit rating.[3] Accordingly, a constructive regulatory environment is important.

The Resolution's proposed 9.35% ROE is forty-four basis points below the average authorized ROE for vertically integrated electric utilities and below all but eight ROEs authorized for vertically-integrated electric utilities since 2014.[4] In fact, as the chart below indicates, it would be lower than the authorized ROEs of all the other electric utilities operating in Louisiana, Mississippi, Alabama, Georgia, and Florida, which are frequently exposed to storms from the Gulf of Mexico.

1 Moody's Investor Service Credit Opinion, Entergy New Orleans, LLC (Nov. 27, 2018), p. 1.
2 S&P Global Ratings, Ratings Direct, Entergy New Orleans, LLC (Sept, 11, 2019), p. 3.
3 See Moody's Investor Service Credit Opinion, Entergy New Orleans, LLC (Nov. 27, 2018), p. 2.
4 Exhibit ENO-29 (Hevert Revised Rebuttal), at p. 5.

Southern Coastal Utility ROEs

Company	ROE
Alabama Power (AL)	13.75%
Atlanta Gas Light (GA)	10.55%
CLECO (LA)	10.00% (current)/ 11.00% (requested)
Duke (FL)	10.50%
FP&L (FL)	10.55%
Ga Power (GA)	10.95%
Gulf Power (FL)	10.25%
Mississippi Power (MS)	12.88%
Scana (SC)*	10.75%
Tampa (FL)	10.25%

Furthermore, the proposed ROE is arbitrary and not supported by law. The United States Supreme Court set forth the well-settled legal standard requiring that, when regulators set a ROE, it must be set at a rate "commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[5] The Supreme Court has further explained that "a public utility is entitled to such rates as will permit it to earn a return on the value of the property . . . **equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties**. . . ."[6]

Because of its small size and geography (prone to storms and severe weather events, surrounded by water and below sea-level elevation), ENO is far riskier than any other utility in the region, and a simple scan of the chart above demonstrates that the proposed 9.35% ROE is far below the returns of other Gulf Coast utilities. This comparison demonstrates that the 9.35% ROE is low and in violation of the law. Aside from legal considerations, the Council effectively would be asking ENO's equity investor to commit capital to a much riskier utility for a low return, which is an untenable proposition for any investor.

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5 *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

6 *Bluefield Waterworks & Improvements Co. v. Public Service Comm'n of W. Va.*, 262 U.S. 679, 692 (1923) (emphasis added).

Simply put, while perhaps tempting in the short term, all past Councils and other regulators in the region have resisted the temptation to set an unreasonably low ROE for ENO. This Council should not be the first to create an intentional death spiral, demanding higher performance while crippling ENO's ability to achieve it. ENO believes that it can reduce its current return on equity (ROE) of 11.1% significantly if paired with the Formula Rate Plan ("FRP") of the nature reflected in the proposed Resolution, but a 9.35% ROE falls wholly short of the long-term financial stability needed for ENO to deliver the results that customers, the Council, and ENO envision. This path flies in the face of sound regulatory policy and will impair, if not fully prohibit, ENO's ability to make the investments in the future of New Orleans to achieve the vision that ENO believes it shares with the City. While financially prohibiting ENO's ability to make investments to deliver reliable, low-cost, and sustainable service to New Orleans is without doubt the goal of some intervenors in this proceeding, it should not be the Council's.

Equity Ratio

In addition to the ROE, the second driver of a utility's ability to earn a just and reasonable return on its investment in public service is its capital structure. A utility needs to be funded at an adequate equity level such that banks and other lenders feel assured that the utility will have sufficient cash flows to be able to repay its borrowings. As with the ROE, the utility's capital structure must reflect its business risks. ENO's current capital structure is approximately 52% equity and 48% debt, reflecting a slightly higher level of equity to account for its higher business risk.

The conclusion in the proposed Resolution that ENO's equity ratio should be capped at 50% for purposes of setting the base rates resulting from this proceeding and the FRP is arbitrary. Once again, the Resolution, and the proposals made by the Advisors fail to take into account ENO's size and specific financial challenges. The proposed Resolution finds that ENO's equity ratio is unreasonable because it is higher than Entergy Corporation's equity ratio, but the Advisors concede that Entergy Corporation's equity ratio would be unreasonably low and likely imprudent for ENO. The proposed Resolution finds that ENO's equity ratio is unreasonable because it is more than the average of the other Entergy Operating Companies. There is no legal or regulatory rule that requires ENO's equity ratio to be no higher than the average of the other Entergy Operating Companies, and there is no indication that any consideration was given as to why ENO's equity ratio may need to be permitted more flexibility than other larger utilities.

Moreover, in this regard the proposed Resolution is likewise inconsistent with Louisiana law. The Louisiana Supreme Court rejected its own previous decisions and held that a regulator cannot substitute a hypothetical "theoretically optimal" capital structure for the utility's actual capital structure absent a finding that the capital structure resulted from an imprudent or unreasonable decision.[7] The party's challenging ENO's capital structure admit that they are not claiming that ENO has made an imprudent or unreasonable decision affecting its capital structure,

[7] *South Central Bell Telephone Co. v. Louisiana Public Service Commission*, 594 So.2d 357, 366 (La. 1979).

and there is no such finding in the proposed Resolution nor does the evidentiary record include any evidence to support such a finding.

Income Tax Normalization and Accelerated Tax Depreciation

The proposed Resolution is so arbitrary and capricious that it contains two rulings related to accumulated deferred income taxes ("ADIT") that would result in IRS normalization violations, and the loss of ENO's ability to use accelerated tax depreciation. This loss would harm customers by increasing the capital costs borne by customers. While this issue is very complex and involves tax law, in short, the proposed Resolution would trade a short-term small cost decrease for costs many times higher going forward.

Specifically, the proposed Resolution excludes ENO's net operating loss ("NOL") ADIT associated with accelerated depreciation[8] from rate base despite ENO providing IRS private letter rulings involving other utilities in which the IRS states that excluding such NOL ADIT is a normalization violation and explains how such NOL ADIT is to be calculated.[9] Nevertheless, the proposed Resolution ignores the IRS private letter rulings, which the Advisors have admitted address circumstances very similar to that of ENO.

Second, the proposed Resolution includes ADIT in rate base associated with stranded meters[10] as a reduction to rate base causing a revenue requirement reduction calculated at ENO's full weighted average cost of capital, while excluding the stranded meters from rate base and affording the meters a lower rate of return. Federal law requires consistency between the ratemaking treatment of assets and the related ADIT liability with respect to rate base.[11]

The United States Tax Code allows utilities to take accelerated depreciation to help offset the upfront cost of new investment; however, utilities that take advantage of this effective no-cost loan from the government must normalize their taxes for ratemaking purposes over the life of the investment. Normalizing tax investment means matching the tax depreciation rate to the book depreciation rate. Customers benefit from tax normalization because they get the value of the accelerated tax depreciation as an offset to the utility's rate base, thereby lowering the cost to customers upon which the utility's earnings are calculated. For example, today, that offset is $80 million to ENO's electric operations and $70 million to its gas operations, providing a total reduction of approximately $17 million to ENO's revenue requirement. If, however, the rates set for the utility are not consistent with normalization, then the utility loses the right to these rate base offsets prospectively. Thus, the consequence to customers is higher costs in the future, which can be substantial, especially when the Company invests in major projects *e.g.*, AMI, New Orleans Solar Station and New Orleans Power Station.

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8 This type of ADIT is debit ADIT recorded in Account 190 and increases rate base by offsetting a portion of the ADIT in Account 282 in the calculation of rate base.

9 Exhibit ENO-50 (Roberts Rebuttal), Exhibit RLR-2.

10 The investment in these legacy meters is stranded as result of the Council-approved AMI project.

11 Exhibit ENO-50 (Roberts Rebuttal) at p. 15.

In this case, the proposed Resolution would disallow ENO's two tax normalization adjustments, which together comprise approximately $69,000 of ENO's revenue requirements. Using ENO's current rate base offset as a conservative proxy for its going forward investment, this $69,000 *decrease* compares unfavorably to the $17 million revenue requirement *increase* that would occur over time due to the loss of accelerated tax depreciation. The result is penny wise and pound foolish, and it is one that ENO cannot control because the IRS makes the rules on tax normalization.

Formula Rate Plans

Formula Rate Plans can be a streamlined, cost-effective alternative to traditional ratemaking if the regulator and utility can agree upon the terms of the FRP. Agreement by the utility is necessary because the FRP supplants the utility's right to file a rate case, except in those circumstances agreed upon by the utility. Due to the unreasonably low ROE set forth in the proposed resolution, ENO will likely be unable to agree to an FRP that would require prospective rates to be reset annually using an evaluation period cost of equity that is not commensurate with ENO's risk profile and that fails to reasonably reflect the cost of capital throughout the term of the FRP. As such, the authorized ROE, or Evaluation Period Cost of Equity, must necessarily take into account macroeconomic uncertainties that could change within the three-year term of the FRP, in additional to the specific risk profile of the utility. Moreover, the Resolution does not address recovery for certain projects that have already been approved by the Council in the absence of an FRP that is agreeable to both the Company and the Council. The proposed Resolution fails to provide an alternative for timely recovery of such projects therefore would deprive ENO of a reasonable opportunity to recover its authorized return on the investment in these Council-approved projects. Furthermore, certain provisions that address FRP recovery are not only *internally* inconsistent, but also inconsistent with the Council's prior decisions on those matters without any reasons cited for the deviation.

Power Plant Depreciation Rates

As the Council is aware, utilities recover the cost of their investment in new plant through depreciation. The depreciation rate reflects the expected life of the asset, together with a provision for expected maintenance capital to be invested in the plant over time. It is important that the depreciation rate match the expected life of the plant because, if it does not, it forces customers to continue paying for a plant long after the plant ceases to provide service, and this is on top of the cost of the plant that is then being used to serve these customers. By contrast, an appropriate depreciation rate times the utility's recovery of the cost of an investment with the actual life of that investment supports the utility's ability to make the optimal choice for customers regarding how to replace that asset at the end of its useful life.

The proposed Resolution seeks to reduce the depreciation rates for ENO's Union Power Station Power Block 1 ("Union") and the New Orleans Power Station ("NOPS") to 40 and 50 years, respectively. Based upon a full depreciation study by ENO's expert, these station lives far exceed the 30-year expected useful lives of these plants.

Ignoring the evidence of ENO's witness, who is the only Certified Depreciation Professional testifying in the proceeding and the only witness to have conducted an actual depreciation study, the Resolution seizes on information presented by one intervenor from a government database that included examples of combined-cycle gas turbine ("CCGT") units like Union that have been in operation for forty to fifty years. However, this same database shows that that the average useful life of all currently-retired CCGT units listed is 26.8 years – significantly less than the handful of plants with longer lives. The proposed Resolution does not explain why one piece of information from the database to be more persuasive but other information from the same database to be irrelevant, and it wholly fails to address why the Council should base a decision on a data base rather than input from both an experienced engineer and an actual depreciation study conducted by a certified Depreciation Professional.

The proposed Resolution is even more egregious in recommending a 50-year depreciation life for New Orleans Power Station. NOPS is not a combustion turbine but is a reciprocal engine technology. No party other than ENO presented evidence regarding the appropriate depreciation rate for this technology. Equally important, to set the depreciation rate for NOPS in the context of this rate case—where it was not even at issue—is wholly inappropriate. The determination of the depreciation rate for NOPS falls within the scope of the determination of the estimated non-fuel revenue requirement in the Electric Formula Rate Plan (or other recovery mechanism).

Taken together, this course of action is akin to taking out a 5-year loan on a car only expected to have 2 years of useful life. In this scenario, the loan payment may be lower, but the borrower would be expected to pay three years beyond the point the car can be used, and these payments will be in addition to costs that must be expended to replace the car. This is not sound regulatory policy. Moreover, taking this approach to depreciation and back-end loading costs will place significant upward pressure on bills in later years and, thus, inhibit ENO's ability to make the investment needed to support the zero emission goals that the City and the Council desire.

Energy Smart

ENO objects to the proposed Resolution's conclusions regarding Energy Smart. ENO proposed the Demand-Side Management Cost Recovery Rider to fulfill the Council's earliest stated objectives for Energy Smart, namely to "provide sufficient, timely, and stable program funding" to deliver DSM offerings to customers and to place DSM investment on equal footing with more traditional supply-side resources and other investments in capital assets used to serve ENO's customers. What's more, ENO's proposal would place supply and demand resources on an equal footing, creating a strong incentive for ENO to invest in more energy efficiency while lowering the cost that customers pay for these expenses per year. The proposed Resolution's adoption of a permanent Energy Efficiency Cost Recovery Rider does not accomplish the Council's previously stated objectives and will lead to much higher bill impacts in the next few years than ENO's proposed DSMCR rider. Also, the proposed Resolution's direction that the lost contribution to fixed costs resulting from Energy Smart be addressed through the decoupling process, particularly that process called for in the proposed Resolution, is wholly unsupported by the record in this proceeding.

Conclusion

ENO would appreciate the opportunity to discuss with Council representative(s) how certain portions of the resolution can be amended to reflect a more balanced result that is based on sound regulation, that comports with applicable regulatory law, is internally consistent and supports ENO's strategy to transform the utility in the way that this community needs and deserves.

Sincerely,

Alyssa Maurice-Anderson

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/ama

cc: Mr. David Ellis
Mr. Brian Guillot
Official Service List