

In Re:

CNO Docket
No. UD-18-07
EXHIBIT
ENO-64

Application of Entergy New Orleans, LLC, etc.

Byron S. Watson

June 10, 2019

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BEFORE THE
COUNCIL OF THE CITY OF NEW ORLEANS

APPLICATION OF)
ENTERGY NEW ORLEANS,)
LLC FOR A CHANGE IN) DOCKET NO. UD-18-07
ELECTRIC AND GAS)
RATES PURSUANT TO)
COUNCIL RESOLUTION)
R-15-194 AND)
R-17-504 AND FOR)
RELATED RELIEF)

* * * * *

Deposition of BYRON S. WATSON, 6041 S.
Syracuse Way, Suite 105, Greenwood Village,
Colorado 80111, taken at the law offices of
DENTONS, US LLP, located at 650 Poydras Street,
Suite 2850, New Orleans, Louisiana 70130,
commencing at 9:09 A.M., on Monday, the 9th day
of June, 2019.

APPEARANCES:

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- AND -

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ALSO PRESENT:

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Polly Rosemond (via telephone)
21 Susan Stevens Miller (via telephone)

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REPORTED BY:

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E X A M I N A T I O N I N D E X

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E X H I B I T I N D E X

EXHIBIT NO. 1.....28
(Copy of Form 10-K)

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S T I P U L A T I O N

It is stipulated and agreed by
and among counsel for the parties hereto that
the deposition of the aforementioned witness is
hereby being taken under the Louisiana Code of
Civil Procedure, Article 1421, et seq., for all
purposes, in accordance with law;

That the formalities of reading and
signing are specifically not waived.

That the formalities of filing, sealing,
and certification are specifically waived;

That all objections, save those
as to the form of the question and the
responsiveness of the answer, are hereby
reserved until such time as this
deposition, or any part thereof, may be
used or sought to be used in evidence.

* * * * *

KATHY ELLSWORTH SHAW, Certified
Court Reporter, State of Louisiana,
officiated in administering the oath to
the witness.

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P R O C E E D I N G S

MR. WILLIAMS:

All right. Good afternoon,
everyone. My name is John Williams.

We're here to take the deposition of
Mr. Bryon Watson on his surrebuttal and
cross-answering testimony. I think we
can start with appearances.

My name is John Williams from the
law firm of Duggins Wren Mann & Romero,
Limited Liability Partnership. I'm here
on behalf of Entergy New Orleans. With
me today is Alyssa Maurice-Anderson on
behalf of counsel for Entergy New
Orleans.

MR. BEATMANN:

Jay Beatmann with Dentons on behalf
of the Council.

MR. WATSON:

And the deponent, Brian Watson.

MR. WILLIAMS:

Okay. Let's go ahead to the folks
on the phone. Why don't you make your
appearance?

MR. PIONTEK:

1 Sure. This is Luke Piontek on
2 behalf of the CCPUG.

3 MR. REED:

4 This is Presley Reed on behalf of
5 the Council of the City of New Orleans.

6 MR. WILLIAMS:

7 Anyone else at this point?

8 (No response.)

9 BYRON S. WATSON,
10 after having been first duly sworn by the
11 above-mentioned Certified Court Reporter, was
12 examined and testified as follows:

13 MR. WILLIAMS:

14 Okay. Let's turn to the
15 stipulations for the deposition. As
16 we've discussed prior to going on the
17 record, we are going to stipulate that
18 the deposition will be taken pursuant to
19 the Louisiana Code of Civil Procedure.
20 Reading and signing the deposition will
21 not be waived. However, the sealing and
22 certification of the deposition will be
23 waived. And objections will be reserved
24 to the hearing except as to the form of
25 the question or the responsiveness of the

1 answer and to be conducted as a discovery
2 deposition.

3 Everything good, Mr. Beatmann?

4 MR. BEATMANN:

5 Yes, that's correct.

6 Did someone else join?

7 MS. ROSEMOND:

8 Yes. Good afternoon. This is Polly
9 Rosemond with Entergy New Orleans.

10 MR. BEATMANN:

11 Hi, Polly.

12 MR. WILLIAMS:

13 Hi, Polly.

14 MS. ROSEMOND:

15 Hi, everyone.

16 MR. WILLIAMS:

17 Okay. Anybody else on the phone
18 need to address the stipulations, or are
19 we good to go?

20 (No response.)

21 MR. WILLIAMS:

22 Okay. I think we're good to go.

23 EXAMINATION BY MR. WILLIAMS:

24 Q. Good afternoon, Mr. Watson.

25 A. Hello.

1 Q. I want to start with page 21 of your
2 surrebuttal -- I'm sorry -- your -- yeah,
3 surrebuttal testimony.

4 A. I'm there.

5 Q. And here you begin to address
6 opinions regarding credit ratings; correct?

7 A. Yes.

8 Q. And that includes your opinions
9 regarding the Moody's credit rating; correct?

10 A. Yes.

11 Q. Do you agree that an equity investor
12 looking at Moody's credit rating for Entergy
13 New Orleans would understand Moody's view to be
14 that Entergy New Orleans issue a rating is not
15 investment grade?

16 A. Yes. Moody's rating, yes.

17 Q. You agree that Moody's considers ENO
18 to be non-investment grade?

19 A. Specifically issue a credit rating,
20 yes.

21 Q. So when you state at page 21 that
22 ENO is not below investment grade, that is your
23 opinion rather than a statement that ENO does
24 not have such a credit rating; correct?

25 A. It is my opinion based upon

1 consideration of all the evidence, which is
2 that Moody's rates ENO one notch below
3 investment grade and S&P rates ENO, I believe,
4 two notches above investment grade.

5 Q. So you disagree with Moody's view?

6 A. I think that considering all the
7 information, ENO is an investment grade
8 corporation.

9 Q. Well, let me put a fine point on it.
10 You do disagree with Moody's view then; is that
11 correct?

12 MR. BEATMANN:

13 Well, I'm going to object to the
14 extent that he states in his testimony
15 what he thinks about Moody's view, and
16 it's on the page that you just cited and
17 carried over on page 22.

18 But subject to that objection, if
19 you can clarify it any more, go ahead.

20 THE WITNESS:

21 All right. Moody's is obviously a
22 well-regarded ratings agency and I do not
23 perform a complete analysis on my own to
24 state whether I agree with either S&P or
25 Moody's. I'm just merely noting in here

1 that Moody's reliance on geography and
2 size-related matters -- Well, I made my
3 notations in my testimony. So if there's
4 any extent which I disagree with Moody's,
5 it is with regard to their weighting of
6 geography and size and I believe I said
7 as much in my testimony.

8 EXAMINATION BY MR. WILLIAMS:

9 Q. So you think Moody's does express a
10 legitimate point of view then? I mean, it's a
11 really simple question.

12 MR. BEATMANN:

13 Excuse me. I'm going to object. If
14 you're going to argue with him about what
15 he feels that Moody -- about Moody's
16 opinions or their credit rating reports,
17 then, you know -- I would ask that you
18 ask a specific question. That's a very
19 general question that you just asked. He
20 went into more specifics about his
21 opinion on the Moody's report in his
22 testimony. But you're asking generally
23 does he disagree with Moody's. I don't
24 know how he can answer that.

25 If you can clarify that more, go

1 ahead.

2 MR. WILLIAMS:

3 All right. Let me ask again.

4 EXAMINATION BY MR. WILLIAMS:

5 Q. Do you think Moody's rating of Ba
6 for ENO is inappropriate?

7 A. I think that -- And a no less
8 regarded, perhaps equal or even higher regarded
9 organization, S&P, found ENO to be three
10 notches higher on a comparable scale. And in
11 my personal observation of Moody's work in the
12 issuance of the securitization bond, as I said
13 in my testimony, while ENO's size and geography
14 are known, its storm history are known, you
15 know, Moody's weighing of that concern and
16 consideration is clearly much higher than S&P's
17 weighting of that concern and consideration.
18 And so to the extent I have a problem with
19 anything Moody's has done, it's not that they
20 are wrong that New Orleans is subject to
21 storms, but that the weighting they're giving
22 it seems to be quite a bit more than they
23 gave -- than did S&P.

24 Q. Do you think there's a basis for
25 Moody's Ba rating for Entergy New Orleans?

1 A. Based on my review of the documents
2 in this proceeding and also my observation of
3 the process of issuing ENO's securitization
4 bond, I think that Moody's had little problem
5 with ENO's financial condition or regulatory
6 environment, but specifically had a problem
7 with the geography and size.

8 Q. Do you think that geography and size
9 provides a basis for giving Entergy New Orleans
10 a Ba credit rating?

11 A. I didn't testify as being qualified
12 to issue credit ratings.

13 Q. Have you ever worked for a credit
14 rating agency?

15 A. No.

16 Q. Have you ever worked in the treasury
17 area of a utility company?

18 A. No.

19 Q. Have you ever had responsibility for
20 raising capital for a utility company?

21 A. A utility company, no.

22 Q. Have you ever had responsibility for
23 a utility's financial disclosures?

24 A. Again, no. The qualifier of the
25 utility is the issue you're preventing me from

1 saying yes.

2 Q. So you haven't been involved with
3 financial disclosures such as SEC Form 10-K,
4 10-Q, or 8-K?

5 A. I have.

6 Q. For a utility company?

7 A. No.

8 Q. So who have you been involved in
9 those things for?

10 A. I at one time was employed by a
11 publicly traded manufacturing company and I
12 worked in the audit, treasury, and financial
13 disclosure functions.

14 Q. So what kind of company was that? I
15 mean, what size company I should say?

16 A. It employed roughly 1,000 people,
17 mostly union machinists.

18 Q. And what kind of activities were you
19 involved in for that entity as far as raising
20 capital?

21 A. I secured bank forms of capital
22 senior secured debt, capital and operating
23 leases, as well as the financial planning to
24 maintain covenant compliance on all forms of
25 debt.

1 Q. What about your responsibility for
2 financial disclosures with that company?

3 A. I assisted in the preparation of
4 10-Ks, 10-Qs, and proxy statements.

5 Q. What was the name of that company?

6 A. Precision Standard, Incorporated.

7 Q. Do you remember what its
8 capitalization was?

9 A. I do not. It was substantially
10 smaller than Entergy.

11 Q. Entergy Corporation or Entergy New
12 Orleans?

13 A. Both.

14 Q. Do you agree Moody's is a reputable
15 credit rating agency?

16 A. I do.

17 Q. Do you agree that its services are
18 widely used by electric utilities?

19 A. I agree they're widely used. I
20 haven't surveyed utilities specifically, but I
21 would be fairly confident that it's used in all
22 sectors.

23 Q. Are you aware of any information
24 that cast doubt on the independence of Moody's
25 in terms of giving credit ratings?

1 A. No.

2 Q. Or anything that cast doubt on its
3 qualifications to give credit ratings?

4 A. Neither Moody's nor S&P.

5 Q. Have you heard of the Security
6 Exchange Commission Office of Credit Ratings?

7 A. I am not familiar.

8 Q. So you don't know whether they're in
9 charge of overseeing credit rating agencies
10 such as Moody's?

11 A. The name suggests they might be.

12 Q. But you don't know anything about
13 that office?

14 A. I know that there are registered
15 ratings agencies, a large handful of them, and
16 that, I guess, is the extent of my familiarity
17 with that function.

18 Q. Do you know if Moody's is such a
19 registered rating agency?

20 A. I would assume that both Moody's and
21 S&P have all the registrations and
22 qualifications for this kind of work.

23 Q. Do you agree Moody's credit rating
24 is market data that equity investors would look
25 at potentially in terms of considering

1 investment in ENO?

2 A. One component.

3 Q. Do you agree a rational equity
4 investor could conclude that ENO's Ba rating
5 for Moody's would be a reason to expect a high
6 record of return relative to investment grade
7 peers?

8 A. No, I don't necessarily agree with
9 that. It's a split rating and there are many
10 other factors that a rational investor would
11 consider. And when you have a split rating, I
12 think that a rational investor, when
13 considering all the other favorable aspects of
14 ENO, would tend to give that reduced weighting.

15 Q. Would it be unreasonable for an
16 equity investor to consider that Ba, Moody's
17 credit rating, as a reason to expect a higher
18 return?

19 A. No, I just don't think so because,
20 again, there's so many factors and you have a
21 split rating between two highly regarded
22 organizations and there's so many other
23 important considerations for an equity investor
24 that, no, I don't think that that would have a
25 meaningful impact.

1 Q. So do you think it would have no
2 impact on an equity investor then in terms of
3 evaluating an investment in a company like ENO
4 or ENO?

5 A. If there is an impact, I don't
6 believe it could be identified because there
7 are so many other considerations involved.

8 Q. Now, both Moody's and S&P in their
9 credit rating agency reports discuss ENO's
10 business risks; correct?

11 A. I think so, yes.

12 Q. And would you agree that Moody's and
13 S&P agree on ENO's fundamental business risks?

14 A. I do not have recollection to say
15 whether they are in complete agreement, but my
16 recollection is generally yes.

17 Q. I'm not going to make this an
18 exhibit because it's under the -- I think it's
19 proprietary, it's highly sensitive. So I'm
20 going to hand it to you so you can take a look
21 at it. This is the S&P ratings, direct rating
22 of Entergy New Orleans included as an exhibit
23 to direct testimony of Entergy New Orleans
24 witness Joshua Thomas.

25 Take a look at page 2. There in the

1 middle of the page, it addresses the business
2 risks; correct?

3 A. Yes.

4 Q. The second bowl references a small
5 service territory and the susceptibility to
6 weather-related disasters; correct?

7 A. Correct.

8 Q. And the smaller customer is another
9 business risk, smaller customer size utility?

10 A. Relatively smaller customer size
11 utility.

12 Q. And also limited regulatory business
13 diversity? Do you see that?

14 A. I do.

15 Q. I'm going to do the same thing,
16 Mr. Watson. I'm going to take a look at the
17 Moody's rating report that's attached to
18 Mr. Thomas's testimony.

19 If you look at the first page there,
20 Credit challenges include small and
21 concentrated service territory; correct? (As
22 read.)

23 A. Yes.

24 Q. Vulnerable to extreme weather
25 events? (As read.)

1 A. Yes.

2 Q. So this confirms, doesn't it, that
3 the business risks Moody's and S&P are talking
4 about are congruent, so to speak?

5 A. As I've said in testimony and here,
6 it's the relative weighting that Moody's gave
7 those concerns.

8 Q. Now, are you familiar with S&P's
9 standalone credit profile?

10 A. I'm generally familiar with it.

11 Q. Is it correct that in terms of what
12 S&P is talking about, a standalone credit
13 profile means an issuer's creditworthiness in
14 absence of extraordinary intervention from its
15 parent or affiliate?

16 A. I'll accept that.

17 Q. What is S&P's standalone credit
18 profile for ENO?

19 A. I don't know.

20 Q. Go back to that S&P global ratings
21 document. Go to page 6. Do you see at the top
22 where it mentions standalone credit profile?

23 A. Yes.

24 Q. What is that?

25 A. Triple B minus.

1 Q. That indicates, does it not, that
2 S&P's standalone credit profile absent
3 consideration and support from its parent for
4 ENO is triple B minus; right?

5 A. Yes.

6 Q. Were you aware of that when you
7 prepared this surrebuttal testimony?

8 A. Yes.

9 Q. So in terms of standalone
10 operations, Moody's is at Ba, which the highest
11 non-investment grade level Moody's has;
12 correct?

13 A. Correct.

14 Q. And the standalone for S&P is triple
15 B minus, which is the lowest investment grade;
16 correct?

17 A. I believe -- I'm not sure if that's
18 the case. I'll accept your statement, but I
19 haven't reviewed the chart of relative ratings
20 today.

21 Q. Fair enough. We'll assume that
22 they're essentially side by side, one being the
23 lowest investment grade, the other being the
24 highest non-investment grade; correct?

25 A. Okay.

1 Q. What was the approach you used to
2 find the credit ratings you looked at in your
3 proxy group? How was that set up?

4 A. In my analysis for proxy groups,
5 amongst the many screens, the credit rating
6 screen was one notch higher or lower than ENO's
7 triple B plus S&P rating. So either triple B,
8 triple B plus, or triple A minus.

9 Q. So if you use Moody's rating, could
10 you create a proxy group based on that
11 approach?

12 A. It would have been very small. It
13 would not have -- probably would not have made
14 a lot of sense because my recollection is there
15 was a small handful of companies in that range.

16 Q. And if you used a S&P standalone
17 credit rating as the center point of your proxy
18 group, would that have made a legitimate proxy
19 group?

20 A. I'm not sure. It might have.

21 Q. Let me ask you this. Do you know
22 how many -- Let me stop there.

23 Why do you say it might have if
24 you're not sure?

25 A. Simply because there are more

1 companies in the plus or minus one notch range
2 of triple B minus than I think -- I think there
3 are a handful of companies that have triple B
4 ratings, if I recall from my exhibit.

5 Q. Well, speaking of S&P, this
6 triple B. How many, I guess, double B rated
7 electric utilities are there that S&P rates?

8 A. I don't know.

9 Q. Are there any?

10 A. There -- I don't know.

11 Q. So you don't know as we sit here
12 whether you could include in your proxy group
13 any utilities below investment grade if you
14 took that approach?

15 A. Can you repeat the question, please?

16 Q. Based on your knowledge, if your
17 objective was to include the highest
18 non-investment grade utility in your proxy
19 group as one notch below the triple B minus,
20 that's the middle under this hypothetical
21 scenario, could you actually include any
22 appreciable number of utilities in the group?

23 A. No.

24 Q. And would that be the same if you
25 used the Ba rating from Moody's as the midpoint

1 of your proxy group range?

2 A. That would be the same.

3 Q. How many IOUs are rated
4 non-investment grade by Moody's? Do you know?
5 I'm sorry. Let me say it again. How many
6 electric IOUs?

7 A. It would appear by observing my
8 Exhibit BSW-8 that it would be perhaps roughly
9 five.

10 Q. Where are you getting that from in
11 Exhibit BSW-8?

12 A. Page 5 of 9. Maybe six.

13 Q. Which ones are you referring to?

14 A. Let me -- Yeah. Let's go through
15 it. So it would appear -- Well, we've
16 stipulated that triple B minus is investment
17 grade --

18 Q. Correct.

19 A. -- so Hawaiian would be okay. PG&E,
20 which is a special case. They're in default
21 due to liabilities. And then Summer Electric,
22 again, I believe they're exposed to
23 construction of a failing nuclear facility.
24 Oh, MGE Energy and Wilmington Capital may be --
25 That may be the complete list of non-investment

1 grade companies.

2 Q. Okay. I couldn't quite follow you.
3 Those are all -- They have a listing of null,
4 N-U-L-L?

5 A. Well, and then also PG&E is rated as
6 D for default.

7 Q. So state those one more time so I
8 can find -- I'm having a little -- so I can
9 follow you better hopefully.

10 A. To the extent a null indicates
11 failure to achieve an investment grade rating
12 -- It could also mean they don't have any debt
13 outstanding, but assuming that's improbable,
14 MGE Energy, PGE Corp, Summer, and Wilmington.

15 Q. So there's four of them; right?

16 A. Okay. Four.

17 Q. How about on the S&P side?

18 A. That was S&P.

19 Q. Moody's, is it the same?

20 A. Well, I believe it's generally
21 understood that S&P is the most broadly used
22 ratings agency. So when Moody's has a null
23 rating, for example, for CMS Energy, I don't
24 believe that means it's not investment grade,
25 or DTE, that just means they don't -- they're

1 not under contract with that corporation. I
2 believe it's reliably so that almost everyone
3 uses S&P as one of their ratings, you know, in
4 major corporations.

5 Q. So you're telling me you're not sure
6 which of the non-investment grade utilities --

7 A. What I'm saying is if, for example,
8 Evergy, which is rated A minus by S&P and a
9 null by Moody's, I don't believe Moody's has
10 found it to be non-investment grade. Whereas,
11 MGE Energy, for example, I think Moody's would
12 agree that it's not investment grade or doesn't
13 have investment grade debt. And then, you
14 know, Hawaiian Electric, I don't know if it can
15 be known, for example.

16 So because Moody's isn't used quite
17 as much, although it is popularly used, as S&P,
18 I'm not sure that this table is going to allow
19 me to answer your question.

20 Q. All right. I see what you're
21 saying.

22 Is it correct then that for MG&E,
23 both S&P and Moody's agree that entity is
24 non-investment grade?

25 A. That it does not have investment

1 grade debt.

2 Q. And for PG&E Corp, is there
3 agreement there?

4 A. I'm fairly certain they would agree
5 that PG&E is not investment grade.

6 Q. Summer Energy, is there agreement
7 there?

8 A. I would expect there would be again
9 because of the nuclear facility.

10 Q. And Wilmington, would there also be
11 agreement there between the two rating agencies
12 that they're not investment grade?

13 A. That they don't have investment
14 grade debt, yes.

15 Q. In your experience, Mr. Watson,
16 assuming all else equal among companies, would
17 a below investment grade rating limit the pool
18 of potential investors for a company such as
19 ENO?

20 A. Noting that that's not what we have
21 here, we have a split rating, but if you had
22 two firms that both said ENO was below
23 investment grade, yes, it would.

24 Q. So is your experience that there
25 must be two rating agency firms that rate the

1 firm below investment grade before it limits
2 people's ability to invest in it?

3 A. I'm not certain of that. I know
4 that certain investment types -- investor
5 types, rather, have funds available to them
6 that must be invested in certain bond ratings.
7 They have an amount for bonds and it must go to
8 a minimum rating and I know that split ratings
9 allow some leeway.

10 Q. All right. So it may be, in fact,
11 the case that a single non-investment grade
12 rating could limit investors from investing in
13 a company such as ENO; is that right?

14 A. I don't know. The evidence would
15 suggest not because I believe ENO has been
16 successfully securing what I believe to be
17 market rate bonds regularly over the past
18 couple of years.

19 Q. I'm going to hand you a couple of
20 pages from --

21 MR. WILLIAMS:

22 You can make this Exhibit 1.

23 EXAMINATION BY MR. WILLIAMS:

24 Q. Exhibit 1 is two pages from
25 Entergy's Form 10-K reporting the fiscal year

1 ending December 31, 2017. Can you accept that
2 subject to check?

3 A. Yes.

4 Q. Take a look at the second page.

5 A. Okay.

6 Q. You see the last paragraph of that
7 page? That's page 288; correct?

8 A. Yes.

9 Q. And you see there in the first
10 sentence of that paragraph, Factors that rating
11 agencies evaluate to arrive at credit ratings
12 for Entergy and its subsidiaries? (As read.)

13 A. I do.

14 Q. Would you agree the factors the
15 company lists in the 10-K, regulatory
16 framework, ability to recover costs and
17 returns, diversification, financial strength,
18 liquidity, those are factors evaluated in the
19 Moody's report?

20 A. I think those are factors evaluated
21 in a credit ratings evaluation, yes.

22 Q. And do you agree that in that same
23 paragraph, Entergy discloses that any operating
24 company within its family falling below
25 investment grade likely would limit the

1 potential pool of investors and funding
2 sources? (As read.)

3 MR. BEATMANN:

4 Are you asking whether he agrees
5 that this sentence says that?

6 MR. WILLIAMS:

7 No. I'm saying -- Yeah. I'm
8 agreeing that the company is making that
9 representation. Let's make it clear.

10 THE WITNESS:

11 And I've reviewed the sentence.
12 What is the question again, please?

13 EXAMINATION BY MR. WILLIAMS:

14 Q. I just want you to confirm Entergy
15 is representing that falling below investment
16 grade, an OPCO of its -- within its family,
17 that event would limit the potential pool of
18 investors and funding sources?

19 A. Well, let me just -- Specifically
20 what I think I'm reading here is that Entergy
21 is representing that a downgrade from the point
22 at which this was written could do that.

23 Q. Let me ask it this way. Do you
24 believe or do you disagree that falling below
25 investment grade likely would limit the

1 potential pool of investors and funding sources
2 for a company such as ENO?

3 A. If both Moody's and S&P both held
4 that opinion, I think yes.

5 Q. All right. And if only Moody's held
6 that opinion, what would be your response?

7 A. I think the evidence suggests that
8 it does not materially harm ENO because they
9 are securing debt capital on a regular basis at
10 market rates.

11 Q. Could you give me an example of what
12 you're talking about in terms of debt capital
13 that was securing market rates?

14 A. It has been entered into evidence in
15 this -- in discovery anyway -- in this
16 proceeding, ENO's capitalization, recent
17 capitalization and capitalization plans, as a
18 matter of fact, in my -- My recollection is
19 that sometime around September 2018 a sizeable
20 first mortgage bond was issued by ENO at what
21 appeared to me to be an investment grade coupon
22 and yield to maturity.

23 Q. A first mortgage bond is secured
24 debt; correct?

25 A. Well, it's not secured to a specific

1 item. It's a mortgage on all of the
2 corporation as I understand it.

3 Q. Yeah. It's secured to all the
4 property and assets of the corporation;
5 correct?

6 A. Correct.

7 Q. And are you aware whether ENO has
8 a -- issued unsecured debt?

9 A. I'm not aware of any substantial
10 outstanding unsecured debt balance. I do know
11 they have a revolver available to them, but I
12 don't believe they've drawn on it and I
13 actually don't know whether it's secured.

14 Q. Equity investment also is unsecured
15 by collateral; correct?

16 A. That's correct. It's not commonly
17 referred to as debt.

18 Q. Do you know if there are firms that
19 declined to purchase debt from ENO based on its
20 non-investment grade status?

21 A. I'm not aware of the decision making
22 of anybody with regard to the purchase or non
23 purchase of ENO debt or securities.

24 Q. Okay. Let me go back to the
25 statement in the 10-K that we were discussing

1 in Exhibit 1. Okay?

2 A. Okay.

3 Q. I had asked you if you had disagreed
4 that Moody's rating the company below
5 investment grade would limit the potential pool
6 of investors and you said no because -- and you
7 gave me the reason that the company had issued
8 secured debt; right?

9 A. I suppose so.

10 Q. Can you give me any other reasons
11 why you disagree that Moody's below investment
12 grade issued rating would not limit the pool of
13 investors and funding sources for ENO?

14 A. No. My observation is merely that
15 ENO is securing capital at market rates.

16 MR. BEATMANN:

17 John, let me check this.

18 MR. WILLIAMS:

19 Let's take a quick break.

20 (Whereupon a discussion was held off
21 the record.)

22 EXAMINATION BY MR. WILLIAMS:

23 Q. Mr. Watson, in your opinion, if the
24 pool of investors like we've been discussing
25 was decreased, what would happen to the cost of

1 capital?

2 A. It could increase somewhat.

3 Q. Go to page 22 of your surrebuttal
4 testimony.

5 A. Okay. I am there.

6 Q. And there at 22, line 1, you say, In
7 my opinion, Moody's gave undo weight to ENO's
8 geography and size. (As read.)

9 Do you see that?

10 A. I do.

11 Q. Can you explain in more detail what
12 you mean by that statement?

13 A. Well, carrying back to page 21, that
14 statement was specific to ENO's securitization
15 bond issuance. A securitization bond is
16 protected from the influences of bankruptcy,
17 the sale of ENO, a great many things. It's
18 essentially the -- secured by the asset of all,
19 in this case, electric sales in New Orleans
20 until such time as it's paid off. And,
21 therefore, geography and size could temporarily
22 hinder under the most extreme Katrina-like
23 circumstances the recovery of that bond, but it
24 would be very unlikely, short of some kind of
25 apocalypse, to prevent the full payment with

1 interest of a securitization bond such as this
2 particular one. And that is the reason why I
3 believe that Moody's giving that bond a
4 non-triple A rating unlike, to my knowledge,
5 every other securitization bond ever issued was
6 undue.

7 Q. So that statement about undue
8 weight, that does not go to -- more generally
9 to Moody's Ba rating, issuer rating?

10 A. Only to the extent that it is a
11 window into the mind-set of Moody's. The
12 point, I guess, is that Moody's and S&P
13 disagree or do not have the same opinion of
14 ENO. And I think that Moody's treatment of the
15 ENO securitization bond, which, like I said,
16 gave undue weight to geography and size, is of
17 some probative value.

18 Q. Well, do you agree that ENO's
19 geography and size could support a conclusion
20 that its electric system is subject to
21 catastrophic damage or destruction by a single
22 hurricane?

23 A. Obviously, yes.

24 Q. And do you think it would be
25 irrational for a credit rating professional

1 issuing a credit opinion to give substantial
2 weight to that circumstance?

3 A. My complaint was undue weight, but I
4 do think it should be given some consideration,
5 yes.

6 Q. So you would agree it's not
7 irrational for a credit rating agency person to
8 give substantial weight to that circumstance?

9 A. It's rational to give weight to that
10 while also considering any number of other
11 factors, such as the pre-funded storm reserve,
12 the Council's longstanding historical practice
13 of granting ENO recovery of storm-related
14 costs, and the general resilience of the city
15 following a very, very severe adverse event
16 like Katrina.

17 Q. And is it unreasonable for a credit
18 rating professional creating a report like such
19 as Moody's to conclude that ENO is at risk for
20 the same type of damage it suffered during
21 Hurricane Katrina and Rita?

22 A. I think that a credit rating agency
23 should take note of what I believe are
24 understood improvements to the storm hardening
25 of New Orleans from a flooding style event.

1 Q. In fact, Moody's did take note of
2 that, didn't it?

3 A. Can you point me to where?

4 Q. Page 5 of the Moody's report.

5 A. Yes.

6 Q. So despite taking note of that
7 point, Moody's still gave substantial weight to
8 the ongoing risk of catastrophic storm damage;
9 right?

10 A. Unlike S&P, which managed to give
11 ENO a triple B plus rating.

12 Q. So as far as Moody's is concerned,
13 the answer is yes; correct?

14 A. I suppose so.

15 Q. At the top of page 22, you reference
16 Moody's being ENO's, quote, contractor, close
17 quote. Do you see that?

18 A. I do.

19 Q. So what are you suggesting there?

20 A. What I'm suggesting is that -- Well,
21 my statement speaks for itself. I have some
22 concerns about relying upon Moody's to justify
23 higher ROE when an equally qualified outfit
24 also contracted by ENO doesn't have nearly that
25 level of concern.

1 Q. So what's the difference between S&P
2 being ENO's contractor and Moody's being ENO's
3 contractor?

4 A. In what regard? They are both
5 contractors for this service amongst many that
6 are qualified to perform the service.

7 Q. So the fact that Moody's is a
8 contractor in and of itself, doesn't raise any
9 concern for you; is that right?

10 A. It's my understanding ENO needs to
11 contract with two, minimum two such firms.

12 Q. You mentioned that, again on
13 page 22, ENO should not tout the negative
14 opinions of its contractor. (As read.)

15 Do you see that?

16 A. Yes.

17 Q. Are you touting the opinions of S&P
18 in support of your recommendation?

19 A. I did rely upon S&P, but I'm not
20 touting them.

21 Q. So what's the difference between
22 your reliance and ENO's reliance on Moody's?

23 A. Well, to my knowledge, everybody
24 that performed a credit rating screen in this
25 docket, in this proceeding, used the S&P

1 because the Moody's data is difficult to use.
2 So I merely think that the Moody's split rating
3 is not something to be held up as a reason to
4 boost ENO's ROE.

5 Q. Are you saying Moody's is not
6 sufficiently independent of ENO?

7 A. Oh, no.

8 Q. You're not saying that Moody's
9 opinions are controlled by ENO; correct?

10 A. I have no knowledge of that.

11 Q. And you're not saying that ENO
12 somehow influenced Moody's opinion in some
13 inappropriate manner, are you?

14 A. I suspect that ENO makes the
15 strongest case it can ethically that its credit
16 rating should be as high as reasonably
17 practicable.

18 Q. Why do you say Moody's information
19 is difficult to use?

20 A. We discussed this. There are not
21 enough proxy companies to compare using Moody's
22 scale versus S&P.

23 Q. Any other reason?

24 A. No. That would be it.

25 Q. Are you aware of other witnesses in

1 this case that found Moody's difficult to use
2 in terms of financial ROE analysis?

3 A. I don't recall anybody specifically
4 saying, "I can't use Moody's," but I believe
5 every witness that used a credit rating screen
6 used S&P data.

7 Q. I think in your testimony, you
8 expressed some concern over the continued use
9 of Moody's; is that right?

10 A. Can you point me to the particular
11 statement?

12 Q. At the top of page 22, line 3.

13 A. Yes, I did say that.

14 Q. So are you suggesting that ENO
15 should find some other firm to be its credit
16 rating agency?

17 A. If an independent credit rating firm
18 of high regard could have more concurrence with
19 S&P, which is arguably the most highly regarded
20 credit organization, I think it would be
21 beneficial to consider using them in the
22 future, yes.

23 Q. So basically your concern is based
24 on the outcome of the rating that they
25 provided, the result?

1 A. My concern is based on the disparity
2 between Moody's rating and the rating of the
3 highly regarded independent firm, S&P.

4 Q. Well, do you find the triple B minus
5 standalone credit profile of S&P and the Ba
6 rating of Moody's, is that disparity a matter
7 of concern?

8 A. Well, I didn't utilize the
9 standalone rating as the basis for my analysis
10 because ENO is part of the Entergy system.

11 Q. So it was not your objective to get
12 at the cost of equity for ENO on a standalone
13 basis?

14 A. Yes.

15 Q. All right. What other rating agency
16 firms do you think that ENO would -- should
17 consider?

18 A. I don't want to tell ENO how to run
19 its business. It's not my job or my intent.

20 Q. Are there other firms that you
21 believe are more qualified than Moody's?

22 A. More qualified?

23 Q. Yes, sir.

24 A. I'm not sure that more qualified is
25 something I can quantify. There are other

1 qualified firms.

2 Q. Are there other firms that rate as
3 many electric utilities as Moody's that are
4 available?

5 A. Other than S&P, I doubt it.

6 Q. Can you go to page 7 of your
7 testimony?

8 A. I'm sorry. Seven or 70?

9 Q. Seven. This is where you begin to
10 talk about capital structure; correct?

11 A. Yes.

12 Q. And you have a set of companies that
13 form your proxy group; correct?

14 A. Correct.

15 Q. Do any of the companies for your
16 proxy group have a -- Let me restate that.

17 Do any of the operating companies
18 within the various utilities that form your
19 proxy group, do they have a capital structure
20 that tracks the capital structure of the parent
21 company?

22 A. I'm not -- I have not reviewed the
23 parent company under the proxy companies to be
24 able to answer that.

25 Q. What sort of evaluation have you

1 done of capital structures of the proxy group
2 or their operating companies?

3 A. I have observed the capital
4 structure of the holding companies as part of
5 general data, but I didn't tabulate it for my
6 testimony.

7 Q. Okay. And did you make any analysis
8 of the operating companies' capital structure,
9 the companies that are owned by the companies
10 in your proxy group?

11 A. No.

12 Q. Have you made an evaluation of the
13 capital structure benchmarks employed by rating
14 agencies in connection with the preparation of
15 your testimony?

16 A. I'm generally aware that they
17 evaluate equity ratios, but I haven't set to
18 memory the standards at which they might
19 influence a notch change in rating. I know
20 they exist.

21 Q. Did you look at -- Okay. So you did
22 not look at either S&P or Moody's benchmarks
23 for debt-to-capital ratios?

24 A. Again, like I said, I have reviewed
25 them, but not specific to this testimony.

1 Q. So you don't know where ENO's
2 proposed capital structure falls in those
3 benchmarks?

4 A. No.

5 Q. Are you claiming that any of ENO's
6 financing activities during period one or
7 period two test years have been imprudent?

8 A. No.

9 Q. Are you familiar with the Louisiana
10 Supreme Court's holding on the use of actual
11 capital structure in setting utility rates?

12 MR. BEATMANN:

13 I'm going to object to the extent
14 that it calls for a legal conclusion.

15 Subject to that, you can answer if
16 you have an understanding.

17 THE WITNESS:

18 I know it was cited in rejoinder
19 testimony.

20 EXAMINATION BY MR. WILLIAMS:

21 Q. Are you aware of what the holding
22 is?

23 A. I believe that the holding is that
24 unless the capital structure is unreasonable,
25 that the general direction, indication,

1 whatever is to go with the actual structure.

2 Q. Understanding you're not a lawyer,
3 is that the reason you didn't address that in
4 your testimony?

5 A. My surrebuttal, I believe I did. I
6 recommended the Council find ENO's capital
7 structure to be unreasonable.

8 Q. Do you conclude or do you assert
9 that ENO's capital structure is the product of
10 unreasonable or imprudent investment?

11 A. Investment?

12 Q. Yes, sir.

13 A. Not necessarily, no. I don't assert
14 their capital structure is the result of any
15 particular investment activity.

16 Q. Well, I mean, you said not
17 necessarily. So are you saying it could be the
18 product of some unreasonable or imprudent
19 investment?

20 A. What I believe is that ENO's capital
21 structure is the result of a plan that has been
22 executed and there are many components that can
23 allow you to achieve a 52.2 percent equity
24 ratio and no single action is necessarily
25 unreasonable or imprudent. My only point

1 throughout my testimonies has been that the end
2 result is unreasonable.

3 Q. I just want to make sure I
4 understand. So you have not identified any
5 particular action, investment that you found
6 unreasonable or imprudent that adds up to that
7 capital structure; correct?

8 A. Yes.

9 Q. What is your past experience,
10 Mr. Watson, testifying on capital structure in
11 this rate setting context we're here on?

12 A. I believe I testified in the Union
13 Power block proceeding that the 50 percent
14 equity ratio cap was reasonable.

15 Q. Have you ever testified to the
16 effect that utilities' equity ratio should be
17 reduced because of concerns about the parent's
18 capital structure?

19 MR. BEATMANN:

20 I'm going to object. It seems like
21 we're starting to plow old ground. If
22 there's something in his surrebuttal that
23 you want to talk about, then I'd ask that
24 we stay focused on that, but all these
25 questions were answered the first

1 go-round.

2 MR. WILLIAMS:

3 Well, that's fine. He's talking in
4 general about capital structure and
5 double leverage. You know, it's got the
6 same topics as we talked about.

7 MR. BEATMANN:

8 We went over that for four plus
9 hours.

10 MR. WILLIAMS:

11 Okay.

12 EXAMINATION BY MR. WILLIAMS:

13 Q. What is the standard you used to
14 determine what a reasonable equity ratio is?

15 A. I recommended the Council find
16 52.2 percent at this time to be unreasonable
17 and, therefore, I didn't put forth an explicit
18 standard for what is reasonable.

19 Q. So why do you conclude that
20 50 percent is reasonable and 52 percent is not?

21 A. Well, as I discuss in my
22 surrebuttal, ENO proposed and the Council
23 accepted 50 percent equity ratio related to
24 Union Power Block 1, which is a sizeable
25 portion -- 20 percent, I don't know -- of ENO's

1 rate base.

2 Q. And so that is the basis for your
3 conclusion that 50 percent is an appropriate
4 outcome?

5 A. No. That is a component of
6 consideration. Another component of
7 consideration is the average equity ratio of
8 the operating companies.

9 Q. Do you understand the concept of
10 financial risk?

11 A. Yes.

12 Q. What is that?

13 A. Financial risk is the risk to the
14 organization's ability to fulfill all its
15 obligations related to its financing and
16 capital structure.

17 Q. Is it right that the higher the
18 amount of debt you have in your capital
19 structure, the greater financial risk, all else
20 equal?

21 A. Yes, but I don't believe it's a
22 linear function.

23 Q. When you have high -- include higher
24 levels of debt in capital structure, can that
25 be associated with increasing cost of capital?

1 A. Again, I don't believe it's a linear
2 function, but eventually, yes.

3 Q. Relatively higher amounts of debt in
4 the capital structure, is that a rating agency
5 negative?

6 A. At some point, yes.

7 Q. Are you recommending that ENO manage
8 its finances to increase its debt and reduce
9 equity?

10 A. I'm not recommending anything with
11 regard to how ENO should run its business. I'm
12 making recommendations regarding ratemaking.

13 Q. So you don't have an opinion on
14 whether ENO's actual financial management
15 should follow your ratemaking recommendations?

16 A. ENO is free to manage any capital
17 structure within some reason. I believe that
18 rates should be set according to my
19 recommendations to the Council.

20 Q. So that wasn't exactly my question.
21 My question was do you have an opinion as to
22 whether ENO should manage its finances to match
23 your ratemaking?

24 MR. BEATMANN:

25 I'm going to object to the extent

1 that he doesn't talk about this in his
2 surrebuttal.

3 But if you have an opinion, you can
4 answer.

5 THE WITNESS:

6 I don't. However, it's my opinion
7 that a 50 percent equity ratio has in the
8 past been demonstrated to not harm ENO
9 because they've maintained an equity
10 ratio below 50 percent in prior years,
11 and, therefore, should ENO chose to do
12 that, if the incentive to have a high
13 equity ratio were limited, I think that
14 history demonstrates that it would not be
15 harmful to ENO.

16 EXAMINATION BY MR. WILLIAMS:

17 Q. So should ratemaking treatment
18 deviate from actual financial management?

19 A. To the extent the actual management
20 is unreasonable or the results of it is.

21 Q. Pages 8 and 9 of your surrebuttal,
22 you talk about double leverage.

23 A. Yes.

24 Q. Page 9, line 5, you say, Entergy
25 Corp's 34.1 percent equity ratio might not be

1 prudent for ENO's circumstances. (As read.)

2 Do you see that?

3 A. I do.

4 Q. Can you describe for me any
5 circumstances in which a 34.1 percent equity
6 ratio would be prudent for a utility in ENO's
7 circumstances?

8 A. If in some market, which might be
9 improbable, a 34.1 percent equity ratio was not
10 regarded excessively negatively by the
11 investment community, then that would be --
12 that would be appropriate.

13 Q. Can you describe in any current
14 circumstances whether a 34.1 percent equity
15 ratio might be prudent?

16 A. In the current market for first
17 mortgage utility bonds, I don't believe that
18 that would be.

19 Q. What about for just general
20 financial management purposes? Would a
21 34 percent equity ratio ever be appropriate for
22 ENO in the current financial circumstances?

23 A. Ever?

24 Q. Under current market circumstances?

25 A. In the current market, I could not

1 foresee a 34.1 percent equity ratio being
2 appropriate for ENO.

3 Q. As you sit here today, are you
4 contending that what is happening here is that
5 Entergy is effectively borrowing at the top
6 corporate level and placing that money into ENO
7 as common equity providing a return which is
8 greater than the original borrowed cost?

9 A. Well, I believe that you are either
10 quoting or paraphrasing my direct testimony and
11 I think the key word, as I clarified in
12 discovery, is effectively. I'm not suggesting
13 that's what ENO did. I'm saying the effect is
14 as if they had done that.

15 Q. So does that opinion apply to the
16 extent ENO's equity comes from its own retained
17 earnings?

18 A. Yes.

19 Q. Why is that?

20 A. Because, again, the overall treasury
21 management of a corporation, and as it's been
22 discussed by other witnesses, cash is fungible
23 and, therefore, the decision to reduce
24 dividends rather than issue a bond yields the
25 same amount of cash available to fulfill the

1 organization's capital needs.

2 Q. Does your opinion still hold to the
3 extent debt at the parent level is non-recourse
4 project debt?

5 A. Debt of the parent company is
6 non-recourse?

7 Q. Project debt?

8 A. I suppose in general, yes, my
9 opinion does stand.

10 Q. Why would that be -- create double
11 leverage?

12 A. Because, again, it's the cash is
13 fungible argument. If you have project debt
14 for a merchant nuclear facility, for example,
15 there is still the ability to transfer funds up
16 and down the corporate scale through capital
17 planning.

18 Q. Isn't it correct that non-recourse
19 project debt is associated with a specific
20 project?

21 A. Yes, but that doesn't mean that the
22 cash required by the corporate treasury can't
23 come from multiple sources.

24 Q. But the debt cannot be used for any
25 other purpose; correct?

1 A. Yes, but that, nonetheless, is debt
2 that won't be required from some other source.

3 Q. But if that debt is part of the
4 capital structure, it has a particular cost of
5 debt at the operating company and at the parent
6 company, does it not?

7 A. I'm sure.

8 Q. Would that not mean there is not a
9 difference in what the parent company is
10 borrowing at and what the operating company
11 is -- its cost of funds on that debt?

12 A. Yes, but when you borrow for that
13 project on a project-specific basis, all your
14 other corporate cash flow sources are available
15 for the other purposes of the corporation.
16 It's the -- The point is cash is fungible.

17 Q. So is any difference between the
18 parent company and the operating company equity
19 ratio double leverage?

20 A. I'm sorry. One more time, please.

21 Q. Is any difference between the parent
22 company and the operating company equity ratio
23 double leverage?

24 A. Well, as I said in my testimony, I
25 think that there's some valid consideration of

1 Entergy Wholesale Commodities, EWC, and that is
2 part of the reason why I didn't recommend
3 levelizing everything.

4 Q. So you're saying not any difference
5 between the parent and the operating company
6 equity ratio is double leverage?

7 A. I think in my testimony, I said an
8 unreasonable difference and I specifically
9 discussed EWC and did not recommend some kind
10 of a lower level of equity to reflect the
11 complete corporation.

12 Q. All right. So how do you calculate
13 or determine what's an unreasonable difference
14 between the parent and the operating company
15 equity ratio?

16 A. I don't know that it can be
17 calculated, but in my testimony, I just
18 observed that market difference between Entergy
19 Corp and all of the EOCs, and I observed the
20 average of the EOCs, and that was the basis of
21 my recommendation the Council find a 52.2
22 percent equity ratio unreasonable.

23 Q. Is there a point at which the
24 difference between the parent and the operating
25 company equity ratio is shrunk to where double

1 leverage is no longer a concern?

2 A. Probably.

3 Q. Do you know what that would be?

4 A. I haven't quantified it.

5 Q. Can you point me to any financial
6 literature that states return on investment
7 depends on the source of funds used to finance
8 the investment?

9 A. No.

10 Q. Last question on double leverage.
11 Page 13 of your testimony, line 5 and 6, you
12 say, My observations and recommendations to the
13 Council because my testimony explored the
14 capital structure of the EOCs who all share
15 many risk characteristics. (As read.)

16 What are the many risk
17 characteristics that ENO shares with the other
18 Entergy operating companies?

19 A. In my opinion, the most important
20 one is that they are regulated monopolies that
21 are allowed to have the reasonable opportunity
22 to recover all of their costs plus a reasonable
23 return. They are all within a common
24 geography. Adjustments were made to our
25 calculated ROE to reflect geography of ENO.

1 And I suppose the other risk characteristic
2 they share is that they are all part of the
3 Entergy Corporation umbrella.

4 Q. Do all the Entergy operating
5 companies share ENO's small size risk?

6 A. No. As I said, size and geography
7 is something that Advisor Witness Proctor
8 addressed in his ROE testimony.

9 Q. They don't share customer
10 concentration risk, the Entergy operating
11 companies, other than ENO; correct?

12 A. I don't know.

13 Q. They don't all share catastrophic
14 storm risk to the same degree as Entergy New
15 Orleans; correct?

16 A. Like I said, when I mentioned
17 geography, that's what I meant.

18 Q. That they don't share that risk?

19 A. Yes. When I said that Advisor
20 Witness Proctor addressed geography and size in
21 his ROE recommendation testimony, by geography,
22 I meant storm risk.

23 Q. You said earlier, just a minute ago,
24 that the Entergy operating companies shared
25 common geography. What did you mean by that?

1 A. That they're all in the south.

2 Q. So you think Entergy Arkansas's
3 geography is common to -- in common with
4 Entergy New Orleans?

5 A. To some extent, I think that the
6 weather patterns and load peaks probably have
7 some similarities compared to, say, Florida,
8 which might have a reversed load peak.

9 Q. So you think all the Entergy
10 operating companies share common load peaks?

11 A. I don't know.

12 Q. Other than being in the south, is
13 there anything other to link these companies as
14 having common geography?

15 A. No.

16 Q. Go to page 18. Do you see Table 1
17 there, Mr. Watson?

18 A. I do.

19 Q. Are any of the other parties'
20 recommended ROE's adjusted for business risk
21 like you and Mr. Proctor's recommendation?

22 A. I'm not sure that I recall that they
23 did. I don't recall that they did.

24 Q. To the extent they're not adjusted
25 for business risk, isn't the apples-to-apples

1 comparison their recommendations to your
2 8.09 percent unadjusted DCF?

3 A. I'm not sure that I agree with that,
4 no.

5 Q. Go ahead and explain why you
6 disagree.

7 A. I don't agree because their
8 recommendation and our recommendation are both
9 based upon our respective evaluations of all
10 the relevant information. And so when they
11 perform their analysis, I'm certain that they
12 could have felt that it was appropriate to make
13 a risk adjustment to properly reflect ENO's
14 capital requirement.

15 Q. Can you point me to any statement of
16 any other witnesses indicating they made a risk
17 adjustment?

18 A. Well, no, but that is their
19 recommendation that they believe will allow ENO
20 a fair return.

21 Q. So in the case of each of these
22 other witnesses besides the advisors, their
23 recommended ROE is the product of their models,
24 the range of their models; correct?

25 MR. BEATMANN:

1 I'm going to object to the extent
2 that it calls for speculation. I don't
3 know how this witness can answer what
4 another witness thought or went into his
5 recommendation.

6 But if you know, you can answer.

7 MR. WILLIAMS:

8 Let me clarify. I just mean from
9 reading their testimony. That's all I
10 meant.

11 MR. BEATMANN:

12 That's a perfect clarification.

13 MR. WILLIAMS:

14 All right.

15 THE WITNESS:

16 I don't recall their making
17 adjustments beyond their models.

18 EXAMINATION BY MR. WILLIAMS:

19 Q. And just to make sure I'm clear, if
20 you made no adjustment, your model result would
21 result in 8.09 percent; is that correct?

22 A. No flotation and no risk adjustment,
23 yes.

24 Q. All right. Let's go to page 34.

25 THE WITNESS:

1 Can we pause the recording for a
2 second?

3 MR. BEATMANN:

4 We're going to take a five-minute
5 break on the phone.

6 (Whereupon a recess was taken.)

7 EXAMINATION BY MR. WILLIAMS:

8 Q. Okay. Let's go to page 36.

9 A. Okay.

10 Q. And there you address ENO's claims
11 concerning IRS normalization rules; right?

12 A. Yes.

13 Q. What is the extent of your education
14 and training regarding IRS income tax
15 normalization rules?

16 A. I know they exist. I've read them.
17 However, I --

18 MR. WILLIAMS:

19 Off the record.

20 (Whereupon a discussion was held off
21 the record.)

22 MR. WILLIAMS:

23 Back on the record.

24 EXAMINATION BY MR. WILLIAMS:

25 Q. So I take it other than reading

1 normalization rules, you haven't had any
2 particular education or training regarding
3 them?

4 A. My experience with normalization
5 rules relates to their application in
6 ratemaking.

7 Q. Okay. And is that just based on
8 your on-the-job experience?

9 A. I mean my CFA designation involved
10 training as to the analysis of tax-related
11 matters such as normalization.

12 Q. So you're familiar with income tax
13 normalization requirements then?

14 A. I am familiar. I acknowledge that
15 Rory is an expert in the area.

16 Q. Do you consider yourself an expert
17 in this area?

18 A. I consider myself an adequate expert
19 to analyze it for ratemaking purposes. I would
20 not hold myself forth as, you know, able to
21 perform Entergy's tax filings.

22 Q. Have you ever testified before on
23 whether a particular regulatory accounting
24 treatment was or was not a violation of
25 normalization rules?

1 A. No.

2 Q. Can you recall if you've ever
3 conducted such an evaluation?

4 A. I suppose that, yes, I have based
5 upon the plain language meaning of various IRS
6 PLRs and regulations.

7 Q. Is that something that came up in
8 this case, or are you talking about some other
9 case where you did that?

10 A. Both cases. For example, the change
11 in ADIT normalization rule of which there was
12 an ENO adjustment in their cost-of-service
13 study. I've forgotten the specific adjustment
14 number. I evaluated that.

15 Q. I'm sorry. What was the nature of
16 that adjustment?

17 A. Basically when you have
18 forward-looking rate setting and you have a
19 perspective change to ADIT balances, you
20 normalize it according to a schedule of months
21 of factors, of factors by month.

22 Q. And in that instance, were you
23 attempting to evaluate whether the adjustment
24 complied with normalization requirements?

25 A. The adjustment is intended to comply

1 with a particular IRS regulation. There is a
2 very long series of letters and numbers that I
3 couldn't -- I couldn't recall sitting here. I
4 doubt anyone could. And I did, indeed,
5 evaluate it compared to normalization practices
6 and the relevant rule and we chose not to
7 object to ENO's adjustment.

8 Q. Have you performed any independent
9 analysis of whether the advisors' proposal
10 regarding ADIT on retired meters, whether that
11 is consistent with normalization requirements?

12 A. No. What I did is, I -- First of
13 all, Mr. Roberts did not say it is contrary to
14 normalization. He says it's potentially a
15 normalization violation, which is not a direct
16 statement of opinion to me. And so, therefore,
17 I said that my testimony is based upon properly
18 reflecting the value to ratepayers of that
19 ADIT. And I made an alternate recommendation.

20 Q. So is it right you're not giving an
21 opinion one way or the other on the potential
22 normalization violation here?

23 A. That's right. I think that's what I
24 said in my surrebuttal.

25 Q. How is your treatment of the retired

1 meter ADIT consistent with the treatment of the
2 meter asset regarding the inclusion in rate
3 base?

4 A. You mean the meter regulatory asset?

5 Q. Well, the asset being the plant in
6 service associated with the retired meters?

7 A. So the treatment under the AMI AIP
8 was that the net book value of those meters to
9 be retired would be reflected in a regulatory
10 asset to be amortized. And so my recommended
11 treatment was just to recognize that those
12 retirements also have a tax component and to
13 reflect the value to ratepayers of that capital
14 to ENO in the form of ADIT.

15 Q. So your recommendation is that the
16 ADIT be included in rate base; correct?

17 A. Yes.

18 Q. And that the retired meter
19 investment not be included in rate base;
20 correct?

21 A. Yes.

22 Q. So how is that consistent treatment
23 of those two rate base components?

24 A. Because the regulatory asset does
25 not reflect ADIT. It was negotiated and

1 calculated based upon net book value and the
2 AIP specifically says the net book value,
3 therefore, the cost free capital component of
4 the ADIT, which is on ENO's books and was
5 presented as per book information in their
6 application, shows that there is a cost free
7 capital component which should be credited as a
8 value to ratepayers in the form of a rate base
9 credit.

10 Q. So you're saying the consistency is
11 because of the requirements of the agreement in
12 principle?

13 A. Yes.

14 Q. Is there any other reason you have
15 for opining that there's consistent treatment
16 of the ADIT and the asset?

17 A. It's on ENO's books.

18 Q. On ENO's books. You would agree,
19 though, the asset is not in rate base; correct?

20 A. An alternate asset -- Yes. It
21 doesn't matter. Yes, they're not in rate base.

22 Q. Do you have an opinion on whether
23 tax normalization rules require that when an
24 asset is not included in rate base, ADIT should
25 not be included in rate base?

1 A. I have reviewed some rules that
2 suggest that.

3 Q. So you think that is, in fact, a
4 requirement of tax normalization rules?

5 A. I don't disagree with Rory that --
6 or Mr. Roberts -- that it's a potential
7 violation. I don't actually understand why he
8 qualified his opinion with a potential.

9 Q. Let's go to page 4 of your
10 surrebuttal, Mr. Watson. Take a look at page
11 4, lines 8, through page 5, lines 2.

12 A. I'm familiar with this section.

13 Q. Okay. So are you saying that if the
14 Council adopts the advisors' recommendation to
15 approve ENO Adjustment 14 and Mr. Prep's
16 recommendation that the Council consider pro
17 forma adjustments in future formula rate plans,
18 the result would be the FRP would address
19 regulatory lag associated with increasing
20 capital investment?

21 A. It certainly would address it, yes.

22 Q. If the company and the Council are
23 unable to reach agreement on the form of a
24 formula rate plan, in that instance, how would
25 regulatory lag associated with ENO's

1 contemplated level of future investment in its
2 five-year business plan be addressed?

3 A. There would be -- In a growing rate
4 base environment under the assumed scenario,
5 which I think is reasonable, that a full rate
6 case takes a year, whereas the FRP takes
7 perhaps six or so months, there would be some
8 potential for some increase to a regulatory lag
9 if you don't have an FRP and you do annual rate
10 cases.

11 Q. Okay. Let me lay out a hypothetical
12 for you regarding that scenario. Okay?

13 Assume a project is placed in
14 service January 1, 2020.

15 A. Uh-huh (indicating affirmatively).

16 Q. And assume the earliest a rate case
17 can be filed using calendar year 2020 data is
18 June 1, 2021.

19 A. So you're saying new rates are set
20 on June of 2020?

21 Q. No. The test year ends December 31,
22 2020.

23 A. Okay.

24 Q. Investment, January 1, 2020; test
25 year ends December 31, 2020.

1 A. You'll have to pardon me. Please
2 start over.

3 Q. Okay. The investment goes into
4 service January 1, 2020.

5 A. Okay.

6 Q. The test year ends December 31,
7 2020.

8 A. Okay.

9 Q. And assume that ENO is not able to
10 file a rate case until June 1, 2021. Okay?

11 A. 6/21.

12 Q. That's six months after the end of
13 the test year. Do you have that?

14 A. Yes.

15 Q. And then rates go into effect
16 June 1, 2022. In other words, it takes a year
17 to process the rate case.

18 A. Okay.

19 Q. Are those all plausible assumptions
20 from what you experience regarding base rate
21 cases is?

22 A. Yeah, certainly.

23 Q. Now, in this scenario, would you
24 agree that ENO suffers a minimum of 29 months
25 of lag --

1 A. No.

2 Q. -- where it is not earning return on
3 the January 1, 2020, investment?

4 A. Your scenario assumes some
5 improbable hypotheticals, so I don't agree.
6 The first one is that there was no rate
7 evaluation prior to this filing in June '21,
8 2021, that covered the January 2020 investment.
9 If there are ongoing rate cases, a AJ14 like
10 pro forma should have allowed rates to already
11 include the January 2020 investment.

12 Second of all, if the investment is
13 substantial, ENO has in the past requested
14 special recovery of major investments with a
15 rate step up. For example, NOPS and Union
16 Power Block 1 and Nine Mile 6 are all either
17 were allowed contemporaneous rate adjustments
18 or expected to be allowed such a thing.

19 So, no, I don't agree.

20 Q. Well, the case we're working on
21 right here and that we're talking about today,
22 it's established to set rates based on
23 investment through 2019; correct?

24 A. Yeah, rate base as of December 31st,
25 2019.

1 Q. So if we were to establish a new
2 test year for a new base rate case, that would
3 take up all of 2020; correct?

4 A. Yeah. Like I said, if an FRP is not
5 adopted, ENO could experience some increased
6 regulatory lag compared to the FRP scenario.

7 Q. Right. So I guess I'm saying as we
8 sit here today with a new rate case, there
9 would not be another base rate case till
10 sometime in 2021 filed; right?

11 A. I don't know that I necessarily
12 agree with that. I think that if today was
13 decided that there would be no FRP, I believe
14 that based upon past experience, ENO could have
15 a new rate case filing by the end of the year.

16 Q. And what would be the test year for
17 that case?

18 A. I suppose the period one would be
19 '18 and period two would be '19, and consistent
20 with an AJ14, ENO would perform its rate base
21 as of year end 2020.

22 Q. And so you would propose a test year
23 be established for period two based on the same
24 year that's being used to establish rates in
25 this case?

1 A. Well, that would be period one, but
2 period two is more often the one that's used to
3 evaluate rates.

4 Q. So in that case, you say you could
5 file a rate case in June '20, June 2020 then?

6 A. I mean, file yet another one in --

7 Q. If I understood it, you were telling
8 me you thought you could file a rate case more
9 quickly than what the hypothetical assumed?

10 A. I believe that ENO can put together
11 a rate case in roughly six months. It's been
12 represented to me as being the case verbally.

13 Q. So if -- '19 and '20, 2019 and 2020
14 for period one and period two, you're saying
15 that rate case could be filed in June 2020?

16 A. Yes. Although what I had said
17 previously was period one was '18, period two
18 was '19, and they could file it by the end of
19 this year.

20 Q. So you would have the company stack
21 sort of pancake rate cases then?

22 A. Our recommendation to the Council is
23 to approve an FRP.

24 Q. Right. I'm just trying to
25 understand what would be the alternative if the

1 FRP weren't agreed to?

2 A. Well, there are multiple
3 alternatives. ENO has seen fit to not --
4 through negotiation purposes or through
5 negotiation, not file a rate case for multiple
6 years. As I've said, the Council has in the
7 past considered ENO's applications for interim
8 rate adjustments related to major investments,
9 so I don't know that pancaked rate cases are
10 the only solution available to ENO.

11 Q. Well, if ENO were to use a -- try to
12 move up this filing of the next rate case to
13 where 2019 were period one and 2020 were period
14 two, that case would likely be filed in June
15 2020 since it takes six months to prepare;
16 correct?

17 A. I believe so. In order to have
18 their books closed and file a rate case,
19 something like that would be my general
20 understanding.

21 Q. And a year to process, more or less?

22 A. Typically, it seems like.

23 Q. So new rates would go into effect in
24 that case June 2021; right?

25 A. I suppose so, yes.

1 Q. In that case, the scenario that the
2 regulatory lag for that January 1, 2020,
3 investment would be 18 months; right?

4 A. Under that scenario, yes.

5 Q. And that doesn't consider compliance
6 processes that can occur after the Commission
7 -- after the Council issues its final ruling on
8 the merits of the case; correct?

9 A. I think it probably does. I think
10 that rates go into effect after a year after
11 their application, so I think that it's
12 reasonable to expect rates 12 months later.

13 Q. So it's your experience that the
14 compliance process can't result in that year
15 being extended some months further even?

16 A. I'm familiar with the possibility of
17 a refund in the event the compliance presses it
18 down the line more than a year.

19 Q. A refund?

20 A. Or an excess or an under collection
21 surcharge, a true-up.

22 MR. WILLIAMS:

23 Give me two minutes here.

24 Off the record.

25 (Whereupon a pause occurred in the

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proceedings.)

MR. WILLIAMS:

Okay, Mr. Watson. That's all my
questions. Thank you for your patience.

THE WITNESS:

Thank you.

MR. WILLIAMS:

Any other questions?

(No response.)

MR. BEATMANN:

I think we're done.

MR. WILLIAMS:

Hearing none, we're all done.
Thank you.

MR. BEATMANN:

That's it.

(Whereupon the deposition was
concluded at three o'clock P.M.)

* * * * *

1 REPORTER'S CERTIFICATE

2 This certification is valid only for a
3 transcript accompanied by my original signature
4 and original required seal on this page.

5 I, Kathy Ellsworth Shaw, Certified Court
6 Reporter in and for the State of Louisiana, as
7 the officer before whom this testimony was
8 taken, do hereby certify that BYRON S. WATSON,
9 to whom oath was administered, after having
10 been duly sworn by me upon authority of R.S.
11 37:2554, did testify as hereinabove set forth
12 in the foregoing 75 pages; that this testimony
13 was reported by me in stenotype reporting
14 method, was prepared and transcribed by me or
15 under my personal direction and supervision,
16 and is a true and correct transcript to the
17 best of my ability and understanding; that the
18 transcript has been prepared in compliance with
19 transcript format guidelines required by
20 statute or by rules of the board, and that I am
21 informed about the complete arrangement,
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this matter nor is there any such relationship
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matter nor is there any such relationship
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matter; I am not related to counsel or to the
parties herein, nor am I otherwise interested
in the outcome of this matter.

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25 749 Aurora Avenue
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