BEFORE THE

COUNCIL OF THE CITY OF NEW ORLEANS

IN 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 AND FOR RELATED RELIEF	**)))))**	**DOCKET NO. UD-18-07**

DIRECT TESTIMONY
OF
THOMAS J. FERRIS

ON BEHALF OF

THE ADVISORS TO THE

COUNCIL OF THE CITY OF NEW ORLEANS

FEBRUARY 1, 2019

PREPARED DIRECT TESTIMONY OF

THOMAS J. FERRIS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Thomas J. Ferris. My business address is 1 Sugar Maple Trail, Madison, Wisconsin. I am a Certified Public Accountant in the state of Wisconsin and a self-employed Regulatory Utility Accounting Consultant working as a sub-contractor to Bruno & Tervalon LLP, CPAs, New Orleans.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.

A. I received a BBA degree in accounting in 1974 and a BA degree in economics in 1972, both from the University of Wisconsin-Madison.

Q. **ON WHOSE BEHALF DO YOU APPEAR IN THIS PROCEEDING?**

A. I am presenting testimony on behalf of the Council of the City of New Orleans ("Council") Accounting Advisors[1] ("Accounting Advisors"). The Council regulates the rates, terms, and conditions of electric and gas service of Entergy New Orleans, LLC ("ENO"). ENO is a subsidiary of Entergy Utility Holding Company, LLC ("EUH"). EUH is itself directly and indirectly owned by Entergy Corporation ("Entergy").

Q. **PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

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[1] Council Accounting Advisors refers to the accounting firm Bruno & Tervalon, LLP, CPAs.

A. Exhibit No. ___ (TJF-2) provides a summary of my relevant education and professional experience and Exhibit No. ___ (TJF-3) lists my previous testimony experience.

Q. **PLEASE SUMMARIZE THE RECOMMENDATION IN YOUR TESTIMONY.**

A. Based upon my analysis of ENO's affiliated transactions during the test-year period, I recommend that the cost of Project F5PPZZ4091, Restricted Stock Incentive Plan, should not be recovered in rates. This recommendation would reduce ENO's revenue requirement related to its electric operations by $648,314 and the revenue requirement related to its gas operations by $145,211.

Q. **PLEASE DISCUSS THE ACCOUNTING ADVISORS' AUDIT OF ENO AFFILIATE TRANSACTIONS.**

A. On May 31, 2018, ENO filed with the Council its Annual Affiliate Transactions Report for the year ending December 31, 2017. This Report was filed pursuant to the New Orleans City Code Section 158, Article II, Division 3, Sub-section 158-139.

On September 21, 2018, ENO filed an application in Docket UD-18-07 for a change in electric and gas rates pursuant to Council Resolutions R-15-194 and R-17-504. ENO's filing in Docket UD-18-07 contains an allocation of affiliate costs from Entergy Services, Inc. ("ESI") as shown in ENO's Annual Affiliate Transactions Report for the year ending December 31, 2017.

During calendar year 2017, affiliated costs billed to ENO by ESI and other affiliates totaled $85,719,574. Of this total, billings from ESI amounted to $65,998,194.

The Accounting Advisors performed a comprehensive review and analysis of ENO's affiliate transactions with ESI for the year ending December 31, 2017. Since billings from ESI made up the majority of affiliate billings to ENO and since billings from other affiliates were mostly directly billed and did not distribute costs based on an allocation factor, the Accounting Advisors focused on transactions between ENO and ESI.

Regulatory concerns regarding affiliated transactions include cost shifting, profit shifting, risk shifting, and anti-competitive behavior (cross subsidization and other anti-competitive behaviors). Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Therefore, the purpose of the Accounting Advisors' comprehensive review and analysis of ENO's affiliate transactions was to ensure that:

1. The Report was filed in compliance with New Orleans City Code Section 158, Article II, Division 3, Sub-section 158-139;
2. ENO's affiliated transactions did not result in any cost shifting, profit shifting, risk shifting, and anti-competitive behavior;
3. ENO and its affiliates' methods for accumulating and allocating costs were reasonable;
4. Charges from affiliates were
    a. reasonable as to pricing methodology,

b. in compliance with federal and jurisdictional regulations, and

c. consistently treated;

5. The billing return components used by ESI and Entergy operating companies for billing non-regulated affiliates were reasonable; and

6. All costs billed by affiliates to ENO were allowable for rate relief.

Q. **PLEASE DISCUSS THE ACCOUNTING ADVISORS' PROPOSED ADJUSTMENTS AS A RESULT OF THE AUDIT OF ENO AFFILIATE TRANSACTIONS.**

A. Affiliate billings from ESI to ENO for the year ending December 31, 2017, total $54,181,150 for electric operations and $11,817,044 for gas operations. These billings have been adjusted for certain projects and cost items that were deemed by the Accounting Advisors to be (1) below-the-line expenses not recoverable in rates, (2) non-base rate expense projects and cost items, (3) above-the-line expenses that are not currently recoverable in retail base rates, or (4) expenses recommended as not recoverable in rates based on prior Council decisions regarding similar expenses. The total of the four billing adjustment items is $2,435,440 for electric operations and $388,913 for gas operations. As a result, adjusted above-the-line affiliate charges to ENO during the year December 31, 2017, for electric operations and gas operations totaled $51,745,710 and $11,428,131, respectively.

In general, expenses attributable to normal utility operations and charged to the ratepayer are referred to as "above the line". Certain other costs which are non-operating are normally borne solely by shareholders, not customers, and therefore those costs are classified as "below the line." Examples of below-the-line activities/expenses (Billing Adjustment Item #1) include: expenditures for political activities and contributions; payments or donations for charitable, social or community welfare purposes; payments by the company for penalties or fines for violation of any regulatory statutes by the company or its officials; and other miscellaneous expenses which are non-operating in nature. Billing Adjustment Item #1 totals $641,298 for electric operations and $110,613 for gas operations for the year ending December 31, 2017.

Billing Adjustment Item #2, non-base rate expense projects and cost items, consist of 2018 rate case expenses and storm restoration costs. ENO proposes to defer 2018 rate case expenses as a regulatory asset and amortize these costs over three years. Storm restoration costs are being run through the storm reserve escrow fund. Billing Adjustment Item #2 totals $470,168 for electric operations and $6,006 for gas operations for the year ending December 31, 2017.

Billing Adjustment Item #3, above-the-line expenses that are not currently recoverable in retail base rates, consist of certain general advertising expenses that ENO is not seeking recovery of in this proceeding and costs related to ENO's long-term incentive plan, equity awards plan, stock option expenses, and restricted share awards plan not recoverable in rates. Billing Adjustment Item #3 totals $738,866 for electric operations and $160,514 for gas operations for the year ending December 31, 2017.

Costs associated with Billing Adjustment Items #1, #2, and #3 were properly treated by ENO in this proceeding and no further adjustments are necessary.

Billing Adjustment Item #4, expenses recommended as not recoverable in rates based on prior Council decisions regarding similar expenses, relates to Project Code F5PPZZ4091, Restricted Stock Incentive Plan. Costs for this project code totaled **$585,108 for electric operations and $111,780 for gas operations** for the year ending December 31, 2017. Since Billing Adjustment Item #4 relates to project F5PPZZ4091 which is similar to incentive plans for which costs were removed from ENO's past rate cases, the Accounting Advisors recommend that costs for this project should not be recovered in rates in this or any future rate case or FRP. The budgeted 2018 O&M costs billed to ENO for this project reflected in the ENO application's Period II cost of service study total $648,314 for electric operations and $145,211 for gas operations. Advisor-recommended Adjustment ADV08, therefore, is a reduction in revenue requirement of **$648,314 for electric operations and $145,211 for gas operations.**

Q. PLEASE EXPLAIN THE RATIONALE FOR ACCOUNTING ADVISOR ADJUSTMENT RELATED TO PROJECT F5PPZZ4091.

A. Project F5PPZZ4091, Restricted Stock Incentive, was a new incentive plan in 2011. According to the Entergy scope statement for this project, the overall purpose of this project is to capture and manage costs associated with Entergy's new long-term incentive Restricted Stock program. The Restricted Stock program is a stock ownership plan associated with the incentive compensation plan for management levels 1 through 5. The primary products or deliverables of this project code are to improve operating efficiency and encourage fiscal responsibility within the Entergy System for the long-term. Since the participants' compensation is tied to the long-term performance of Entergy Corporation common stock, it provides incentive to focus on the future impacts of current policies and decisions.

Similar to Project F5PPZZ4091, Project F5PCZZ4080, Equity Awards, and Project F5PCZZ4090, Restricted Share Awards, are stock ownership plans. The primary products or deliverables of these project codes are the same as for Project F5PPZZ4091, to improve operating efficiency and encourage fiscal responsibility within the Entergy System for the long-term. Since the participants' compensation is tied to the long-term performance of Entergy Corporation common stock, it provides incentive to focus on the future impacts of current policies and decisions.

Project F5PCZZ4045, Long-Term Incentive Plan, is a long-term restricted unit plan. The primary products or deliverables of this project code is to maximize the quality of operating efficiency and fiscal responsibility of the Entergy System in the long-term by tying the participants to the long-term performance of Entergy Corporation common stock.

ENO adjustment AJ07, Stock Options and Incentive Compensation, removes the Long-Term Incentive Plan, Equity Awards Plan, Stock Options Expense, and Restricted Share Awards Plan from recovery in rates per 2010 Agreement in Principle, Docket No.

UD-08-03. Incentive pay, executive incentive pay, and stock options may be recovered in rates only to the extent that the company demonstrates that such plans benefit ratepayers. In its review of various forms of incentive compensation in Docket No. UD-08-03, Council's Advisors examined the basis for each incentive and evaluated whether the incentive compensation was related strictly to Entergy's stock price and financial performance criteria, or on cost control, safety, operational and customer service criteria in addition to financial performance measures. The Council's Advisors found that the financial performance measurement criteria used in these Entergy incentive compensation plans was based on Entergy's cash flow and earnings per share, thus, based on elements directly affecting Entergy's stock price. The Advisors found that incentive compensation based solely on Entergy's stock price was of significant benefit to its shareholders. As such, the Advisors removed 100 percent (100%) of the revenue requirements associated with the Long-Term Incentive, Equity Awards, Stock Options Incentive, and Restricted Share Awards Plans.

In making its recommendation to disallow the above stock options and incentive compensation, the Council's Advisors in Docket UD-08-03 also recommended that the Council should take administrative notice of orders issued in the regulatory jurisdictions of other Entergy affiliates wherein the issue of incentive compensation was examined and resulted in the removal of a significant portion of these costs from eligible revenue requirements. These regulatory jurisdictions were the Arkansas Public Service

Commission in Docket No. 06-101-U, Order 10, and the Louisiana Public Service Commission in Docket No. U-20925.

Q. **DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

A. Yes, it does.