American Institute of Certified Public Accountants, Institute of Management Accountants, and Society of Louisiana Certified Public Accountants.

Q5. PLEASE DESCRIBE BRIEFLY YOUR PROFESSIONAL EXPERIENCE.

A. I have been employed by subsidiaries of Entergy Corporation for approximately 26 years and have held various positions in the Accounting organization. Prior to my employment with the Entergy Companies, I was employed by the New Orleans Metropolitan Convention and Visitors Bureau, Inc. (formerly known as the Greater New Orleans Tourist & Convention Commission, Inc.) in a key accounting position. My work experience is described in more detail in Exhibit CEB-1.

Q6. WHAT ARE YOUR PRINCIPAL AREAS OF RESPONSIBILITY?

A. As Jurisdictional Finance Director, I am responsible for financial management, financial planning and monitoring, and providing regulatory support to ETI. I am responsible also for interfacing with both company accounting and regulatory personnel on various accounting issues related to financial reporting for ETI. In my present role, I report to the Senior Vice President – Chief Accounting Officer.

Q7. ARE YOU SPONSORING ANY EXHIBITS AND/OR SCHEDULES?

A. Yes, I am sponsoring the exhibits listed in the Table of Contents to my testimony. In addition, I am co-sponsoring Rate Filing Package Schedules K-1 through K-6 and sponsoring Schedules K-7 through K-9.

B. Purpose of Testimony

Q8. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony describes the Company's financial condition and why it is important for the Commission to consider ETI's financial integrity in the context of this proceeding. I also present the Company's capital structure and overall cost of capital. My testimony shows that a rate increase in this case will be important in providing the Company with the financial strength needed to deal successfully with expected future financial challenges and operational plans.

Q9. WHY IS RATE RELIEF NECESSARY TO ETI'S FINANCIAL HEALTH?

A. Since the end of the test year in ETI's last rate case (June 30, 2011), ETI's non-fuel expenses have increased. Specifically, purchased power and transmission equalization costs have increased, as have Operation and Maintenance ("O&M"), including Administrative and General ("A&G") expenses. In addition, the Company has and continues to incur MISO implementation costs, and the cost effects of operating in MISO next year need to be taken into account. Further, upon MISO integration, ETI will lose its sole remaining wholesale customer, East Texas Electric Cooperative ("ETEC"), which requires a reallocation of base rate costs to the retail jurisdiction. My analysis shows that, if ETI is unable to achieve timely recovery of these incremental costs, its cash flow will be strained, which causes a deterioration in its key financial ratios. In addition, even with the relief provided in Docket No. 39896, ETI is still not earning its authorized return on equity ("ROE"). This combination of circumstances points to the conclusion that current rates are not adequately supportive of the Company's financial integrity.

As explained by Company witness Dr. Samuel C. Hadaway, the Company is requesting an increase in its authorized ROE in this proceeding to provide its investors a fair return that is comparable to that of similar investments. Furthermore, over the next several years, ETI expects to spend hundreds of millions of dollars on repair and replacement of existing assets, projects that improve reliability and economics of the System, projects specifically designed to strengthen the System based on new standards and expectations, and regulatory compliance projects. Capital expenditures at those levels cannot be funded internally via cash from operations; instead, ETI must seek external sources of funds from the capital markets on favorable terms. At the same time, the impact of two major hurricanes in 2005 and 2008 on ETI's service area and customers demonstrates that ETI has real, significant and potentially catastrophic exposure to hurricane damage. In fact, Moody's Investors Service ("Moody's") includes ETI's exposure to major storms as a significant ratings driver.[2]

If the requested rate relief is not obtained in this proceeding, ETI's analysis shows that its financial condition will deteriorate as evidenced by its forecasted credit metrics. Deteriorating financial health causes two primary adverse effects: (1) cash-flows become constrained to the extent that revenues are no longer adequate to cover operating expenses, fund capital projects, and pay dividends, which means there is no opportunity to earn a reasonable ROE; and (2) access to capital markets becomes impaired, potentially leading to higher financing costs. The first effect is inequitable to ETI's investors and at odds with the most basic principles of utility rate setting, and the second effect leads to higher costs for ETI's customers. An improved financial condition, on the other hand, provides for an opportunity to earn a reasonable return while at the same time providing ETI the means to continue providing reliable service through investments in infrastructure at lower costs to customers.

[2] *Moody's Investors Service*, Credit Opinion: Entergy Texas, Inc. (Dec. 26, 2012).

Q10. WHY ARE YOU QUALIFIED TO ADDRESS THESE ISSUES AND TO PROVIDE THIS TESTIMONY?

A. As Jurisdictional Finance Director, I have supported the Senior Vice President - Chief Accounting Officer, ETI's President and Chief Executive Officer ("CEO"), and the President and CEO's Lead Team, by providing information on accounting and financial results, forecasted planning results and assumptions, and advice to facilitate timely financial, regulatory, and operational decisions that support the overall strategic plan for ETI's utility business. These activities require that I monitor ETI's financing needs, credit metrics, debt ratings, and liquidity. Further, through my prior role in the External Reporting organization at ESI, as well as in my current role, I have been involved in debt issuance and refinancing activities, which include significant participation in due diligence activities and meetings with debt underwriters and rating agency representatives.

C. Organization of Testimony

Q11. PLEASE DESCRIBE HOW THE REMAINDER OF YOUR TESTIMONY IS ORGANIZED.

A. In Section II of my testimony, I describe the Company's financial condition and why a healthy financial condition is in the interest of the Company and its customers. In Section III, I review ETI's future plans and explain how the rate increase requested in this case will contribute to the financial strength needed to successfully implement those plans. In Section IV, I address certain issues resulting from Docket No. 39896. In Section V, I present the Company's capital structure and overall cost of capital. Company witness Michael P. Considine supports the calculation of cost of debt and preferred stock, while Company witness Hadaway sponsors the proposed ROE. In Section VI, I explain the pro forma adjustments that I sponsor. In Section VII, I conclude my testimony.

II. ETI'S FINANCIAL CONDITION

Q12. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?

A. The purpose of this section of my testimony is to place this case within the context of its role in providing support for ETI's financial integrity. I briefly discuss the concept of financial integrity. I then describe the Company's financial condition. I further present an overview of ETI's future financial plans and challenges, including planned capital expenditures, and how rate relief in this case supports the financial strength needed to meet these goals. These are all important elements of the Commission's consideration of ETI's financial integrity.

Q13. WHAT DO YOU MEAN BY FINANCIAL INTEGRITY?

A. I understand the term "financial integrity" to be a concept that is associated with the ability to access capital at reasonable rates and on reasonable terms under a variety of economic and financial market conditions. Financial integrity is critical to ETI's ability to satisfy its obligation to supply safe and reliable electric service. A strong financial position provides the financial flexibility necessary to meet the ongoing demand for utility services. In my position as Jurisdictional Finance Director, I am primarily concerned with maintaining the financial integrity of ETI, and I monitor on an ongoing basis the financial condition of ETI as evidenced by financial statements, bond ratings, and other financial measures. As I discuss more below, solid financial integrity is a critical component of the Company's ability to address the ongoing financial challenges associated with providing reliable service.

Q14. WHAT WOULD HAPPEN TO THE FINANCIAL INTEGRITY OF THE COMPANY IF THE REQUESTED RATE RELIEF IS NOT OBTAINED?

A. As explained in detail below, without the rate relief requested in this case, ETI's key financial metrics will deteriorate over time to a level that is not in line with its current credit rating, and in some cases not even in line with the range consistent with an investment grade bond rating. Such a significant financial deterioration could lead to adverse rating agency action that could threaten the Company's current bond ratings. Moody's explained in its most recent Credit Opinion on ETI that ETI could be downgraded "if there were a significant decline in the financial metrics, including CFO pre-working capital interest coverage below 2.5 times and

CFO pre-working capital to debt below 10% on a sustained basis."[3] Without rate relief, ETI's forecasted credit metrics trend close to those levels.

A lower bond rating would also likely translate into higher costs to access capital in an anticipated period of heavy expenditures, which higher costs will ultimately be passed on to customers through their electric rates. Constructive rate treatment in this case, on the other hand, will provide continuing support to ETI's key financial metrics, and in that way promote a sound financial condition and maintenance of ETI's current credit rating while allowing for the opportunity to earn a reasonable return on invested capital, which in turn enhances the ability of the Company to attract capital on reasonable terms.

Q15. WHY ARE CREDIT RATINGS IMPORTANT?

A. An investment-grade credit rating is critical to ETI's ability to issue debt. An investment-grade rating is at or above the Baa3/BBB- level. Ratings below that level indicate that investors bear a higher risk of issuer default. Because of that higher risk, investors demand a premium return on their investment in a less than investment-grade company, and thus bond interest rates are higher. Additionally, the ability of a company to sell bonds rated below investment-grade is uncertain. Thus, an issuer with a

---

3 *Moody's Investors Service*, Credit Opinion: Entergy Texas, Inc. (Dec. 26, 2012).

non-investment-grade rating must pay investors more for buying its bonds, and at any point in time, the issuer cannot be confident that investors would buy the bonds at all. Lower credit quality also carries with it more restrictive borrowing covenants, which often restrict financing flexibility.

Q16. WHAT ARE THE KEY CREDIT METRICS TO WHICH YOU REFER?

A. Investors generally rely on nationally recognized credit rating agency services to evaluate a company's financial integrity and to inform them of the company's current financial position. The two primary rating agencies that provide credit ratings for ETI — Moody's and S&P — emphasize very similar metrics. Moody's has published a report detailing its rating methodology for regulated electric and gas utilities.[4] The report identifies four principal factors that Moody's considers in making its ratings decisions. Factor 4, which accounts for 40% of the rating, involves financial strength, liquidity, and key financial metrics. Among the key metrics are "Cash From Operations Pre-Working Capital/Debt" ("CFO/Debt"), "Cash From Operations Pre-Working Capital Plus Interest/Interest" ("CFO/Int"), "Cash From Operations Pre-Working Capital Minus Dividends/Debt" ("CFO-Div/Debt"), and "Debt/Capitalization" ("Debt/Cap"). CFO/Debt, CFO/Int, and CFO-Div/Debt are measures of the Company's cash flow, while Debt/Cap measures the degree to which the

[4] *Moody's Global Infrastructure Finance*: Regulated Electric and Gas Utilities (Aug. 2009).

Company uses debt to fund its operations. S&P uses similar metrics, as described below. While rating agencies typically look at numerous financial metrics, and base their ratings decisions on a number of qualitative and quantitative factors, cash flow metrics and measures of liquidity are among the most important quantitative considerations in credit ratings.[5]

Q17. WHAT ARE ETI'S CURRENT CREDIT RATINGS?

A. ETI's current credit ratings are as follows:

Moody's	Issuer Rating:	Ba1
	Senior Secured:	Baa2
S&P	Corporate Credit:	BBB
	Senior Secured:	A-[6]

These ratings range from the highest non-investment grade tier (Ba1) to investment grade (A-).

[5] *See Standard & Poor's Global Credit Portal, RatingsDirect*: Methodology and Assumptions: Liquidity Descriptors for Global Corporate Issuers (Sept. 28, 2011).

[6] On February 14, 2013, S&P revised its criteria for rating utility first mortgage bonds. In doing so it raised the ratings on 22 issuers and lowered the ratings on three issuers. ETI's Senior Secured ratings were increased from BBB+ to A- as a result of S&P's new methodology. *Standard and Poor's, RatingsDirect*: S&P Takes Action on 23 U.S. Issuers After Revising Criteria For Recovery Ratings On Utility First Mortgage Bonds (Feb. 14, 2013).

Q18. WHAT ARE ETI'S FORECASTED MOODY'S FINANCIAL CREDIT METRICS WITHOUT THE REQUESTED RATE RELIEF?

A. Without the rate relief requested in this case, ETI's forecasted financial metrics for CFO-Debt — one of the metrics key to rating agency analysis — (consistent with a Ba, non-investment grade rating). CFO/Int, also deteriorates until it, too, falls into a non-investment grade rating (Ba). CFO-Div/Debt declines from an A- rating position to borderline Baa/Ba territory. The following tables show the Moody's benchmarks ("B/M") for various credit ratings, and where ETI's forecast credit metric falls compared to the benchmark, assuming no rate relief.

Comparison of Moody's CFO/Debt Benchmark to ETI Forecast Assuming No Rate Relief

Moody's Bond Rating	Moody's B/M CFO/Debt	ETI CFO/Debt 2013	ETI CFO/Debt 2014	ETI CFO/Debt 2015	ETI CFO/Debt 2016
Aaa	>40%				
Aa	30%-40%				
A	22%-30%				
Baa	13%-22%				
Ba	5%-13%				
B	<5%				

Comparison of Moody's CFO Pre-Working Capital + Interest/Interest Benchmark to ETI Forecast Assuming No Rate Relief

Moody's Bond Rating	Moody's B/M CFO/Int	ETI CFO/Int 2013	ETI CFO/Int 2014	ETI CFO/Int 2015	ETI CFO/Int 2016
Aaa	>8.0x				
Aa	6.0x-8.0x				
A	4.5x-6.0x				
Baa	2.7x-4.5x				
Ba	1.5x-2.7x				
B	<1.5x				

Comparison of Moody's CFO Pre-Working Capital – Dividend/Debt Benchmark to ETI Forecast Assuming No Rate Relief

Moody's Bond Rating	Moody's B/M CFO-Div/Debt	ETI CFO-Div/Debt 2013	ETI CFO-Div/Debt 2014	ETI CFO-Div/Debt 2015	ETI CFO-Div/Debt 2016
Aaa	>35%				
Aa	25%-35%				
A	17%-35%				
Baa	9%-17%				
Ba	0%-9%				
B	<0%				

Comparison of Moody's Debt/Capitalization Benchmark to ETI Forecast Assuming No Rate Relief

Moody's Bond Rating	Moody's B/M Debt/Cap	ETI Debt/Cap 2013	ETI Debt/Cap 2014	ETI Debt/Cap 2015	ETI Debt/Cap 2016
Aaa	<25%				
Aa	25%-35%				
A	35%-45%				
Baa	45%-55%				
Ba	55%-65%				
B	>65%				

Q19. HAS S&P ALSO PUBLISHED BENCHMARK RANGES TO WHICH ETI'S FORECAST RESULTS WITHOUT RATE RELIEF CAN BE COMPARED?

A. Yes. S&P has issued a report providing guidance on its ratings methodology for industrial companies that lists three primary financial metrics used in developing its ratings:

1) Funds From Operations ("FFO") as a percentage of debt outstanding ("FFO/Total Debt"), which is similar to Moody's CFO/Debt;

2) Size of Debt compared to Earnings Before Income Tax, Depreciation and Amortization ("Debt/EBITDA"); and

3) Debt to total capitalization ("Debt/Capital").[7]

The FFO/Total Debt ratio is a cash flow measure that describes the extent to which a company's cash flow supports its debt service. The higher the number, the more favorable the FFO/Total Debt ratio. Debt/EBITDA is a measure of a company's ability to pay off its incurred debt. The higher the result, the more favorable the Debt/EBITDA ratio. The Debt/Capital metric indicates the degree to which debt is used to finance a company's operations. The lower the percentage, the lower the debt burden.

[7] *S&P RatingsDirect: Criteria Methodology*: Business Risk/Financial Risk Matrix Expanded (May 27, 2009).

Q20. PLEASE DESCRIBE THE ASPECTS OF S&P'S RATING METHODOLOGY THAT ARE HELPFUL IN UNDERSTANDING ETI'S CREDIT RATING.

A. S&P uses a ratings matrix to help develop its credit ratings that combines consideration of "Financial Risk" and "Business Risk." The S&P matrix matches credit ratings to financial and business risk as follows:

S&P Ratings Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	A-	BBB	-
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB	BBB	BB+	BB-	B+
Fair	-	BBB-	BB+	BB	BB-	B
Weak	-	-	BB	BB-	B+	B-
Vulnerable	-	-	-	B+	B	CCC+

S&P ranks ETI as having a Business Risk Profile near the low end of the "Excellent" category reflecting, in part, a "generally challenging regulatory framework."[8] S&P ranks ETI's Financial Risk Profile as "Significant."[9] S&P's ratings matrix above shows that the mid-point credit rating for a utility with that profile is "A-" (plus or minus one credit rating notch). The tables below show the financial risk categories in which ETI's forecasted key cash flow metrics fall compared to S&P benchmarks for the various

[8] *Standard & Poor's Ratings Services, RatingsDirect*: Entergy Texas, Inc. (Jan. 25, 2013).

[9] *Id.*

levels of financial risk covered by the S&P matrix, assuming ETI does not receive the rate relief it seeks in this case:[10]

Comparison of S&P's FFO/Debt Benchmark to ETI Forecast Assuming No Rate Relief

S&P Financial Risk Rank	S&P B/M FFO/Debt	ETI FFO/Debt 2013	ETI FFO/Debt 2014	ETI FFO/Debt 2015	ETI FFO/Debt 2016
Minimal	>60%				
Modest	45%-60%				
Intermediate	30%-45%				
Significant	20%-30%				
Aggressive	12%-20%				
Highly Leveraged	<12%				

Comparison of S&P's Debt/EBITA Benchmark to ETI Forecast Assuming No Rate Relief

S&P Financial Risk Rank	S&P B/M Debt/EBITDA	ETI Debt/EBITDA 2013	ETI Debt/EBITDA 2014	ETI Debt/EBITDA 2015	ETI Debt/EBITDA 2016
Minimal	1.5x				
Modest	1.5x-2x				
Intermediate	2x-3x				
Significant	3x-4x				
Aggressive	4x-5x				
Highly Leveraged	>5x				

10 S&P's ratings on ETI are based the consolidated credit profile of its parent, Entergy Corporation. Nonetheless, the metrics below are calculated based on ETI as a stand-alone entity, which is very useful in evaluating ETI's credit position and liquidity.

Comparison of S&P's Debt/Capital Benchmark to ETI Forecast Assuming No Rate Relief

S&P Financial Risk Rank	S&P B/M Debt/Capital	ETI Debt/Capital 2013	ETI Debt/Capital 2014	ETI Debt/Capital 2015	ETI Debt/Capital 2016
Minimal	<25%				
Modest	25%-35%				
Intermediate	35%-45%				
Significant	45%-50%				
Aggressive	50%-60%				
Highly Leveraged	>60%				

Given that ETI is already at the low end of the "Excellent" Business Risk Profile, and combined with forecasted credit metrics trending into the Aggressive and Highly Leveraged Financial Risk Profiles, ETI is in danger of sliding into a non-investment grade BB position on the S&P ratings matrix.

Q21. WHY WOULD IT BE SIGNIFICANT IF ETI'S CREDIT RATINGS DETERIORATE INTO NON-INVESTMENT GRADE STATUS?

A. It would be significant because lower bond ratings generally translate into higher borrowing costs. The fact that ETI's Issuer Rating from Moody's is non-investment grade already means that ETI pays higher commitment fees and interest on borrowings from its credit facility than it would if it were rated Baa3 or higher. In addition, bonds rated below investment grade are more susceptible to significantly higher interest costs should adverse events occur. For example, if the Company were to face adverse future financial events, those events will further stress a credit rating that is trending toward below investment grade by some measures. ETI's Issuer Rating from Moody's already resides within junk bond territory. The Company's strongest senior secured rating of "A-" from S&P is defined by that rating agency as being:

> somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor's capacity to meet its financial commitment on the obligations is still strong.[11]

This definition stresses the importance of a strong balance sheet and financial flexibility in managing adverse economic conditions or changing circumstances because a negative reaction from the credit rating agencies, such as a downgrade or the assignment of a "negative" watch or outlook, can have adverse consequences on the Company's access to and cost of capital.

The implications of adverse credit reactions or downgrades are even more glaring during times of tight credit markets. For example, there are factors beyond the control of the ETI that can lead to a tightening of credit markets, such as the stability of the European economy. Such external events coupled with the large amount of utility infrastructure planning and construction may limit the amount of capital available in the

---

[11] *S&P Ratings Definitions* (Aug. 24, 2009).

credit markets, resulting in access to capital becoming more difficult and expensive. These considerations imply that financially healthier utilities will have greater access to capital and will likely receive more favorable financing terms than their less healthy counterparts. The effect of this situation is likely to be proportionately greater as a utility moves further down the spectrum of creditworthiness.

Also, a downgrade can affect a utility's cash position as well as access to needed capital. A lower credit rating, and in particular a non-investment grade credit rating, could require a utility to post cash against forward gas and power purchase contracts, pre-pay for gas or power deliveries or even pre-pay for operational services such as storm restoration work from third parties and other utilities. Depending on the cost of energy commodities at the time, which can increase in response to a large storm, this could cause a material liquidity concern because of a large need for immediate cash. In this sense, a utility's credit rating can become a significant operational concern in stress scenarios.

Q22. WHAT ARE THE IMPLICATIONS OF THE DECLINE IN FINANCIAL METRICS THAT RESULT WITHOUT RATE RELIEF IN THIS CASE?

A. It is very difficult to predict the effect that changes in financial condition will have on a utility's credit rating. Financial metrics are but one piece of the rating agency process, although they are significant. Moody's ascribes a "factor rating" of 40% to the rating factor "financial strength, liquidity and key financial metrics" for utilities. Credit ratings are based on many factors, both quantitative and qualitative. However, the deterioration of ETI's credit metrics is apparent. Such an obvious change in key credit rating metrics could be a matter of significant concern to the rating agencies.

Q23. WHAT HAVE THE RATING AGENCIES SAID ABOUT ETI'S CREDIT RATINGS?

A. Moody's has indicated that the "ratings of ETI could be downgraded if the business and regulatory environment in which it operates were to deteriorate, if future rate case outcomes were not credit supportive; or if there is a significant decline in financial metrics, including CFO-pre-working capital interest coverage below 2.5 times and CFO pre-working capital to debt below 10% on a sustained basis." [12]

Clearly, the forecasted financial results I discuss above raise the very problem of financial deterioration that is a focus of Moody's concern in the quoted report. Approval of the rate increase requested by the Company, however, will help avoid that deterioration, will support the ongoing maintenance of the Company's current credit ratings, and, particularly in light of the cost of significant capital projects discussed

[12] *Moody's Investors Service*, Credit Opinion: Entergy Texas, Inc. (Dec. 26, 2012); *see also Moody's Investors Service*, Credit Opinion: Entergy Corporation (Dec. 21, 2012).

below, will enhance the Company's ability to have ready access to capital at reasonable rates, all to the ultimate benefit of ETI's customers.

Q24. ARE THERE ANY OTHER IMPLICATIONS OF A CREDIT DOWNGRADE?

A. A credit rating downgrade would affect ETI's ability to secure favorable vendor payment terms, including collateral requirements.

Q25. ASIDE FROM THE CREDIT METRICS, WHAT OTHER FACTORS IN THIS CASE COULD AFFECT ETI'S CREDIT STANDING?

A. One of the key considerations that go into a credit rating for a regulated utility such as ETI is its regulatory environment. An S&P report explained:

> Regulation is a critical aspect that underlies integrated utilities' creditworthiness. Decisions by state public service commissions can profoundly affect financial performance.... [O]ur evaluation of regulation focuses on the willingness and ability of regulation to provide cash flow and earnings quality adequate to meet investment needs, earnings stability through timely recognition of volatile cost components such as fuel and satisfactory returns of invested capital and equity.[13]

Similarly, Moody's states the following about assessing regulatory framework:

[13] *S&P RatingsDirect*: Assessing U.S. Vertically Integrated Utilities? Business Risk Drivers (Sept. 14, 2006); *see also S&P RatingsDirect*: Top Ten Credit Issues Facing U.S. Utilities (Jan. 29, 2007).

> For a regulated utility, the predictability and supportiveness of the regulatory framework in which it operates is a key credit consideration and the one that differentiates the industry from most other corporate sectors.[14]

Credit rating agencies closely follow regulatory decisions, particularly those related to rate cases, because such developments can have a significant effect on the utility's liquidity and its ability to honor debt and contractual commitments. Accordingly, the decisions in this rate case will have an impact on ETI's financial health and creditworthiness, which, in turn, directly affects the cost to ETI to access capital. As described below, ETI is continuing a period of significant capital spending and will need to have ready access to the debt markets on reasonable terms.

Q26. DID ETI ACHIEVE A REASONABLE RETURN ON ITS EQUITY CAPITAL IN 2012?

A. No.

Q27. HOW DO ETI'S ACTUAL EARNINGS LEVELS COMPARE TO THE EARNINGS LEVELS AUTHORIZED BY THE COMMISSION?

A. As shown in the table below, ETI has not earned its authorized return on equity in over 14 years. ETI's best year in the last five years – 2011 – resulted in earnings of about $80.8 million and a resulting reported return on equity of 9.38%. That year, however, was a year of unusually warm

---

[14] *Moody's*, Infrastructure Finance, Regulated Electric and Gas Utilities (Aug. 2009).

weather. Were earnings from that year weather normalized, the resulting ROE would have been less than 7%. As shown in the chart below, 7% is about the average of ETI's recent return on equity over the most recent five-year span.

	PUCT-Reported Earned Return[15]	PUCT-Reported ROE[16]	Actual ROE[17]	Authorized ROE
1999	8.09%	7.64%		10.95%
2000	8.84%	9.38%		10.95%
2001	6.53%	5.66%		10.95%
2002	8.03%	9.72%		10.95%
2003	7.50%	9.04%		10.95%
2004	9.33%	7.66%		10.95%
2005	6.85%	7.88%		10.95%
2006	5.89%	5.66%		10.95%
2007	N/A	N/A		10.95%
2008	5.16%	4.98%	6.08%	10.95%
2009	N/A	N/A	7.32%	10.00%
2010	7.22%	7.10%	7.93%	10.125%
2011	N/A	N/A	9.38%	10.125%
2012	6.73%	6.73%	4.79%	9.80%

As these numbers show, in just the last five years, ETI has consistently fallen millions of dollars below the revenues it needs to earn its authorized return on equity.

15 Texas jurisdictional returns as reported in the Commission-approved format (as "annual reports" for years 1999-2004 and "earnings monitoring reports for years 2005-2012).

16 *Id.*

17 SEC-reported net income divided by average stockholder equity. ETI did not exist as a stand-alone company for reporting purposes prior to 2008.

Q28. WOULD THE ROE IN 2012 HAVE BEEN HIGHER IF THE EARNINGS EFFECT OF THE ONE-TIME WRITE-OFFS RESULTING FROM THE ORDER ON REHEARING IN DOCKET NO. 39896 WERE EXCLUDED?

A. Yes, but the ROE would have increased to only 6.4%, which is still 340 basis points below the 9.8% ROE that was approved in that docket.

Q29. DO YOU EXPECT THE RATES APPROVED IN DOCKET NO. 39896 WILL ALLOW THE COMPANY TO EARN ITS AUTHORIZED RETURN ON EQUITY?

A. No. The Company's last base rate change (Docket No. 39896) resulted in a rate increase of about $28 million annually, which became effective as of June 30, 2012. That case improved ETI's cash flow somewhat, but, as the ROE for 2012 (which included six months of the increased rates) demonstrates, it does little to address ETI's long-standing failure to earn an adequate return on its equity investment in Texas. There are three primary reasons for this.

First, most of the $28 million increase in 2012 was related to increases in depreciation rates and amortization expenses. Those types of increases do improve cash flow, but they do not help earnings or return on equity. That is because the increase in rate revenues for depreciation and amortization expense is matched dollar for dollar by increases in operating expense. As a result, the increased revenues from the 2012 rate case had only a small effect on earnings.

Second, although the over-all operating revenues (*i.e.*, billings to customers) of the Company have been declining over the last several years, resulting in very significant reductions in customer bills, the Company's non-fuel costs are increasing at a rate faster than the increase in non-fuel revenues. The upshot is that over the last several years, even as customer bills fall, the combination of rate increases and load growth has not provided the Company with sufficient incremental base rate revenues to match increases in incremental non-fuel costs, resulting in the inability of the Company to earn a reasonable return on equity.

Third, the Company's need for additional revenues reflects not only the need to recover its incremental cost increases from one test year to the next but also, as in the previous cases, the Company needs additional revenue to reflect known and measureable increases in its test year costs.

Q30. YOU MENTIONED ABOVE THE DECLINE IN ETI'S OPERATING REVENUES. CAN YOU DEMONSTRATE AND EXPLAIN THIS DECLINE?

A. Yes. As shown on page 395 of the most recent United States Securities and Exchange Commission Form 10-K for the year ended 2012, ETI's electric operating revenues declined from $1,757,199,000 in 2011 to $1,581,496,000 in 2012, which is a difference of $175,703,000. Operating revenues are the amounts customers pay ETI for electric service. This means that a decline in operating revenues reflects a decline in customer bills. In other words, ETI's customers' electric bills declined by \$175 million,[18] or on average by about 10%, in 2012 notwithstanding recent base rate increases totaling \$37 million.[19]

One could extend this analysis of operating revenues back to 2008, when operating revenues of ETI were \$2,012,258,000, as shown on page 395 of the 10-K. Since 2008, Texas customer bills have decreased by about \$430 million annually, or about 21%. This decrease in operating revenues occurs despite base rate case increases of approximately \$143 million since 2008.[20]

Q31. WHY ARE OPERATING REVENUES DECLINING?

A. Operating revenues, and customer bills, are declining mostly due to lower fuel costs. There are two primary causes of lower fuel costs. The first is lower fuel rates, or fuel prices, mostly caused by declining fuel costs or the dispatch of cheaper fuels. Of the \$175 million reduction in operating revenues between 2011 and 2012, \$156 million was due to reductions in fuel prices, mostly natural gas.

A second and separate cause of fuel savings is better fuel efficiency in power plants. Since 2010, ETI has entered into two

---

[18] Includes wholesale and other revenue effects.

[19] The \$37 million base rate increase is the sum of a \$9 million increase in 2011 and the \$28 million increase in 2012.

[20] The \$143 base rate increase is the sum of a \$46.7 million increase in 2009, a \$59 million increase in 2010, a \$9 million increase in 2011, and a \$28 million increase in 2012.

third-party purchase contracts that supply ETI with almost 550 MW of natural gas-fired power. They are the 300 MW Frontier contract and the 242 MW Carville contract. Because those units are more efficient than the older units they displaced, the power plants that supply this power burn less natural gas to produce energy. Since the beginning of the fuel reconciliation period in this case (July 1, 2011) through the end of the test year, the portions of these two contracts that are not in base rates have resulted in $38 million in fuel savings and resulting decreases in operating revenues and customer bills.

Q32. HAS GROWTH IN ETI'S SERVICE AREA GENERATED SUFFICIENT CASH FLOW TO KEEP UP WITH ITS COSTS?

A. No, it has not. This conclusion is supported by the trend in ETI's weather-adjusted retail sales from 2008 through 2012. ETI's annual weather-adjusted retail sales growth has been sluggish during this time period as evidenced by

this rate of growth is an indication that funds from operations will be insufficient to support the cost of ETI's ongoing level of operations and infrastructure investments. It is therefore important that ETI have the ability to raise capital on reasonable terms.

Q33. PLEASE SUMMARIZE THE SIGNIFICANCE OF YOUR ANALYSIS OF ETI'S FINANCIAL INTEGRITY.

A. Rising costs along with decreasing revenues are preventing ETI's investors from having an opportunity to earn a reasonable return. The projected deteriorating financial metrics, including increased capital spending, as discussed below, show that ETI runs the risk of increased financing costs without rate relief. Increased financing costs will result in increased costs to ETI's customers.

On the other hand, granting the Company's request would provide for financing of ETI's planned capital projects under favorable terms while at the same time enabling ETI's investors the opportunity to earn a fair return. It would result in a financially healthier Company that would continue to weather severe storms, harden its system, build the infrastructure necessary to continue providing reliable service, integrate into MISO, and prepare for operations as a stand-alone Operating Company after exiting the System Agreement.

III. ETI'S FUTURE FINANCIAL PLANS AND CHALLENGES

Q34. WHAT TOPICS DO YOU ADDRESS IN THIS SECTION OF YOUR TESTIMONY?

A. The point of my testimony in this section is to explain to the Commission how the proposed rate increase in this case will support ETI's ability to operate from a strong financial base going forward as it addresses the combination of financial plans and challenges associated with: 1) making significant future capital expenditures necessary to provide continuing reliable service; 2) addressing future capacity costs and needs; and 3) operating in a service area highly exposed to weather-related event risk.

A. Future Capital Expenditures

Q35. WHAT IS THE FOCUS OF THIS SECTION OF YOUR TESTIMONY?

A. I address the Company's upcoming planned capital expenditures and how an improved financial condition will support the successful completion of these capital projects.

Q36. PLEASE DESCRIBE ETI'S FUTURE CAPITAL NEEDS.

A. ETI has significant planned capital expenditures upcoming in the near future. These planned capital expenditures include plant upgrades, transmission upgrades,[21] system reliability and economic improvements, and regulatory compliance projects. ETI's current approved capital budget anticipates capital expenditures totaling $636 million through 2015:

[21] If the transaction with ITC Holdings Corp. closes, ITC would be the entity responsible for transmission upgrades on what were the ETI transmission assets. ETI would be charged for these upgrades through ITC's rates.

	2013 ($ millions)	2014 ($ millions)	2015 ($ millions)
Generation			
Transmission			
Distribution			
Other			
Total			

The level of projected capital expenditures is substantial compared to ETI's current rate base of approximately $1.6 billion. Moreover, these investments are significant compared to the level of depreciation and amortization expense included in ETI's proposed rates, which is approximately $90 million. Considering that the planned annual capital investments significantly exceed the cash provided by depreciation and amortization expense, it is clear that ETI will have to access the capital markets to continue to make the growth and reliability-related investments required in its service area.

Q37. WHAT CAN BE DONE TO HELP MITIGATE THE COST OF ACQUIRING CAPITAL?

A. The most important tool for securing attractive financing rates is the assurance that ETI is financially healthy. Thus, a constructive result from this proceeding will mitigate the Company's exposure to refinancing and interest rate risk, which will redound to the benefit of customers.

Q38. ARE THERE ANY OTHER FACTORS SPECIFIC TO UTILITY CAPITAL MARKETS THAT ARGUE FOR IMPROVED FINANCIAL HEALTH FOR THE COMPANY GOING FORWARD?

A. Yes. Utility companies and industry analysts foresee a continuing high level of capital expenditures. For example, in June 2012, EEI projected that industry-wide capital expenditures will reach $83.5 billion in 2013 and $79.3 billion in 2014.[22] Moody's similarly noted that capital expenditures for most U.S. utilities remain at elevated levels, "outpacing depreciation and amortization ... expense by almost 100%, on average, for the past five years."[23] Moody's explained that the expenditures are primarily for regular maintenance and infrastructure improvement, meeting load growth, and compliance with environmental mandates.[24] Moody's expects that these high capital expenditures will continue for the foreseeable future.[25]

Moody's cautioned that a sustained period of heightened capital investment can create negative ratings pressure for utilities, especially if recovery is deferred, or if financing plans are overly biased toward debt,

---

22 EEI, Industry Capital Expenditures (Jun. 28, 2012).

23 Moody's Investors Service, *High Capital Expenditures Adding to Rate Pressure for Utilities* (Oct. 26, 2012).

24 *Id.*

25 Moody's Investors Service, *Regulatory Support, Low Natural Gas Prices Maintains Stability* (Feb. 6, 2013).

which hurts financial metrics.[26] Moreover, this large amount of utility infrastructure planning and construction can reasonably be expected to lead to tightening in the credit markets, with normal supply and demand dynamics in place, and with access to capital becoming more difficult and expensive. These considerations will mean that financially healthier utilities will receive more favorable financing terms. The impact of this situation will be proportionately greater as a utility goes farther down the spectrum of creditworthiness. Further, it typically takes time to regain a previous credit rating once it has been downgraded. Thus, higher capital costs could be in place for several years and would adversely affect the interest costs on all debt issuances during that period.

Q39. IS ETI SIMILARLY FORECASTING CONTINUED HIGH LEVELS OF CAPITAL SPENDING?

A. Yes. The forecast I presented above shows ETI's capital spending will remain high, and in fact it will continue to increase year over year, through at least 2015.

[26] Moody's Investors Service, *High Capital Expenditures Adding to Rate Pressure for Utilities* (Oct. 26, 2012).

B. Resource Planning

Q40. HOW WILL A HEALTHY FINANCIAL CONDITION HELP ETI WITH RESPECT TO RESOURCE PLANNING?

A. ETI will face a number of challenges in the coming years with respect to resource planning. As discussed by Company witness Robert R. Cooper, ETI is currently short of its generation capacity requirements relative to the other Operating Companies. There are also a number of other changes across the Entergy System set to occur in the near future that will affect ETI's capacity needs and costs, including: changes to resources at other Operating Companies, Entergy Arkansas, Inc. and Entergy Mississippi, Inc. leaving the System Agreement, and the expiration of the ETEC contracts. A little further out, the circumstances surrounding ETI's potential exit from System Agreement further complicate the resource planning picture. In any event, addressing capacity needs and costs will be a priority for ETI.

A strong financial condition will provide ETI with flexibility to address its future capacity needs and costs. Should ETI need to acquire, build, or refurbish units, a strong financial position will allow it to access debt markets on better terms. Should ETI need to address capacity needs with Purchased Power Agreements ("PPAs") or in some sort of capacity market, strong cash flows will better allow ETI to shoulder the increased expenses until they can be recovered in rates. Maintaining strong cash flows is important in those situations because reduced cash flow can negatively affect the Company's financial credit metrics, which can have an adverse effect on the Company's credit rating. Degrading credit ratings have an adverse effect on the cost of debt, which increases the costs of planned infrastructure improvements to customers. Deteriorating cash flows also undercut the Company's opportunity to earn a reasonable return on its invested capital.

Q41. DO PURCHASED POWER COSTS HAVE ANOTHER EFFECT ON CREDIT METRICS?

A. Yes, it is my understanding that the rating agencies consider a company's purchased power obligations as imputed debt, which is factored into the debt components of the financial ratios. For example, S&P states that "[w]e view purchased power supply agreements (PPAs) as creating fixed, debt-like financial obligations that represent substitutes for debt-financed capital investments in generating capacity."[27] As a result, if ETI fills its resource portfolio with purchased capacity, its ratings-adjusted debt ratios are likely to increase, which can have a negative effect on the Company's credit ratings.

[27] *S&P RatingsDirect*: Encyclopedia of Analytical Adjustments for Corporate Entities (Jul. 9, 2007).

Q42. HOW CAN THE COMPANY'S CASH FLOWS BE STRENGTHENED?

A. Approving the rate increase, including the ROE advocated by Company witness Samuel C. Hadaway, would provide better cash flows to fund construction, pay dividends and maintain healthy credit metrics, which in turn will maintain or improve credit ratings. Approving the Company's special circumstances request for recovery of certain capacity costs will also strengthen cash flows. As described by Mr. Cooper, the Company entered into two PPAs that have provided significant fuel savings to customers during the fuel reconciliation period, while much of the capacity costs of those contracts were not recovered in rates. Granting the special circumstances recovery of $23 million in capacity costs for those two PPAs would most certainly improve the Company's financial position and cash flows. Also, recovery of these purchased capacity costs, for which customers are already receiving the benefit through lower fuel costs, would help improve ETI's earned return on equity and, thus, its financial health.

C. Effect of ETI's Exposure to Catastrophic Storms

Q43. IS ETI'S EXPOSURE TO CATASTROPHIC STORM DAMAGE AN IMPORTANT ELEMENT OF ITS FINANCIAL AND OPERATIONAL RISKS?

A. Yes. The damage to ETI's utility infrastructure wrought by Hurricane Rita in 2005 and Hurricane Ike in 2008 has demonstrated that the risk of catastrophic storm damage is real. While Hurricane Isaac narrowly missed ETI's service area, it caused substantial damage to ETI's affiliated Operating Companies in Louisiana in August 2012.

Q44. HOW DOES A DISASTROUS STORM SUCH AS HURRICANE RITA OR HURRICANE IKE IMPACT THE COMPANY FINANCIALLY?

A. Such events put a premium on adequate "liquidity" — that is, cash flow to provide for payment of unexpected additional, very large expense items needed to get the system up and running as soon as possible. This requires not only the immediate investments required just to get the power restored but also the additional investment required thereafter to make the necessary infrastructure repairs to the grid. The Company also faces additional pressure on its liquidity in the form of higher fuel prices and potentially higher collateral requirements from suppliers.

Although the Texas Legislature passed a bill in 2009 (SB 769) that provides all Texas utilities with a reasonable expectation that the costs of preparing for, responding to, and repairing catastrophic infrastructure damage caused by severe weather events, the time that passes between when costs are incurred to restore service and when those costs are recovered via securitization or otherwise can be and historically has been significant. Thus, liquidity is a serious concern during that intervening period, which has been recognized by the credit rating agencies.[28]

Q45. HOW CAN THE OUTCOME OF THIS RATE CASE POSITION THE COMPANY TO BEST RESPOND TO CATASTROPHIC STORM DAMAGES?

A. If rates are set in this case sufficient to cover ETI's reasonable and necessary costs and to provide a reasonable return, as proposed, that outcome will support increased liquidity for the Company to support its response to a future disastrous event such as a hurricane. In addition, improvement in the Company's financial condition will help ETI access the services and capital necessary to restore the system during a period in which it receives reduced or no revenues from customers.

IV. HURRICANE RITA REGULATORY ASSET

Q46. WHAT DID THE COMMISSION ORDER IN DOCKET NO. 39896 WITH REGARD TO THE HURRICANE RITA REGULATORY ASSET?

A. The Commission determined that the Hurricane Rita regulatory asset had been established in a prior proceeding and that the appropriate balance as

[28] *See* Moody's Investors Service, *Credit Opinion: Entergy Texas, Inc.* (Dec. 26, 2012) ("the experience of Entergy's Gulf Coast subsidiaries is dealing with severe storm events … can lead to material calls on liquidity.").

of the end of the test year in Docket No. 39896 was $15,175,563, applying a five-year amortization beginning August 15, 2010.

Q47. HAS THE COMPANY ADJUSTED THE BALANCE IN THIS CASE CONSISTENT WITH THE COMMISSION'S FINDINGS IN DOCKET NO. 39896?

A. Yes. Although the Company has appealed the Commission's decision with respect to its findings on the Hurricane Rita Regulatory Asset issue, the Company has included the adjusted balance in the proceeding, without prejudice to its continuing appeal on this issue.

V. CAPITAL STRUCTURE

Q48. PLEASE SUMMARIZE THE RECOMMENDATIONS CONCERNING CAPITAL STRUCTURE AND COST OF CAPITAL.

A. ETI is proposing to use the test year capital structure. The following table summarizes the Company's proposed capital structure and cost of capital, incorporating the cost of debt and preferred stock provided by Company witness Considine, along with Company witness Hadaway's recommended return on equity, to arrive at ETI's overall weighted average cost of capital ("WACC").

ETI	% of Total Capitalization	Cost of Capital Rate	WACC (%)
Long-Term Debt	51.41%	6.7302	3.4600%
Preferred Stock	0.00%	0.00%	0.00%
Common Equity	48.59%	10.4%	5.0534%
Total	100.00%		8.5133%

ETI's proposed test-year debt to total capital ratio is very near S&P's benchmark range (45% to 50%) for companies with ETI's business risk profile ranking of "excellent" and financial risk profile of "significant."[29] Company witness Hadaway addresses the similarity between ETI's proposed capital structure and that of comparable utilities.

VI. PRO FORMA ADJUSTMENTS

Q49. ARE YOU SPONSORING ANY PRO FORMA ADJUSTMENTS?

A. Yes. The pro forma adjustments that I sponsor are listed below.

- AJ21A – Remove Company Aircraft Costs
- AJ21B – Remove Ticket Costs
- AJ21E – Remove Hurricane Rita Severance & Relocation Costs
- AJ21H – Remove Costs from Gas and Nuclear Organizations
- AJ21I – Remove Non-Recoverable Costs

These test year pro forma adjustments are for items that the Company has removed because they are not being sought for recovery

[29] *S&P RatingsDirect: Criteria Methodology*: Business Risk/Financial Risk Matrix Expanded (May 27, 2009).

and/or because they are not recoverable pursuant to P.U.C. Subst. R. 25.231(b)(2). For example, AJ21A removes the costs of Company-owned aircraft from the cost of service. Exhibit SBT-12 to the testimony of Stephanie B. Tumminello describes each of these test year pro forma adjustments.

VII. CONCLUSION

Q50. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Granting the Company's requested rate increase will allow it the opportunity to earn a reasonable return for investors. Moreover, as the Company looks to the future, including integration into MISO and exiting the System Agreement, it is clear that the rate increase proposed by the Company will support a healthy financial condition that is necessary to deal with its ongoing infrastructure and operational needs, and the associated financial challenges of meeting those needs. Approval of the proposed rates will assure the financial markets that Texas regulation can support a solid and potentially improving credit profile and make it more likely that the Company will navigate successfully through future unexpected and severely adverse financial events. All of these outcomes, in turn, will support access to capital at reasonable terms and reliable service to the benefit of customers. ETI's future capital expenditures, capacity issues, integration into MISO, exit from the System Agreement, and its exposure to weather-related event risk present significant financial challenges as ETI looks to its future in Texas.

Q51. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

This page has been intentionally left blank.

CHRIS E. BARRILLEAUX, C.P.A.
639 LOYOLA AVENUE
NEW ORLEANS, LA 70113
(504) 576-4309

PROFESSIONAL EXPERIENCE

Director, Jurisdictional Finance, Entergy Services, Inc., New Orleans, LA	2006 - Present
Project Manager, Entergy Services, Inc., New Orleans, LA	2003 - 2006
Manager-Utility Operations Accounting, Entergy Services, Inc., New Orleans, LA	2001 - 2003
Manager-Intrasystem Affiliate Billing, Entergy Services, Inc., New Orleans, LA	1996 - 2001
Manager-External Reporting and Accounting Policy, Entergy Services, Inc., New Orleans, LA	1996
Senior Accountant-ESI Accounting, Entergy Services, Inc., New Orleans, LA	1995 - 1996
Senior Accountant-External Reporting Section, Entergy Services, Inc., New Orleans, LA	1994 - 1995
Senior Accountant-Corporate Accounting Department, Entergy Services, Inc., New Orleans, LA	1993 - 1994
Senior Accountant-Regulatory Accounting, Louisiana Power & Light Company, New Orleans, LA	1991 - 1993
Accountant-External Reporting, Louisiana Power & Light Company, New Orleans, LA	1987 - 1991
Controller-New Orleans Metropolitan Convention and Visitors Bureau, Inc., New Orleans, LA	1985 - 1987

EDUCATION AND CERTIFICATON

Bachelor of Science Degree in Accounting, University of New Orleans, 1985.
Master of Business Administration Degree (with honors), Tulane University, 2003.
Certified Public Accountant, Louisiana, 1987.

PROFESSIONAL AFFILIATIONS

American Institute of Certified Public Accountants
Society of Louisiana Certified Public Accountants
Institute of Management Accountants
Beta Gamma Sigma Honor Society

This page has been intentionally left blank.

DOCKET NO. 41791

APPLICATION OF ENTERGY TEXAS, INC. FOR AUTHORITY TO CHANGE RATES AND RECONCILE FUEL COSTS	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

DIRECT TESTIMONY

OF

SAMUEL C. HADAWAY

ON BEHALF OF

ENTERGY TEXAS, INC.

SEPTEMBER 2013

ENTERGY TEXAS, INC.
DIRECT TESTIMONY OF SAMUEL C. HADAWAY
2013 RATE CASE

TABLE OF CONTENTS

EXHIBITS

I. INTRODUCTION AND SUMMARY OF TESTIMONY

Q1. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Samuel C. Hadaway. I am a Principal in FINANCO, Inc., Financial Analysis Consultants, 3520 Executive Center Drive, Austin, Texas 78731.

Q2. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of Entergy Texas, Inc. (hereinafter "ETI" or the "Company").

Q3. BRIEFLY DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I have a Bachelor's degree in economics from Southern Methodist University, as well as MBA and Ph.D. degrees with concentrations in finance and economics from the University of Texas at Austin ("UT Austin"). I am an owner and full-time employee of FINANCO, Inc. FINANCO provides financial research concerning the cost of capital and financial condition for regulated companies as well as financial modeling and other economic studies in litigation support. In addition to my work at FINANCO, I have served as an adjunct professor in the McCombs School of Business at UT Austin and in what is now the McCoy College of Business at Texas State University. In my prior academic work, I taught economics and finance courses and I conducted research and directed graduate students in the areas of investments and capital market research. I was previously Director of the Economic Research Division at the Public Utility Commission ("Commission") of Texas where I supervised the Commission's finance, economics, and accounting staff, and served as the Commission's chief financial witness in electric and telephone rate cases. I have taught courses at various utility conferences on cost of capital, capital structure, utility financial condition, and cost allocation and rate design issues. I have made presentations before the New York Society of Security Analysts, the National Rate of Return Analysts Forum, and various other professional and legislative groups. I have served as a vice president and on the board of directors of the Financial Management Association.

A list of my publications and testimony I have given before various regulatory bodies and in state and federal courts is contained in my resume, which is included as Appendix A.

Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to estimate the appropriate rate of return on equity capital ("ROE") for ETI.

Q5. PLEASE DEFINE THE TERM "COST OF EQUITY CAPITAL."

A. The cost of equity capital (sometimes referred to as "cost of equity" or "COE") is the rate of return that equity investors require or expect to receive from their investments in common stocks. Conceptually, COE is no different than the interest rate on debt or the cost of preferred stock. Equity investors expect a return on their capital commensurate with the risks they take in making the investment and consistent with returns that might be available from other similar investments.

Q6. IS COE THE SAME AS ROE?

A. The terms are often used interchangeably. In regulatory proceedings, however, ROE is the commission-established component that, along with the utility's cost of debt and preferred stock, is used to calculate the utility's overall cost of capital, which is used in setting rates. To establish ROE, regulatory commissions typically consider the quantitative results of various traditional cost of equity models, which I describe below, as well as other relevant economic factors and circumstances.

Q7. HAVE YOU ESTIMATED THE COE FOR A GROUP OF UTILITIES COMPARABLE TO ETI?

A. Yes. As I customarily do, I have applied the discounted cash flow ("DCF") model to a group of comparable electric utilities to estimate ROE for ETI. However, the results from that analysis do not currently pass basic tests of reasonableness. A comparison of COE estimates from the DCF model to contemporaneous estimates from the equity risk premium model demonstrates significant difficulty in deriving reliable results from the DCF model.

As I will show later, utility interest rates over the past three months have *increased* by over 70 basis points (*see* Table 1 below). During this time, estimates of COE from the DCF model have *dropped* by 40 to 60 basis points. These results are in stark contrast to basic economic theory, and to simple common sense. While COE does not necessarily move in lockstep with interest rates, the two generally do move in the same direction. When a COE estimation model produces an entirely contrary result, as the DCF model currently does, that model should be reconsidered and other approaches given more weight. My updated risk premium model shows a more reasonable result. That model currently indicates that COE has increased by 40 basis points or more, with a current COE range of 10.0 percent to 10.4 percent.

As I will explain in more detail later, all quantitative models for estimating COE have been significantly affected by the artificially low interest rates that resulted from the government's expansionary monetary policy. Additionally, the Federal Reserve System ("Fed"), in its June 19, 2013 policy announcement, has signaled a shift toward less accommodative monetary policy and the capital markets have now responded with an increasing interest rate trend. Given the structure of and required inputs for the quantitative models used to estimate COE, it is virtually impossible, with the data so far available, to capture these trends. Therefore, based on portions of my quantitative results and my further review of other economic data and current market conditions, I support an allowed ROE of 10.4 percent for ETI. While the requested ROE is at the top of my quantitative model results, under current market conditions and economic circumstances, I believe an ROE at this level is reasonable for establishing the Company's rates.

Q8. HOW IS YOUR ANALYSIS STRUCTURED?

In my DCF analysis, I apply a comparable company approach. ETI's cost of equity cannot be estimated directly from its own market data because the Company is a wholly-owned subsidiary of Entergy Corporation. As such, ETI does not have publicly traded common stock or other independent market data that would be required to estimate its cost of equity directly. This approach is also appropriate because it provides a statistically sound estimate of ROE that is consistent with *Hope* and *Bluefield* requirements.

I begin my comparable company review with all the vertically-integrated electric utilities that are included in the *Value Line Investment Survey* ("Value Line"). Value Line is a widely-followed, reputable source of financial data that is often used by professional regulatory economists. ETI has a corporate credit rating of BBB and a First Mortgage Bond rating