BEFORE THE

LOUISIANA PUBLIC SERVICE COMMISSION

APPLICATION OF ENTERGY LOUISIANA, LLC FOR APPROVAL OF REGULATORY BLUEPRINT NECESSARY FOR COMPANY TO STRENGTHEN THE ELECTRIC GRID FOR STATE OF LOUISIANA	))))))	**DOCKET NO. U-_____**

DIRECT TESTIMONY

OF

ADRIEN M. MCKENZIE, CFA

ON BEHALF OF

ENTERGY LOUISIANA, LLC

PUBLIC REDACTED VERSION

AUGUST 2023

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EXHIBIT LIST

I. INTRODUCTION

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A1. My name is Adrien M. McKenzie, and my business address is 3907 Red River, Austin, Texas, 78751.

Q2. IN WHAT CAPACITY ARE YOU EMPLOYED?

A2. I am President of FINCAP, Inc., a firm providing financial, economic, and policy consulting services to business and government.

Q3. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND QUALIFICATIONS.

A3. A description of my background and qualifications, including a resume containing the details of my experience, is attached as Exhibit AMM-1.

A. Overview

Q4. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS CASE?

A4. The purpose of my direct testimony is to present to the Louisiana Public Service ("LPSC" or the "Commission") my independent assessment of the fair and reasonable rate of return on equity ("ROE") for the jurisdictional electric utility operations of Entergy Louisiana, LLC ("ELL" or the "Company"). In addition, I also examined the reasonableness of the Company's capital structure, considering both the specific risks faced by the Company, as well as other industry guidelines.

Q5. PLEASE SUMMARIZE THE INFORMATION AND MATERIALS YOU RELY ON TO SUPPORT THE OPINIONS AND CONCLUSIONS CONTAINED IN YOUR TESTIMONY.

A5. To prepare my testimony, I use information from a variety of sources that would normally be relied upon by a person in my capacity. In connection with this filing, I consider and rely upon corporate disclosures, publicly available financial reports, prior regulatory filings, and other published information relating to ELL. I also review information relating generally to current capital market conditions and specifically to investor perceptions, requirements, and expectations for utilities. These sources, coupled with my experience in the fields of finance and utility regulation, have given me a working knowledge of the issues relevant to investors' required return for ELL, and they form the basis of my analyses and conclusions.

Q6. HOW IS YOUR TESTIMONY ORGANIZED?

A6. First, I summarize my conclusions and recommendations, giving special attention to the importance of financial strength and the implications of regulatory mechanisms and other risk factors. I also comment on the reasonableness of the Company's proposed capital structure.

Next, I briefly review ELL's operations and finances. I then discuss current conditions in the capital markets and their implications in evaluating a just and reasonable return for the Company. I then explain the development of the proxy group of electric utilities used as the basis for my quantitative analyses. With this as a background, I discuss well-accepted quantitative analyses to estimate the current cost

of equity for the proxy group of utilities. These include the discounted cash flow ("DCF") model, the Capital Asset Pricing Model ("CAPM") and the empirical CAPM ("ECAPM"), an equity risk premium approach based on allowed equity returns, and reference to expected earned rates of return for utilities, which are all methods that are commonly relied on in regulatory proceedings. Additionally, I discuss the issue of stock flotation expenses and the implications of these legitimate costs on the estimation of a reasonable ROE for the Company.

Based on the results of my analyses, I evaluate a fair ROE for ELL. My evaluation takes into account the specific risks for the Company's utility operations in Louisiana and ELL's requirements for financial strength. Finally, consistent with the fact that utilities must compete for capital with firms outside their own industry, I corroborate my utility quantitative analyses by applying the DCF model to a group of low-risk non-utility firms.

B. Summary and Conclusions

Q7. WHAT IS YOUR RECOMMENDED ROE FOR ELL?

A7. I apply the DCF, CAPM, ECAPM, risk premium, and expected earnings analyses to a proxy group of electric utilities, with the results being summarized on Exhibit AMM-2. As shown there, I recommend a cost of equity range for the Company's electric operations of 10.1% to 11.1%, or 10.2% to 11.2% after adjusting for the impact of common equity flotation costs. It is my conclusion that the 10.7% midpoint of this range represents a just and reasonable ROE that is adequate to compensate ELL's

investors, while maintaining the Company's financial integrity and ability to attract capital on reasonable terms.

Q8. IS ELL REQUESTING AN ROE THAT IS LOWER THAN YOUR RECOMMENDATION?

A8. Yes. As reflected in the testimony of Company witness Phillip R. May, ELL's class cost of service study incorporates an ROE of 10.5%. The evidence presented in my testimony provides substantial support to conclude that a 10.5% ROE for the Company is both reasonable and conservative.

II. RETURN ON EQUITY FOR ELL

Q9. WHAT IS THE PURPOSE OF SECTION II OF YOUR DIRECT TESTIMONY?

A9. Section II of my Direct Testimony presents my conclusions regarding the fair ROE applicable to ELL's jurisdictional electric utility operations. I also describe the relationship between ROE and preservation of a utility's financial integrity and the ability to attract capital. Finally, I discuss the reasonableness of the Company's capital structure request in this case.

A. Importance of Financial Strength

Q10. WHAT IS THE ROLE OF THE ROE IN SETTING A UTILITY'S RATES?

A10. The ROE is the cost of attracting and retaining common equity investment in the utility's physical plant and assets. This investment is necessary to finance the asset base needed to provide utility service. Investors commit capital only if they expect to

earn a return on their investment commensurate with returns available from alternative investments with comparable risks. Moreover, a just and reasonable ROE is integral in meeting sound regulatory economics and the standards established by the U.S. Supreme Court. The *Bluefield* case set the standard against which just and reasonable rates are measured:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties. . . . The return should be reasonable, sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties.[1]

The *Hope* case expanded on the guidelines for a reasonable ROE, reemphasizing the findings in *Bluefield* and establishing that the rate-setting process must produce an end-result that allows the utility a reasonable opportunity to cover its capital costs. The Court stated:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard, the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain credit and attract capital.[2]

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[1] *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923) (*Bluefield*).

[2] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*).

In summary, the Supreme Court's findings in *Hope* and *Bluefield* established that a just and reasonable ROE must be sufficient to 1) fairly compensate the utility's investors, 2) enable the utility to offer a return adequate to attract new capital on reasonable terms, and 3) maintain the utility's financial integrity. These standards should allow the utility to fulfill its obligation to provide reliable service while meeting the needs of customers through necessary system replacement and expansion, but the Supreme Court's requirements can only be met if the utility has a reasonable opportunity to actually earn its allowed ROE.

While the *Hope* and *Bluefield* decisions did not establish a particular method to be followed in fixing rates (or in determining the allowed ROE),[3] these and subsequent cases enshrined the importance of an end result that meets the opportunity cost standard of finance. Under this doctrine, the required return is established by investors in the capital markets based on expected returns available from comparable risk investments. Coupled with modern financial theory, which has led to the development of formal risk-return models (*e.g.*, DCF and CAPM), practical application of the *Bluefield* and *Hope* standards involves the independent, case-by-case consideration of capital market data in order to evaluate an ROE that will produce a balanced and fair end result for investors and customers.

[3] *Id.* at 602, finding, "the Commission was not bound to the use of any single formula or combination of formulae in determining rates." and, "[I]t is not theory but the impact of the rate order which counts."

Q11. THROUGHOUT YOUR TESTIMONY YOU REFER REPEATEDLY TO THE CONCEPTS OF "FINANCIAL STRENGTH," "FINANCIAL INTEGRITY," AND "FINANCIAL FLEXIBILITY." WOULD YOU BRIEFLY DESCRIBE WHAT YOU MEAN BY THESE TERMS?

A11. These terms are generally synonymous and refer to the utility's ability to attract and retain the capital that is necessary to provide service at reasonable cost, consistent with the Supreme Court standards. ELL's plans call for a continuation of capital investments to preserve and enhance service reliability and meet the needs of the Company's customers. The Company must generate adequate cash flow from operations to fund these requirements and maintain access to capital from external sources.

Rating agencies and potential debt investors tend to place significant emphasis on maintaining strong financial metrics and credit ratings that support access to debt capital markets under reasonable terms. Company witness Todd A. Shipman discusses these topics in depth in his direct testimony. This emphasis on financial metrics and credit ratings is shared by equity investors who also focus on cash flows, capital structure, and liquidity, much like debt investors.

Q12. WHAT PART DOES REGULATION PLAY IN ENSURING THAT ELL HAS ACCESS TO CAPITAL UNDER REASONABLE TERMS AND ON A SUSTAINABLE BASIS?

A12. Regulatory signals are a major driver of investors' risk assessment for utilities. Investors recognize that constructive regulation is a key ingredient in supporting utility credit ratings and financial integrity. Security analysts study commission orders and

regulatory policy statements to advise investors about where to put their money. As Moody's Investors Service ("Moody's") noted, "the regulatory environment is the most important driver of our outlook because it sets the pace for cost recovery."[4] Similarly, S&P Global Ratings ("S&P") observed that, "Regulatory advantage is the most heavily weighted factor when S&P Global Ratings analyzes a regulated utility's business risk profile."[5] The Value Line Investment Survey ("Value Line") summarizes these sentiments:

> As we often point out, the most important factor in any utility's success, whether it provides electricity, gas, or water, is the regulatory climate in which it operates. Harsh regulatory conditions can make it nearly impossible for the best run utilities to earn a reasonable return on their investment.[6]

In addition, the ROE set by regulators impacts investor confidence in not only the jurisdictional utility, but also in the ultimate parent company that is the entity that actually issues common stock.

Q13. DO CUSTOMERS BENEFIT BY ENHANCING THE UTILITY'S FINANCIAL FLEXIBILITY?

A13. Yes. Providing an ROE that is sufficient to maintain the Company's ability to attract capital under reasonable terms, even in times of financial and market stress, is not only consistent with the economic requirements embodied in the U.S. Supreme Court's

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[4] Moody's Investors Service, *Regulation Will Keep Cash Flow Stable as Major Tax Break Ends* (February 19, 2014), Industry Outlook.

[5] S&P Global Ratings, *Assessing U.S. Investors-Owned Utility Regulatory Environments* (August 10, 2016), RatingsExpress.

[6] Value Line Investment Survey, *Water Utility Industry* (January 13, 2017), *Id.* at p. 1780.

Hope and *Bluefield* decisions, but it is also in customers' best interests. Customers enjoy the benefits that come from ensuring that the utility has the financial wherewithal to take whatever actions are required to ensure safe and reliable service at a favorable cost.

B. Conclusions and Recommendations

Q14. WHAT ARE YOUR FINDINGS REGARDING A FAIR ROE FOR ELL?

A14. Considering the economic requirements necessary to support continuous access to capital under reasonable terms and the results of my analysis, I recommend a 10.7% ROE for ELL's utility operations, which is consistent with the case-specific evidence presented in my testimony. The bases for my conclusion are summarized below:

- In order to reflect the risks and prospects associated with ELL's electric utility business, my analyses focused on a proxy group of twenty-nine electric utility firms.
- Because investors' required return on equity is unobservable and no single method should be viewed in isolation, I applied the DCF, CAPM, ECAPM, and risk premium methods to estimate a just and reasonable ROE for ELL, as well as referencing the expected earnings approach.
- As summarized on Exhibit AMM-2, considering the average values resulting from these analyses, and giving less weight to extremes at the high and low ends of the range, I conclude that the cost of equity falls in the 10.1% to 11.1% range.
- My evaluation of a fair ROE also incorporates an upward adjustment of 10 basis points to account for flotation costs, which are a legitimate cost incurred to raise equity capital supporting ELL's investment in utility infrastructure. Incorporating this flotation cost adjustment results in my recommended ROE range of 10.2% to 11.2%.
- My ROE recommendation for ELL's electric operations is the midpoint of this range, or 10.7%.

Q15. WHAT OTHER EVIDENCE DO YOU CONSIDER IN EVALUATING A FAIR ROE FOR ELL?

A15. My conclusion that an ROE of 10.7% is fair and reasonable and should be approved is reinforced by the need to consider the following exposures faced by investors:

- ELL's electric operations are subject to risk factors associated with the Company's ownership of nuclear-powered generating facilities.
- The Company's service area is located in a storm-prone region, which implies a higher risk operating environment and exposes ELL to the additional financial pressures associated with repairing the damage caused by catastrophic weather events.
- ELL's customer base contains a relatively high concentration of industrial customers, which exposes the Company to greater cash flow volatility.
- ELL is in the midst of a major capital expenditure program to meet customer demand, expand access to renewable resources, and increase resiliency against future storm events. As Company witness Ryan E. O'Malley discusses, ELL will require significant investor-supplied capital to meet these goals, which heightens the need for supportive regulatory actions.
- ELL must have sufficient financial strength to meet these challenges effectively. Continued support for ELL's financial integrity, including the opportunity to earn a reasonable ROE, is imperative to ensure that the Company has the capability to buttress its credit standing while funding the major investment in utility infrastructure that is necessary to meet the needs of its customers and confront the ongoing risks posed by catastrophic weather events.

These findings indicate that a 10.7% ROE for ELL is fair and reasonable.

Q16. WHAT DID THE DCF RESULTS FOR YOUR SELECT GROUP OF NON-UTILITY FIRMS INDICATE WITH RESPECT TO YOUR EVALUATION?

A16. As shown on page 3 of Exhibit AMM-12, average DCF estimates for a low-risk group of firms in the competitive sector of the economy ranged from 10.5% to 11.1% before

consideration of flotation costs. While I did not base my recommendations on these results, they confirm that an ROE for ELL of 10.7% falls in a reasonable range to maintain the Company's financial integrity, provide a return commensurate with investments of comparable risk, and support the ability to attract capital.

Q17. WHAT IS YOUR CONCLUSION REGARDING THE 10.5% ROE USED IN ELL'S CLASS COST OF SERVICE STUDY?

A17. The 10.5% ROE incorporated in the Company's class cost of service study falls below the 10.7% midpoint of my recommended range. Considering capital market expectations, the need to maintain financial integrity and support additional capital, and the Company's specific risk exposures, it is my opinion that 10.5% understates investors' required return for ELL. The 10.5% ROE used in ELL's class cost of service study represents a reasonable compromise between balancing the impact of higher rates on customers and the need to provide the Company with a return that is adequate to compensate investors.

III. FUNDAMENTAL ANALYSES

Q18. WHAT IS THE PURPOSE OF SECTION III OF YOUR DIRECT TESTIMONY?

A18. This section briefly reviews the operations and finances of ELL. As a predicate to my quantitative analyses, I also examine conditions impacting todays' capital markets and the general economy. An understanding of the fundamental factors driving the risks and prospects of utilities is essential in developing an informed opinion of investors' expectations and requirements that are the basis of a fair ROE.

A. Entergy Louisiana

Q19. BRIEFLY DESCRIBE ELL AND ITS UTILITY OPERATIONS.

A19. ELL is one of five regulated utility subsidiaries of Entergy Corporation ("Entergy").[7] The Company is a vertically-integrated electric utility encompassing the electric generation, transmission, distribution, and customer service functions. ELL is comprised of two legacy Entergy utilities: the former Entergy Louisiana, LLC, and Entergy Gulf States Louisiana, which were combined on October 1, 2015, to form the Company[8]. ELL provides service to approximately 1.1 million retail electric customers consisting of residential, commercial, industrial, and government entities.[9] The Company's service territory covers 58 parishes in the northeastern and southern portions of Louisiana.

In 2022, ELL's total electric retail operating revenues consisted of 33% residential, 24% commercial, 42% industrial, and 2% governmental.[10] At year-end 2022, the company had 10,829 megawatts ("MW") of owned and leased generating capacity, consisting of 8,361 MW of gas and oil-fired capacity, 2,129 MW of nuclear capacity, and 339 MW of coal capacity.[11]

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[7] Entergy's other operating subsidiaries are Entergy Arkansas, LLC, Entergy Mississippi, LLC, Entergy New Orleans, LLC, and Entergy Texas, Inc.

[8] On September 14, 2015, the LPSC issued Order No. U-33244-A formally approving the business combination of Legacy EGSL and Legacy ELL, through which those companies combined substantially all of their respective assets and liabilities into a single operating company, Entergy Louisiana Power, LLC, which subsequently changed its name to Entergy Louisiana, LLC ("ELL"). Upon consummation of the business combination, ELL became the public utility that is subject to LPSC regulation and is the successor of Legacy EGSL and Legacy ELL.

[9] ELL also provides natural gas service to approximately 95,000 retail customers in the Baton Rouge area.

[10] For 2022, ELL's total kilowatt hour retail sales consisted of 24% residential, 19% commercial, 55% industrial, and 1% governmental. These figures in the testimony and footnote are based on FERC Form 1 data.

[11] Entergy Corporation, 2022 Form 10-K *Id.* at 259.

During 2022, ELL's operating revenues totaled approximately $6.3 billion, which accounted for approximately 46% of Entergy's total revenues.[12] At year-end 2022, ELL's total assets were $28.1 billion.[13]

Q20. WHERE DOES ELL OBTAIN THE CAPITAL USED TO FINANCE ITS INVESTMENT IN UTILITY PLANT?

A20. As a wholly-owned subsidiary, ELL's common equity capital is provided by Entergy, whose common stock is publicly traded on the New York Stock Exchange under the ticker symbol "ETR". In addition to capital supplied by Entergy, ELL also issues long-term debt securities under its own name and has been assigned an issuer credit rating of "BBB+" by S&P and a long-term rating of "Baa1" by Moody's.

Q21. DOES ELL ANTICIPATE THE NEED FOR CAPITAL GOING FORWARD?

A21. Yes. The Company must continue to undertake the investments to maintain and improve the electric system and to meet customer expectations, including providing safe and reliable service. In addition, investments are needed to meet growing industrial demand needs and expand access to renewable generating resources, as well as to harden ELL's infrastructure against future storm events. As discussed in the testimony of Mr. O'Malley, planned utility capital expenditures are expected to exceed [redacted] from 2023 to 2027, including billions of dollars of storm hardening capital

[12] *Id.* at 46, 370.

[13] *Id.* at 374.

expenditures. This represents a substantial investment given ELL's current rate base of approximately $15.7 billion.[14] These planned capital expenditures could increase if ELL receives certain Commission approvals. S&P indicated that "we expect ELL's financial measures will remain at the lower end of the range for its financial risk profile category, primarily reflecting the company's robust capital spending."[15] Continued support for ELL's financial integrity and flexibility will be instrumental in attracting the capital necessary to fund these projects in an effective manner.

B. Outlook for Capital Costs

Q22. PLEASE SUMMARIZE CURRENT ECONOMIC CONDITIONS.

A22. U.S. real GDP contracted 3.4% during 2020, but with the easing of COVID-19 lockdowns, the economic outlook improved significantly in 2021, with GDP growing at a pace of 5.7%. Real GDP in the US expanded by 2.1% in 2022 and 2.0% in the first quarter of 2023.[16] Meanwhile, indicators of employment remained stable, with the national unemployment rate falling slightly to 3.4% in April 2023.[17]

The underlying risk and price pressures associated with the COVID-19 pandemic were overshadowed by a dramatic increase in geopolitical risks

[14] This rate base amount is reflected in ELL's most recent formula rate plan filing.

[15] S&P Global Ratings, *Entergy Louisiana LLC* (August 25, 2022), Ratings Direct.

[16] Bureau of Economic Analysis, *Gross Domestic Product,* BEA (August 8, 2023), *available at* https://www.bea.gov/data/gdp/gross-domestic-product.

Bureau of Economic Analysis, *Gross Domestic Product, Fourth Quarter and Year 2022 (Third Estimate), GDP by Industry, and Corporate Profits,* BEA (April 10, 2023), *available at* https://www.bea.gov/news/2023/gross-domestic-product-fourth-quarter-and-year-2022-third-estimate-gdp-industry-and/.

[17] Bureau of Labor Statistics, *The Employment Situation – July 2023,* U.S. Department of Labor (August 4, 2023), *available at* https://www.bls.gov/news release/pdf/empsit.pdf

accompanying Russia's invasion of Ukraine in early 2022. These events have also been accompanied by heightened economic uncertainties as inflationary pressures due to supply chain disruptions were further stoked by sharp increases in global commodity prices. The substantial disruption in the energy economy and dramatic rise in inflation led to sharp declines in global equity markets as investors reacted to the related exposures. S&P concluded that:

> The balance of risks is firmly on the downside—with rapid monetary tightening potentially pushing major economies into recession; growing geopolitical tensions exacerbating Europe's energy crisis; lingering high prices pressuring costs and eroding households' purchasing power; and China grappling with structural factors that are undermining its economic growth.[18]

Stimulative monetary and fiscal policies, coupled with economic ramifications stemming from supply-chain disruptions and rapid price rises in the energy and commodities markets, have led to increasing concern that inflation may remain significantly above the Federal Reserve's longer-run benchmark of 2%. In June 2022, CPI inflation peaked at its highest level since November 1981. Since then, CPI inflation has gradually moderated to 5.0% in March 2023.[19] The so-called "core" price index, which excludes more volatile energy and food costs, rose at an annual rate of 5.6% in March 2023. Similarly, PCE inflation rose 5.7% in March 2023, or 4.8% after

[18] S&P Global Ratings, *Global Credit Conditions Q4 2022: Darkening Horizons*, (September 29, 2022) Comments.

[19] U.S. Bureau of Labor Statistics, *Economic News Release,* BLS (May 9, 2023) *available at* https://www.bls.gov/news.release/cpi nr0 htm.

excluding more volatile food and energy costs.[20] As Federal Reserve Chair Powell has noted:

> Although inflation has moderated recently, it remains too high. The longer the current bout of high inflation continues, the greater the chance that expectations of higher inflation will become entrenched.[21]

More recently, turmoil in the banking sector has shaken investor confidence and increased volatility in bond and equity markets. The Federal Reserve and U.S. Treasury took quick and dramatic action to shore up banks' liquidity needs and strengthen public confidence in the banking system, but as Moody's noted, "bank stress has added uncertainty to the outlook."[22]

Q23. HOW HAVE THESE DEVELOPMENTS IMPACTED THE FEDERAL RESERVE'S MONETARY POLICIES?

A23. As of its policy meeting in May 2023, the Federal Open Market Committee ("FOMC") has responded to concerns over accelerating inflation by raising the benchmark range for the federal funds rate by a total of 5.00% since March 2022.[23] In addition to these increases, Chair Powell has surmised that the significant draw-down of its balance sheet holdings that began in June 2022 could be the equivalent of another one quarter percent

[20] Bureau of Economic Analysis, *Personal Income and Outlays, March* 2023 (April 28, 2023), BEA, *available at* https://www.bea.gov/news/2023/personal-income-and-outlays-march-2023.

[21] Federal Reserve, *Transcript of Chair Powell's Press Conference* (February 1, 2023), *available at* https://www federalreserve.gov/mediacenter/files/FOMCpresconf20230201.pdf.

[22] Moody's Investors Service, *Baseline US macro forecasts unchanged but outlook more uncertain*(April 12, 2023), Sector Comment.

[23] The FOMC is a committee composed of twelve members that serves as the monetary policymaking body of the Federal Reserve System.

rate hike over the course of a year.[24] In March 2023, Chair Powell noted that, "The process of getting inflation back down to 2 percent has a long way to go and is likely to be bumpy,"[25] with the recent banking crisis amply demonstrating these latent risks. More recently, Chair Powell confirmed that "we are continuing the process of significantly reducing our securities holdings," but added that "It will take time … for the full effects of monetary restraint to be realized, especially on inflation."[26]

Q24. WHAT IMPACT DO INFLATION EXPECTATIONS HAVE ON THE RETURN THAT EQUITY INVESTORS REQUIRE FROM ELL?

A24. Implicit in the required rate of return for long-term capital—whether debt or common equity—is compensation for expected inflation. This is highlighted in the textbook, *Financial Management, Theory and Practice*:

> The four most fundamental factors affecting the cost of money are (1) production opportunities, (2) time preferences for consumption, (3) risk, and (4) inflation.[27]

In other words, a part of investors' required return is intended to compensate for the erosion of purchasing power due to rising price levels. This inflation premium is added to the real rate of return (pure risk-free rate plus risk premium) to determine the nominal

[24] Federal Reserve, *Transcript of Chair Powell's Press Conference* (May 4, 2022), *available at* https://www federalreserve.gov/mediacenter/files/FOMCpresconf20220504.pdf.

[25] Federal Reserve, *Transcript of Chair Powell's Press Conference* (March 22, 2023), *available at* https://www federalreserve.gov/mediacenter/files/FOMCpresconf20230322.pdf.

[26] Federal Reserve, *Transcript of Chair Powell's Press Conference* (May 3, 2023), *available at* https://www federalreserve.gov/mediacenter/files/FOMCpresconf20230503.pdf.

[27] Eugene F. Brigham, Louis C. Gapenski, and Michael C. Ehrhardt, Financial Management, Theory and Practice, 126 (1999).

required return. As a result, higher inflation expectations lead to an increase in the cost of equity capital.

Q25. HAVE THESE DEVELOPMENTS IMPACTED THE RISKS FACED BY UTILITIES AND THEIR INVESTORS?

A25. Yes. Moody's has assigned a "negative" outlook to the regulated utilities sector, citing "increasingly challenging business and financial conditions stemming from higher natural gas prices, inflation and rising interest rates."[28] Fitch Ratings, Inc. noted that its deteriorating outlook for utilities "reflects mounting cost pressures for electric and gas utilities due to elevated commodity prices, inflationary headwinds and rising interest costs."[29]

Meanwhile, S&P reported that since 2020 credit ratings downgrades in the utility sector have outpaced upgrades by more than 3 to 1, with the median rating falling to the triple-B category for the first time.[30] S&P noted that, while inflation has moderated, it will continue to pressure credit quality in the utility industry, along with rising interest rates and higher capital spending.[31]Value Line echoed these sentiments for electric utilities, concluding that:

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[28] Moody's Investors Service, *Regulated Gas Utilities--US, 2023 Outlook Negative Due to Higher Natural Gas Prices, Inflation and Rising Interest Rates*(November 10, 2022) Outlook.

[29] Fitch Ratings, Inc., *North American Utilities, Power & Gas Outlook 2023* (December 7, 2022).

[30] S&P Global Ratings, *The Outlook for North American Regulated Utilities Turns Stable*, (May 18, 2023) RatingsDirect.

[31] *Id.*

> The current macroeconomic environment is a challenging period for this group. The main difficulties are wage inflation, higher interest rates, and high commodity prices for raw materials and purchased power.[32]

Q26. DO CHANGES IN UTILITY COMPANY BETA VALUES CORROBORATE AN INCREASE IN INDUSTRY RISK?

A26. Yes. Beta measures a stock's price volatility relative to the market as a whole and reflects the tendency of a stock's price to follow changes in the market. A stock that tends to respond less to market movements has a beta less than 1.00, while stocks that tend to move more than the market have betas greater than 1.00. Beta is the only relevant measure of investment risk under modern capital market theory and is widely cited in academics and in the investment industry as a guide to investors' risk perceptions.

As shown subsequently in Table 2, the average beta for the Utility Group is 0.90.[33] Prior to the pandemic, the average beta for this same group of electric utilities was 0.56.[34] The significant shift in pre- and post-pandemic beta values for the Utility Group is further exemplified in Figure 1 below. As illustrated there, average beta value for the Utility Group increased significantly with the beginning of the pandemic in March 2020, continued to increase during 2021, and has remained elevated. This dramatic increase in a primary gauge of investors' risk perceptions is further proof of the rise in the risk of utility common stocks.

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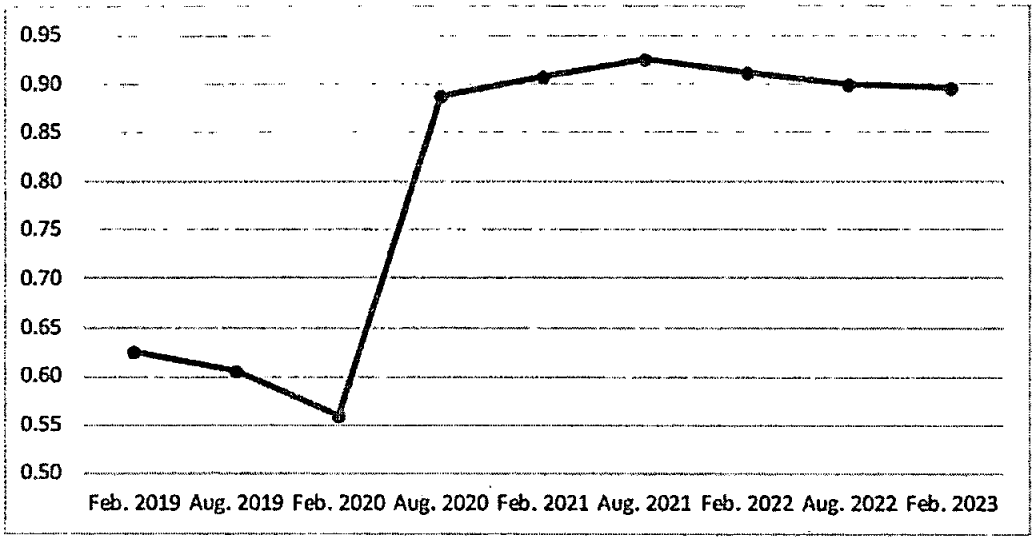
[32] The Value Line Investment Survey, *Electric Utility (West) Industry* (April 21, 2023).

[33] As indicated on Exhibit AMM-7, this is based on data as of May 5, 2023.

[34] The Value Line Investment Survey, *Summary & Index* (February 14, 2020).

FIGURE 1
UTILITY GROUP BETA VALUES



Q27. HAVE INCREASED RISKS AND HIGHER INFLATION RESULTED IN HIGHER CAPITAL COSTS?

A27. Yes. While the cost of equity is unobservable, yields on long-term bonds provide a widely referenced benchmark for the direction of capital costs, including required returns on common stocks. Table 1 below compares the average yields on Treasury securities and Baa-rated public utility bonds during March 2023 with those prevailing in May 2021, when ELL's Formula Rate Plan ("FRP") was last extended with a midpoint ROE of 9.5%.[35]

[35] *See,* Order No. U-35565 (May 19, 2021), *In re: Application for Extension and Modification of Formula Rate Plan, Docket No. U-35565 Order.*

TABLE 1
BOND YIELD TRENDS

Series	April 2023	May 2021	Change (bps)
10-Year Treasury Bonds	3.46%	1.62%	184
30-Year Treasury Bonds	3.69%	2.32%	137
Baa Utility Bonds	5.47%	3.58%	189

Source: https://fred.stlouisfed.org/series/GS30; Moody's Credit Trends.

As shown above, trends in bond yields document a substantial increase in the returns on long-term capital demanded by investors. With respect to utility bond yields—which are the most relevant indicator in gauging the implications for the Company's common equity investors—average yields are now almost 190 basis points above the level prevailing at the time the Commission approved the extension and modification of ELL's FRP.

Q28. WHAT IMPLICATIONS DO THESE TRENDS HAVE IN EVALUATING A FAIR ROE FOR ELL?

A28. The upward move in interest rates demonstrates that long-term capital costs—including the cost of equity—have increased significantly. Exposure to rising interest rates, inflation, and capital expenditure requirements also reinforce the importance of buttressing ELL's credit standing. Considering the potential for financial market instability, competition with other investment alternatives, and investors' sensitivity to risk exposures in the utility industry, maintaining credit strength is a key ingredient in maintaining access to capital at reasonable cost.

Q29. WOULD IT BE REASONABLE TO DISREGARD THE IMPLICATIONS OF CURRENT CAPITAL MARKET CONDITIONS IN ESTABLISHING A FAIR ROE FOR ELL?

A29. No. They reflect the reality in which ELL must attract and retain capital. The standards underlying a fair rate of return require an authorized ROE for the Company that is competitive with other investments of comparable risk and sufficient to preserve its ability to maintain access to capital on reasonable terms. These standards can only be met by considering the requirements of investors over the time period when the rates established in this proceeding will be in effect. If the upward shift in investors' risk perceptions and required rates of return for long-term capital is not incorporated in the allowed ROE, the results will fail to meet the comparable earnings standard that is fundamental in determining the cost of capital. From a more practical perspective, failing to provide investors with the opportunity to earn a rate of return commensurate with ELL's risks will weaken its financial integrity and hamper the Company's ability to attract the capital necessary to provide safe and reliable service at the lowest reasonable cost.

IV. COMPARABLE RISK PROXY GROUP

Q30. WHAT IS THE PURPOSE OF SECTION IV OF YOUR DIRECT TESTIMONY?

A30. Section IV of my direct testimony explains the basis for the proxy group I used to estimate the cost of equity, examines alternative objective indicators of investment risk for these firms, and compares the investment risks applicable to ELL with my reference group.

Q31. WHAT KEY PRINCIPLES UNDERPIN THE EVALUATION OF A PROXY GROUP?

A31. The United States Supreme Court's *Hope* and *Bluefield* decisions establish a standard of comparison between a subject utility and other companies of comparable risk in determining a just and reasonable ROE. The generally accepted approach is to select a group of companies that are of similar risk to the subject utility (the "proxy group"), and then to perform various quantitative analyses based on the proxy group to estimate investors' required returns. The results of these analyses, in turn, are used to evaluate a range of reasonableness and a final recommendation for the ROE attributable to the subject utility.

A. Determination of the Proxy Group

Q32. HOW DO YOU IMPLEMENT QUANTITATIVE METHODS TO ESTIMATE THE COST OF COMMON EQUITY FOR ELL?

A32. Application of quantitative methods to estimate the cost of common equity requires observable capital market data, such as stock prices and beta values. Moreover, even for a firm with publicly traded stock, the cost of common equity can only be estimated. As a result, applying quantitative models using observable market data only produces an estimate that inherently includes some degree of observation error. Thus, the accepted approach to increase confidence in the results is to apply quantitative methods to a proxy group of publicly traded companies that investors regard as risk comparable. The results of the analysis on the sample of companies are relied upon to establish a range of reasonableness for the cost of equity for the specific company at issue.

Q33. HOW DO YOU IDENTIFY THE PROXY GROUP OF UTILITIES RELIED ON FOR YOUR ANALYSES?

A33. To reflect the risks and prospects associated with ELL's jurisdictional utility operations, I began with the following criteria to identify a proxy group of utilities:

1. Included in the Electric Utility Industry groups compiled by Value Line.
2. Corporate credit ratings from Moody's and S&P that fall within one notch of the Company's current ratings. For Moody's, this resulted in a ratings range of Baa2, Baa1, and A3; for S&P the range is BBB, BBB+, and A-.
3. Paid common dividends over the last six months and have not announced a dividend cut since that time.
4. No ongoing involvement in a major merger or acquisition that would distort quantitative results.

These criteria result in a proxy group of twenty-nine companies, which I refer to as the "Utility Group."[36]

B. Relative Risks of the Utility Group and ELL

Q34. HOW DO YOU EVALUATE INVESTORS' RISK PERCEPTIONS FOR THE UTILITY GROUP?

A34. My evaluation of relative risk considers five published benchmarks that are widely relied on by investors; namely, credit ratings from Moody's and S&P, along with Value Line's Safety Rank, Financial Strength Rating, and beta values. Credit ratings are assigned by independent rating agencies for the purpose of providing investors with a broad assessment of the creditworthiness of a firm. Ratings generally extend from triple-A (the highest) to D (in default). Other symbols (*e.g.*, "+" or "-") are used to

[36] Of these twenty-nine companies, twenty are combination electric/natural gas utilities, while nine are electric utilities.

show relative standing within a category. Because the rating agencies' evaluation includes all of the factors normally considered important in assessing a firm's relative credit standing, corporate credit ratings provide broad, objective measures of overall investment risk that are readily available to investors. Widely cited in the investment community and referenced by investors, credit ratings are also frequently used as a primary risk indicator in establishing proxy groups to estimate the cost of common equity.

While credit ratings provide the most widely referenced benchmark for investment risks, other quality rankings published by investment advisory services also provide relative assessments of risks that are considered by investors in forming their expectations for common stocks. Value Line's primary risk indicator is its Safety Rank, which ranges from "1" (Safest) to "5" (Riskiest). This overall risk measure is intended to capture the total risk of a stock and incorporates elements of stock price stability and financial strength. Given that Value Line is perhaps the most widely available source of investment advisory information, its Safety Rank provides useful guidance regarding the risk perceptions of investors.

The Financial Strength Rating is designed as a guide to overall financial strength and creditworthiness, with the key inputs including financial leverage, business volatility measures, and company size. Value Line's Financial Strength Ratings range from "A++" (strongest) down to "C" (weakest) in nine steps. These objectives, published indicators incorporate consideration of a broad spectrum of risks, including financial and business position, relative size, and exposure to firm-specific factors.

As discussed previously, beta measures a utility's stock price volatility relative to the market, with higher betas indicating greater risk.

Q35. HOW DOES THE OVERALL RISK OF YOUR PROXY GROUP COMPARE TO ELL?

A35. Table 2 compares the Utility Group with the Company across the five key indices of investment risk discussed above. Because ELL has no publicly traded common stock, the Value Line risk measures shown reflect those published for its parent, Entergy.

TABLE 2
COMPARISON OF RISK INDICATORS

			Value Line		
	S&P	Moody's	Safety Rank	Financial Strength	Beta
Utility Group	BBB+	Baa2	2	A	0.90
ELL	BBB+	Baa1	2	B++	0.95

Q36. WHAT DOES THIS COMPARISON INDICATE REGARDING INVESTORS' ASSESSMENT OF THE RELATIVE RISKS ASSOCIATED WITH YOUR UTILITY GROUP?

A36. ELL's S&P rating is identical to the average for the Utility Group, while the average Moody's credit rating corresponding to the Utility Group is one notch lower than the Baa1 rating assigned to the Company. The Value Line Safety Rank corresponding to ELL is identical to that of the Utility Group, while the average Financial Strength rating and beta value for the Utility Group indicate slightly lower risk than the Company. Considered together, a comparison of these objective risk measures indicates that

investors would likely conclude that the overall investment risks for the firms in the Utility Group are comparable to those of ELL.

Q37. IN EVALUATING A FAIR ROE, IS IT APPROPRIATE TO CONSIDER THE SPECIFIC RISK EXPOSURES FACED BY ELL?

A37. Yes. Besides risks that all utilities in the industry face, ELL is confronted by several other risk factors that distinguish the Company from the comparable group. These factors include risks associated with ownership of nuclear-powered generating facilities, a service area located in a hurricane-prone region, and a customer base with a high concentration of industrial users. It is imperative that ELL possess sufficient financial strength so that it can respond effectively to the challenges that these attributes of its business profile may present, as described in the direct testimony of Company witnesses O'Malley and Shipman.

Q38. HOW DOES ELL'S OWNERSHIP OF NUCLEAR-POWERED GENERATION INFLUENCE INVESTORS' RISK PERCEPTIONS?

A38. While nuclear generation confers significant advantages to customers and electricity markets through fuel cost savings, fuel diversity, and reduced emissions impacts, investors also associate nuclear power plants with risks that are not encountered with other sources of generation. As Moody's has previously noted:

> We think nuclear generating plants are different, and should not be viewed through the same lenses as other generation supplies, such as base-load coal, natural gas or renewable generation.[37]

Nuclear power, while saving customers significant fuel and/or emissions costs and addressing reliability concerns, entails a level of complexity that is not typically seen in traditional forms of generation, which in turn can necessitate significant unexpected expenditures. S&P also recognized these additional risks and exposures posed by nuclear facilities:

> Meanwhile, we continue to view nuclear plants as a comparatively risky source of electricity because unexpected things happen despite the NRC's oversight – in fact, plant shutdowns sometimes occur specifically because of that oversight. When things do go wrong, the NRC is required to delay startup until both operating procedures and repaired or replaced equipment meet its increasingly higher standards.[38]

Moody's has also confirmed that "ownership of nuclear generating facilities brings a higher level of complexity associated with operating and maintaining the units."[39]

These concerns were exacerbated by the events at the Fukushima Daiichi nuclear complex in Japan, as S&P noted:

> Standard & Poor's Ratings Service believes that the failure of the back-up safety systems will heighten scrutiny of the systematic risks for U.S. nuclear power generators. We aren't taking any rating actions at this time. Still, the failures and their consequences raise the likelihood of greater costs and enhanced regulatory oversight for existing U.S. facilities. A renewed public focus on the inherent risks of nuclear power will demand as much. This could result in delays in license-extension approvals and deteriorating economics for new plant construction. At

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[37] Moody's Investors Service, *Credit Opinion: Exelon Generation Company LLC*, (February 12, 2014) Global Credit Research.

[38] Standard & Poor's Ratings Services, *U.S. Utilities' Slow Approach Delays Nuclear Development, But Will Likely Help Their Credit Quality*, (May 1, 2013) RatingsDirect.

[39] Moody's Investors Service, *New Nuclear Generation in the United States: Keeping Options Open vs. Addressing an Inevitable Necessity*, (October 2007) Special Comment.

> the same time, closure of nuclear power plants, either due to increased costs or regulatory action, might significantly affect U.S. electricity supply and have substantial capital spending implications for utilities.[40]

In addition, longer-term uncertainties regarding the disposal of spent fuel and the ultimate costs of decommissioning continue to accompany any investment in nuclear generating facilities. In order to mitigate these potential exposures, Moody's cited the importance of a constructive regulatory relationship and "a need to establish financial policies over the near-term aimed at producing very strong financial credit ratios in order to maintain a given rating."[41] These exposures, unique to nuclear generators, highlight the need for an ROE that accommodates these uncertainties and supports the Company's financial strength and ability to attract capital.

Q39. HAVE THE RATING AGENCIES RECOGNIZED THE IMPLICATIONS OF THE COMPANY'S NUCLEAR EXPOSURE?

A39. Yes. Moody's recently noted that, "The company also operates nuclear-fueled generation, which includes operational risks around spent fuel waste and pollution management of radioactive uranium.[42] S&P recently echoed these concerns, stating that, "We believe nuclear generation has a higher operating risk than other forms of power generation.[43]

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[40] Standard & Poor's Corporation, *The U.S. Nuclear Power Industry Looks at Japan and Awaits More Scrutiny* (March 16, 2011), Global Credit Research.

[41] Moody's Investors Service, *New Nuclear Generation in the United States: Keeping Options Open vs. Addressing an Inevitable Necessity* (October 2007), Special Comment.

[42] Moody's Investors Service, *Entergy Louisiana, LLC: Update following outlook change to stable* (July 19, 2023), Credit Opinion.

[43] S&P Global Ratings, *Entergy Louisiana LLC* (August 25, 2022), RatingsDirect.

Q40. DOES ELL ALSO ENCOUNTER SPECIFIC WEATHER-RELATED EXPOSURES?

A40. Yes. Because of its location, ELL must regularly contend with the consequences of destructive weather events, most notably, damaging hurricanes. Moody's recently noted that the Company operates in a "storm-prone service territory,"[44] adding:

> While we have long cited the company's geographical footprint as a risk for ongoing storm activity, the frequency and severity of these storms was the most on record, and reflects a higher operating risk environment for ELL, compared to most utilities in the US. Due to the physical effects of climate change and the capital required to bolster infrastructure and recover from damaging events, we require ELL's financial profile to be more robust than the average utility, in order to maintain a given rating.[45]

Moody's has noted that, "If significant storm costs are not recovered on a timely basis" and "[a]nother major storm … adds materially to unrecovered costs," these factors could lead to a downgrade.[46] S&P also recognized the Company's weather-related exposure, citing, "Exposure to severe hurricanes and storms within its service territory" as one of ELL's key risks, adding that, "Lack of sufficient system hardening limits the company's ability to protect against severe storms and increases its business risk relative to peers."[47]

In only the last two decades, ELL has felt the effects of Hurricanes Katrina and Rita in 2005; Hurricanes Gustav and Ike in 2008; Hurricane Isaac in 2012; Hurricanes Laura, Delta and Zeta in 2020; and Hurricane Ida in 2021, which S&P noted "was the

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[44] Moody's Investors Service, *Entergy Louisiana, LLC: Update Following Outlook Change to Stable* (July 19, 2023), Credit Opinion.

[45] *Id.*

[46] Moody's Investors Service, *Entergy Louisiana, LLC: Update to Credit Analysis* (October 4, 2022), Credit Opinion.

[47] S&P Global Ratings, *Entergy Louisiana LLC* (August 25, 2022), RatingsDirect.

most destructive hurricane in Louisiana since the 2005 Hurricane Katrina."[48] Moody's cited the extraordinary costs associated with ELL's hurricane exposure in just the past several years, noting that, "The combination of Hurricanes Laura, Delta, Zeta and Ida over a two-year period was unprecedented in Louisiana and the nearly $5.0 billion of storm damage they cause to ELL's asset base, represented over 35% of ELL's approximately $14 billion in total rate base at the time."[49]

As noted above, recovery from these unpredictable events can accumulate to billions of dollars in damages and repairs and requires ELL to mount large scale and costly recovery efforts. While the LPSC's regulatory provisions relating to prudently incurred storm costs are generally viewed as supportive,[50] investors are still exposed to loss of revenues and other impacts during adverse weather conditions, including sometimes prolonged flooding, and restoration periods. This is a risk that is unmitigated by any mechanism for storm cost recovery. As S&P recently noted:

> Without the appropriate regulatory compact and other risk mitigation, the financial aftermath of these events could be devastating to any individual utility, adding another layer of unpredictability that utilities must effectively manage.[51]

[48] *Id.*

[49] Moody's Investors Service, *Entergy Louisiana, LLC: Update Following Outlook Change to Stable* (July 19, 2023), Credit Opinion.

[50] ELL's FRP helped to mitigate the impact of storm-related costs on rates and include proactive rate setting for the remediation of future costs (*i.e.*, storm reserves). Also, the LPSC issues financing orders allowing securitization and recovery of storm costs.

[51] S&P Global Ratings, *Can U.S. Utilities Weather the Storm?* (November 8, 2018).

Q41. IS WEATHER EXPOSURE FOR UTILITIES SUCH AS ELL INTENSIFYING?

A41. Yes. As Moody's recently noted in their review of the utility sector:

> [O]ver the next 10 to 20 years, the risk of severe weather events, such as hurricanes and wildfires, will likely worsen in certain US regions, according to data from Moody's ESG Solutions. Meanwhile, the coastal regions in the Southeast and along the Gulf of Mexico are at the greatest risk of severe hurricanes. Stronger hurricanes, fueled by climate change, pose an ever-greater threat to coastal states' electric grids.[52]

S&P also recently noted that, "Physical risks such as exposure to wildfires, storms, extreme temperature events, and hurricanes, remains a considerable risk for the industry, and concluded that "over the past three years the U.S. experienced its highest level of damages ever from physical risks."."[53] As S&P summarized with respect to weather-related risk:

> Not only do the frequency of these disasters appear to be increasing, but their costs are rising. The natural disasters that have occurred over the past decade have wiped out billions of dollars of assets over a relatively short period. Without the appropriate regulatory compact and other risk mitigation, the financial aftermath of these events could be devastating to any individual utility, adding another layer of unpredictability that utilities must effectively manage.[54]

[52] Moody's Investors Service, *as Extreme Weather Events and Net-Zero Efforts Rise, ABS will Lower Utility Credit Risk*(November 9, 2022), Sector In-Depth.

[53] S&P Global Ratings, *The Outlook for North American Regulated Utilities Turns Stable*(May 18, 2023) RatingsDirect.

[54] S&P Global Ratings, *Can U.S. Utilities Weather the Storm?* (November 8, 2018), Comments.

Q42. WHAT IS "SECURITIZATION" IN THE CONTEXT OF STORM COST RECOVERY?

A42. "Securitization" refers to specific legislation and financing orders that allow utilities to fund storm related infrastructure investment and recovery costs through the issuance of securitized bonds, which generally have significantly lower interest rates as compared to a more traditional utility financing process. Following a major weather event, ELL incurs the costs to restore power and then files for recovery with the LPSC, which initiates a regulatory process that includes a review of expenditures. Once the LPSC issues a decision on the filing, securitization bonds are marketed and issued, with the proceeds being used to refund the Company for the deferred storm recovery costs. Meanwhile, the related financing costs associated with the securitized bonds are added as a line item on customers' bills.

Q43. IS SECURITIZATION A TYPE OF STORM COST RIDER?

A43. No. Securitization allows access to lower interest rates on debt incurred in order to finance storm recovery costs, but there are significant delays and regulatory hurdles in place that distinguish cost recovery under securitization from storm recovery riders. In discussing the management of regulatory risk in the context of storm recovery, S&P was careful to note the difference between securitization, storm recovery riders and reserve accounts, and to emphasize that ELL had access to securitization, but not rider recovery.[55] And while ELL has deposited $290 million in a restricted escrow account

[55] *Id.*

as a storm damage reserve for future storms, this balance is significantly less than the restoration costs experienced with recent hurricanes.

Q44. IS STORM COST RECOVERY POTENTIALLY INHIBITED BY CUSTOMER AFFORDABILITY?

A44. Yes. S&P recently noted that the financial solutions to intensifying natural disasters come with their own risks, such as customer affordability pressures:

> While regulators generally allow utilities to recover prudently incurred costs from ratepayers, utilities are always cognizant of the effect rising costs have on customers' bills. As these bills increase, customers find it incrementally more difficult to pay, which often hampers a utility's ability to effectively manage regulatory risk. This predicament is a drawback in many of the financial solutions used to reduce weather-related risks, and if not well managed, may lead to unintended consequences.[56]

Q45. IS CUSTOMER AFFORDABILITY RELATED TO STORM COST RECOVERY AN ISSUE FOR ELL?

A45. Yes. While the LPSC's regulatory framework and the precedent for storm cost securitization in Louisiana are generally viewed as supportive by ratings agencies, the practical realities of increasing customer bills and related customer affordability could weaken the Company's financial position. Moody's summarized these dynamic issues:

> While Louisiana has been supportive of the recovery of these exogenous costs to date, customer affordability issues will remain an ongoing challenge for ELL, since management is looking to accelerate storm hardening efforts of its transmission and distribution assets. These rising capital costs, on top of inflation, high interest rates and other economic

[56] *Id.*

> pressures, could result in challenged customer relations and the prospect of political intervention into rate making, which would make ELL's financial improvement more difficult.[57]

S&P also took note of the practical complexities of storm cost recovery in Louisiana:

> Although the state has a well-established law that enables utilities to seek securitization to recover such costs, increasing commodity prices, interest rates, inflationary pressures, and the company's robust capital spending could all pressure the customer bill, potentially weakening the company's consistent ability to effectively manage regulatory risk.

These statements illustrate that even though the LPSC allows for the financing of storm costs through securitization, such cost recovery in practice is not a simple matter. The hard reality of unpredictable and costly storms in ELL's service territory increases ELL's risk profile, even within a supportive regulatory environment.

Q46. WHAT DOES THE EVIDENCE SUGGEST WITH REGARD TO ELL'S ABILITY TO RECOVER RECENT STORM COSTS ON A TIMELY BASIS?

A46. ELL lacks access to storm rider recovery, and the process of securitization necessarily involves a degree of uncertainty and regulatory lag. In ELL's case, the regulatory lag associated with securitization has been significant in recent years. For example, Hurricanes Laura, Delta and Zeta impacted ELL's service area in August and October of 2020. Winter Storm Uri caused extensive damage to ELL's transmission and distribution system in February 2021 and Hurricane Ida caused yet more destruction in September 2021. But it wasn't until May 2022 that a $3.2 billion securitization closed

[57] Moody's Investors Service, *Entergy Louisiana, LLC: Update to Credit Analysis* (October 4, 2022), Credit Opinion.

to finance the costs of the 2020 hurricanes, February 2021 winter storms, and a portion of Hurricane Ida. Another $1.5 billion securitization closed in March 2023 to address the remaining costs associated with Hurricane Ida from 2021. These recent examples highlight the fact that despite the Company's constructive collaboration with the LPSC to ameliorate the financial impacts of extreme weather events, ELL's investors remain exposed to significant regulatory lag and risk in the context of cost recovery, even with ELL's access to the securitization process.

Moreover, at the rate that ELL has been accumulating securitized debt in recent years and considering the potential impact on affordability, investors are likely to question ELL's continuing ability to securitize recovery costs of future storms. As S&P summarized for investors, "While we view securitization as a good backstop for storm restoration costs, securitization takes time to receive the ultimate funds and takes up headroom in the customer bill, potentially increasing the risk of the company consistently managing regulatory risk."[58]

Q47. DO THESE WEATHER-RELATED RISKS HAVE IMPLICATIONS FOR ELL'S FINANCIAL POSITION?

A47. Yes. In addition to increasing ELL's overall risk profile (which in turn has a direct impact on requirements for financial strength), the service territory's exposure to adverse weather impacts has a direct impact on the Company's need for financial strength. ELL must maintain ready access to larger reserves of credit and liquidity than

[58] S&P Global Ratings, *Entergy Louisiana LLC* (August 25, 2022), RatingsDirect.

most other utilities. Given the high value that ELL and its customers place on service availability and reliability, rapid restoration of service after a weather-induced outage is the Company's highest priority. ELL must be able to marshal both internal and external resources on a massive scale very quickly, and this leads to an extraordinary need for credit and liquidity. Restoration efforts must be funded long before the recovery of prudently incurred costs can be expected. A financially strong utility will be better prepared to deal with these situations when they inevitably arise, ultimately benefiting impacted customers.

Q48. HAS ELL'S FINANCIAL STRENGTH RECENTLY BEEN IMPACTED BY WEATHER EXPOSURE?

A48. Yes. ELL was downgraded to BBB+ by S&P in September 2021 due to weakened financial metrics in the wake of Hurricane Ida and the associated storm damage earlier that year. S&P explained the downgrade:

> [W]e downgraded ELL to 'BBB+' from 'A-' due to the large restoration costs for its transmission and distribution (T&D) infrastructure following Ida, increasing near-term capital spending, and operating expenses. We revised the comparable ratings analysis (CRA) modifier to negative, reflecting ELL's position at the lower end of the excellent business risk profile compared with peers, in part due to the limited ability for the utility to protect against severe storms.[59]

[59] S&P Global Ratings, *Credit FAQ: Entergy Corp.'s Energy Transition and Ongoing Storm Costs Stress Financial Measures* (January 13, 2022).

Q49. WHAT CONCLUSIONS SHOULD THE LPSC DRAW FROM YOUR REVIEW OF ELL'S WEATHER EXPOSURE?

A49. ELL's service area faces extreme exposure to the catastrophic damage of tropical storms and hurricanes. In addition to emphasizing the importance of the basic principle that prudently incurred restoration costs are recoverable as part of the cost of providing service, my evaluation also shows why it is in customers' interests for a utility to maintain adequate financial strength to deal with the kind of extreme weather events that may affect its service territory. ELL's overall risk profile is increased by the nature of its service area and its requirements for financial strength are greater than most other utilities for the same reason.

While the investment community recognizes that the LPSC has been generally supportive in permitting recovery of the costs of storm damage, the Company nonetheless must maintain the financial strength and liquidity necessary to mounting a rapid and far-reaching response in the likely event of a future hurricane strike. This requirement for financial strength should be considered in evaluating a fair ROE for ELL.

Q50. PLEASE DESCRIBE THE CONCEPT OF ATTRITION AS IT RELATES TO RATEMAKING.

A50. Attrition is the deterioration of the actual return below the allowed return that occurs when the relationships between revenues, costs, and rate base used to establish rates do not reflect the actual costs incurred to serve customers during the period that rates are in effect. For example, if external factors are driving costs to increase more than

revenues, then the rate of return will fall short of the allowed return even if the utility is operating efficiently. Similarly, when growth in the utility's investment outstrips the rate base used for ratemaking, the earned rate of return will fall below the allowed return through no fault of the utility's management. These imbalances can be exacerbated due to regulatory lag between the time when the data used to establish rates is measured and the date when the rates go into effect.

Q51. APART FROM STORM COST DEFERRALS, ARE ELL'S INVESTORS CONCERNED WITH THE IMPACT OF ATTRITION MORE GENERALLY?

A51. Yes. Investors are most concerned with the return they can reasonably expect to earn in the future, not simply the allowed ROE or what they might expect in theory if a historical test year were to repeat. To be fair to investors and to benefit customers, a regulated utility must have an ***opportunity to actually earn a reasonable return*** that will maintain financial integrity, facilitate capital attraction, and compensate for risk. In other words, it is the end result in the future that determines whether or not the *Hope* and *Bluefield* standards are met. S&P observed that its analysis "centers on the utility's ability to consistently earn the authorized ROE,"[60] and noted that, "The regulatory framework/regime's influence is of critical importance when assessing regulated utilities' credit risk because it defines the environment in which a utility operates and

[60] Standard & Poor's Corporation, *Key Credit Factors for The Regulated Utilities Industry* (November 19, 2013), RatingsDirect, *Id.* at 12 (emphasis added). *See also,* Standard & Poor's Corporation, *Assessing U.S. Utility Regulatory Environments*(November 7, 2008), RatingsDirect (concluding that, "Notably, the analysis does not revolve around "authorized" returns, but rather on actual earned returns. We note the many examples of utilities with healthy authorized returns that, we believe, have no meaningful expectation of actually earning that return because of rate case lag, expense disallowances, etc.").