

BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION	)	
OF ENTERGY ARKANSAS, INC. FOR	)	DOCKET NO. 13-028-U
APPROVAL OF CHANGES IN RATES FOR	)	
RETAIL ELECTRIC SERVICE	)	

REHEARING REPLY TESTIMONY

OF

HUGH T. MCDONALD

PRESIDENT AND CHIEF EXECUTIVE OFFICER  
ENTERGY ARKANSAS, INC.

ON BEHALF OF

ENTERGY ARKANSAS, INC.

APRIL 11, 2014

1 I. INTRODUCTION

2 Q. PLEASE STATE YOUR NAME.

3 A. My name is Hugh T. McDonald.

4

5 Q. ARE YOU THE SAME HUGH T. MCDONALD WHO FILED REHEARING  
6 DIRECT TESTIMONY IN THIS DOCKET ON MARCH 14, 2014?

7 A. Yes, I am.

8

9 Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

10 A. I am submitting this rehearing reply testimony to the Arkansas Public  
11 Service Commission ("APSC" or the "Commission") on behalf of Entergy  
12 Arkansas, Inc. ("EAI" or the "Company").

13

14 Q. WHAT IS THE PURPOSE OF YOUR REHEARING REPLY TESTIMONY?

15 A. The purpose of my rehearing reply testimony is to address issues raised  
16 by several parties related to EAI's rehearing direct testimony on Return on  
17 Equity ("ROE"), Allowance for Funds Used During Construction ("AFUDC")  
18 and other issues related to findings in Order No. 21 (the "Order") that  
19 affect the Company's cash flow. My testimony will summarize the  
20 Company's rehearing position that reaction to the Order from Moody's, an  
21 authoritative credit rating agency, and financial analysts who advise  
22 investors indicate that the totality of the Order did not achieve the

1 appropriate balance between the interests of customers and owners of the  
2 Company.

3

4 Q. IS EAI SPONSORING OTHER WITNESSES PRESENTING REHEARING  
5 REPLY TESTIMONY?

6 A. Yes. EAI witness David E. Hunt, in his rehearing reply testimony,  
7 responds to the rehearing testimonies offered on April 4, 2014 of Federal  
8 Executive Agencies ("FEA") witness Michael P. Gorman, APSC General  
9 Staff ("Staff") witness Robert Daniel, Arkansas Attorney General ("AG")  
10 witness William B. Marcus, Wal-Mart witness Steve W. Chriss, and  
11 Arkansas Electric Energy Consumers, Inc. ("AEEC") witness David C.  
12 Parcell. Former utility analyst Ellen Lapson of Lapson Consulting and  
13 Sam Hadaway, Principal, Financo, Inc., respond to the rehearing  
14 testimonies of Messrs. Gorman, Daniel, Marcus, and Parcell.

15

1     **II.     RESPONSE TO PARTIES**

2     Q.     SEVERAL PARTIES ARGUE THAT BECAUSE THE ROE ADOPTED BY  
3           THE COMMISSION IN THIS DOCKET IS AT THE MIDPOINT OF THE  
4           STAFF'S DISCOUNTED CASH FLOW ("DCF") RANGE, AN APPROACH  
5           THE APSC HAS USED HISTORICALLY, THEN THE RESULT MUST BE  
6           REASONABLE AND NO FURTHER INQUIRY IS NEEDED.  WHAT DO  
7           YOU SAY IN RESPONSE?

8     A.     EAI presented evidence throughout this proceeding and explained in its  
9           Petition for Rehearing and Clarification the fallacy that a mechanistic  
10          application of the DCF model given the facts in this case produced an  
11          allowed ROE that is reasonable.  The evidence is based on the fact that  
12          the DCF results are currently skewed by the Federal Reserve's monetary  
13          policy, Quantitative Easing, which is artificially lowering interest rates in an  
14          attempt to support a stronger economic recovery.  No party disputes that  
15          Quantitative Easing impacts market metrics.  In fact, Staff and FEA both  
16          presented testimony of ROE witnesses that readily acknowledge  
17          adjustments to the DCF inputs and/or results should be made.<sup>1</sup>  EAI  
18          witness Sam Hadaway presented evidence that shows the impact that  
19          Quantitative Easing is having on interest rates.<sup>2</sup>

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<sup>1</sup> Daniel Direct Testimony at 37-38 (August 2, 2013); Gorman Rehearing Responsive Testimony at 13 (April 2, 2014).

<sup>2</sup> Hadaway Direct Testimony at 15-20 (March 1, 2013).

1           The new evidence presented in EAI's rehearing direct testimony  
2 demonstrates that, in response to the Order, Moody's effectively  
3 downgraded EAI's credit rating as compared to its peers and that utility  
4 stock analysts expressed "disappointment" because of the total, negative  
5 impact of the Order on the Company's cash flow.<sup>3</sup> The analysts' opinions  
6 are validated by a simple comparison of the ROE authorization in this  
7 case to those of other vertically integrated utilities. No matter how the  
8 proxy group for comparison is defined, the fact of the matter is that 9.3  
9 percent allowed ROE assigned to EAI in this case is one of the lowest  
10 ROEs ever awarded to a vertically integrated utility.<sup>4</sup> Such a result is not  
11 reasonable as an appropriate balance of customers' and owners' interests  
12 because it acts to discourage investment at a time EAI needs to invest  
13 billions of dollars in infrastructure and discretionary projects that promote  
14 economic development in the state. The impacts on EAI's financial  
15 integrity, as demonstrated by reactions from financial analysts and  
16 Moody's, is essential in finding the appropriate balance among all  
17 stakeholders.

18           Some parties argue that the mid-point of the DCF is appropriate  
19 because it falls within what they deem is a reasonable range, without any  
20 test of whether that result is reasonable in the real world. It is hard to  
21 imagine circumstances when a reasonableness check on a mechanistic

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<sup>3</sup> Lapson Rehearing Direct Testimony at 5, 12 (March 14, 2014).

<sup>4</sup> *Id.* at 18, referencing Hunt Rehearing Direct Testimony at 14 (March 14, 2014).

1 process would not be appropriate. Galileo checked his astronomical  
2 calculations with a telescope, just to make sure Venus was where the  
3 formula said it would be. Launching a man to the moon involved reams of  
4 calculations, but NASA knew the success would be judged by the reality of  
5 Apollo astronauts actually landing on the moon. And more personally,  
6 who would buy a house without testing the asking price against the sale  
7 prices of comparable homes in the neighborhood. Yet, some parties  
8 argue that the Commission should rely exclusively on a calculation  
9 methodology with no test of whether the result makes sense in reality.  
10

11 Q. SOME PARTIES ARGUE THAT EAI'S TESTIMONY EXCEEDED THE  
12 SCOPE OF THESE REPORTS BY COMMENTING ON THE  
13 CALCULATION OF AFUDC. PLEASE COMMENT.

14 A. To begin, I should note that EAI's Petition for Rehearing and Clarification  
15 identified the Moody's report in the introduction to the petition as support  
16 for the fact that the "cumulative effect of the individual findings and  
17 conclusions of the Order is to frustrate rather than facilitate EAI's  
18 operations in the new, post-System Agreement environment, deny  
19 recovery of reasonable levels of incurred costs, and exacerbate an  
20 already stressed financial outlook for the Company."<sup>5</sup> Consideration of the  
21 cumulative effect of the Order necessarily includes discussion of the

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<sup>5</sup> EAI Petition for Rehearing and Clarification at 6 (January 29, 2014).

1 calculation of AFUDC, which also was listed as the second subpart to  
2 EAI's discussion of issues adversely affecting its ability to invest in  
3 infrastructure along with ROE as the first subpart. The Commission  
4 specifically allowed EAI to introduce the Moody's and financial analyst  
5 reports. Ms. Lapson included in her rehearing direct testimony an excerpt  
6 from one analyst report in reaction to the Order:

7  
8 We viewed the order negatively for ETR [Entergy Corp.],  
9 particularly since the commission has recommended  
10 additional cost disallowances versus Staff's recommendation  
11 and a lower ROE. In the order, the PSC has directed Staff to  
12 file an updated revenue deficiency as compared to Staff's  
13 most recent \$110M recommendation based on an ROE of  
14 9.3% vs. the 9.6% ROE recommended by Staff and cost  
15 disallowances totaling about \$15M related to incentive  
16 compensation.<sup>6</sup>

17 It was not just the 9.3 percent ROE that Deutsche Bank found negative in  
18 the result of the Order, but the total effect including the cost disallowances  
19 that will make it difficult for EAI to achieve even the relatively low allowed  
20 return. In addition, as Ms. Lapson explained in her rehearing direct and  
21 reply testimonies, the allowed ROE, cost disallowances, and an AFUDC  
22 calculation that does not fully compensate for financing costs were factors  
23 Moody's used in its credit ratios to evaluate a change in the credit rating of  
24 investor owned utilities.<sup>7</sup> Moody's specifically cited the "less than  
25 favorable outcomes" from the Order in this case and the result in the  
26 Company's prior rate case as the reason EAI was not one of the 143 out

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<sup>6</sup> Lapson Rehearing Direct Testimony at 15-16 (March 14, 2014), *quoting* Hunt Rehearing Direct Testimony, EAI Exhibit DEH-6 at 7 (March 14, 2014).

1 of 164 rated companies whose credit ratings had been under  
2 consideration and were upgraded.<sup>8</sup>

3  
4 Q. PLEASE SUMMARIZE THE COMPANY'S POSITION ON REHEARING.

5 A. EAI faces a challenge of raising capital over the coming years to meet the  
6 capital requirements of providing service to its customers. Financial  
7 analysts sent a clear signal to investors that the impact of the Order  
8 produced a negative result for the Company's financial outlook.<sup>9</sup> The  
9 credit agency Moody's announced that its decision not to upgrade EAI  
10 when it upgraded ratings of 143 of EAI's peers reflected that agency's  
11 concerns over the effects of the Order on the financial metrics Moody's  
12 uses to rate utility securities.<sup>10</sup> While the Commission has historically  
13 relied in contested cases on the midpoint of a DCF analysis in setting the  
14 allowed return for utilities it regulates, in this case, that result is  
15 unreasonable in part because of the Federal Reserve's policy to keep  
16 interest rates artificially low. The result of that methodology produced a  
17 9.3 percent allowed return that is the lowest, non-penalty ROE granted to  
18 a vertically integrated electric utility in 2013 and the second lowest non-  
19 penalty ROE since Regulatory Research Associates began compiling

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<sup>7</sup> Lapson Rehearing Direct Testimony at 7-9, 14 (March 14, 2014); Lapson Rehearing Reply Testimony at 12-13 (April 11, 2014).

<sup>8</sup> Hunt Rehearing Direct Testimony, EAI Exhibit DEH-8 at 2 (March 14, 2014).

<sup>9</sup> See Lapson Rehearing Direct Testimony at 15-17 (March 14, 2014); see Hunt Rehearing Direct Testimony, EAI Exhibit DEH-4, EAI Exhibit DEH-5, EAI Exhibit DEH-6, and EAI Exhibit DEH-7 (March 14, 2014).

<sup>10</sup> Lapson Rehearing Reply Testimony at 7 (April 11, 2014).



1 records in 1980. No party has explained how a 9.3 percent ROE will allow  
2 EAI to compete for capital when the average allowed ROE for vertically  
3 integrated electric utilities in 2013 was 9.93 percent, much less how EAI  
4 could be expected even to earn this low allowed ROE with all the cost  
5 disallowances in the Order.

6 The negative reaction to the Order from Moody's and financial  
7 analysts was based on the total impact on EAI from the Commission's  
8 determination on all the issues, and the APSC granted rehearing on all the  
9 issues requested by EAI. A careful review of the record in this case will  
10 justify using no less than the 9.6 percent allowed ROE recommended by  
11 the Staff for a baseline as the Commission considers evidence supporting  
12 a higher ROE given current market conditions and EAI's investment  
13 needs. AEEC witness David Parcell included in his rehearing reply  
14 testimony a list of the key issues on which the Company seeks the  
15 Commission's focus in this rehearing.<sup>11</sup> In addition to a revision to the  
16 allowed ROE addressed above, the evidence in the case will justify  
17 revising the Order to:

- 18 1. Direct the Company to utilize the Federal Energy Regulatory  
19 Commission formula for calculating AFUDC consistent with  
20 established policy on AFUDC until the Staff has investigated the  
21 options and a generic docket is completed. The Commission's

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<sup>11</sup> Parcell Rehearing Responsive Testimony, Exhibit DCP-18, EAI response to Staff data request 206-1 (April 4, 2014).

1 reliance on settlements to justify the Order's direction to cap the  
2 AFUDC rate is not a reasoned basis for the Commission's  
3 decision in this case on this issue."<sup>12</sup>

4 2. Direct that the payroll adjustment for EAI, Entergy Services, Inc.  
5 ("ESI"), and Entergy Operations, Inc. ("EOI") be calculated  
6 consistently. As stated in EAI's Petition for Rehearing and  
7 Clarification, "Because the HCM savings were calculated based  
8 on EAI, ESI, and EOI payroll as of December 2012, test year  
9 payroll for 2012 should be consistently used for all of the  
10 companies (EAI, ESI, and EOI), and EAI's payroll adjustment for  
11 all of the companies should be based on the most recent  
12 available year, 2012."<sup>13</sup>

13 3. Allow the Company to recover its total level of payroll costs in  
14 rates. As stated in the Petition, "...the appropriate standard for  
15 cost recovery, as advocated by Staff and EAI, is as follows:  
16 reasonable expenses of the Company which are necessary for  
17 the provision of utility service should be allowed in rates."<sup>14</sup> "No  
18 party asserted that EAI's total level of compensation was  
19 unreasonable."<sup>15</sup> "The Order erred by not deciding if EAI and  
20 Staff showed that EAI's incentive compensation programs are

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<sup>12</sup> EAI's Reply to Responses to the Petition for Rehearing and Clarification at 17-18 (February 14, 2014).

<sup>13</sup> EAI's Petition for Rehearing and Clarification at 33 (January 29, 2014).

<sup>14</sup> *Id.* at 43.

<sup>15</sup> *Id.* at 37.

1                   necessary to attract and retain qualified employees and thus  
2                   necessary for the provision of utility service.”<sup>16</sup>

3                   4. Determine that the Supplemental Executive Retirement Plan  
4                   (“SERP”) is not incentive compensation and is a cost necessary  
5                   for the provision of utility service. As stated in the Petition,  
6                   “[T]hese nonqualified pension plans have no direct alignment to  
7                   shareholders”<sup>17</sup> and “...there is no evidentiary justification for  
8                   disallowing the SERP retirement benefit for salary levels which  
9                   exceed \$255,000 versus any other level.”<sup>18</sup> “The Order does  
10                  not provide any rationale to support a conclusion that reference  
11                  to that [Internal Revenue Service] Code limit to structure the  
12                  retirement plan is improper or unreasonable or that the level of  
13                  SERP benefit is otherwise unreasonable to attract and retain  
14                  talent needed for EAI and thus is not necessary for the provision  
15                  of utility service.”<sup>19</sup>

16                  5. Determine that FIN 48 balances are not sources of zero cost  
17                  capital and order that these balances be removed from the  
18                  calculation of Accumulated Deferred Income Tax (“ADIT”). As  
19                  stated in the Petition, “The evidence shows that FIN 48 ADIT  
20                  balances are distinguishable from other sources of ADIT and

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<sup>16</sup> *Id.* at 43.

<sup>17</sup> *Id.* at 46.

<sup>18</sup> *Id.* at 47.

<sup>19</sup> *Id.*

1 represent a liability for which the Company will most likely have  
2 to pay the IRS, with interest, and thus are not a zero cost source  
3 of capital....a FIN 48 tax position is a tax position that has a  
4 greater likelihood than not (greater than 50 percent) that it will  
5 be disallowed by the IRS. The simple fact that EAI has  
6 characterized certain tax positions as FIN 48 tax positions is  
7 substantial evidence that EAI will not sustain these positions.”<sup>20</sup>  
8 6. Find that, because EAI was not eligible for the Manufacturers’  
9 Tax Deduction during the test year or pro forma year and will  
10 not be eligible in the near future, and because the  
11 Manufacturers’ Tax Deduction is a deduction and not a rate, this  
12 deduction should not be reflected in the Revenue Conversion  
13 Factor. As stated in the Petition, “The undisputed evidence is  
14 that EAI was not eligible for the Manufacturers’ Tax Deduction  
15 during the test year and pro-forma year and will not be eligible  
16 for the deduction for the foreseeable future because of its net  
17 operating loss position.”<sup>21</sup> The Petition further states, “Tax rates  
18 are properly comprehended in the revenue conversion factor,  
19 but tax deductions are not, and, most certainly, non-existent tax  
20 deductions are not.”<sup>22</sup>

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<sup>20</sup> *Id.* at 57-58.

<sup>21</sup> *Id.* at 59.

<sup>22</sup> *Id.* at 60.

1  
2           The Company also requests that the Commission approve the  
3 findings referenced in Staff's Reply to the Petition:

- 4           1. Allow the Company to include Wholesale Accounts  
5           Receivable in Working Capital Assets;  
6           2. Allow the Company to establish a regulatory asset on  
7           its books for its deferred rate case expense; and  
8           3. Clarify that the dismantlement study reporting  
9           requirements approved by the Commission in Order  
10          No. 21 were intended to, "reflect that EAI should  
11          provide a dismantlement study at the time it proposes  
12          new depreciation rates if the previous study was greater  
13          than 10 years old, not necessarily to require a new  
14          dismantlement study every 10 years."

15          EAI respectfully asks the Commission to grant all relief requested  
16          by the Company on rehearing, and render a decision that provides the  
17          Company with a secure financial platform to support its operations outside  
18          the System Agreement and to meet the needed investment challenges  
19          and be able to provide reliable service to its customers in the future.

20  
21   Q.   DOES THIS CONCLUDE YOUR REHEARING REPLY TESTIMONY?  
22   A.   Yes.

CERTIFICATE OF SERVICE

I, Steven K. Strickland, do hereby certify that a copy of the foregoing has been served upon all parties of record by forwarding the same by electronic mail and/or first class mail, postage prepaid, this 11th day of April, 2014.

/s/ Steven K. Strickland  
Steven K. Strickland

BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION )  
OF ENTERGY ARKANSAS, INC. FOR )  
APPROVAL OF CHANGES IN RATES FOR )  
RETAIL ELECTRIC SERVICE )

DOCKET NO. 13-028-U

REHEARING REPLY TESTIMONY

OF

DAVID E. HUNT

DIRECTOR, REGULATORY FILINGS  
ENTERGY SERVICES, INC.

ON BEHALF OF

ENTERGY ARKANSAS, INC.

APRIL 11, 2014

1    **I.       INTRODUCTION**

2    Q.     PLEASE STATE YOUR NAME.

3    A.     My name is David E. Hunt.

4

5    Q.     ARE YOU THE SAME DAVID E. HUNT WHO PREVIOUSLY FILED  
6           TESTIMONY IN THIS DOCKET?

7    A.     Yes, I am.

8

9    Q.     ON WHOSE BEHALF ARE YOU TESTIFYING?

10   A.     I am submitting this rehearing reply testimony to the Arkansas Public  
11           Service Commission ("APSC" or the "Commission") on behalf of Entergy  
12           Arkansas, Inc. ("EAI" or the "Company").

13

14   Q.     WHAT IS THE PURPOSE OF YOUR REHEARING REPLY TESTIMONY?

15   A.     The purpose of my rehearing reply testimony is to respond to issues  
16           raised in the responsive rehearing testimonies of other parties in this  
17           proceeding. The general topics I will address are:

- 18           •     the Commission's decision to review new information pursuant  
19                 to the current Rules of Practice and Procedure ("RPPs");  
20           •     concerns over using Regulatory Research Associates ("RRA")  
21                 data in evaluating the allowed rate of return on common equity  
22                 ("ROE") for EAI, including criticisms of my presentation of the



1 RRA data and prior Commission concerns about the use of  
2 RRA data; and  
3 • various issues raised by parties regarding my rehearing direct  
4 testimony.

5  
6 **II. COMMISSION REVIEW OF NEW INFORMATION**

7 Q. APSC GENERAL STAFF ("STAFF") WITNESS ROBERT DANIEL  
8 RECOMMENDS THAT THE COMMISSION NOT RELY UPON THE  
9 INFORMATION PROVIDED BY EAI IN ITS REHEARING DIRECT  
10 TESTIMONY BASED UPON HIS UNDERSTANDING OF ARK. CODE  
11 ANN. § 23-4-406 AND A 1986 SOUTHWESTERN BELL COURT  
12 DECISION.<sup>1</sup> IS MR. DANIEL'S RECOMMENDATION APPROPRIATE?

13 A. No, for two reasons. First, my understanding of Ark. Code  
14 Ann. § 23-4-406 as a non-lawyer is that this law describes the limits for the  
15 use of accounting data to be used in a test year or pro forma year in a  
16 utility rate application. The data used to set an allowed ROE are not found  
17 in the Company's accounting records. In fact, as discussed in Mr. Daniel's  
18 direct testimony, his calculation of growth factors in his analysis used  
19 various historical and forward-looking information encompassing the  
20 period 2008 through 2017.<sup>2</sup> Second, Mr. Daniel does not address Ark.

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<sup>1</sup> Daniel Rehearing Direct Testimony at 4-5.

<sup>2</sup> *Id.* at 31-32.

1 Code Ann. § 23-2-422 (c), referenced by the Commission in Amended

2 Order No. 25:

3 Upon receiving the application, the commission shall  
4 have power to grant or deny rehearing, to abrogate or modify  
5 its order without further hearing, or ***to reopen the record for***  
6 ***the purpose of receiving and considering additional***  
7 ***evidence.***<sup>3</sup>

8 This statute is also reflected in the Commission's RPPs as Rule 4.14(d).

9

10 Q. ARKANSAS ATTORNEY GENERAL ("AG") WITNESS WILLIAM B.  
11 MARCUS ALSO RAISES A CONCERN ABOUT ORIGINATION OF THIS  
12 EVIDENCE AFTER THE END OF THE PRO FORMA YEAR.<sup>4</sup> DOES MR.  
13 MARCUS' CONCERN RAISE ANY DIFFERENT ISSUE THAN MR.  
14 DANIEL'S?

15 A. No. Mr. Marcus' concerns about the pro forma year also are unfounded  
16 for the same reasons.

17

18 Q. WAL-MART WITNESS STEVE W. CHRISS ALSO RAISES ISSUES WITH  
19 THE SUBMISSION OF THE ANALYST REPORTS IN EAI'S REHEARING  
20 DIRECT TESTIMONY, INCLUDING CONCERNS ABOUT THE  
21 ESTABLISHMENT OF AN "EX POST FACTO LITMUS TEST" FOR

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<sup>3</sup> Order No. 25 at 3 (emphasis added).

<sup>4</sup> Marcus Rehearing Testimony at 2.

1 COMMISSION DECISIONS.<sup>5</sup> DO YOU HAVE A RESPONSE TO MR.  
2 CHRISS' CONCERNS?

3 A. Yes. The Company has not requested that the Commission ignore the  
4 evidence already in the case and solely use this new evidence to  
5 determine the appropriate allowed ROE. The Company seeks only to  
6 supplement the existing record with information that did not exist until the  
7 Commission issued Order No. 21 (the "Order") and the investment  
8 community responded. As the Company stated in its Petition for  
9 Rehearing and Clarification,

10 Given the unobservable nature of the cost of equity and its  
11 critical importance to setting rates, this is a subject about  
12 which a regulator should want more information, not less,  
13 and would use all evidence at its disposal.<sup>6</sup>

14

15 Q. ARKANSAS ELECTRIC ENERGY CONSUMERS, INC. ("AEEC")  
16 WITNESS DAVID C. PARCELL ALSO RAISED CONCERNS ABOUT THE  
17 INCLUSION OF EVIDENCE AFTER THE COMMISSION ISSUED THE  
18 ORDER.<sup>7</sup> ARE HIS CONCERNS VALID OR MARKEDLY DIFFERENT  
19 FROM THE CONCERNS ABOVE?

20 A. No. My understanding is that the Commission is under its own timetable  
21 to evaluate the evidence and testimony before issuing an order resolving  
22 the Company's Petition for Rehearing and Clarification.

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<sup>5</sup> Chriss Responsive Rehearing Testimony at 3.

<sup>6</sup> EAI Petition for Rehearing and Clarification at 15.

<sup>7</sup> Parcell Rehearing Responsive Testimony at 2.

1     **III.     USE OF RRA DATA IN EVALUATING THE ALLOWED ROE**

2     Q.     WHAT IS THE APPROPRIATE USE OF THE RRA DATA IN THE  
3           CONTEXT OF EVALUATING EAI'S ALLOWED ROE IN THIS  
4           PROCEEDING?

5     A.     I provided the most recent results in other rate cases for vertically  
6           integrated utilities<sup>8</sup> so that the Commission will have a complete picture of  
7           how a 9.3 percent ROE positions the Company relative to many utilities  
8           with which EAI competes for capital. EAI is not proposing that the  
9           Commission set the ROE in this case based upon the ROE authorizations  
10          in other jurisdictions. Such a claim detracts from the intent of my  
11          testimony.

12

13    Q.     AEEC'S MR. PARCELL CRITICIZES YOUR PRESENTATION OF THE  
14           AVERAGE ALLOWED ROE IN 2013 OF 10.02 PERCENT,  
15           SPECIFICALLY NOTING THE INCLUSION OF GENERATION-ONLY  
16           ROE CASES IN CALCULATING THAT VALUE.<sup>9</sup> IS HIS CRITICISM  
17           VALID?

18    A.     No, it is not valid, and it is slightly perplexing in that my presentation  
19           excluded generation-only cases to provide a more comparable subset of  
20           the RRA data that ultimately resulted in a lower average allowed ROE.  
21           My rehearing direct testimony first presented the results of the full 2013

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<sup>8</sup> Hunt Rehearing Direct Testimony, EAI Exhibit DEH-9.

<sup>9</sup> Parcell Rehearing Responsive Testimony at 9.

1 RRA report. After the presentation of those data, I explained that the data  
2 supporting the 10.02 percent average allowed ROE are not the best  
3 comparison to EAI's allowed ROE because "[t]he 2013 RRA results reflect  
4 a variety of regulatory decisions, **including ROEs for specific**  
5 **generating facilities** and ROEs for utilities that only provide transmission  
6 or distribution service."<sup>10</sup> I then explained why the 9.93 percent allowed  
7 ROE for the vertically integrated subset of the RRA data is more  
8 comparable to EAI. Mr. Parcell recommends 9.8 percent as the starting  
9 point for comparison but did not provide details supporting that figure.<sup>11</sup>  
10 The presentation of the RRA data in my rehearing direct testimony was  
11 straight forward and thus did not warrant the specific criticisms raised by  
12 Mr. Parcell.

13  
14 Q. AEEC'S MR. PARCELL CONDUCTED AN ANALYSIS OF RRA  
15 ALLOWED ROE RESULTS USING 2012 AND 2013 DATA,<sup>12</sup> AND  
16 FEDERAL EXECUTIVE AGENCIES' ("FEA") MICHAEL P. GORMAN  
17 DISCUSSED RECENT 2014 RESULTS.<sup>13</sup> DOES THE EXPANSION OF  
18 THE TIME PERIOD MATERIALLY CHANGE THE ANALYSIS YOU  
19 PRESENTED IN YOUR REHEARING DIRECT TESTIMONY?

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<sup>10</sup> Hunt Rehearing Direct Testimony at 8 (emphasis added).

<sup>11</sup> Parcell Rehearing Responsive Testimony at 9.

<sup>12</sup> *Id.* at 10.

<sup>13</sup> Gorman Rehearing Direct Testimony at 17.

1 A. No. Expanding the analysis period does not materially change the results  
2 I presented and discussed. The average allowed ROE for the period 2012  
3 through the first quarter of 2014 for all decisions with an indicated ROE, as  
4 reported by RRA, is 10.11 percent compared to 10.02 percent for 2013  
5 only. If one narrows the analysis to the more comparable vertically  
6 integrated decisions, the average for 2012 through the first quarter of 2014  
7 is 10.03 percent compared to 9.93 percent for 2013 only. I have updated  
8 Figures 1 and 2 from my rehearing direct testimony to include 2012  
9 quarterly data through the first quarter of 2014. The updated figures  
10 display all of the allowed ROE results along with the average allowed ROE  
11 for all decisions and vertically integrated utilities only. They are attached  
12 as EAI Exhibit DEH-10 for all results and EAI Exhibit DEH-11 for vertically  
13 integrated results only.

14 Table 1 below is an update of Table 1 in my rehearing direct  
15 testimony reflecting quarterly allowed ROE results for all decisions.

16

**Table 1**  
**Allowed ROEs By Quarter**  
**2012 – 1<sup>st</sup> Quarter 2014<sup>14</sup>**

Quarter	Average Allowed ROE
1 <sup>st</sup> 2012	10.82%
2 <sup>nd</sup> 2012	9.92%
3 <sup>rd</sup> 2012	9.78%
4 <sup>th</sup> 2012	10.10%
1 <sup>st</sup> 2013	10.24%
2 <sup>nd</sup> 2013	9.84%
3 <sup>rd</sup> 2013	10.06%
4 <sup>th</sup> 2013	9.89%
1 <sup>st</sup> 2014	10.17%

Although the averages by quarter vary, there is not a clear upward or downward trend in allowed ROEs indicated by this expanded time period, which also was my conclusion when looking at the 2013 data only.<sup>15</sup>

Q. WHERE DOES EAI'S ALLOWED ROE FALL IN THIS EXPANDED TIME PERIOD ANALYSIS?

A. EAI's 9.3 percent allowed ROE is the second lowest non-penalty allowed ROE for vertically integrated electric utilities over this expanded timeframe. The only lower non-penalty allowed ROE was the Northern States Power ("NSP") decision in South Dakota that was discussed in my rehearing direct testimony.<sup>16</sup> When looking at all allowed ROE decisions

<sup>14</sup> Hunt Rehearing Direct Testimony, EAI Exhibit DEH-9 at 3. The 1<sup>st</sup> quarter 2014 average is taken from the April 9, 2014 RRA Major Rate Cases report.

<sup>15</sup> Hunt Rehearing Direct Testimony at 7.

<sup>16</sup> *Id.* at 14-16.

1 during this expanded period, the only additional cases added below EAI's  
2 result were the NSP South Dakota case and a 9.2 percent allowed ROE in  
3 a Consolidated Edison ("Con Ed") case in New York from February 2014  
4 fell below EAI's 9.3 percent allowed ROE. The Con Ed case was  
5 discussed in the UBS Report attached as confidential EAI Exhibit DEH-5  
6 to my rehearing direct testimony.

7

8 Q. AECC'S MR. PARCELL ALSO POINTS TO 2012 AND 2013 NATURAL  
9 GAS DISTRIBUTION UTILITY ROE RESULTS AS EVIDENCE THAT AN  
10 ALLOWED ROE BELOW 9.5 PERCENT IS REASONABLE.<sup>17</sup> IS HIS  
11 ANALYSIS OF THOSE RESULTS COMPLETE?

12 A. No, in two regards. First, he presents only those ROE results of 9.5  
13 percent or less. If you review all natural gas distribution utility allowed  
14 ROE results, a different picture emerges. EAI Exhibit DEH-12 presents all  
15 natural gas distribution utility ROE results from 2012 through the first  
16 quarter of 2014, similar to EAI Exhibit DEH-10 and EAI Exhibit DEH-11.  
17 The average allowed ROE for that period is 9.81 percent, and EAI still falls  
18 in the bottom quartile of natural gas distribution utility results.

19 Second, Mr. Parcell does not acknowledge any differences  
20 between vertically integrated electric and natural gas distribution allowed  
21 ROEs. For 2013, vertically integrated electric utility allowed ROEs

---

<sup>17</sup> Parcell Rehearing Responsive Testimony at 12.



1 averaged 9.93 percent<sup>18</sup> compared to 9.68 percent for natural gas  
2 distribution utilities,<sup>19</sup> a 0.25 percent difference. For 2012 through the first  
3 quarter of 2014, the difference is similar with 10.03 percent for vertically  
4 integrated electric utilities versus 9.81 percent for natural gas distribution  
5 utilities, a 0.22 percent difference.  
6

7 Q. MR. DANIEL TESTIFIED THAT THE COMPANY'S REQUESTED ROE  
8 WAS INAPPROPRIATE IN COMPARISON TO THE ALLOWED ROES  
9 PRESENTED IN THE RRA DATA. HOW DO YOU RESPOND?

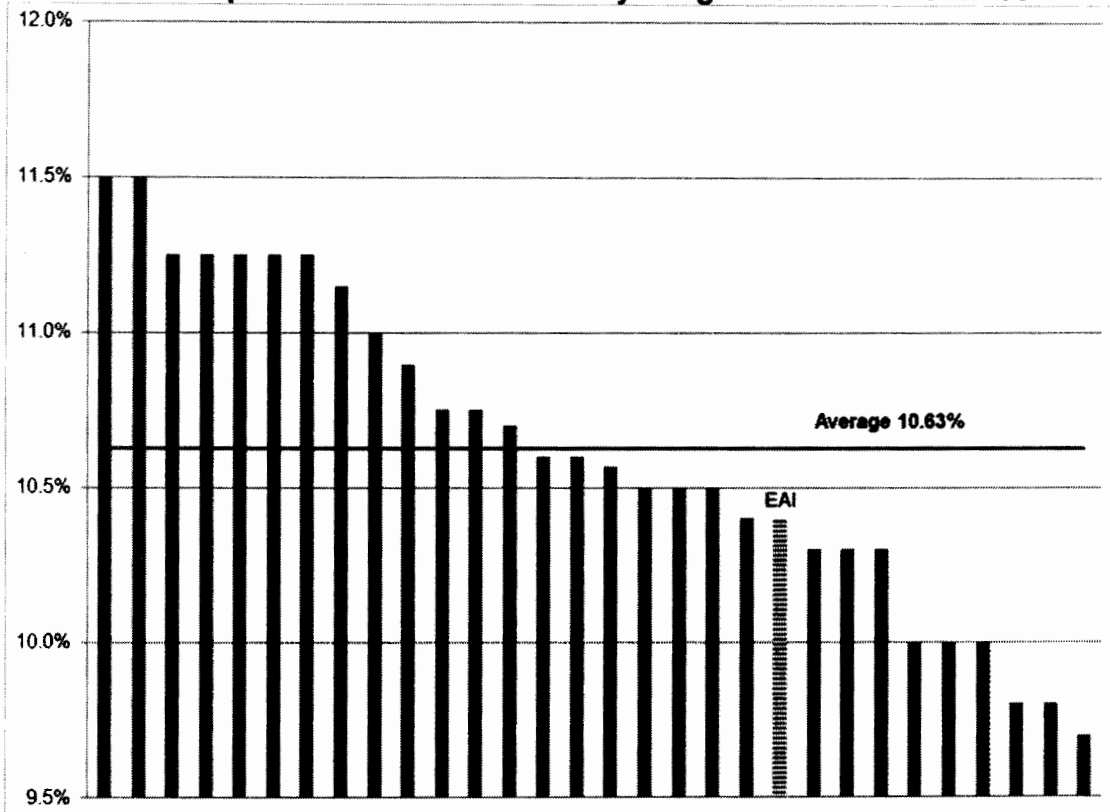
10 A. It is not unusual for a utility's proposed ROE in a rate proceeding to differ  
11 from the ultimate decision reached by regulators. It is also not unusual for  
12 intervenors' proposed ROEs to differ from the ultimate decision reached  
13 by regulators. EAI's requested ROE of 10.4 percent was below average  
14 when compared with the 10.63 percent average ROE requested by other  
15 vertically integrated utilities that received ROE decisions in 2013. Figure 1  
16 below presents a graph showing where EAI falls in that range.  
17

---

<sup>18</sup> Hunt Rehearing Direct Testimony at 9.

<sup>19</sup> Hunt Rehearing Direct Testimony, EAI Exhibit DEH-9 at 3.

**Figure 1**  
**2013 Requested ROEs For Vertically Integrated Electric Utilities**



Additionally, Mr. Daniel pointed out that only one authorization in 2013 was higher than EAI's requested 10.4 percent. However, Mr. Daniel failed to acknowledge that, similarly, only one authorization fell below the 9.3 percent ROE authorized by the Order. In fact, but for the penalty decision that resulted in 9.0 percent and the 9.3 percent here, the vast majority of the other decisions in 2013 were above even Staff's recommended 9.6 percent.

1 Q. MR. GORMAN TESTIFIED THAT BOND RATINGS ARE A BETTER  
2 INDICATOR OF COMPARABILITY OF ALLOWED ROES THAN THE  
3 DISTINCTION BETWEEN TRANSMISSION- AND DISTRIBUTION-ONLY  
4 UTILITIES AND VERTICALLY INTEGRATED UTILITIES.<sup>20</sup> IS THIS  
5 VALID?

6 A. No. Although he calls the separation of transmission and distribution  
7 utilities from vertically integrated utilities "very simplistic and unreliable,"<sup>21</sup>  
8 it is a valid distinction, as evidenced by RRA's warning about the  
9 comparing of historical ROE data because "...certain states have  
10 unbundled electric rates and implemented retail competition for  
11 generation."<sup>22</sup> Mr. Gorman's FEA Exhibit Rehearing MPG-3 attempts to  
12 justify the comparability of allowed ROEs less than 9.5 percent based on  
13 bond ratings. His exhibit actually confirms my own presentation of the  
14 RRA data in that no vertically integrated electric utility falls below EAI's  
15 allowed 9.3 percent except for Maui Electric's 9.0 percent ROE that  
16 includes a 0.5 percent penalty as described in my rehearing direct  
17 testimony. Once Maui Electric is excluded, the remaining transmission  
18 and distribution companies with lower ROEs have higher combined bond  
19 ratings (looking at both Standard & Poor's and Moody's) than EAI. He  
20 also did not provide a complete analysis of allowed ROE results and bond

---

<sup>20</sup> Gorman Rehearing Direct Testimony at 16-17; Gorman Rehearing Direct Testimony, FEA Exhibit Rehearing MPG-3.

<sup>21</sup> *Id.* at 16.

<sup>22</sup> Hunt Rehearing Direct Testimony, EAI Exhibit DEH-9 at 2.

1 ratings for decisions above 9.5 percent. If Mr. Gorman performed this  
2 analysis, he would have noted currently Baa2-rated companies like  
3 Southwestern Electric Power Company ("SWEPCO") receiving a 10  
4 percent ROE in a 2013 Louisiana decision and a 9.65 percent ROE in a  
5 2013 Texas decision, Kansas City Power & Light Greater Missouri Op.  
6 receiving a 9.7 percent ROE in two 2013 Missouri decisions, and Entergy  
7 Mississippi, Inc. receiving a 10.8 percent ROE as part of its formula rate  
8 plan rate change in 2013. In fact, with the recent Moody's upgrades  
9 discussed in EAI witness Ellen Lapson's rehearing reply testimony,<sup>23</sup> 38 of  
10 the 48 utilities that received ROE decisions in 2013 now have higher bond  
11 ratings than EAI.

12

13 Q. STAFF WITNESS DANIEL, AEEC WITNESS PARCELL, AND AG  
14 WITNESS MARCUS POINT TO VARIOUS ISSUES WITH USING THE  
15 RRA DATA AS A REFERENCE POINT IN EVALUATING THE ALLOWED  
16 ROE FOR EAI INCLUDING REFERENCES TO PRIOR COMMISSION  
17 ORDERS.<sup>24</sup> WHAT ISSUES WERE RAISED?

18 A. The issues revolved around three areas – supposed circularity of using  
19 RRA data, inability of other parties to review the details of how the ROE

---

<sup>23</sup> Lapson Rehearing Reply Testimony, EAI Exhibit EL-2.

<sup>24</sup> Daniel Rehearing Direct Testimony at 6-8; Parcell Rehearing Responsive Testimony at 8;  
| Marcus Rehearing Testimony at 6.

1 was determined, and the Commission's need to base its decision on  
2 evidence presented in this case.

3  
4 Q. HOW DO YOU ADDRESS THOSE CONCERNS?

5 A. It is true that comparisons to current or recent averages may become less  
6 pertinent over time owing to economic events unrelated to and  
7 uncontrollable by utility ratemaking, such as economic expansion or  
8 recession, federal interest rate policy, international conflicts, and weather  
9 events. These events will drive changes in underlying economic and  
10 financial data that will yield indicators suggesting allowed ROEs should  
11 change over time. But that should not preclude this Commission from  
12 evaluating how EAI stands now in comparison to other utilities that are  
13 competing with EAI in the capital markets and from setting rates to ensure  
14 EAI has appropriate access to capital.

15 The ability to review the details underlying an ROE decision has  
16 grown as technology allows easier access to documents when questions  
17 arise about regulatory matters. As a starting point, the RRA report  
18 provided as EAI Exhibit DEH-9 to my rehearing direct testimony provides  
19 an excellent summary of material regulatory characteristics of the cases  
20 as noted by Staff witness Daniel.<sup>25</sup> Where additional research is needed,  
21 the public availability of regulatory information is greater than ever. The

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<sup>25</sup> Daniel Rehearing Direct Testimony at 5-6.

1 analysis of the Maui Electric and NSP cases in my rehearing direct  
2 testimony was facilitated by the review of detailed documents made  
3 available over the internet by those utilities' Hawaii and South Dakota  
4 regulators, respectively. Where questions arise about an allowed ROE  
5 result, there is adequate access and opportunity to obtain the basis for  
6 that decision if there is concern about how it was determined.

7 In its original application, the Company provided, as part of witness  
8 Samuel C. Hadaway's testimony, the RRA data as a point of reference for  
9 evaluating the allowed ROE in this proceeding.<sup>26</sup> Additionally, an updated  
10 RRA report was provided at the hearing.<sup>27</sup> This rehearing process has  
11 allowed for the provision of supplemental RRA evidence that did not exist  
12 at the time of the hearing along with a reasonable procedural schedule to  
13 have it evaluated by all parties.

14  
15 Q. HAS THE APSC EVER REFERENCED ANOTHER COMMISSION'S  
16 DECISION IN EVALUATING THE REASONABLENESS OF AN ROE  
17 GRANTED IN THE ARKANSAS JURISDICTION?

18 A. Yes. In Docket No. 80-060-U involving SWEPCO, the Commission  
19 reviewed the reasonableness of the ROE reflected in the settlement of  
20 that case by noting the then recently allowed ROE for SWEPCO's parent

---

<sup>26</sup> Hadaway Direct Testimony, EAI Exhibit SCH-4.

<sup>27</sup> See T. at 619, EAI Proffered Exhibit 1.

1 before the Public Utility Commission of Texas.<sup>28</sup> As that was a time of  
2 unusual interest rates (high then versus low now), such a comparison was  
3 a reasonable step to ensure a fair result.  
4

5 **IV. OTHER ISSUES**

6 Q. MR. PARCELL CLAIMS THAT THE FEDERAL ENERGY REGULATORY  
7 COMMISSION'S ("FERC") METHODOLOGY FOR ESTIMATING THE  
8 COST OF EQUITY FOR TRANSMISSION COMPANIES IS RELEVANT  
9 HERE BECAUSE EAI IS REQUESTING FERC'S METHOD FOR  
10 CALCULATING THE ALLOWANCE FOR FUNDS USED DURING  
11 CONSTRUCTION ("AFUDC").<sup>29</sup> HOW DO YOU RESPOND?

12 A. As explained by EAI witness Ellen Lapson,<sup>30</sup> the methodology used by  
13 FERC in estimating the cost of equity for transmission companies is not  
14 relevant to this case. Additionally, it is widely known that FERC has  
15 historically employed the use of ROE adders to further promote  
16 investment in transmission infrastructure throughout the country. As to  
17 FERC's method for calculating AFUDC, this Commission, until now, has  
18 consistently chosen the FERC formula for AFUDC in contested rate  
19 cases.<sup>31</sup> The Company proposes to use the FERC formula in this

<sup>28</sup> Order No. 5 of Docket No. 80-060-U (formerly U-3116 and U-3136) at 8 (October 23, 1981).

<sup>29</sup> Parcell Rehearing Responsive Testimony at 7.

<sup>30</sup> Lapson Rehearing Reply Testimony at 17-18.

<sup>31</sup> See EAI's Petition for Rehearing and Clarification at 26-27.

- 1           contested case because the FERC AFUDC formula more accurately  
2           reflects the Company's true cost of financing construction.<sup>32</sup>  
3  
4    Q.    DOES THIS CONCLUDE YOUR REHEARING REPLY TESTIMONY?  
5    A.    Yes.

---

<sup>32</sup> See Lewis Direct Testimony at 24-32.



CERTIFICATE OF SERVICE

I, Steven K. Strickland, do hereby certify that a copy of the foregoing has been served upon all parties of record by forwarding the same by electronic mail and/or first class mail, postage prepaid, this 11th day of April, 2014.

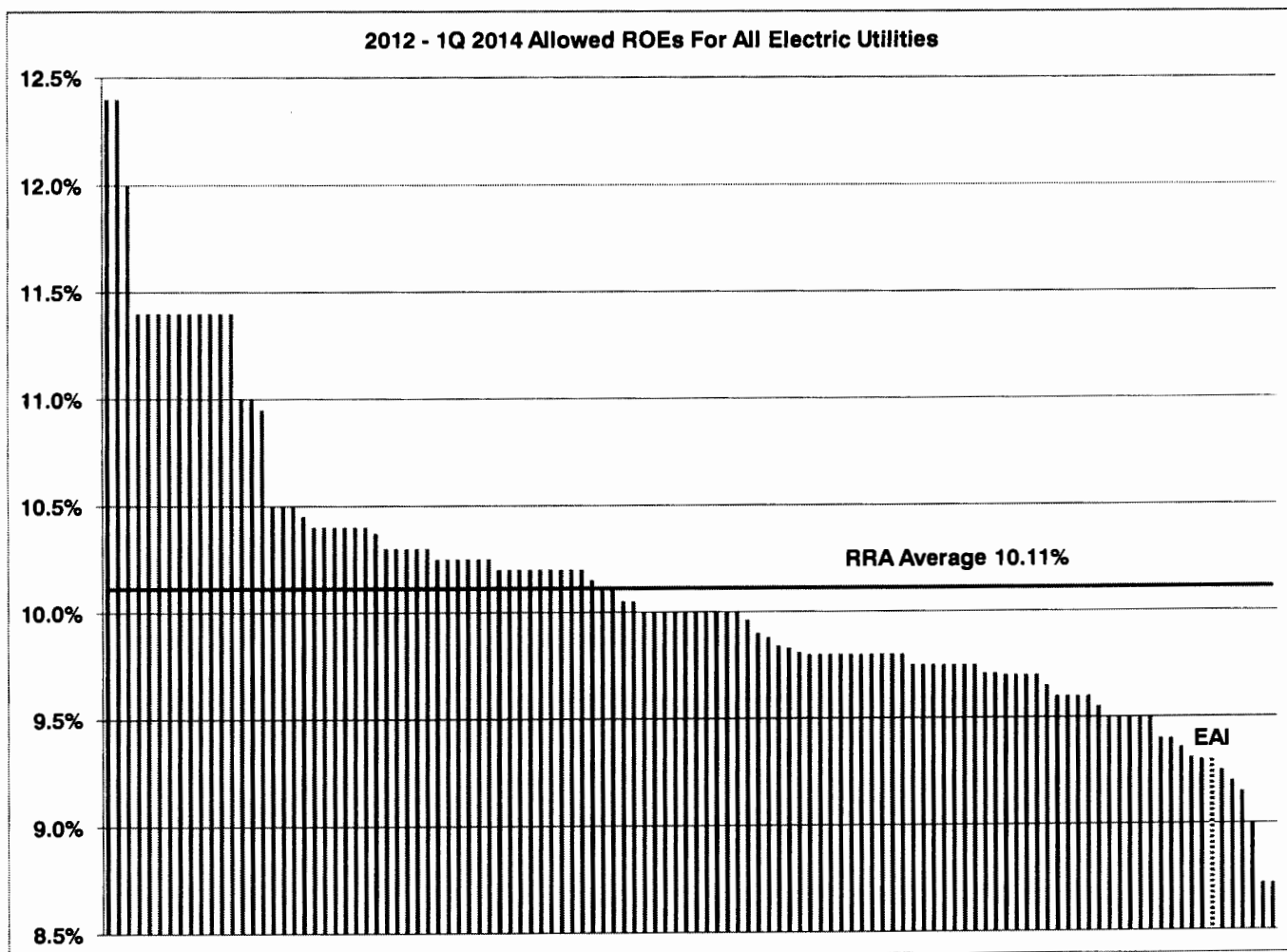
/s/ Steven K. Strickland  
Steven K. Strickland

BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION	)	
OF ENTERGY ARKANSAS, INC. FOR	)	DOCKET NO. 13-028 -U
APPROVAL OF CHANGES IN RATES FOR	)	
RETAIL ELECTRIC SERVICE	)	

EAI EXHIBIT DEH-10

2012 - 1Q 2014 ALLOWED ROES FOR ALL ELECTRIC UTILITIES



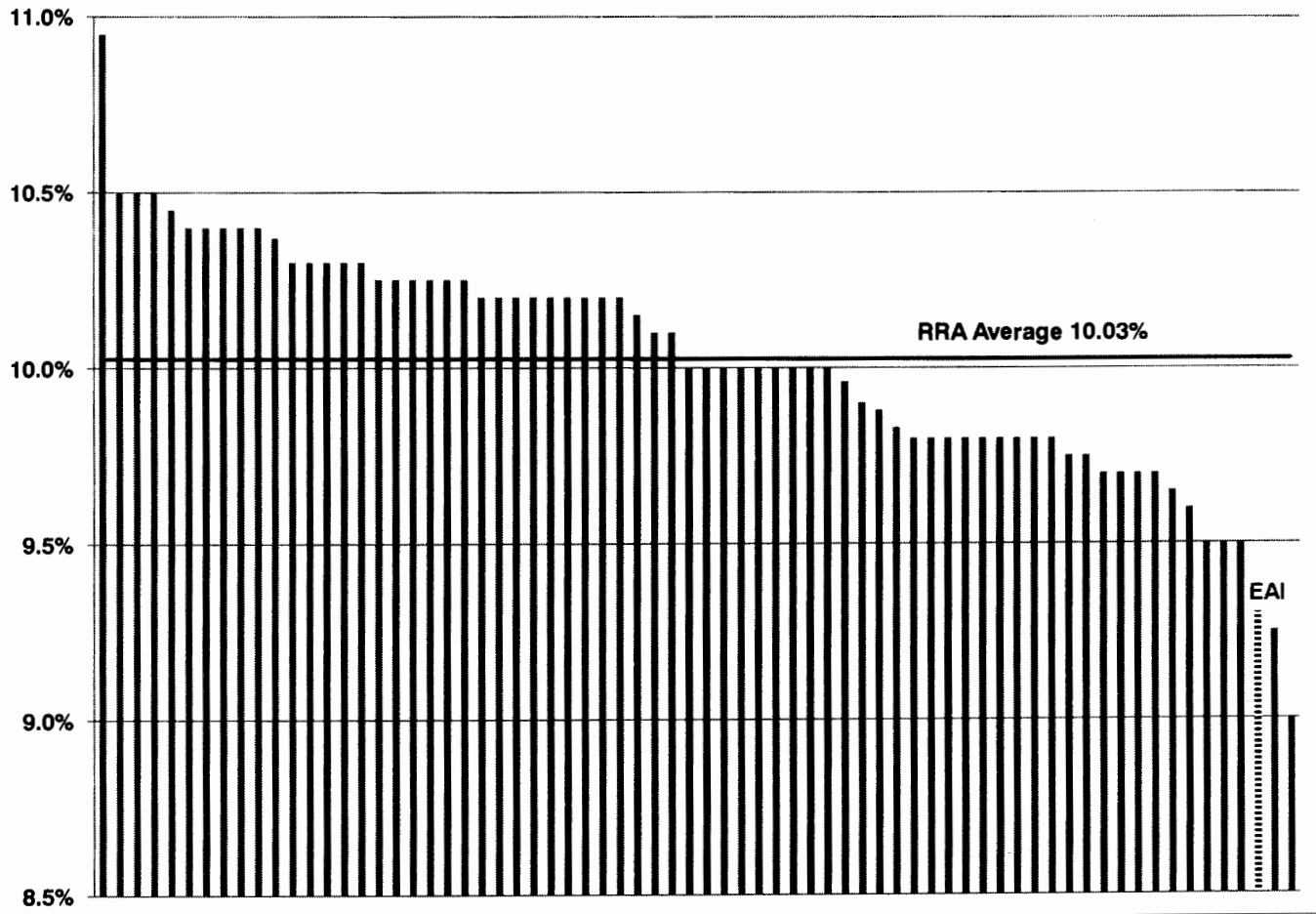
BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION	)	
OF ENTERGY ARKANSAS, INC. FOR	)	DOCKET NO. 13-028-U
APPROVAL OF CHANGES IN RATES FOR	)	
RETAIL ELECTRIC SERVICE	)	

EAI EXHIBIT DEH-11

2012 - 1Q 2014 ALLOWED ROES FOR VERTICALLY INTEGRATED ELECTRIC  
UTILITIES

2012 - 1Q 2014 Allowed ROEs For Vertically Integrated Electric Utilities

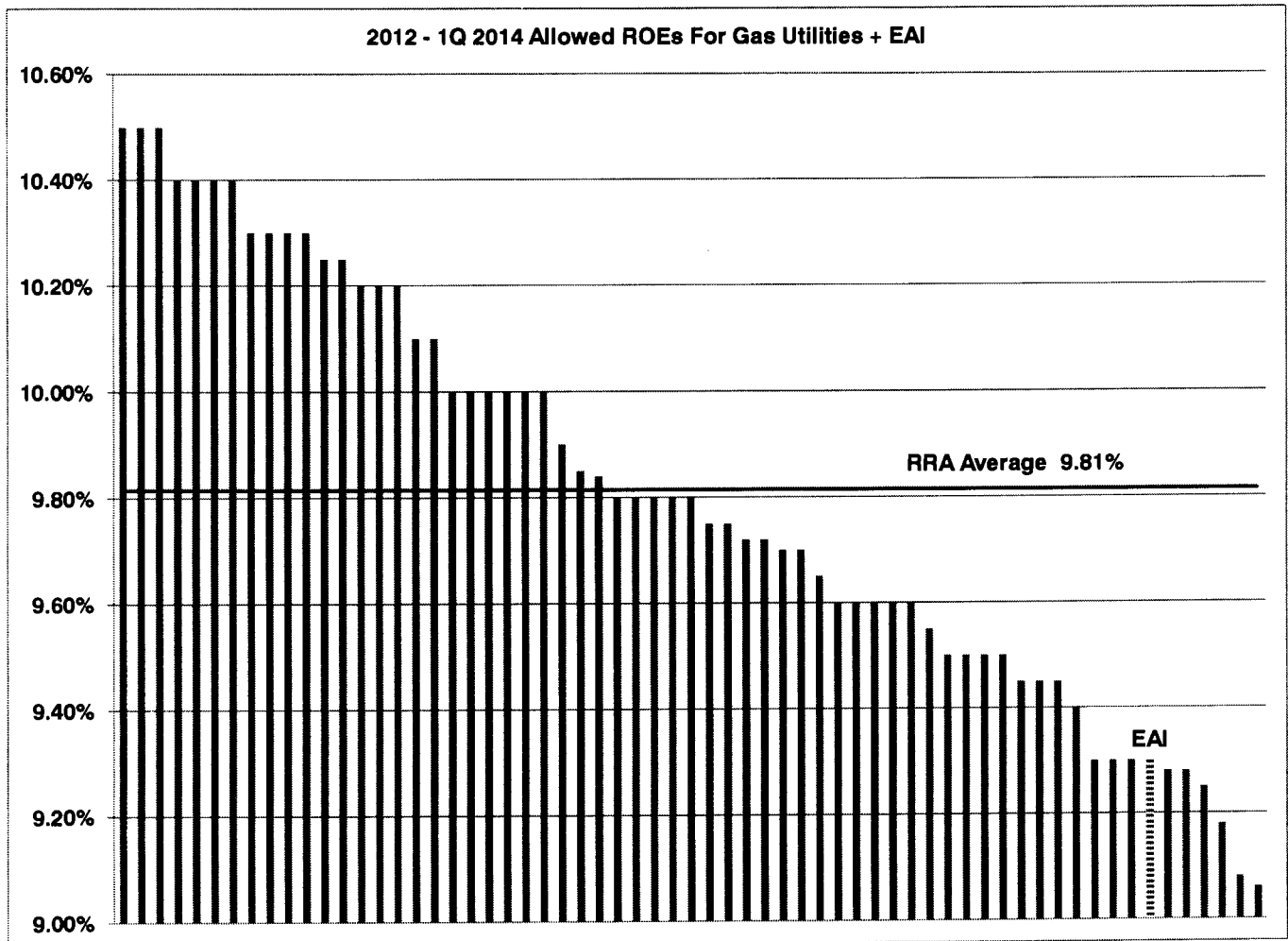


BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION	)	
OF ENTERGY ARKANSAS, INC. FOR	)	DOCKET NO. 13-028-U
APPROVAL OF CHANGES IN RATES FOR	)	
RETAIL ELECTRIC SERVICE	)	

EAI EXHIBIT DEH-12

2012 - 1Q 2014 ALLOWED ROES FOR GAS UTILITIES + EAI



BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION )  
OF ENTERGY ARKANSAS, INC. FOR )  
APPROVAL OF CHANGES IN RATES FOR )  
RETAIL ELECTRIC SERVICE )

DOCKET NO. 13-028-U

REHEARING REPLY TESTIMONY

OF

ELLEN LAPSON

PRINCIPAL, LAPSON ADVISORY

ON BEHALF OF

ENTERGY ARKANSAS, INC.

APRIL 11, 2014



1    **I.     INTRODUCTION**

2    Q.    PLEASE STATE YOUR NAME.

3    A.    My name is Ellen Lapson.

4

5    Q.    ON WHOSE BEHALF ARE YOU TESTIFYING?

6    A.    I am testifying on behalf of Entergy Arkansas, Inc. ("EAI" or the  
7           "Company").

8

9    Q.    ARE YOU THE SAME ELLEN LAPSON WHO PREVIOUSLY FILED  
10          TESTIMONY IN THIS DOCKET?

11   A.    Yes, I am.

12

13   Q.    ON WHOSE BEHALF ARE YOU TESTIFYING?

14   A.    I am submitting this rehearing reply testimony to the Arkansas Public  
15          Service Commission ("APSC" or the "Commission") on behalf of Entergy  
16          Arkansas, Inc. ("EAI" or the "Company").

17

18   Q.    WHAT IS THE PURPOSE OF YOUR REHEARING REPLY TESTIMONY?

19   A.    The purpose of my rehearing reply testimony is to respond to the  
20          rehearing testimony entered by the following witnesses: Arkansas  
21          Attorney General ("AG") witness William B. Marcus; APSC General Staff  
22          ("Staff") witness Robert Daniel; Federal Executive Agencies ("FEA")

1 witness Michael P. Gorman; and Arkansas Electric Energy Consumers,  
2 Inc. ("AEEC") witness David C. Parcell.

3  
4 **II. MOODY'S RATING ACTION**

5 Q. TWO PARTIES ARGUED THAT YOUR TESTIMONY INDICATED THAT  
6 MOODY'S DOWNGRADED EAI'S DEBT RATINGS ON JANUARY 31,  
7 2014, WHEREAS NO SUCH DOWNGRADE OCCURRED.<sup>1</sup> WHAT IS  
8 YOUR RESPONSE?

9 A. As I stated in my rehearing direct testimony, the impact on EAI of the  
10 Moody's action was an effective credit rating downgrade relative to its  
11 utility sector peers.<sup>2</sup> When Moody's affirmed EAI's rating on January 31,  
12 2014, the ratings of 143 other companies in the U.S. electric and gas  
13 sector were raised by one notch. While the rating of EAI was not  
14 downgraded, its relative credit position within its sector was lowered.  
15 Figure 1 and Tables 1 and 2 summarize Moody's corporate credit ratings  
16 of 188 companies in the U.S. corporate utility sector on January 28, 2014  
17 (before Moody's carried out the mass upgrades) and on February 1, 2014  
18 (immediately after the mass upgrades).

19  

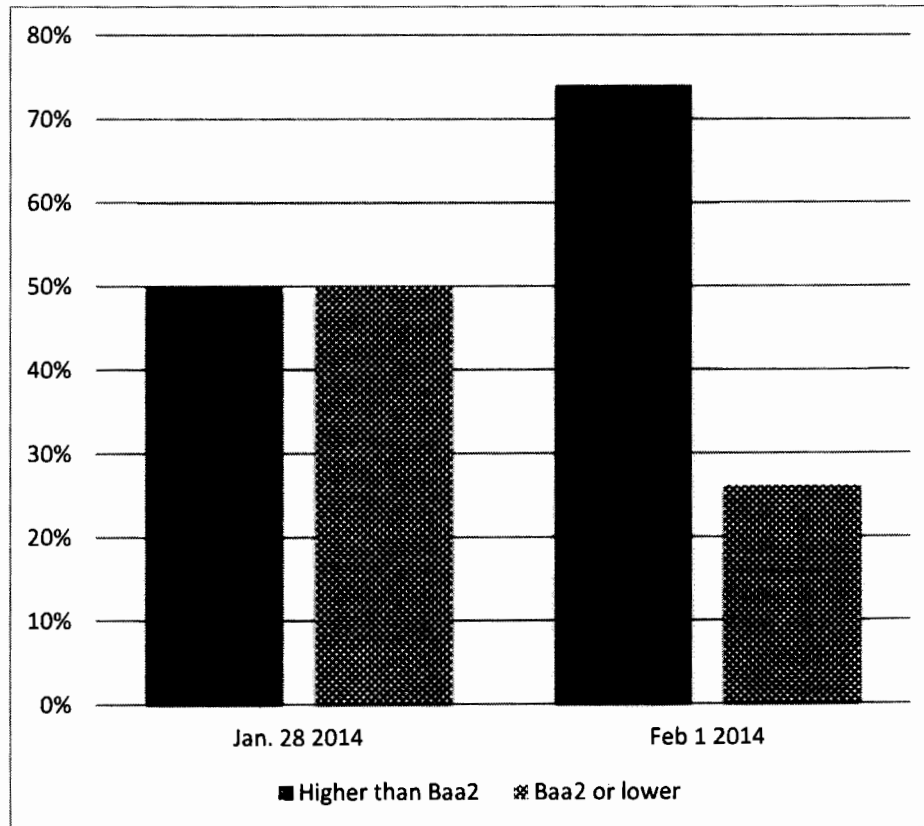
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<sup>1</sup> Daniel Rehearing Direct Testimony at 11; Parcell Rehearing Responsive Testimony at 14-15.

<sup>2</sup> Lapson Rehearing Direct Testimony at 11.

2  
3  
4

**Figure 1**  
**U.S. Utility Sector Issuer Ratings versus EAI's Baa2 Issuer Rating**



5  
6  
7  
8

**Table 1**  
**Moody's Issuer Ratings of 188 U.S. Utilities**

Issuer Rating	Jan. 28, 2014	Feb 1, 2014
Aa2	0	1
Aa3	1	1
A1	2	15
A2	16	28
A3	31	39
Baa1	44	55
<b>Baa2 (EAI's rating)</b>	<b>62</b>	<b>33</b>
Baa3	27	15
Below Baa3	5	1
Issuer Ratings	188	188

**Table 2**  
**Baa2 Rating of EAI Relative to Ratings of 188 U.S. Utilities**

	<u>Jan. 28, 2014</u>	<u>Feb 1, 2014</u>
Higher than Baa2	50%	74%
<b>Same as EAI (Baa2)</b>	<b>33%</b>	<b>18%</b>
Lower than Baa2	<u>17%</u>	<u>9%</u>
	100%	100%

On January 28, 2014 the number of utilities with Moody's corporate credit ratings lower than EAI was 32 (17 percent); the number of utilities with the same corporate credit rating as EAI was 62 (33 percent); and the number of utilities with ratings higher than EAI was 94 (50 percent). On February 1, 2014, after Moody's rating actions, there were only 16 (9 percent) utilities rated lower than EAI, 33 (18 percent) utilities rated the same as EAI, and 139 (74 percent) utilities rated higher than EAI. I have provided my analysis and data supporting Figure 1 and Tables 1 and 2 in the attached EAI Exhibit EL-2. It is quite clear that EAI's credit ranking suffered erosion relative to the Moody's ratings of the entire set of its peer companies in the U.S. electric and gas utility sector. By failing to receive an upgrade, EAI's credit position relative to peer companies moved from the bottom half of the group to the bottom quarter. This is a meaningful difference in the financial marketplace. Even FEA witness Mr. Gorman recognized that the outcome was not positive.<sup>3</sup>

Q. SEVERAL PARTIES ASSERTED THAT MOODY'S RATING DECISION  
WITH REGARD TO EAI WAS NOT VERY SIGNIFICANT OR ADVERSE,

<sup>3</sup> Gorman Rehearing Direct Testimony at 6.

1 SINCE AFTER THE CHANGE, EAI'S CREDIT RATINGS COMPARES  
2 FAVORABLY WITH THE RATINGS OF SOME OTHER ENTERGY  
3 CORPORATION OPERATING SUBSIDIARIES.<sup>4</sup> WHAT IS YOUR  
4 RESPONSE?

5 A. EAI does not compete for capital in the financial markets against only a  
6 handful of other Entergy Corporation operating subsidiaries. I am not  
7 aware of any bond investor whose investment rules limit its portfolio  
8 selection to only the securities of Entergy Corporation affiliates. The effect  
9 of efforts by Messrs. Marcus and Gorman to compare EAI's credit rating  
10 with the ratings of other Entergy Corporation operating subsidiaries is to  
11 divert attention from the significance placed by the investment community  
12 on the shift in Moody's assessment of the relative risk of EAI as a  
13 corporation relative to the entire U.S. utility sector, against which EAI's  
14 securities compete most directly for investor funds.

15 In my view, the only significance of comparing the ratings of EAI  
16 with those of other Entergy Corporation affiliates is that the ownership of  
17 EAI by Entergy Corporation, which includes a non-utility business, was not  
18 a barrier to EAI's upgrade, because four other Entergy Corporation's  
19 operating subsidiaries were upgraded. Therefore, the only barriers to  
20 EAI's receiving an upgrade were those expressed by Moody's in its  
21 January 31 report, and they were specific to the Arkansas rate-setting

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<sup>4</sup> Gorman Rehearing Direct Testimony at 4, 6; Marcus Rehearing Testimony at 4; Parcell Rehearing Responsive Testimony at 14.

1 methods, the 2010 and 2013 rate orders, and the resulting weak cash flow  
2 measures of EAI.

3  
4 Q. MR. PARCELL STATED THAT MOODY'S CITED IN A FEBRUARY 3,  
5 2014 PUBLICATION SEVERAL REASONS THAT CERTAIN UTILITIES'  
6 RATINGS WERE NOT UPGRADED, INCLUDING ONE COMPANY WITH  
7 A VERY STRONG FINANCIAL CONDITION.<sup>5</sup> AMONG THE REASONS  
8 GENERALIZED BY THE MOODY'S REPORT WERE THAT THE RATING  
9 WAS ALREADY HIGH, THE PRESENCE OF NON-UTILITY  
10 BUSINESSES, HOLDING COMPANY LEVERAGE, OR DECLINING  
11 FINANCIAL METRICS.<sup>6</sup> DO YOU HAVE ANY COMMENT ON THIS  
12 OBSERVATION?

13 A. Yes. The fact that some companies' ratings were not upgraded for those  
14 reasons is not relevant to the case of EAI. Moody's did not leave any  
15 uncertainty concerning the cause for its decision not to upgrade EAI's  
16 rating. In its January 31, 2014 report, Moody's explicitly stated that the  
17 action was "based on the less than favorable rate case outcomes in May  
18 2010 and December 2013."<sup>7</sup> Furthermore, Moody's stated that the  
19 "outcome was disappointing," referring to Order No. 21 (the "Order") in this  
20 docket.<sup>8</sup> In the course of the brief comments on EAI, Moody's refers eight

---

<sup>5</sup> Parcell Rehearing Responsive Testimony at 12.

<sup>6</sup> *Id.*

<sup>7</sup> Hunt Rehearing Direct Testimony, EAI Exhibit DEH-8.

<sup>8</sup> *Id.*

1 times to the significance of EAI's operating cash flow ratios and recent  
2 deficiencies in those metrics. Thus, Moody's January 31 report is an  
3 important and relevant document in this rehearing proceeding in that the  
4 January 31 report applies explicitly to EAI, whereas the February 3 report  
5 Mr. Parcell cited does not.

6  
7 Q. MR. PARCELL OBSERVED THAT MOODY'S RATES EAI'S SECURED  
8 MORTGAGE DEBT AT A HIGHER RATING THAN THE MOODY'S  
9 CORPORATE CREDIT RATING OR ISSUER RATING THAT YOU CITED  
10 IN YOUR DIRECT TESTIMONY, AND CLAIMS THAT THE SECURED  
11 DEBT RATING IS OF GREATER RELEVANCE THAN THE CORPORATE  
12 CREDIT RATING.<sup>9</sup> DO YOU AGREE?

13 A. While it is true that Moody's rates secured debt two notches above the  
14 issuer rating, that higher rating is in recognition of the enhanced recovery  
15 prospects of secured debt in the event of a company's default due to its  
16 dedicated collateral. This is Moody's standard practice in the sector.  
17 Corporate issuer ratings and secured debt ratings are not independent  
18 variables; they move in tandem, and the issuer rating (similar to the  
19 unsecured debt rating) is the driver. Thus, with a corporate issuer rating  
20 of Baa2, EAI's secured debt rating is set two notches higher at A3; if  
21 Moody's had upgraded EAI's corporate issuer rating to Baa1 on January  
22 31, then the rating of EAI's secured bonds would have been raised at the

---

<sup>9</sup> Parcell Rehearing Responsive Testimony at 14.

1 same time to A2 from A3. Indeed, the secured bonds of various other  
2 utilities that were previously rated A3 rose on January 30 and 31 to A2,  
3 and some that were previously rated A2 were raised to A1. Thus, in  
4 relationship to the rest of the U.S. electric utility sector, the relative  
5 position of EAI's secured debt ratings was reduced by the utility sector  
6 upgrades, just as was the relative ranking of EAI's corporate issuer rating.

7 It is important to note that corporate issuer ratings are especially  
8 meaningful to this rehearing proceeding because they signify Moody's  
9 assessment of the riskiness of the corporate entity EAI. They are the  
10 estimate of corporate default probability, without taking into consideration  
11 how much senior debt investors would stand to recover after default in a  
12 bankruptcy proceeding. In the APSC's role of balancing the interests of  
13 investors and consumers and safeguarding the public interest, the  
14 riskiness of the corporate entity and its probability of default are highly  
15 important, more so than the estimated recovery by senior secured lenders  
16 after a default. It is of great relevance to this proceeding that Moody's  
17 communicated to the investment community that its assessment of the  
18 corporate risk of EAI is less favorable as a consequence of the Order. As  
19 shown in Figure 1 and Tables 1 and 2, Moody's now indicates that three  
20 quarters of the companies in the broad U.S. utility sector are less risky  
21 than EAI, versus one-half previously.



1

2 Q. MR. GORMAN RECOMMENDS THAT THE APSC SHOULD NOT  
3 CONSIDER MOODY'S RATINGS ACTIONS AS AN INDICATOR THAT  
4 THE COMMISSION SHOULD CHANGE ITS RATE SETTING  
5 PRACTICES, BECAUSE THE RATING AGENCY CONSIDERS ONLY  
6 BONDHOLDER INTERESTS AND NOT CUSTOMERS' INTERESTS.<sup>10</sup>  
7 DO YOU AGREE?

8 A. No. In order to balance the requirements of investors and those of  
9 consumers, as the Commission must do, the Commission should consider  
10 all available evidence of investor reactions and investor sentiment, and  
11 should not dismiss evidence from the bond market and the financial  
12 community out of hand because it represents the views of providers of  
13 capital. There are some aspects of the APSC's recent rate-setting,  
14 including the Order in this proceeding, that cause EAI to have weaker  
15 operating cash flow ratios than many other utilities in other jurisdictions,  
16 and especially so when combined with an authorized Return on Equity  
17 ("ROE") that is among the lowest of vertically integrated electric utilities.<sup>11</sup>  
18 Moody's provides that perspective to the investment market, and it is vital  
19 information for the APSC to consider. Achieving balance between the  
20 interests of investors and customers requires that the views of the  
21 financial community be heard and considered.

---

<sup>10</sup> Gorman Rehearing Direct Testimony at 7.

<sup>11</sup> Hunt Rehearing Direct Testimony at 14.

1

2 Q. ACCORDING TO MR. GORMAN, MOODY'S DECISION NOT TO  
3 UPGRADE EAI'S RATING WAS NOT RELATED TO THE ROE  
4 DECISION IN THE CURRENT RATE CASE.<sup>12</sup> WHAT IS YOUR  
5 RESPONSE?

6 A. It is clear from the January 31, 2014 report that Moody's decision was  
7 influenced by the entirety of the Order, which includes not only the ROE  
8 decision, but every element of the Order that results in deficiencies in  
9 operating cash flow and weak cash flow credit measures.

10

11 Q. MR. GORMAN STATED THAT EAI'S ABILITY TO SELL BONDS IN  
12 MARCH 2014 PROVES THAT THE ORDER HAS NOT ADVERSELY  
13 AFFECTED EAI'S ACCESS TO ISSUING BONDS AT ATTRACTIVE  
14 RATES.<sup>13</sup> WHAT IS YOUR RESPONSE?

15 A. The rates set by the Order are not yet reflected in EAI's financial results  
16 and will not be fully reflected until later in 2014 and beyond. EAI sought  
17 rehearing out of concern that the rates set by the Order will result over  
18 time in weak operating cash flow measures that will adversely affect  
19 investor sentiment over the coming year to two years, when the results of  
20 the Order will be fully reflected in EAI's reported financial statements and  
21 particularly the Statement of Cash Flow.

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<sup>12</sup> *Id.* at 5.

<sup>13</sup> Gorman Rehearing Direct Testimony at 9.

1  
2 **III. AFUDC, DISALLOWANCES, AND OPERATING CASH FLOW**

3 Q. ACCORDING TO WITNESSES MARCUS AND DANIEL, THE NEW  
4 EVIDENCE ENTERED BY EAI HAS NO CONNECTION TO THE  
5 CALCULATION OF ALLOWANCE FOR FUNDS USED DURING  
6 CONSTRUCTION ("AFUDC") OR OTHER REGULATORY  
7 DISALLOWANCES.<sup>14</sup> WHAT DO YOU SAY IN RESPONSE?

8 A. The method specified by the APSC for accruing AFUDC is a major factor  
9 that will affect EAI's future operating cash flow. As I pointed out in my  
10 rehearing direct testimony, operating cash flow was an important theme in  
11 Moody's January 31, 2014 commentary. Moody's mentioned operating  
12 cash flow financial ratios eight times with regard to EAI in the context of its  
13 rating decision not to upgrade EAI's corporate credit rating, and in  
14 describing what could cause future rating changes by Moody's either  
15 down or up. Operating cash flow is the bedrock of a corporation's  
16 sustainability and financial stability. With ongoing high capital  
17 expenditures at EAI, any deficiency in the method of applying AFUDC will  
18 be expressed in larger deficiencies of operating cash flow over the coming  
19 years. Similarly, other regulatory disallowances will exacerbate cash flow  
20 deficiencies. There is no justification for the view of other witnesses that  
21 ROE is the only issue that factored into the Moody's decision or the  
22 investment community's reaction. It is evident from Moody's explanation

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<sup>14</sup> Daniel Rehearing Direct Testimony at 13; Marcus Rehearing Testimony at 2.

1 of its decision that the credit rating agency reacted to the totality of the  
2 Order, of which a low allowed ROE, albeit significant, is merely one  
3 element.

4

5 Q. DO YOU AGREE WITH MR. DANIEL'S ASSERTION THAT HIS  
6 RECOMMENDED METHOD FOR APPLYING AFUDC IS  
7 REASONABLE?<sup>15</sup>

8 A. No. Mr. Daniel stated that the Company funds its operations, including  
9 construction projects that give rise to AFUDC, from all sources of capital,  
10 including internally generated funds and zero cost items; and therefore the  
11 approved overall cost of capital should also be the rate for the purpose of  
12 capitalizing AFUDC. However, the fallacy is that only a finite amount of  
13 zero cost items is available to EAI, and that finite amount of zero cost  
14 funds was allocated in this case entirely toward reducing the overall cost  
15 of capital applied to the assets that make up the rate base. That same  
16 finite amount is not available to fund construction work in progress  
17 ("CWIP") without a double-count of the same benefit. The result of  
18 double-counting that finite amount of zero-cost items is a failure to accrue  
19 the full amount of cost in CWIP, which will inevitably result in an  
20 inadequate accounting for the amount of plant-in-service in rate base at a  
21 later date. In addition, the restriction against accruing AFUDC before a  
22 project is formally approved or during periods when work is interrupted

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<sup>15</sup> Daniel Rehearing Direct Testimony at 13.

1 results in further under-recognition of shareholders' full capital investment  
2 in projects. With a high level of capital spending, the missing cash flow  
3 will be increasingly evident over the next several years both to bond  
4 investors and shareholders.

5  
6 Q. MR. MARCUS TESTIFIED THAT THE CREDIT SUISSE EQUITY  
7 ANALYST REPORT INDICATES THAT THE DISALLOWANCE OF  
8 INCENTIVE PAY AND STOCK OPTIONS WAS SIMILAR TO A  
9 DISALLOWANCE BY THE NEW YORK COMMISSION OF SIMILAR  
10 EXPENSE IN THE CASE OF CONSOLIDATED EDISON, AND THAT  
11 SUCH A DISALLOWANCE IS NOT UNCOMMON AND OF NO  
12 CONCERN.<sup>16</sup> PLEASE COMMENT.

13 A. The issue is not whether this disallowance was common or uncommon,  
14 expected or unexpected by the investment community. The issue is this  
15 disallowance is one of many disallowances in the Order, and all such  
16 disallowances contribute to the overall deficiency in EAI's operating cash  
17 flow and related financial measures. Compensation costs are costs of  
18 doing business, and there was no evidence presented in the case to  
19 suggest that the level of EAI's costs were imprudent or unreasonable or  
20 will go away as a result of the Order. Although the Credit Suisse analyst  
21 may be aware of another case in which such a disallowance occurred,

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<sup>16</sup> Marcus Rehearing Testimony at 5.

1           there is no reason to infer that the Credit Suisse analyst approves of it or  
2           advocates investment in EAI or Entergy Corporation as a result.

3  
4   **IV.   USE OF EQUITY ANALYSTS' REPORTS**

5   Q.   MESSRS. DANIEL AND GORMAN STATED THAT EQUITY ANALYSTS'  
6       REPORTS HAVE NO MERIT AND SHOULD NOT BE GIVEN ANY  
7       WEIGHT BECAUSE THE EQUITY ANALYSTS ARE NOT  
8       INDEPENDENT AND UNBIASED SOURCES, AND THEY DO NOT  
9       BALANCE INVESTOR AND RATEPAYER INTERESTS.<sup>17</sup> DO YOU  
10      AGREE?

11   A.   No, I do not. Equity analysts who publish reports on traded companies'  
12       equities compete for the attention and trust of investors by endeavoring to  
13       provide the best and most timely information to their investor market.  
14       Mr. Gorman cites the standard "boiler plate" disclosures that appear in  
15       equity analysts reports as evidence of actual conflicts of interest that  
16       compromise the quality of the reported information; but in reality, these  
17       disclosures simply acknowledge that the leading equity analysts are  
18       employed by firms that make markets in securities and derivatives.  
19       Market-making causes firms to take intraday or overnight positions in  
20       securities, but these are incidental to trading and market-making, and  
21       housed in different parts of the financial institution. The annual surveys  
22       conducted by *Institutional Investor* indicate that major institutional

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<sup>17</sup> Daniel Rehearing Direct Testimony at 5; Gorman Rehearing Direct Testimony at 10.

1 investors and portfolio managers rely on the views and perspectives of  
2 leading equity analysts. Mr. Daniel finds fault because the equity analysts  
3 represent only the views of the investment market, and not the interests of  
4 customers; but their views are valuable precisely because of the insights  
5 they provide into the interests and viewpoint of equity analysts and  
6 shareholders. In order to strike a balance between the interests of  
7 shareholders and a utility's customers, the perspectives of shareholders  
8 and the financial markets are an important input. In this rehearing  
9 proceeding, the issue is whether the Order as it stands has successfully  
10 balanced those interests.

11

12 **V. FAIRNESS AND REASONABLENESS OF ROE**

13 Q. MR. DANIEL ASSERTED THAT THE 9.3 PERCENT ROE  
14 DETERMINATION FOR EAI IS FAIR AND REASONABLE BECAUSE IT  
15 IS WITHIN HIS RECOMMENDED ROE RANGE OF 9.0 TO 9.6  
16 PERCENT.<sup>18</sup> PLEASE COMMENT.

17 A. The question at the heart of this rehearing proceeding is whether the  
18 authorized return in the Order, taken together with other features of the  
19 Order affecting EAI's cash flow and financial ratios appropriately balances  
20 the requirements of shareholders and the interests of customers and the  
21 public interest, as is constitutionally required of the APSC. Neither *Hope*  
22 nor *Bluefield* requires that the APSC use a formula to calculate a number

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<sup>18</sup> Daniel Rehearing Direct Testimony at 2, 12.

1 at the midpoint of a DCF range. Reactions by Moody's and leading equity  
2 analysts suggest that 9.3 percent is low relative to investor expectations  
3 and to the cash flow needed by EAI to maintain healthy financial ratios.  
4 The information from RRA indicates that the 9.3 percent determination is  
5 very low relative to ROEs determined for peer integrated electric utilities.

6 Mr. Daniel reiterated in his rehearing direct testimony that he  
7 recommended a point estimate of 9.6 percent,<sup>19</sup> the top of his DCF range.  
8 In his direct testimony, Mr. Daniel's noted a required ROE for EAI of 9.6  
9 percent is reasonable under the current unique and challenging  
10 conditions.<sup>20</sup> EAI's Mr. McDonald testified that "[a] careful review of the  
11 record in this case will justify using the 9.6 percent allowed ROE  
12 recommended by the Staff for a baseline as the Commission considers  
13 evidence supporting a higher ROE given current market conditions and  
14 EAI's investment needs."<sup>21</sup>

15  
16 Q. MR. PARCELL SUPPORTS THE ADEQUACY AND REASONABLENESS  
17 OF THE 9.3 PERCENT ROE FOR EAI BY CITING TO THE PROPOSAL  
18 IN A PETITION TO THE FEDERAL ENERGY REGULATORY  
19 COMMISSION ("FERC") SEEKING TO REDUCE MISO'S BASE ROE TO  
20 9.15 PERCENT, AND HE CITES A DCF TESTIMONY OF A FERC

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<sup>19</sup> *Id.* at 2.

<sup>20</sup> Daniel Direct Testimony at 38.

<sup>21</sup> McDonald Rehearing Reply Testimony at 9.



1 STAFF WITNESS IN A FERC TRANSMISSION RATE CASE WITH AN  
2 ROE RECOMMENDATION OF 8.7 PERCENT. PLEASE COMMENT.<sup>22</sup>

3 A. While Mr. Parcell claims that ROEs proposed by witnesses in FERC  
4 electric transmission cases have some precedential value, there has not  
5 been any finding by FERC in the referenced transmission rate case, so  
6 there is no precedential weight where no ROE determination has been  
7 made. The business of electric transmission is quite different from EAI's  
8 business, and the APSC's tariff-setting methods lack many elements that  
9 FERC applies to electric transmission entities, such as annual formula  
10 ratemaking and cash return on CWIP. In addition, FERC uses a different  
11 methodology for selecting DCF peers and carrying out DCF analyses than  
12 the APSC General Staff, on which the Commission relied for its DCF  
13 range. Thus, there is no merit in Mr. Parcell's attempted comparisons.

14  
15  

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<sup>22</sup> Parcell Rehearing Responsive Testimony at 7, 13.

1 **VI. RESPONSES ON OTHER TOPICS**

2 Q. PLEASE COMMENT ON MESSRS. GORMAN AND PARCELL  
3 STATEMENTS THAT THERE IS NO EVIDENCE INTEREST RATES  
4 HAVE RISEN SINCE THE FEDERAL RESERVE BEGAN TO TAPER OFF  
5 ITS "QUANTITATIVE EASING" PROGRAM.<sup>23</sup>

6 A. I do not advance any predictions of interest rates. However, as an  
7 observer of the capital markets and the financial market environment, it  
8 appears that distortions persist as a result of ongoing Quantitative Easing.  
9 I would note that as of April 1, the Federal Reserve is still purchasing \$55  
10 billion of debt securities per month, so there has not yet been a clear  
11 signal of the direction of rates as the program is further reduced. Also, the  
12 public learned after the March 18-19, 2014 Federal Reserve Open Market  
13 Committee meeting that its participants had raised their individual  
14 predictions of future interest rates for 2015 versus their prior individual rate  
15 forecasts in December 2013.

16  
17 Q. MR. PARCELL STATED THAT YOU TESTIFIED THAT RATING  
18 AGENCIES SUCH AS MOODY'S FAVOR THE USE OF RIDERS OR  
19 ADJUSTMENT MECHANISMS, AND EAI HAS ACCESS TO RIDERS  
20 AND ADJUSTMENT MECHANISMS.<sup>24</sup>

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<sup>23</sup> Gorman Rehearing Direct Testimony at 14-15; Parcell Rehearing Responsive Testimony at 5.

<sup>24</sup> Parcell Rehearing Responsive Testimony at 16.

1 A. Mr. Parcell has failed to provide any relevant evidence on the number and  
2 effectiveness of the riders and adjustment mechanisms of EAI versus  
3 those of other utilities in other jurisdictions. In fact, nearly every U.S. utility  
4 has one or more riders or adjustment mechanisms, and so without further  
5 evidence to compare the nature, effectiveness and timeliness of those  
6 mechanisms, Mr. Parcell has not made any valid point.

7  
8 Q. MR. PARCELL ALLEGED THAT THERE ARE INCONSISTENCIES  
9 BETWEEN YOUR TESTIMONY AND THAT OF EAI WITNESS JULIE  
10 CANNELL.<sup>25</sup> ARE YOU FAMILIAR WITH MS. CANNELL'S TESTIMONY  
11 IN EARLIER STAGES OF THIS CASE?

12 A. Yes, and there are no inconsistencies. Ms. Cannell testified in this case  
13 that the investment community had improved its view of the APSC in the  
14 most recent years and that a reasonable and supportive decision in the  
15 current EAI rate case would help to confirm that improving trend of  
16 investor sentiment. I would have testified similarly prior to the  
17 Commission's entering the Order. The more pertinent point now, which is  
18 irrefutable based on the Moody's report and the reaction of equity  
19 analysts, is that the Order has been received as disappointing rather than  
20 supportive. Mr. Parcell improperly interpreted my testimony, as the  
21 statement that the APSC had been historically viewed as challenging was  
22 a view expressed by Moody's in its January 31 2014 report, which I cited

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<sup>25</sup> *Id.*

1 in quotation marks. In summary, I find no such inconsistencies between  
2 my testimony and Ms. Cannell's.

3

4 Q. MR. GORMAN IS CRITICAL OF MS. CANNELL'S DIRECT TESTIMONY  
5 BECAUSE SHE PREDICTED A DOWNGRADE OF EAI'S ISSUER  
6 RATING BY MOODY'S IF THE RESULT OF THE 2013 RATE CASE WAS  
7 VIEWED BY MOODY'S AS NOT SUPPORTIVE OF EAI'S FINANCIAL  
8 STATUS.<sup>26</sup> PLEASE COMMENT.

9 A. In effect, events have borne out Ms. Cannell's prediction. As I  
10 demonstrated earlier in this testimony with the data in Tables 1 and 2 and  
11 illustrated in Figure 1, Moody's decision not to upgrade EAI's rating when  
12 it upgraded ratings of 143 other peer companies resulted in lowering the  
13 relative standing of EAI within the utility sector. Furthermore, in doing so,  
14 Moody's was explicit in communicating to the financial markets that its  
15 action was a response to the APSC regulatory climate and the totality of  
16 the 2013 and 2010 rate orders.

17

18 Q. DOES THIS CONCLUDE YOUR REHEARING REPLY TESTIMONY?

19 A. Yes.

---

<sup>26</sup> Gorman Rehearing Direct Testimony at 6.

CERTIFICATE OF SERVICE

I, Steven K. Strickland, do hereby certify that a copy of the foregoing has been served upon all parties of record by forwarding the same by electronic mail and/or first class mail, postage prepaid, this 11th day of April, 2014.

/s/ Steven K. Strickland  
Steven K. Strickland

BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION	)	
OF ENTERGY ARKANSAS, INC. FOR	)	DOCKET NO. 13-028 -U
APPROVAL OF CHANGES IN RATES FOR	)	
RETAIL ELECTRIC SERVICE	)	

EAI EXHIBIT EL-2

MOODY'S ISSUER CREDIT RATINGS - U.S. ELECTRIC AND GAS

## Moody's Issuer Credit Ratings - U.S. Electric and Gas Utility Sector

Company Name	Corporate LT Rating Moody's- Feb 1	Corporate LT Rating Moody's- Jan 28	Watch status Jan 28	Corporate LT Rating Action Moody's
1 AEP Texas Central Co.	Baa1	Baa2	Watch Positive	Upgrade
2 AEP Texas North Co.	Baa1	Baa2	Watch Positive	Upgrade
3 AGL Capital Corp	A3	Baa1	Watch Positive	Upgrade
4 AGL Resources	A3	Baa1	Watch Positive	Upgrade
5 Alabama Power Co.	A1	A2	Watch Positive	Upgrade
6 ALLETE Inc.	A3	Baa1	Watch Positive	Upgrade
7 Alliant Energy	A3	Baa1	Watch Positive	Upgrade
8 Ameren Corp.	Baa2	Baa3	Watch Positive	Upgrade
9 Ameren Illinois	Baa1	Baa2	Watch Positive	Upgrade
10 American Electric Power Co.	Baa1	Baa2	Watch Positive	Upgrade
11 American Transmission System	Baa2	Baa2	Stable outlook	No action
12 Appalachian Power Co.	Baa1	Baa2	Watch Positive	Upgrade
13 Arizona Public Service Co.	A3	Baa1	Watch Positive	Upgrade
14 Atlanta Gas Light Co.	A2	A3	Watch Positive	Upgrade
15 Atlantic City Electric Co.	Baa2	Baa2	Watch Positive	Affirm
16 Atmos Energy Corp.	A2	A3	Watch Positive	Upgrade
17 Avista Corp.	Baa1	Baa2	Watch Positive	Upgrade
18 Baltimore Gas and Electric Co.	A3	Baa1	Watch Positive	Upgrade
19 Berkshire Gas Co.	Baa1	Baa2	Watch Positive	Upgrade
20 Black Hills Corp	Baa1	Baa2	Watch Positive	Upgrade
21 Black Hills Power Inc.	A3	Baa1	Watch Positive	Upgrade
22 CenterPoint Energy Houston	A3	Baa1	Watch Positive	Upgrade
23 CenterPoint Energy Inc.	Baa1	Baa2	Watch Positive	Upgrade
24 Central Hudson Gas & Electric	A2	A3	Watch Positive	Upgrade
25 Central Maine Power Co.	A3	Baa1	Watch Positive	Upgrade
26 Cleco Corp.	Baa2	Baa3	Watch Positive	Upgrade
27 Cleco Power LLC	Baa1	Baa2	Watch Positive	Upgrade
28 Cleveland Electric Illuminating	Baa3	Baa3	Stable outlook	No action
29 CMS Energy Corp.	Baa2	Baa3	Watch Positive	Upgrade
30 Commonwealth Edison Co.	Baa1	Baa2	Watch Positive	Upgrade
31 Connecticut Light & Power Co.	Baa1	Baa2	Watch Positive	Upgrade
32 Consolidated Edison Co. of NY	A2	A3	Watch Positive	Upgrade
33 Consolidated Edison Inc.	A3	Baa1	Watch Positive	Upgrade
34 Consumers Energy Co.	A3	Baa1	Watch Positive	Upgrade
35 CT Natural Gas Corp.	A3	Baa1	Watch Positive	Upgrade
36 Dayton Power and Light	Baa3	Baa3	Stable outlook	No action
37 Delmarva Power & Light Co.	Baa1	Baa2	Watch Positive	Upgrade
38 Dominion Resources Inc.	Baa2	Baa2	Watch Positive	Affirm
39 DTE Electric Co.	A2	A3	Watch Positive	Upgrade
40 DTE Energy Co.	A3	Baa1	Watch Positive	Upgrade
41 DTE Gas Co.	Aa3	A1	Watch Positive	Upgrade
42 Duke Energy Carolinas LLC	A1	A2	Watch Positive	Upgrade
43 Duke Energy Corp	A3	Baa1	Watch Positive	Upgrade
44 Duke Energy Florida Inc.	A3	Baa1	Watch Positive	Upgrade
45 Duke Energy Indiana Inc.	A2	A3	Watch Positive	Upgrade
46 Duke Energy Kentucky Inc.	Baa1	Baa1	Watch Positive	Affirm
47 Duke Energy Progress Inc.	A1	A2	Watch Positive	Upgrade
48 Duquesne Light Co.	A3	Baa1	Watch Positive	Upgrade
49 Duquesne Light Holdings Inc.	Baa3	Baa3	Watch Positive	Affirm
50 Edison International	A3	Baa1	Watch Positive	Upgrade
51 El Paso Electric Co.	Baa1	Baa2	Watch Positive	Upgrade
52 Elm Road Generating Station Supercritic	A1	A2	Watch Positive	Upgrade
53 Empire District Electric Co.	Baa1	Baa2	Watch Positive	Upgrade
54 Entergy Arkansas Inc.	Baa2	Baa2	Watch Positive	Affirm
55 Entergy Corporation	Baa3	Baa3	Stable outlook	No action
56 Entergy Gulf States LA LLC	Baa1	Baa2	Watch Positive	Upgrade
57 Entergy Louisiana LLC	Baa1	Baa2	Watch Positive	Upgrade
58 Entergy Mississippi Inc.	Baa2	Baa3	Watch Positive	Upgrade
59 Entergy New Orleans	Ba2	Ba2	Stable outlook	No action
60 Entergy Texas Inc.	Baa3	Ba1	Watch Positive	Upgrade
61 Exelon Corporation	Baa2	Baa2	Stable outlook	No action
62 FirstEnergy Corp.	Baa3	Baa3	Negative outlook	No action
63 FirstEnergy Solutions	Baa3	Baa3	Stable outlook	No action
64 Florida Power & Light Co.	A1	A2	Watch Positive	Upgrade
65 Georgia Power Co.	A3	A3	Stable outlook	No action

Company Name	Corporate LT Rating Moody's- Feb 1	Corporate LT Rating Moody's- Jan 28	Watch status Jan 28	Corporate LT Rating Action Moody's
66 Great Plains Energy Inc.	Baa2	Baa3	Watch Positive	Upgrade
67 Gulf Power Co.	A2	A3	Watch Positive	Upgrade
68 Hawaiian Electric Co.	Baa1	Baa1	Watch Positive	Affirm
69 Hawaiian Electric Industries	Baa2	Baa2	Watch Positive	Affirm
70 IDACORP Inc.	Baa1	Baa2	Watch Positive	Upgrade
71 Idaho Power Co.	A3	Baa1	Watch Positive	Upgrade
72 Indiana Gas Co.	A2	A3	Watch Positive	Upgrade
73 Indiana Michigan Power Co.	Baa1	Baa2	Watch Positive	Upgrade
74 Indianapolis Power & Light Co.	Baa1	Baa2	Watch Positive	Upgrade
75 Integrys Energy Group Inc.	Baa1	Baa1	Watch Positive	Affirm
76 International Transmission Company	Baa2	Baa2	Watch Positive	Affirm
77 IPALCO Enterprises Inc.	Baa3	Ba1	Watch Positive	Upgrade
78 ITC Great Plains LLC	Baa1	Baa1	Watch Positive	Affirm
79 ITC Holdings Corp.	Baa2	Baa2	Watch Positive	Affirm
80 ITC Midwest LLC	A3	A3	Watch Positive	Affirm
81 Jersey Central Power & Light	Baa2	Baa2	Negative outlook	No action
82 Kansas City Power & Light Company	Baa1	Baa2	Watch Positive	Upgrade
83 Kansas City Power & Light Greater MO (	Baa2	Baa3	Watch Positive	Upgrade
84 Kentucky Power Co.	Baa2	Baa2	Watch Positive	Affirm
85 Kentucky Utilities Co.	A3	Baa1	Watch Positive	Upgrade
86 Laclede Gas Co.	A3	Baa1	Watch Positive	Upgrade
87 Laclede Group Inc.	Baa1	Baa2	Watch Positive	Upgrade
88 LG&E and KU Energy LLC	Baa2	Baa2	Watch Positive	Affirm
89 Louisville Gas & Electric Co.	A3	Baa1	Watch Positive	Upgrade
90 Madison Gas and Electric Co.	A1	A1	Watch Positive	Affirm
91 Metropolitan Edison	Baa2	Baa2	Stable outlook	No action
92 Michigan Electric Transmission Company	A3	A3	Watch Positive	Affirm
93 MidAmerican Energy Co.	A1	A2	Watch Positive	Upgrade
94 MidAmerican Energy Holdings Co	A3	Baa1	Watch Positive	Upgrade
95 Mississippi Power Co.	Baa1	Baa1	Stable outlook	No action
96 Monongahela Power Co	Baa1	Baa1	Stable outlook	No action
97 Nevada Power Co.	Baa1	Baa2	Watch Positive	Upgrade
98 New Jersey Natural Gas Co.	Aa2	Aa3	Watch Positive	Upgrade
99 NextEra Energy, Inc.	Baa1	Baa1	Stable outlook	No action
100 NiSource Capital Markets, Inc.	Baa2	Baa3	Watch Positive	Upgrade
101 NiSource Finance Corp.	Baa2	Baa3	Watch Positive	Upgrade
102 NiSource Inc.	Baa2	Baa3	Watch Positive	Upgrade
103 North Shore Gas Co.	A2	A3	Watch Positive	Upgrade
104 Northeast Utilities	Baa1	Baa2	Watch Positive	Upgrade
105 Northern Illinois Gas Co.	A2	A3	Watch Positive	Upgrade
106 Northern IN Public Svc Co.	Baa1	Baa2	Watch Positive	Upgrade
107 Northern States Power Co - WI	A2	A3	Watch Positive	Upgrade
108 Northern States Power Co. - MN	A2	A3	Watch Positive	Upgrade
109 NorthWestern Corp.	A3	A2	Watch Positive	Upgrade
110 NSTAR Electric Co.	A2	A2	Watch Positive	Affirm
111 NV Energy	Baa2	Baa3	Watch Positive	Upgrade
112 NY State Electric & Gas Corp.	A3	Baa1	Watch Positive	Upgrade
113 OGE Energy Corp.	A3	Baa1	Watch Positive	Upgrade
114 Ohio Edison	Baa2	Baa2	Stable outlook	No action
115 Oklahoma Gas and Electric Co.	A1	A2	Watch Positive	Upgrade
116 Orange & Rockland Utilts Inc.	A3	Baa1	Watch Positive	Upgrade
117 Otter Tail Corp.	Baa2	Baa3	Watch Positive	Upgrade
118 Otter Tail Power Company	A3	A3	Watch Positive	Affirm
119 Pacific Gas and Electric Co.	A3	Baa1	Watch Positive	Upgrade
120 PacifiCorp	A3	Baa1	Watch Positive	Upgrade
121 PECO Energy Co.	A2	A3	Watch Positive	Upgrade
122 Pennsylvania Electric	Baa2	Baa2	Stable outlook	No action
123 Peoples Gas Light & Coke Co.	A2	A3	Watch Positive	Upgrade
124 Pepco Holdings Inc.	Baa3	Baa3	Watch Positive	Affirm
125 Piedmont Natural Gas Co.	A2	A3	Watch Positive	Upgrade
126 Pinnacle West Capital Corp.	Baa1	Baa2	Watch Positive	Upgrade
127 Pivotal Utility Holdings	A2	A3	Watch Positive	Upgrade & Withdraw
128 PNG Companies LLC	Baa2	Baa3	Watch Positive	Upgrade
129 PNM Resources Inc.	Baa3	Ba1	Watch Positive	Upgrade
130 Portland General Electric Co.	A3	Baa1	Watch Positive	Upgrade
131 Potomac Edison Co.	Baa3	Baa3	Stable outlook	No action
132 Potomac Electric Power Co.	Baa1	Baa2	Watch Positive	Upgrade



Company Name	Corporate LT	Corporate LT	Watch status	Corporate LT Rating
	Rating Moody's- Feb 1	Rating Moody's- Jan 28		
133 PPL Corp.	Baa3	Baa3	Watch Positive	Affirm
134 PPL Electric Utilities Corporation	Baa1	Baa2	Watch Positive	Upgrade
135 Progress Energy Inc.	Baa1	Baa2	Watch Positive	Upgrade
136 Public Service Co. of CO	A3	Baa1	Watch Positive	Upgrade
137 Public Service Co. of NH	Baa1	Baa2	Watch Positive	Upgrade
138 Public Service Co. of OK	A3	Baa1	Watch Positive	Upgrade
139 Public Service Electric Gas	A2	A3	Watch Positive	Upgrade
140 Public Service Enterprise Group	Baa2	Baa2	Stable outlook	No action
141 Puget Energy Inc.	Baa3	Ba1	Watch Positive	Upgrade
142 Puget Sound Energy Inc.	Baa1	Baa2	Watch Positive	Upgrade
143 Questar Corp.	A2	A3	Watch Positive	Upgrade
144 Questar Gas Co.	A2	A3	Watch Positive	Upgrade
145 Rochester Gas & Electric Corp.	Baa1	Baa2	Watch Positive	Upgrade
146 San Diego Gas & Electric Co.	A1	A2	Watch Positive	Upgrade
147 SCANA	Baa3	Baa3	Stable outlook	No action
148 SEMCO Energy Inc.	Baa1	Baa2	Watch Positive	Upgrade
149 Sierra Pacific Power Co.	Baa1	Baa2	Watch Positive	Upgrade
150 SourceGas LLC	Baa2	Baa3	Watch Positive	Upgrade
151 South Carolina Elec and Gas	Baa2	Baa2	Stable outlook	No action
152 South Jersey Gas Co.	A2	A3	Watch Positive	Upgrade
153 Southern California Edison Co.	A2	A3	Watch Positive	Upgrade
154 Southern California Gas Co.	A1	A2	Watch Positive	Upgrade
155 Southern Connecticut Gas Co.	Baa1	Baa2	Watch Positive	Upgrade
156 Southern Indiana Gas & Elec Co	A2	A3	Watch Positive	Upgrade
157 Southern Power Co.	Baa1	Baa1	Stable outlook	No action
158 Southwestern Gas Corp.	A3	Baa1	Watch Positive	Upgrade
159 Southwestern Electric Power Co	Baa2	Baa3	Watch Positive	Upgrade
160 Southwestern Public Service Co	Baa1	Baa2	Watch Positive	Upgrade
161 Superior Water, Light and Power Company	A3	Baa1	Watch Positive	Upgrade
162 Tampa Electric Co.	A2	A3	Watch Positive	Upgrade
163 TECO Energy Inc.	Baa1	Baa2	Watch Positive	Upgrade
164 Texas-New Mexico Power Co.	Baa1	Baa2	Watch Positive	Upgrade
165 The Southern Company	Baa1	Baa1	Stable outlook	No action
166 Toledo Edison	Baa3	Baa3	Stable outlook	No action
167 Trans Allegheny interstate Line	Baa1	Baa1	Stable outlook	No action
168 Tucson Electric Power Co.	Baa1	Baa2	Watch Positive	Upgrade
169 UGI Utilities Inc.	A2	A3	Watch Positive	Upgrade
170 UIL Holdings Corp.	Baa2	Baa3	Watch Positive	Upgrade
171 Union Electric Co.	Baa1	Baa2	Watch Positive	Upgrade
172 United Illuminating Co.	Baa1	Baa2	Watch Positive	Upgrade
173 UNS Electric Inc.	Baa1	Baa2	Watch Positive	Upgrade
174 UNS Energy Corp.	Baa2	Baa3	Watch Positive	Upgrade
175 UNS Gas, Inc.	Baa1	Baa2	Watch Positive	Upgrade
176 Vectren Utility Holdings Inc.	A2	A3	Watch Positive	Upgrade
177 Virginia Electric & Power Co.	A2	A3	Watch Positive	Upgrade
178 Washington Gas Light Co.	A1	A2	Watch Positive	Upgrade
179 West Penn Power Co.	Baa2	Baa2	Stable outlook	No action
180 Westar Energy Inc.	Baa1	Baa2	Watch Positive	Upgrade
181 Western Massachusetts Electric	A3	Baa1	Watch Positive	Upgrade
182 Wisconsin Electric Power Co.	A1	A2	Watch Positive	Upgrade
183 Wisconsin Energy Corp.	A2	A3	Watch Positive	Upgrade
184 Wisconsin Gas LLC	A1	A2	Watch Positive	Upgrade
185 Wisconsin Power and Light Co	A1	A2	Watch Positive	Upgrade
186 Wisconsin Public Service Corp.	A1	A2	Watch Positive	Upgrade
187 Xcel Energy Inc.	A3	Baa1	Watch Positive	Upgrade
188 Yankee Gas Services Company	Baa1	Baa2	Watch Positive	Upgrade
No Long-Term Moody's Issuer Rating:				
189 WGL Holdings Inc.	P-2	P-2	Watch Positive	Affirm

Source: Moody's Investors Service

BEFORE THE  
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION	)	
OF ENTERGY ARKANSAS, INC. FOR	)	
APPROVAL OF CHANGES IN RATES FOR	)	DOCKET NO. 13-028-U
RETAIL ELECTRIC SERVICE	)	

REHEARING REPLY TESTIMONY

OF

SAMUEL C. HADAWAY

PRINCIPAL, FINANCO, INC.

ON BEHALF OF

ENTERGY ARKANSAS, INC.

APRIL 11, 2014

1    **I.     INTRODUCTION**

2    Q.    PLEASE STATE YOUR NAME.

3    A.    My name is Samuel C. Hadaway.

4

5    Q.    ARE YOU THE SAME SAMUEL C. HADAWAY WHO FILED DIRECT  
6           TESTIMONY IN THIS DOCKET ON MARCH 1, 2013, REBUTTAL  
7           TESTIMONY ON AUGUST 26, 2013, AND SUR-SURREBUTTAL  
8           TESTIMONY ON SEPTEMBER 23, 2013?

9    A.    Yes, I am.

10

11   Q.    ON WHOSE BEHALF ARE YOU TESTIFYING?

12   A.    I am submitting this rehearing reply testimony to the Arkansas Public  
13           Service Commission ("APSC" or the "Commission") on behalf of Entergy  
14           Arkansas, Inc. ("EAI" or the "Company").

15

16   Q.    WHAT IS THE PURPOSE OF YOUR REHEARING REPLY TESTIMONY?

17   A.    The purpose of my rehearing reply testimony is to respond to the  
18           responsive rehearing testimonies offered on April 4, 2014 by Federal  
19           Executive Agencies ("FEA") witness Michael P. Gorman, APSC General  
20           Staff ("Staff") witness Robert Daniel, Arkansas Attorney General ("AG")  
21           witness William B. Marcus, and Arkansas Electric Energy Consumers, Inc.  
22           ("AEEC") witness David C. Parcell.

1    **II.    RESPONSE TO FEA WITNESS GORMAN**

2    Q.    MR. GORMAN TESTIFIES THAT THE 9.3 PERCENT RETURN ON  
3        EQUITY REFLECTS THE CURRENT FEDERAL RESERVE MONETARY  
4        POLICY AS DEMONSTRATED BY HIS ANALYSIS.<sup>1</sup>    HOW DO YOU  
5        RESPOND?

6    A.    Mr. Gorman is rather selective in supporting his position.    While he now  
7        claims that he included the Fed's less accommodative monetary policy in  
8        his analysis, a review of his pre-filed testimony does not show that he did.  
9        Asserting that he took "interest rate risk" caused by the government's  
10       monetary policy into account, he says that he "made specific adjustments  
11       to increase the authorized return on equity."<sup>2</sup>    He claims that he reflected  
12       "above normal interest rate risk" in his analysis by using a projected  
13       Treasury bond rate and "an above average equity risk premium" in his risk  
14       premium analysis.<sup>3</sup>

15                Mr. Gorman did not do any of these things to reflect Fed policy or  
16        increased "interest rate risk."    Neither in his direct testimony nor his  
17        surrebuttal testimony did Mr. Gorman mention the phrase "interest rate  
18        risk".    In his direct testimony, Mr. Gorman actually presented an interest  
19        rate "spread" analysis, saying that the then current spread between utility  
20        bond yields and Treasury bond yields was lower than the 33 year average

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<sup>1</sup> Gorman Rehearing Direct Testimony at 13.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

1 level, clearly implying that the risk for utility bond investors was below  
2 average.<sup>4</sup> While, in his direct testimony, Mr. Gorman did give 75 percent  
3 weight to the higher end of his risk premium results, in his surrebuttal  
4 testimony, he reverted to a 50/50 percent weighting, effectively eliminating  
5 any "adjustment" that he had previously offered. Had Mr. Gorman  
6 continued his "specific adjustment" in his surrebuttal update, his  
7 surrebuttal risk premium analysis would have supported a Return on  
8 Equity ("ROE") range of 9.61 percent to 9.94 percent, rather than the 9.10  
9 percent to 9.56 percent that Mr. Gorman reported.<sup>5</sup>

10 Nor is Mr. Gorman's use of a *projected* interest rate in his risk  
11 premium analysis an "adjustment" to his typical testimony presentation.  
12 Although Mr. Gorman did not appear in EAI's Arkansas case in 2009, he  
13 did testify in EAI's sister-company case in Texas in that timeframe. In that  
14 testimony, which was in the time period before the government's  
15 "Quantitative Easing" accommodative monetary policies, Mr. Gorman  
16 testified:

17 I added the current and *projected* long-term Treasury bond  
18 yield to my estimated equity risk premium over Treasury  
19 yields. The 13-week average 30-year Treasury bond yield,  
20 ending May 7, 2010 was 4.64%, as shown on Exhibit MPG-  
21 16. *Blue Chip Financial Forecasts* projects the 30-year  
22 Treasury bond yield to be 5.30%....<sup>6</sup>

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<sup>4</sup> Gorman Direct Testimony at 31.

<sup>5</sup> Gorman Surrebuttal Testimony at 8.

<sup>6</sup> Texas Public Utility Commission of Texas, Docket No. 37744, Gorman Direct Testimony at 30 (emphasis added).

1 Similarly, in an Oregon case in 2006, well before the financial crisis  
2 occurred or any accommodative monetary policies had been instituted,  
3 Mr. Gorman used *projected* Treasury bond rates and testified:

4 Using the *projected* 30-year bond yield of 5.3%, and an  
5 electric equity risk premium of 4.4% to 5.9%, produces an  
6 estimated common equity return in the range of 9.7% to  
7 11.2%, with a mid-point estimate at 10.4%.<sup>7</sup>

8 Moreover, other than the 75/25 weight, which he removed in his  
9 surrebuttal testimony in this proceeding, Mr. Gorman did not use an  
10 "above average risk premium" anywhere in his risk premium analysis. In  
11 his surrebuttal testimony, Mr. Gorman, in fact, stated: "Reductions to  
12 nominal interest rates are simply not an adequate reason for increases to  
13 equity risk premiums."<sup>8</sup> In both his Treasury bond risk premium analysis  
14 and his utility bond risk premium analysis, Mr. Gorman used the simple  
15 average risk premium for his selected 1986-2013 time period, with no  
16 adjustment whatsoever. For Mr. Gorman now to claim that he "specifically  
17 adjusted" his analysis to reflect his view that "interest rate risk" is above  
18 normal is not consistent with what he actually did. However, his current  
19 claim should be taken as evidence that such an adjustment is warranted.  
20

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<sup>7</sup> Oregon Public Utility Commission, Docket No. EU 179, Gorman Direct Testimony at 23 (emphasis added).

<sup>8</sup> Gorman Surrebuttal Testimony at 7.

1 Q. HAVE YOU REVIEWED THE BOND RATINGS AND ROE  
2 INFORMATION DISCUSSED BY MR. GORMAN AND PROVIDED IN HIS  
3 FEA EXHIBIT REHEARING MPG-3?

4 A. Yes. Although Mr. Gorman did not use the 10 other companies listed in  
5 his rehearing exhibit in his comparable group, he now asserts that these  
6 companies' allowed ROEs are comparable to the 9.3 percent ROE  
7 allowed for EAI because the companies have bond ratings similar to EAI's.

8

9 Q. IS THIS A FAIR OR REASONABLE COMPARISON?

10 A. No. As shown in Mr. Gorman's rehearing exhibit, seven of the 10  
11 companies are delivery-only, not vertically-integrated utilities, like EAI.  
12 While Mr. Gorman acknowledged that the delivery-only companies' have  
13 lower operating risks than vertically-integrated companies, he claims that  
14 their lower risk is balanced by offsetting financial risk. This claim is not  
15 true. As shown in the Regulatory Research Associates ("RRA") rate case  
16 data allowed as new evidence and attached to EAI witness David Hunt's  
17 rehearing direct testimony, the regulatory-allowed equity percentages are  
18 on average about the same as the equity percentages for the vertically-  
19 integrated comparable companies that Mr. Gorman used in his initial ROE  
20 estimates in his direct testimony in this proceeding. From this bond rating  
21 comparison, Mr. Gorman concluded that the lower allowed ROEs for this  
22 group are a reasonable benchmark for evaluating the 9.3 percent ROE at  
23 issue in this rehearing process. However, Mr. Gorman's statement that

1 the delivery company bond ratings are the same as EAI's is also off the  
2 mark.

3 Like the other new conclusions reached by Mr. Gorman in his  
4 rehearing testimony, his effort to support the Commission's 9.3 percent  
5 allowed ROE with data for these non-comparable companies is flawed.  
6 First, for the seven, delivery-only companies, not one has a bond rating as  
7 low as EAI's Baa2 rating from Moody's. Five of the seven also have  
8 higher bond ratings from S&P. This fact alone would support a conclusion  
9 that these companies' cost of equity is lower than EAI's. Additionally,  
10 some of the data provided in Mr. Gorman's rehearing exhibit are not  
11 based on ROE proceedings at all. In the Ameren Illinois and  
12 Commonwealth Edison (Illinois) cases, the ROEs were set by a  
13 legislatively mandated mechanical procedure, based on Treasury bond  
14 yields, which happened to produce a historically low ROE for 2013. This  
15 result, therefore, provides no support for the reasonableness of a 9.3  
16 percent ROE for EAI. Two additional delivery companies with ROEs at or  
17 below 9.3 percent, Niagara Mohawk Power (New York) and Consolidated  
18 Edison Co. of New York, have issuer bond ratings in the "A" category.  
19 The allowed ROEs for these companies are obviously not reasonable  
20 benchmarks for EAI. The additional comparisons for the three vertically-  
21 integrated companies in Mr. Gorman's new group are also questionable.  
22 As has been noted previously in this proceeding, the Maui Electric case, in  
23 fact, produced the lowest allowed ROE for a vertically-integrated electric



1 company for all of 2013. That company's BBB- rating from S&P, right at  
2 the non-investment grade threshold, certainly raises questions about its  
3 comparability to EAI. The PacifiCorp Washington and UNS Electric  
4 (Arizona) cases both produced ROEs above 9.3 percent, and both  
5 companies have higher bond ratings than EAI's.

6 In summary, Mr. Gorman's efforts to justify an unreasonably low  
7 ROE for EAI are not productive. Even with his most vigorous efforts to  
8 support a 9.3 percent ROE, his own data show that his position is not  
9 supported.

10  
11 **III. RESPONSE TO STAFF WITNESS DANIEL**

12 Q. IN HIS RESPONSIVE REHEARING TESTIMONY, MR. DANIEL SAYS  
13 THAT AN ROE ANYWHERE IN HIS 9.0 PERCENT TO 9.6 PERCENT  
14 RECOMMENDED RANGE IS REASONABLE AND ENDORSES THE  
15 COMMISSION'S 9.3 PERCENT ALLOWANCE. HOW DOES THIS  
16 ENDORSEMENT COMPARE TO MR. DANIEL'S POSITION IN HIS PRE-  
17 FILED DIRECT AND SURREBUTTAL TESTIMONY?

18 A. In both his direct testimony and his surrebuttal testimony, Mr. Daniel  
19 specifically supported as reasonable a 9.6 percent allowed ROE to  
20 account for "unique and challenging" economic and market conditions. In  
21 his direct testimony, he stated, "I conclude that the required rate of return  
22 on equity for EAI of 9.6% is reasonable *under the unique and challenging*

1        *conditions* described above.”<sup>9</sup> In his surrebuttal testimony, Mr. Daniel  
2        stated:

3                Due to these uncertain conditions, I updated my analysis to  
4                the most recently available information in an effort to capture  
5                investors’ reactions to the constantly changing market as a  
6                whole. My analysis continues to suggest that the DCF  
7                results are still reliable and very relevant, and that a  
8                recommendation *above the midpoint* is warranted.<sup>10</sup>

9  
10    Q.    MR. DANIEL TESTIFIED THAT THE COMMISSION’S DECISION TO  
11            AWARD A 9.3 PERCENT ROE “FAIRLY BALANCES INVESTOR AND  
12            CONSUMER INTERESTS ALIKE.”<sup>11</sup> IS THIS ASSESSMENT  
13            ACCURATE AND COMPLETE?

14    A.    No. Mr. Daniel’s recommended ROE range of 9.0 percent to 9.6 percent  
15            does not appropriately balance the interests of ratepayer’s and  
16            shareholders because it is based on a model (the Discounted Cash Flow  
17            (“DCF”) Model) that, during the time period applied by Mr. Daniel, relied on  
18            artificially low dividend yields caused by the government’s then-existing  
19            accommodative monetary policies. I pointed out in my rebuttal and sur-  
20            surrebuttal testimonies that the government’s accommodative monetary  
21            policies had been modified by the Federal Open Market Committee’s  
22            announcement on June 19, 2013, and that it would begin “tapering” its  
23            purchases of mortgage backed securities and long-term government

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<sup>9</sup> Daniel Direct Testimony at 38 (emphasis added).

<sup>10</sup> Daniel Surrebuttal Testimony at 13, (emphasis added).

<sup>11</sup> Daniel Rehearing Direct Testimony at 10.

1 bonds.<sup>12</sup> Table 1 presented in my sur-surrebuttal testimony<sup>13</sup>  
2 demonstrated the higher interest rate environment. Additionally, in EAI  
3 Exhibit SCH-12 attached to my sur-surrebuttal testimony, I provided a  
4 graph of 30-year Treasury bond yields which also demonstrated the  
5 increase in rates. Failure to recognize this increase in interest rates does  
6 not balance ratepayer and shareholder interests because it fails to  
7 recognize substantial evidence that the shareholder cost of equity  
8 increased.

9 Although Mr. Daniel initially recognized at least some of the unique  
10 market conditions in recommending the top end of his DCF range, EAI  
11 witness Hugh McDonald notes that a review of the record in this case will  
12 justify using no less than the 9.6 percent allowed ROE recommended by  
13 the Staff for a baseline as the Commission considers evidence supporting  
14 a higher ROE.<sup>14</sup>

<sup>12</sup> Hadaway Rebuttal Testimony at 6-11; Hadaway Sur-Surrebuttal Testimony at 5-7.

<sup>13</sup> Hadaway Sur-Surrebuttal Testimony at 6.

<sup>14</sup> McDonald Rehearing Reply Testimony at 11.

1    **IV.    RESPONSE TO AG WITNESS MARCUS**

2    Q.    ARE MR. MARCUS' COMMENTS REGARDING THE CONSISTENCY OF  
3           THE APSC'S PREVIOUS DECISIONS RELEVANT TO THE ISSUE OF  
4           WHETHER THE 9.3 PERCENT REPRESENTS A FAIR ROE?<sup>15</sup>

5    A.    No. Mr. Marcus' comments are not relevant to the task at hand—setting a  
6           fair rate of return on equity for EAI's ongoing operations, recognizing that  
7           market conditions are entirely different today than they were in the 2007  
8           time period referred to by Mr. Marcus. In 2007, there was no government  
9           program for accommodative monetary policy. Interest rates, at the time,  
10          were largely set by competitive market forces. In the more recent period  
11          referred to by Mr. Marcus, interest rates have been almost entirely  
12          dominated by government policy. As shown in my direct testimony (EAI  
13          Exhibit SCH-3), average long-term Treasury bond rates fell almost in half  
14          between 2007 and 2012, from 4.8 percent to only 2.9 percent. This result  
15          was directly caused by the government's intervention in credit markets  
16          with policies designed to make corporate and home mortgage borrowing  
17          more accommodative and more stimulative for economic activity.

18

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<sup>15</sup> Marcus Rehearing Testimony at 7.

1    **V.    RESPONSE TO AECC WITNESS PARCELL**

2    Q.    WHAT IS YOUR RESPONSE TO MR. PARCELL'S DISCUSSION OF  
3    THE IMPACT OF THE RECENT FEDERAL RESERVE MONETARY  
4    POLICY ON THE DCF MODEL?<sup>16</sup>

5    A.    As I explained in my direct, rebuttal, and sur-surrebuttal testimonies, the  
6    DCF model has not responded appropriately to the rising interest rate  
7    environment that has resulted from the less accommodative monetary  
8    policies of the Fed announced June 19, 2013, and the evidence presented  
9    supports the use and consideration of other econometric models, as well  
10    as consideration of public policy goals.<sup>17</sup> Mr. Parcell's interest rate table,  
11    with data beginning in September 2013, fails to reflect the significant  
12    increase in interest rates that occurred between June 2013 and  
13    September 2013. While it is true that the slow pace of the Fed's "tapering"  
14    and continuing uncertainties in the economy and financial markets have  
15    stabilized interest rates over the past six months, this does not mean that  
16    the cost of equity did not increase significantly between last spring and the  
17    fall of 2013 when the record in this case was made. Additionally, interest  
18    rate forecasts continue to call for further rate increases as the  
19    government's accommodative policies continue to be reduced. These  
20    factors show that the cost of equity has not decreased by the amount

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<sup>16</sup> Parcell Rehearing Responsive Testimony at 5-6.

<sup>17</sup> Hadaway Direct Testimony at 51-52; Hadaway Rebuttal Testimony at 6-12, 44-45; Hadaway Sur-Surrebuttal Testimony at 3-7.

1 indicated by the Commission's 9.3 percent allowed ROE. Mr. Parcell's  
2 efforts to avoid this fact are without merit and should be rejected.

3

4 Q. DOES THIS CONCLUDE YOUR REHEARING REPLY TESTIMONY?

5 A. Yes.

CERTIFICATE OF SERVICE

I, Steven K. Strickland, do hereby certify that a copy of the foregoing has been served upon all parties of record by forwarding the same by electronic mail and/or first class mail, postage prepaid, this 11th day of April, 2014.

/s/ Steven K. Strickland