Exhibit No.: _____
Issue: Bond Coupon Rate, Marketing, and Pricing
Witness: Katrina T. Niehaus
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Sponsoring Party: The Empire District Electric Company
Case Nos.: EO-2022-0040; EO-2022-0193
Date Testimony Prepared: May 2022

Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

Katrina T. Niehaus

on behalf of

The Empire District Electric Company d/b/a Liberty

May 2022

Liberty™

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I. INTRODUCTION

Q. Please state your name and company affiliation.

A. My name is Katrina T. Niehaus, and I am employed by Goldman, Sachs & Co., 200 West Street, New York, New York.

Q. On whose behalf are you testifying in these proceedings?

A. I provided Direct Testimony on behalf of The Empire District Electric Company d/b/a Liberty ("Liberty" or the "Company") in the securitization matters filed by Liberty in Case No. EO-2022-0040 (Storm Uri) and in Case No. EO-2022-0193 (Asbury), and I am providing Surrebuttal Testimony here on behalf of Liberty in the now consolidated dockets.

Q. What is the purpose of your Surrebuttal Testimony in this proceeding before the Missouri Public Service Commission ("Commission")?

A. I address issues raised by Mark Davis of Ducera Partners, LLC, who filed Rebuttal Testimony in this matter on behalf of Commission Staff ("Staff"). In particular, I respond regarding the post financing order review process Liberty intends to use to provide the Commission with sufficient information so that the issuance advice letter will not be rejected. I also address statements made by Mr. Davis and Office of the Public Counsel ("OPC") witness David Murray regarding the bond coupon rate within the Net Present Value calculation of customer benefits.

II. BOND COUPON RATE

Q. Staff's consultant Mark Davis recommends use of a bond coupon rate of 4% (Davis Rebuttal, p. 4), OPC witness David Murray recommends use of a bond coupon rate of 4.75% (Murray Rebuttal, p. 14), and Liberty used a bond coupon rate of 2.47% in its calculation of the Net Present Value ("NPV") of expected customer benefits of securitization in these dockets. How should the Commission think about the rates used in the NPV analysis in the context of a volatile bond market?

A. Per Staff's Rebuttal Testimony, RSMo. Sections 393.1700.2(1)(f) and 393.1700.2(3)(c)b state that the NPV comparison must be made to "the traditional method of financing" and the Commission must find that the securitization must be "expected to provide quantifiable net present value to customers as compared to recovery of the components of securitized utility tariff costs that would have been incurred absent" securitization.

It is important here to consider the goals of utility securitization statutes more broadly. The Missouri state legislature, with the goal of creating the lowest cost for customers, has created a top-of-market securitization framework with the intent of creating securitization bonds that achieve the highest possible bond credit ratings. As discussed in Liberty's Direct Testimony supporting the requested financing order, we believe the legislature has accomplished these goals and the statute and financing order will allow Liberty to issue AAA bonds. Bond ratings are key to achieving lowest cost because the higher the bond rating, the lower the cost. If a company issues two substantially similar bonds at the same time--one AAA and one non-AAA--the AAA bond will always be lower cost. Bond ratings are a statement to the investor market from an objective, third party bond rating agency that one bond is less likely to default than another. A bond rating is one of the most important features of a bond that investors evaluate, if not the most important feature. AAA is the highest rating a bond may achieve.

Q. Has there been recent volatility in the bond market?

A. Yes. The bond market has been volatile in 2022, mainly driven by the invasion of Ukraine and the Federal Open Market Committee's (FOMC) increases to rates. Market volatility and increasing benchmark rates will raise the cost of all financing available to Liberty in the market, regardless of credit quality or form of debt. In an NPV analysis, it is important to compare apples to apples—while the pricing of AAA bonds will increase with general market volatility, pricing of traditional methods of financing will increase as well.

Q. Will the NPV calculation remain constant?

A. No. It is important to keep in mind that the quantity of this NPV benefit will vary each day as benchmarks and spreads across debt markets adjust, but the Missouri legislature has protected customers against this risk with a securitization statute that contains the necessary provisions to achieve the highest possible bond ratings, and therefore which can achieve the lowest debt cost, regardless of market volatility.

III. <u>POST FINANCING ORDER REVIEW PROCESS</u>

Q. What is required by the Missouri Securitization Statute with regard to the post financing order review process?

A. The Missouri Securitization Statute, RSMo. §393.1700, requires a finding that recovery of Winter Storm Uri costs and Asbury costs through the issuance of securitized utility tariff bonds provide quantifiable net present value benefits to Liberty's customers, as compared with the traditional method for recovering these types of costs, in order for a financing order to be issued in this matter. Further, the Securitization Statute requires that a financing order contain a "finding that the proposed structuring and pricing of the securitized utility tariff bonds are reasonably expected to result in the lowest securitized utility tariff charges consistent with market conditions at the time the securitized utility tariff bonds are priced and the terms of the financing order." RSMo. §393.1700.2(3)(c)c. As such, and as also noted in the Surrebuttal Testimony of Liberty witness Michael Mosindy, it is important that the post financing order process be designed in such a way as to not lead to delays in completing the transaction or otherwise result in increased costs for Liberty or its customers.

Q. To what part of Mr. Davis' Rebuttal Testimony will you respond on this issue?

A. I will respond to that part of Mr. Davis' Rebuttal Testimony (pages 10-14) where he discusses his view of post-financing order Commission review and involvement and the flexibility afforded to Liberty in regard to bond terms and conditions.

Q. In his Surrebuttal Testimony, Mr. Mosindy explains the necessary steps to issue the bonds after a financing order is issued, and he states that only after completing the SEC and rating agency processes can Liberty and the underwriters begin the marketing and pricing process. Are you familiar with this section of Mr. Mosindy's Surrebuttal Testimony?

A. Yes, and I support his testimony and provide background as to the marketing and pricing processes, to which the bond issuance will ultimately be subject.

a. Marketing Process

Q. Please describe the referenced marketing process for the bonds.

A. The marketing process will be shepherded by the lead underwriter (the "lead underwriter"), and the specific steps of the process will be based on the underwriters' expertise and knowledge of the bond market at the time of issuance. As the ratings and documentation processes come to a close, the lead underwriter will work with Liberty and the other bookrunning underwriters to create a marketing plan for the bonds.

Q. Is the bond marketing process the same in all situations?

A. No. Each bond marketing process is slightly different, based on many factors that can change day to day, or even hour to hour. For example, bond market volatility, geopolitical events, views on changes in benchmark rates, and supply or lack thereof of alternative high-quality debt investments can all significantly affect the number and types of investors who might purchase a utility securitization. Therefore, underwriters with large sales distribution forces are necessary to ascertain the greatest amount of information from the largest group of investors. Market knowledge includes not only pricing information of comparable bonds, which is publicly available from sources like Bloomberg, but also feedback from investors across a large swath of debt transactions. For example, understanding that there will be a dearth of corporate investment grade-rated bonds in one week versus another might lead an underwriter to spend time educating corporate investors who have not previously participated in the utility securitization sector. Alternatively, if there is a heavy supply of high-quality investment grade-rated corporate bonds the anticipated week of marketing, an underwriter might decide that time is better spent focusing on increasing order size amongst large asset-backed securities buyers.

Q. Is it important that Liberty and the underwriters be able to act quickly?

A. Yes. Liberty and the underwriters must have flexibility to amend the marketing plan day to day, as they receive feedback from investors, to ensure the bonds receive the greatest amount of interest, thus driving down pricing. In accordance with the Securitization Statute, the Designated Representative and its advisor(s) will be invited to attend calls where such marketing plan is discussed to understand the market backdrop and the rationale for the approach. RSMo. §393.1700.2(3)(h). Decisions regarding communication to investors of pricing thoughts for the bonds must be made quickly to ensure investor interest is sustained. While the Designated Representative, with its advisor(s), will be involved in and able to provide input to Liberty and collaborate with Liberty on the marketing process, such involvement should avoid impeding the marketing timeline. Delays in communications to investors can cause investors to lose interest in a bond offering, particularly in a busy market where there are other bonds that investors can buy.

Q. What does it mean for investors to lose interest?

A. Depending on other investment opportunities (referred to as "supply"), investors may have many options when it comes to making their investment decisions. If they become dissatisfied with a particular offering, they may turn their attention, and more importantly their dollars, to other options. As described in more detail below, if the offering starts to lose investor interest, the underwriters will lose their leverage with the remaining investors, which could hamper the ability to tighten bond spreads resulting in a higher interest rate for the bond and ultimately increased costs to Liberty's customers. As mentioned in my previous answer, there are many things outside of our direct control during the marketing and pricing process, so for the things we can control, like the process for an efficient marketing and pricing effort, I recommend that we do everything we can to ensure the best possible outcome.

b. Pricing Process

Q. Please describe the process to price the bonds, which is referenced in Mr. Mosindy's Surrebuttal Testimony.

A. Following the broad dissemination of the prospectus to investors, the underwriters and Liberty will decide on initial price thoughts ("IPTs"), which give investors an idea of where the bonds will price. The IPTs may be a range and must be set at a level such that investors decide it is worthwhile to spend time reviewing the transaction. For example, setting IPTs at an off-market, aggressive level might cause investors to lose interest and pass on the transaction. After IPTs are released, the objective is to entice a broad base of investors to begin providing indications of interest.

Based on the level of indicated interest (the "oversubscription level"), Liberty and the underwriters may decide that credit spreads can be adjusted lower, lowering the coupon on the bonds. This decision is based on a fulsome review of the market and informal investor feedback. Sometimes investors will stipulate that their indication of interest will not be valid if spreads are decreased below a certain level, but often they do not give such specific feedback. Therefore, the decision to lower spreads after IPTs (sometimes called a "test") is not a mathematical exercise based on the order book but is an art of deciding how much of a decrease the investors are willing to accept. There is always a danger that spreads will be lowered too much, and investors will drop from the deal in a number large enough that the transaction is no longer viable. Additionally, multiple "tests" can cause investors to decide the bond purchase process is too uncertain or complicated and may drop for this reason.

c. Conclusion - Marketing and Pricing

Q. Is there any significance to the length of the marketing and pricing process?

A. Yes. The length of the marketing and pricing process is an issue for Liberty and the underwriters to discuss, as the longer the process goes on, the more competing supply comes to market and the greater risk for market volatility. Issuers do not want to be in a position of trying to win back investors after squeezing too hard on spreads or creating too long of a marketing process, as the Issuer might have then lost its leverage with investors who know they are needed for the deal to succeed.

After discussing pricing feedback and the order book with Liberty, the underwriters will allocate bonds to investors at the final price. If a Designated Representative has been authorized by the financing order, and he/she desires to listen to this feedback, he/she along with the Designated Representative's advisor(s) will be invited to join the discussion. For the reasons stated above, delays of even hours during the pricing process can be extremely detrimental to the bond process, as holding investor interest during this time is critical for a successful issuance. A flexible and nimble marketing and pricing process provides the best assurance to the Commission that the Bonds will in fact be sold at the lowest rates reasonably consistent with market conditions on the day and time of pricing and the terms of the financing order, which will result in the lowest charges to Liberty's customers.

Q. Does this conclude your Surrebuttal Testimony at this time?

A. Yes.

VERIFICATION

I, Katrina T. Niehaus, under penalty of perjury, on this 27th day of May, 2022, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Katrina T. Niehaus