Exhibit No.:	_______________
Issue(s):	Carrying Costs/Discount Rates
Witness/Type of Exhibit:	Murray/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	EF-2022-0155

REBUTTAL TESTIMONY

OF

DAVID MURRAY

Submitted on Behalf of the Office of the Public Counsel

EVERGY MISSOURI WEST, INC. D/B/A EVERGY MISSOURI WEST

CASE NO. EF-2022-0155

** **
Denotes Confidential Information that has been redacted.

June 30, 2022

PUBLIC

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Evergy Missouri West, Inc. d/b/a Evergy Missouri West for a Financing Order Authorizing the Financing of Extraordinary Storm Costs Through an Issuance of Securitized Utility Tariff Bonds	))))))	File No. EF-2022-0155

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

David Murray, of lawful age and being first duly sworn, deposes and states:

1. My name is David Murray. I am a Utility Regulatory Manager for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

David Murray
David Murray
Utility Regulatory Manager

Subscribed and sworn to me this 29th day of June 2022.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI
TIFFANY HILDEBRAND
My Commission Expires
August 8, 2023
Cole County
Commission #15637121

Tiffany Hildebrand
Tiffany Hildebrand
Notary Public

My Commission expires August 8, 2023.

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REBUTTAL TESTIMONY

OF

DAVID MURRAY

EVERGY MISSOURI WEST

FILE NO. EF-2022-1055

Q. Please state your name and business address.

A. My name is David Murray and my business address is P.O. Box 2230, Jefferson City, Missouri 65102.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Utility Regulatory Manager.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the OPC.

Q. What are you addressing in your rebuttal testimony?

A. In response to the positions Evergy Missouri West ("MO West") presented in its direct case, I address: (1) a fair and reasonable cost of capital to compensate MO West for financing of extraordinary costs related to Winter Storm Uri ("Storm Uri") and (2) the discount rate MO West used to estimate the net present value ("NPV") of ratepayers' costs through securitization of Storm Uri costs as compared to ratepayers' costs through the "customary method of financing."[1]

Q. Which MO West witness testified on these topics?

A. Ronald A. Klote.

[1] Section 393.1700.2.(2)(e).

Q. What is your expertise on these topics?

A. Please see Schedule DM-R-1 for my qualifications as well as a summary of the cases in which I have sponsored testimony on rate of return ("ROR") and other financial issues.

SUMMARY

Q. Summarily, what are your opinions on the two topics you identified?

A. First, MO West's carrying costs for financing Storm Uri should be compounded monthly by the average monthly cost of short-term debt for the period February 2021 through the date the securitized bonds are issued (projected to be in January 2023).

Second, the discount rate applied to projected revenue requirements of the various scenarios should be consistent with the risk of the cash flows. Mr. Klote assumes the same discount rate for all three scenarios he reviewed—securitization, recovery through the Fuel Adjustment Clause ("FAC") with amounts in excess of the 3% rate cap collected via a statutory provision[2] included in the passage of Senate Bill 564 ("SB 564"), which authorized plant-in-service accounting ("PISA"), and recovery through an accounting authority order ("AAO"). The appropriate discount rate for securitization is straightforward. It is determined by the required return on the securitized bonds because investors will require a return on the bonds consistent with the low-risk of the payments collected from ratepayers as a separate and distinct charge on their bill. The appropriate discount rate for the other two scenarios analyzed by Mr. Klote is not as straightforward. Mr. Klote suggests it is appropriate to use an implied ROR (which he equates to MO West's weighted average cost of capital) from MO West's 2018 rate case, Case No. ER-2018-0146. ROR's authorized in general rate cases are set based on an embedded cost of debt, not a current cost of debt. Additionally, the authorized ROE is typically higher than a company's COE. Consequently, Mr. Klote's assumed discount rates for the other two scenarios are also too high. I recommend the Commission use the more recent estimate of

[2] Section 393.1655, RSMo

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weighted average cost of capital ("WACC") provided by Evergy Inc.'s financial advisors for purposes of deciding to pursue the Sustainability Transformation Plan ("STP").[3]

REASONABLE COST OF CAPITAL TO DETERMINE CARRYING COSTS

Q. What rate of compensation does Mr. Klote request MO West be provided for financing Storm Uri costs?

A. Mr. Klote recommends that MO West be compensated based on the Company's assumed WACC that it believes was implied in the settlement in MO West's last general rate case, Case No. ER-2018-0146.[4]

Q. What specific capital structure ratios and "costs" did Mr. Klote assume for purposes of determining a 7.358% after-tax WACC?

A. An ROE of 9.5% and a cost of debt of 5.06% applied to a capital structure containing 48.25% common equity and 51.75% long-term debt.[5]

Q. Did the parties to the Stipulation and Agreement ("S&A") in Case No. ER-2018-0146 identify these specific components as MO West's WACC?

A. No. The S&A was silent as to the specific rate of return/cost of capital components related to any party's determination of a fair and reasonable revenue requirement.

Q. How would you characterize the rates of the various components Mr. Klote used to determine MO West's requested compensation for carrying costs?

A. I would characterize these rates as the Company's opinion of the implied return components from the revenue requirement settlement in Case No. ER-2018-0146. I do not agree that these return components represent the Company's current WACC. Specifically,

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[3] The Sustainability Transformation Plan ("STP") is the standalone option Evergy Inc. chose after a strategic review process subsequent to Evergy Inc.'s activist investor, Elliott Management Inc., submitting a public letter to Evergy Inc.'s Board of Directors. The Commission reviewed the STP in Case No. EO-2021-0032.
[4] Klote Direct, p. 10, ll. 1-5.
[5] Klote's workpapers supporting the 8.9% pre-tax ROR shown in Schedule RAK-4.

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I disagree with Mr. Klote's characterization of an implied ROE of 9.5% as MO West's cost of equity. I will discuss this issue in more detail later in my testimony when I discuss Mr. Klote's use of this implied ROR to discount projected future cash flows.

Q. Despite your disagreement with Mr. Klote's characterization of his assumed after-tax ROR of 7.358% (pre-tax ROR of 8.90%) being consistent with MO West's current WACC, do you agree with Mr. Klote's general premise of applying long-term capital costs to compensate MO West for financing Storm Uri costs based on long-term capital costs?

A. No. In my direct testimony in MO West's currently pending rate case, Case No. ER-2022-0130, I testified to the fact that MO West's capital structures since Storm Uri have included significant amounts and proportions of short-term debt. I provided two scenarios for my recommended MO West capital structure in the general rate case – (1) "Short-term rate is used for carrying cost determination in Storm Uri Securitization Case" (i.e. this case) or (2) "Short-term rate is NOT used for carrying cost determination in Storm Uri Securitization Case." MO West's capital structure has been funded with 14% to 24% short-term debt based on MO West's FERC financial statements with common equity adjusted for goodwill (see Case No. ER-2022-0130, Murray Direct, Schedule DM-D-7, p. 7). If the Commission appropriately assigns a short-term debt rate to Storm Uri costs in this case, I would not recommend including this higher proportion of short-term debt in MO West's authorized ROR in the general rate case. However, if the Commission authorizes carrying charges based on a composite ROR in this case, then the authorized ROR in MO West's pending general rate case, Case ER-2022-0130, should be set considering all forms of capital in MO West's capital structure – short-term debt, long-term debt and common equity. Otherwise, the customary practice of using short-term debt to finance these shorter-term assets is not appropriately captured in any aspect of MO West's cost of service.

Q. What is Mr. Klote's rationale for recommending MO West be compensated at a return he suggests is consistent with MO West's WACC?

A. Mr. Klote posits that applying MO West's WACC is consistent with the ratemaking treatment specified in statutes governing plant-in-service accounting ("PISA"). Mr. Klote asserts that if MO West were to recover its extraordinary fuel and purchased power costs through its fuel adjustment clause ("FAC") mechanism, then MO West's rates would exceed the compound annual growth rate ("CAGR") cap of 3% established under Section 393.1655.3. RSMo. Subsection five of that same statute says on its face that if a utility's rates would exceed a 3% increase due to additional costs incurred pursuant to Section 386.266 RSMo (the FAC statute), then recovery of the costs that would increase those rates by more than 3% can be deferred pursuant to Section 393.1400.2.(3), RSMo (a statutory provision included in SB 564). This statute specifies that these deferrals shall include carrying costs at the electric utility's WACC.

Q. Has this Commission addressed whether MO West can recover the extraordinary fuel and purchased power costs it incurred due to Storm Uri through its fuel adjustment clause?

A. Not as a contested issue, but it did not require those costs to flow through MO West's FAC in Case No. ER-2022-0005.

In a contested proceeding, Case No. ER-2022-0025, the Commission ordered MO West's affiliate, Evergy Missouri Metro, to flow its extraordinary revenues from Storm Uri through its FAC. On page eight of its March 13, 2022, *Report and Order* where it did so the Commission said,

> Commission Rule 20 CSR 4240-20.090(8)(A)2.A.(XI), provides that extraordinary costs are not to be passed through the FAC if those extraordinary costs are due to an insured loss, subject to a reduction due to litigation, or for any other reason. The first two reasons for excluding extraordinary costs are logical; costs for an insured loss will be recovered from the insurer and costs that could be reduced because of litigation are uncertain. The basis for the exclusion of extraordinary costs for any other reason is less clear, but the ***Commission is given the ability to allow for the***

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> ***exclusion of extraordinary costs from passing through the FAC if there is a good reason to do so***. (Emphasis added).

Q. Is MO West's requested recovery of Storm Uri costs based on PISA statutory authority?

A. No.

Q. Does it matter if it is not?

A. Yes. If the Commission were to allow MO West to securitize some or all of its extraordinary Storm Uri costs, MO West will only carry those costs over a short period—likely less than two years—a timeframe well below the twenty years specified in the PISA statute. Consistent with the language in the securitization law, customary financial practice is to use short-term financing to fund short-term costs.

Q. Did MO West request the extraordinary costs related to Storm Uri be deferred through an accounting authority order ("AAO") for recovery in a future rate case?

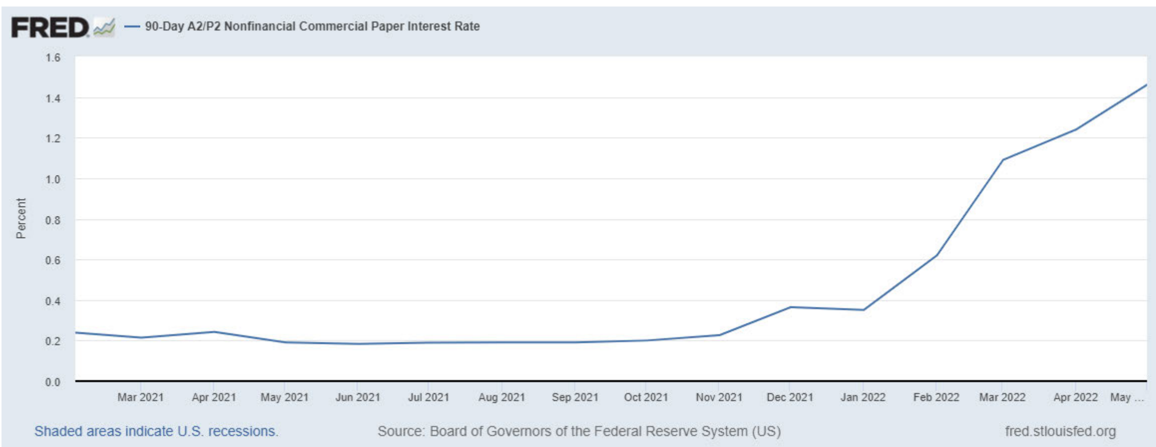
A. Yes. MO West filed an application for an AAO, which was assigned Case No. EU-2021-0283. Due to the passage of the securitization law and MO West's application to securitize Storm Uri costs, the AAO docket was suspended.

Q. Did any parties to the AAO docket make a specific recommendation on the recovery of carrying costs?

A. Yes. MO West requested recovery of carrying costs based on its view of the ROR implied in the settlement in Case No. ER-2018-0146. Staff indicated in its recommendation that any consideration for carrying costs should be determined either in a rate case or a securitization case. OPC had not provided its opinion on whether, and at what cost, MO West should be compensated for financing Storm Uri costs.

Q. What rate should the Commission allow MO West to compensate it for financing Storm Uri related energy costs?

A. I recommend the use of a rate consistent with the rating of MO West's commercial paper program, which is rated A2/P2. At the time I drafted this testimony, I did not have company-specific information as to the cost of MO West's commercial paper, but the following graph shows the market cost of commercial paper for the period February 2021 through the most recent period available. The cost of short-term debt is directly impacted by the Federal Reserve's recent increases to the Fed Funds rate.



Q. What is your support for compensating MO West for financing Storm Uri costs based on a short-term debt rate?

A. MO West projects that it will carry these costs less than two years.[6] Further, the circumstances here are similar to those that exist when determining a fair and reasonable allowance for funds used during construction ("AFUDC") rate. Specifically, it is customary financing practice to use short-term debt as bridge financing while constructing plant. After construction of the plant is completed, if the amount of short-term debt outstanding is significant, the company will refinance the short-term debt with long-term capital. Assuming prudent and customary financing practices, the short-term costs will be captured in the cost of service to ratepayers because it was used to determine the

[6] Klote Direct, Schedule RAK-3.

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carrying/capitalization costs added to plant when placed into service. If this customary ratemaking principle changed and the carrying/capitalization rate allowed is consistent with a company's authorized ROR (presumably similar to WACC), then short-term debt would need to be reflected in the company's authorized ROR. The capitalization of Storm Uri costs—which are fuel and purchased power expenses—is no different.

Q. Has MO West itself recognized that its recent significant use of short-term debt should be fully allocated to capitalizing its construction work in progress ("CWIP") and Storm Uri costs?

A. Yes. In response to Staff Data Request No. 114 in MO West's pending rate case, the Company's response attributes its recent significant balances and proportions of short-term debt in its capital structure to supporting CWIP and Storm Uri costs (*see* Schedule DM-R-2). MO West's quoted response follows:

> ** ____
> ____
> ____
> ____
> ____________________ **[7]

Q. Did Staff's Data Request No. 114 request monthly Storm Uri balances as they relate to short-term debt?

A. No. Staff requested monthly balances of short-term debt and CWIP. This data is used to determine whether short-term debt levels can be fully attributed to CWIP. If not, then this supports including a portion of short-term debt in a company's ratemaking capital structure in the general rate case. MO West's response to Staff Data Request No. 114 anticipated this potential conclusion by voluntarily providing information regarding Storm Uri cost balances and attributing its excess short-term debt to the need to carry these Storm Uri costs until potential Commission approval of its request to securitize these costs.

[7] Case No. ER-2022-0130, Evergy Missouri West's initial and supplemental responses to Staff Data Request No. 114.

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Q. Is using short-term debt a customary financing practice for funding short-term needs, such as fuel and purchased power costs?

A. Yes. Although MO West will be carrying these costs longer than the accounting definition of short-term (less than 12 months), it is customary to fund short-term assets with short-to intermediate-term debt.

Q. Are you aware of any other situations in which a Missouri utility company financed its excess costs related to Storm Uri in a similar customary fashion?

A. Yes. I consider Spire Missouri's December 2021 issuance of 3-year variable rate mortgage debt to finance its extraordinary Storm Uri costs, as an example of a fair and reasonable approach to finance these excess costs.[8] While financing of gas costs is normally limited to a cycle of less than a year, in the event the recovery is extended over a year, a cost of debt consistent with the recovery period would be reasonable.

Q. Did you rely on MO West's response to Staff Data Request No. 114 for purposes of recommending a scenario in MO West's general rate case in which you do not include short-term debt in your recommended ROR?

A. Yes. As recognized by MO West itself in its response to Staff Data Request No. 114, if MO West's short-term debt is fully allocated to CWIP and Storm Uri, then it is appropriate to exclude short-term debt from the ROR applied to MO West's rate base.

Q. What cost of short-term debt does MO West use in its FAC applications, which is the traditional method of compensating companies or ratepayers for under- or over-collections of fuel and purchased power?

A. Based on workpapers provided in the context of MO West's FAC filing assigned File No. ER-2022-0005, MO West used a short-term debt rate of 1.36% in February, March and April 2021.

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[8] https://d18rn0p25nwr6d.cloudfront net/CIK-0001126956/6e2de2ce-53aa-41fd-adb8-6584110659b2.pdf

Q. Is this rate consistent with the interest rate MO West paid on short-term debt during the same period?

A. No. MO West issued commercial paper during this period at an annualized rate of approximately 0.2%.

Q. Why is the rate MO West uses in its FAC applications so much higher than its realized cost of commercial paper during these same months?

A. Based on additional workpapers provided in the context of File No. ER-2022-0005—the FAC case—MO West uses the pricing grid assigned to its credit facility.

Q. Does MO West typically borrow directly from the credit facility or does it use the credit facility as a "backstop" to support its commercial paper borrowings?

A. It uses it as a "backstop." Companies of sufficient size and strong investment grade credit ratings typically enter into credit facilities with capacity similar to their intended expected borrowings in the commercial paper market. Purchasers of commercial paper are then assured that if a company does not have internal access to cash or is unable to issue new commercial paper to refinance outstanding commercial paper, then they can borrow directly from the committed credit facility.

Q. Do you know why MO West is using the terms of its credit facility to determine its short-term debt rate applied in FAC applications?

A. No. But MO West does note under the pricing grid that it primarily uses commercial paper to access short-term funding rather than borrowing directly under its revolving credit facility (see Schedule DM-R-3).

Q. Does MO West pay fees for the committed credit facility?

A. Yes.

Q. Do you know how these fees are recovered from ratepayers?

A. No, but I believe these are added to the interest expense paid on short-term borrowings to determine an effective cost.

Q. If this is the case, would it be acceptable to add this cost for purposes of determining a reasonable financing charge for carrying Storm Uri costs?

A. Yes.

Q. Can you summarize your recommendation for a fair and reasonable financing rate to compensate MO West for carrying Storm Uri costs?

A. Yes. MO West should be compensated for financing Storm Uri costs based on its cost of short-term debt for the period February 2021 through the date of issuance of the securitized debt. This is the customary financing practice for capitalizing assets as it relates to determining the amount of an asset to include in rate base. Perhaps this is why MO West's answer to a data request in MO West's general rate case highlighted the fact that MO West's short-term debt balances have been elevated since February 2021. It has been long standing and logical regulatory practice to assign all short-term debt to capitalize financing costs associated with CWIP. This customary practice should also apply to capitalizing Storm Uri costs.

NET PRESENT VALUE DISCOUNT RATE

Q. Does the securitization statute define net present value ("NPV")?

A. No.

Q. Under traditional corporate finance, what is the purpose of a NPV analysis?

A. It is typically used in the capital budgeting process to determine if an investment is expected to create value for the corporation's shareholders. If an investment/project creates a positive NPV, then this investment/project may be approved for funding.

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Q. Does a NPV determination anticipate cash inflows and outflows?

A. Yes. A NPV determination anticipates the initial investment and potential costs to maintain the investment as cash outflows and revenues from sales as cash inflows. These cash outflows and inflows are netted over the expected period of the investment and are discounted by a discount rate back to the present to determine the NPV.

Q. What is the discount rate?

A. The discount rate in the context of a NPV analysis is the rate used to discount estimated future cash flows to the present.

The determination of a reasonable discount rate is defined by the risk of the cash flows, the interval of the cash flows, and the term of the cash flows. Discount rates used typically vary from as low as a risk-free United States Treasury ("UST") yield to as high as the cost of equity. The discount rate should be commensurate with the risk and term of the investment.

Q. Did you use Mr. Klote's schedules for purposes of evaluating the impact of using the correct discount rates to determine the NPV of each scenario?

A. Yes.

Q. How does Mr. Klote approach his NPV analysis to conclude that customers will pay less under securitization as compared to "customary" financing?

A. Mr. Klote assumes that, absent securitization, MO West would recover a pre-tax ROR of 8.90% based on his assumption of an implied ROR from settlement in Case No. ER-2018-0146 (premised on a 9.5% ROE and 5.06% embedded cost of debt applied to a capital structure consisting of 51.75% common equity and 48.25% long-term debt). Mr. Klote applies this ROR to two alternative ratemaking scenarios – (1) a scenario in which MO West recovers Storm Uri costs over 20 years through a provision allowed under the PISA statute and (2) a scenario in which MO West recovers the Storm Uri cost through a 15 year amortization of a regulatory asset. He compares the monthly payments under these

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scenarios to the monthly payments of the costs to securitize. He assumes the same discount rate, 8.90%, for all scenarios.

Q. Is it appropriate to use the same discount rate for the securitization scenario compared to the other two potential ratemaking scenarios?

A. No. The purpose of securitizing Storm Uri costs is to isolate these costs from the rest of MO West's obligations. This is the essence of the requirement to create a special purpose entity ("SPE") that is assigned all rights, interest and title to the assets through a "true sale" of these assets – the assets in this situation being the right to receive a stream of payments from MO West's ratepayers for purposes of servicing the securitized bond. The risk of these cash flows is defined specifically by the required return on the securitized debt, which MO West estimated to be 3.43% at the time it filed its application.[9]

Q. How does the use of the proper discount rate impact the NPV estimate of the securitization scenario?

A. Using the 3.43% rate on the securitized debt as the appropriate discount rate results in a NPV of debt service and other ongoing costs of $365.07 million. This compares to Mr. Klote's estimated NPV of securitization of $257.6 million, a difference of over $100 million.

Comparing this NPV to Mr. Klote's first scenario—recovery through PISA—indicates securitization would be $43 million more costly to ratepayers. Comparing securitization to the second scenario—recovery through amortization of a regulatory asset—indicates securitization would be $13.8 million less costly to ratepayers.

Q. Does this highlight the impact of using the correct discount rate for purposes of performing a NPV analysis?

A. Yes. It is completely illogical to use the same discount rate to compare the securitization scenario to the other two scenarios. Each scenario presents its own risk factors as it relates

[9] Lunde Direct, Schedule SL-1.

to MO West's recovery of its extraordinary costs. It cannot be overstated that the entire purpose of securitization is to disaggregate the risk of under- or over-recovery of Storm Uri assets from MO West's other corporate obligations. It is this disaggregation and the specific legal and structural separation that allows an asset funded essentially with all debt to potentially receive a "AAA" credit rating, which is equivalent to the rating assigned to U.S. government securities. As with the cash flows of U.S. Treasury bonds, the appropriate discount rate to determine the present value of these future payments is the coupon assigned to the bond at the time it is issued.

Q. Do you agree with the discount rate Mr. Klote used to discount the assumed customer payments under his two alternative ratemaking scenarios?

A. No. He uses a Company-determined implied ROR from the black-box settlement in Case No. ER-2018-0146. Mr. Klote then assumes this ROR is equal to MO West's current WACC.

As the Commission is aware from my ROR testimony in general rate cases, in my opinion the authorized ROE charged to ratepayers is higher than the cost of equity ("COE") to the utility. I have consistently provided corroborating information from the investment community to support my opinions, and do so in MO West's current pending rate case, Case No. ER-2022-0130.[10] Therefore, under traditional ratemaking, ratepayers provide funds (through the payment of bills) to utilities based on a ROR that is higher than a company's WACC. I have no reason to believe this practice will suddenly change.

However, because the discount rate is lower than the ROR charged to ratepayers, this causes the present value of expected cash flows provided by ratepayers under traditional ratemaking to be higher than that estimated by Mr. Klote using 8.9% as a discount rate. For example, if I used the **

[10] Case No. ER-2022-0130, Murray Direct, p. 19, lns. 11-14, p. 29, lns. 15-21; Murray Rebuttal, p. 34, lns. 1-10.

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Therefore, using a discount rate that more closely approximates the current cost of capital to utilities indicates that if MO West is allowed to earn a 8.9% pre-tax ROR on Storm Uri costs, securitization would be less costly than the two potential ratemaking alternatives analyzed by Mr. Klote.

Q. Can you summarize your position as it relates to appropriate discount rates to use to determine the NPV of the scenarios?

A. Yes. The certainty of payments under securitization requires a lower discount rate than under other ratemaking scenarios. A fundamental tenet of discounting future cash flows is to use a discount rate consistent with the risk of the cash flows. Investors in 'AAA' bonds require low returns because the risk of non-payment is extremely low. The discount rate should be the same as the required return on the bond.

The discount rates applied to the other ratemaking scenarios are subject to more subjectivity. However, the rates Mr. Klote uses are too high. A current WACC should be used, which should incorporate current market costs of capital. The WACC estimates provided by Evergy's financial advisors are more reasonable and reliable for discounting expected payments under the two ratemaking scenarios Mr. Klote evaluated.

Q. Does this conclude your rebuttal testimony?

A. Yes.

[11] Schedule DM-D-4, p. 4.

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