

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

SURREBUTTAL 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

July 22, 2022

**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) File No. EF-2022-0155
 Financing of Extraordinary Storm Costs)
 Through an Issuance of Securitized Utility)
 Tariff Bonds)

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 surrebuttal 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.

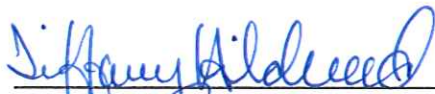


 David Murray
 Utility Regulatory Manager

Subscribed and sworn to me this 22nd day of July 2022.



TIFFANY HILDEBRAND
 My Commission Expires
 August 8, 2023
 Cole County
 Commission #15837121



 Tiffany Hildebrand
 Notary Public

My Commission expires August 8, 2023.

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SURREBUTTAL TESTIMONY

OF

DAVID MURRAY

EVERGY MISSOURI WEST

FILE NO. EF-2022-0155

1 **Q. Please state your name and business address.**

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

4 **Q. Are you the same David Murray who previously filed rebuttal testimony in this case?**

5 A. Yes.

6 **Q. What are you addressing in your surrebuttal testimony?**

7 A. I am addressing the following: (1) Staff's proposed use of Evergy Missouri West's ("MO
8 West") embedded cost of long-term debt to determine carrying costs, and (2) Staff's use of
9 the same discount rate to compare securitization to the two other rate recovery scenarios for
10 purposes of quantifying net present value ("NPV") of ratepayers' costs.

11 **CARRYING COSTS**

12 **Q. Which Staff witness recommended the carrying cost rate assumed in Staff witness**
13 **Mark Davis' financial model?**

14 A. Kimberly K. Bolin.

15 **Q. What is her recommendation?**

16 A. She recommends using MO West's cost of long-term debt from its 2018 rate case, Case No.
17 ER-2018-0146.

1 **Q. What is the basis for Ms. Bolin’s recommendation to use MO West’s cost of long-term**
2 **debt?**

3 A. Ms. Bolin indicates that because it has been over a year since MO West incurred the
4 extraordinary costs related to the Winter Storm Uri (“Storm Uri”) event, this causes MO
5 West’s cost of long-term debt to be appropriate.

6 **Q. How long does MO West anticipate carrying the extraordinary costs related to Storm**
7 **Uri?**

8 A. Less than two years. MO West incurred the extraordinary Storm Uri costs in February 2021.
9 MO West anticipates issuing the securitized bonds in January 2023.

10 **Q. Is it is customary to issue long-term debt to fund an asset that will only be carried on a**
11 **company’s books for less than two years?**

12 A. No. While I agree with Ms. Bolin that for accounting purposes, an obligation longer than 364
13 days is considered long-term, from a practical perspective, I do not agree that this triggers MO
14 West’s cost of long-term debt as the appropriate carrying cost rate.

15 **Q. Why?**

16 A. First, as I demonstrated in my rebuttal testimony, MO West itself admits it has been carrying
17 a significant balance of short-term debt to continue to carry the Storm Uri costs on its books.¹
18 Second, the 5.06% cost of long-term debt Staff used to determine carrying charges is premised
19 on MO West’s embedded cost of long-term debt as of June 30, 2018.

20 **Q. What do you mean by embedded cost of debt?**

21 A. An embedded cost of debt is based on the cost of past debt issuances. Because utility
22 companies consistently issue long-term debt with tenors of up to 30-years, this can cause an
23 embedded cost of long-term debt to be based in part on debt issued in the 1990s, which is not
24 reflective of current required returns on debt. Additionally, an embedded cost of debt

¹ Murray Rebuttal Testimony, Schedule DM-R-2.

1 calculation not only consists of the coupon/interest payments on the debt, but it also factors in
2 the upfront cost of issuing the debt, which typically includes legal fees, underwriting
3 expenses, etc. This typically causes the embedded rate to be higher than the coupon
4 rate/interest rate assigned to the debt.

5 **Q. Did MO West's embedded cost of debt of 5.06% at June 30, 2018, include several debt**
6 **issuances?**

7 A. Yes. MO West's embedded cost of long-term debt at June 30, 2018, consisted of nine debt
8 issuances (see Schedule DM-S-1). MO West's embedded cost of long-term debt at that time
9 included a debt issuance from February 1, 1991, at a cost of 9.56%.

10 **Q. Have any of the debt issuances included in MO West's embedded cost of debt at June**
11 **30, 2018, matured?**

12 A. Yes. As of June 30, 2022, four of the debt issuances included in MO West's embedded cost
13 of long-term debt at June 30, 2018 have matured. These four matured issuances accounted
14 for approximately 66% of MO West's debt outstanding at June 30, 2018.

15 **Q. What is MO West's current embedded cost of long-term debt?**

16 A. In MO West's concurrent rate case, Case No. ER-2022-0130, Company witness Kirkland B.
17 Andrews estimated MO West's embedded cost of long-term debt at 3.787%, as of May 31,
18 2022.²

19 **Q. Does it appear that any of MO West's recent issuances of long-term debt were issued**
20 **for purposes of financing Storm Uri costs?**

21 A. No. Since Storm Uri, all of MO West's debt issuances have maturities in excess of ten years.
22 These financings are not consistent with the customary financing practice of matching
23 durations of liabilities with the assets they support.

² Case No. ER-2022-0130, Kirkland B. Andrews Direct Testimony, Schedule KBA-1.

1 **Q. Would it be logical to issue long-term debt to refinance the short-term debt supporting**
2 **Storm Uri if MO West expects to issue securitized debt?**

3 A. No. MO West has acknowledged such customary financing practice—using short term debt
4 to fund the Storm Uri costs—in its responses to data requests in its general rate case, Case No.
5 ER-2022-0130.³

6 **Q. Are your recommendations in this case and the general rate case logically consistent?**

7 A. Yes. Based on the customary practice of allocating short-term debt to construction work in
8 progress (“CWIP”) and Storm Uri, I excluded short-term debt from my recommended capital
9 structure in MO West’s general rate case. However, if this customary practice is not followed
10 in this case, then short-term debt should be included in MO West’s authorized rate of return
11 (“ROR”) in the general rate case in order to capture such costs in its cost of service.

12 **DISCOUNT RATE**

13 **Q. Which Staff witness recommended the discount rates used in Mr. Davis’ financial**
14 **model?**

15 A. Mr. Davis.

16 **Q. What discount rates did Mr. Davis use for purposes of determining the NPV of**
17 **ratepayers’ costs of securitization compared to the other two rate recovery scenarios**
18 **(fuel adjustment clause (“FAC”) and accounting authority order (“AAO”))?**

19 A. Mr. Davis applied an 8.9% and a 5.06% discount rate for purpose of quantifying the NPV of
20 customer payments for each scenario. As it relates to his estimate of customer savings from
21 securitization, he applied the same discount rates, whether 8.9% or 5.06%, to all three
22 scenarios.⁴

³ *Id.*

⁴ Davis Rebuttal, p. 6, l. 25 – p. 7, l. 5.

1 **Q. Do you agree with Staff witness Mark Davis' use of the same discount rate to compare**
2 **securitization to recovery through the FAC or an AAO?**

3 A. No. The discount rate applied to securitization should be lower than the discount rates
4 applied to recovery through either the FAC or an AAO.

5 **Q. Why?**

6 A. Because the purpose of securitization is to disaggregate the regulatory asset (Storm Uri
7 obligations) from the rest of MO West's balance sheet. This process causes the risk profile
8 of expected cash flows from the securitization of the asset to be different from MO West's
9 expected cash flows related to recovery of its investment through general rates. Hence, the
10 ability for the securitized bonds to achieve the strongest credit rating available ('AAA')
11 without requiring the asset to be supported by equity capital. Because of the certainty or
12 near-certainty of the recovery of principal and return on the principal, investors in the
13 securitized bond will require a much lower return. Consistent with basic principles of
14 finance, the required return on the bond is the proper discount rate for the expected cash
15 flows. By definition, this causes the present value of the expected cash flows to be equal
16 to the principal amount of bonds issued.

17 **Q. How would using the proper discount rate of the required return on the bond impact**
18 **the NPV estimate of Mr. Davis' 15-year securitization scenario?**

19 A. Using Mr. Davis model, the NPV for a 4.5% bond using the same rate for the discount rate
20 results in a NPV of \$310.3 million for ratepayers' payments pursuant to the securitization
21 scenario.

22 **Q. How does this compare to the NPV assumptions of the other two scenarios assuming**
23 **an 8.9% discount rate?**

24 A. According to Mr. Davis' FAC scenario, an 8.9% assumed ROR and 8.9% discount rate
25 results in a FAC NPV of \$299 million.

1 According to Mr. Davis' AAO scenario, an 8.9% assumed ROR and 8.9% discount rate
2 results in an AAO NPV of \$324.2 million.

3 **Q. Would this lead to the conclusion that ratepayers will pay more in present value terms**
4 **under securitization as compared to the FAC method?**

5 A. Yes.

6 **Q. Do you agree with the use of an 8.9% discount rate to determine the NPV of cash**
7 **flows under the FAC and AAO scenarios?**

8 A. No. This discount rate is too high.

9 **Q. Does Mr. Davis apply discount rates lower than 8.9% to the FAC and AAO scenarios?**

10 A. Yes. Although not shown in his testimony, Mr. Davis' workpapers show estimated NPV
11 of ratepayers' costs for the FAC and AAO scenarios based on various illustrative discount
12 rates.

13 **Q. Which of these illustrative discount rates do you consider to be the most reasonable**
14 **for purposes of evaluating the FAC and AAO scenarios?**

15 A. 7%, because it is more consistent with MO West's current cost of capital.

16 **Q. Using the 7% discount rate, what is the implied NPV of ratepayers' costs for the FAC**
17 **and AAO scenarios?**

18 A. \$328.7 million for the FAC scenario and \$283.1 million for the AAO scenario. These
19 estimates imply that securitization is more costly to ratepayers than Staff's AAO scenario.

20 **Q. What explains the significant difference between the NPV of ratepayers' costs of the**
21 **FAC and AAO scenarios using the 7% discount rate?**

22 A. Staff assumed MO West would be allowed a return of 5.06% for recovery through an AAO
23 versus 8.9% for recovery through the FAC.

1 **Q. Do you agree with Mr. Davis that it is appropriate to use a range of discount rates for**
2 **the NPV estimates of ratepayers' costs?**

3 A. Yes, but only for the AAO and FAC scenarios. As I indicated previously, the appropriate
4 discount rate for the securitization scenario is simply the cost of the securitized debt.

5 **Q. What discount rate had you used for the AAO and FAC scenarios in your rebuttal**
6 **testimony?**

7 A. I had used discount rates provided by Evergy's financial advisors for purposes of deciding
8 to pursue a strategic merger or continue as a stand-alone company.⁵

9 **Q. Have utility companies' cost of debt increased since Evergy's financial advisors**
10 **performed this analysis?**

11 A. Yes.

12 **Q. Did you estimate Evergy MO West's current cost of capital in the concurrent general**
13 **rate case, Case No. ER-2022-0130?**

14 A. Yes and no. I estimated MO West's current cost of equity ("COE"), but determined its
15 embedded (*i.e.* historical) cost of long-term debt.

16 **Q. What was your estimate of MO West's COE?**

17 A. In the range of 7% to 7.5%.

18 **Q. Can you use a proxy for a current market cost of debt to estimate MO West's current**
19 **cost of capital?**

20 A. Yes. MO West has a Moody's unsecured bond rating of 'Baa2' and a secured bond rating
21 of 'A3'. Therefore a reasonable proxy would be an average of recent Moody's 'Baa' and
22 'A' rated yields, or about 5%.

⁵ Murray Rebuttal, p. 14, l. 24 – p. 15, l. 4.

1 **Q. If you applied a 7.25% COE and a 5% cost of debt to your recommended capital**
2 **structure of 48% common equity and 52% long-term debt, what is the resulting**
3 **market cost of capital that approximates a reasonable discount rate?**

4 A. 6.08%.

5 **Q. Would using a 6.08% discount rate rather than a 7% discount rate cause higher NPV**
6 **estimates of ratepayers' costs for the AAO and FAC scenarios?**

7 A. Yes.

8 **Q. Can you summarize your surrebuttal testimony?**

9 A. Yes. First, it is customary financing and ratemaking practice to use short-term debt, and
10 its corresponding rates, to finance and capitalize short-term assets and assets yet to be
11 included in rate base (i.e. construction work in progress). Capitalizing Storm Uri costs
12 using this customary approach properly captures the higher balances of short-term debt
13 MO West has been carrying since Storm Uri. Staff's use of MO West's 5.06% embedded
14 cost of long-term debt from its 2018 rate case has no economic connection to MO West's
15 financing of Storm Uri costs.

16 Second, the Commission should order the use of the expected interest rate on the
17 securitization bond for purposes of estimating the NPV of ratepayers' costs under the
18 securitization scenario. The proper discount rate for the AAO and FAC scenarios is higher
19 and should be premised on MO West's current cost of capital.

20 **Q. Does this conclude your surrebuttal testimony?**

21 A. Yes.