Exhibit No.:	______________
Issue(s):	Rate of Return (ROR)/ Return on Equity (ROE)/ Capital Structure
Witness/Type of Exhibit:	Murray/Supplemental Surrebuttal
Sponsoring Party:	Public Counsel
Case No.:	ER-2019-0374

SUPPLEMENTAL SURREBUTTAL TESTIMONY

OF

DAVID MURRAY

Filed on Behalf of the Office of the Public Counsel

THE EMPIRE DISTRICT ELECTRIC COMPANY

FILE NO. ER-2019-0374

April 17, 2020

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric Company's Request for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in its Missouri Service Area	)))))	Case No. ER-2019-0374

VERIFICATION OF DAVID MURRAY

David Murray, under penalty of perjury, states:

1. Attached hereto and made a part hereof for all purposes is my supplemental surrebuttal testimony in the above-captioned case.

2. My answer to each question in the attached supplemental surrebuttal testimony is true and correct to the best of my knowledge, information, and belief.

David Murray
Utility Regulatory Manager
Office of the Public Counsel

SUPPLEMENTAL SURREBUTTAL

OF

DAVID MURRAY

THE EMPIRE DISTRICT ELECTRIC COMPANY

FILE NO. ER-2019-0374

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. Are you the same David Murray who pre-filed Direct, Rebuttal and Surrebuttal Testimony in this case?

A. Yes.

Q. Why are you filing additional testimony in this case?

A. Because I am renewing my original recommended allowed return on common equity ("ROE") of 9.25% due to a recovery in utility capital markets since I prefiled my surrebuttal testimony. At the time I prefiled my surrebuttal testimony, I decided to increase my allowed ROE recommendation to 9.5% because of significant increases in utility bond yields and utility dividend yields that occurred at that time. During mid-March, credit markets started to seize up, causing even investment grade utility companies to have difficulties accessing both short-term and long-term credit. This prompted significant intervention by the Federal Reserve to provide liquidity to support both short-term and long-term credit. This intervention has soothed the capital markets, benefiting both utility stock and bond investors. This has allowed utility security prices to return to valuation levels consistent with those when I had recommended The Empire District Electric Company's ("Empire") ROE be set at 9.25%. It would not be fair to ratepayers to ignore this updated information for purposes of setting Empire's allowed ROE.

Q. Does Empire agree with your view about providing the Commission with the most current information about capital markets and financial conditions for purposes of setting Empire's allowed rate of return ("ROR") in this case?

A. I do not believe so. Empire's ROR witness, Mr. Hevert, provided updated capital market information in his surrebuttal testimony. However, when I submitted DRs to Empire requesting information as to how recent economic and capital market events may be impacting Algonquin Power & Utilities Corporation's ("APUC") investment plans for Empire and/or financing plans to ensure Empire has access to reasonably priced debt capital, Empire objected to these DRs on the basis this information was not relevant. Empire indicated because my requests were related to "recent capital market issues," they fell outside the adjusted test year (see Schedule DM-1).

Q. Why did you request the information you sought in OPC DR Nos. 3048-3051?

A. I considered it important to consider the potential practical effect of recent economic and capital market conditions when deciding on a fair and reasonable ROR to recommend in this case. As explained in my prior testimony in this case, Empire now relies on APUC and Liberty Utilities Company ("LUCo") for its access to capital. LUCo's primary platform for issuing long-term debt on behalf of Empire is Liberty Utilities Finance GP1 ("LUF"). Additionally, Empire's access to liquidity depends on LUCo's access to commercial paper, which was not readily available to even investment grade companies in recent weeks. In the past, as a standalone company, Empire could have provided instant feedback to the Commission on its ability to access capital and whether it was considering alternatives, such as issuing first mortgage bonds, in order to obtain lower cost debt capital. Empire's (or maybe more accurately APUC's) lack of transparency as it relates to corporate financing activities is extremely disconcerting, especially when economic and capital market conditions are not stable.

Q. If the basis for Empire's objections were valid, should you have increased your ROE recommendation in your surrebuttal testimony?

A. No. If anything, through the updated test year (January 31, 2020), the utility industry's cost of capital was near all-time lows. Utility bond yields had declined approximately 20 to 30 basis points since the fall of 2019, which captured the market data I analyzed to develop my recommended ROE of 9.25%. Based on the Company's logic of not considering market data and/or the financial condition of Empire after the updated test year, I would consider a ROE in the lower end of my range to be more reflective of the capital market conditions during this period.

Q. Although Empire considers financial information beyond the true-up period irrelevant, would you provide an update of current utility capital market conditions?

A. Yes.

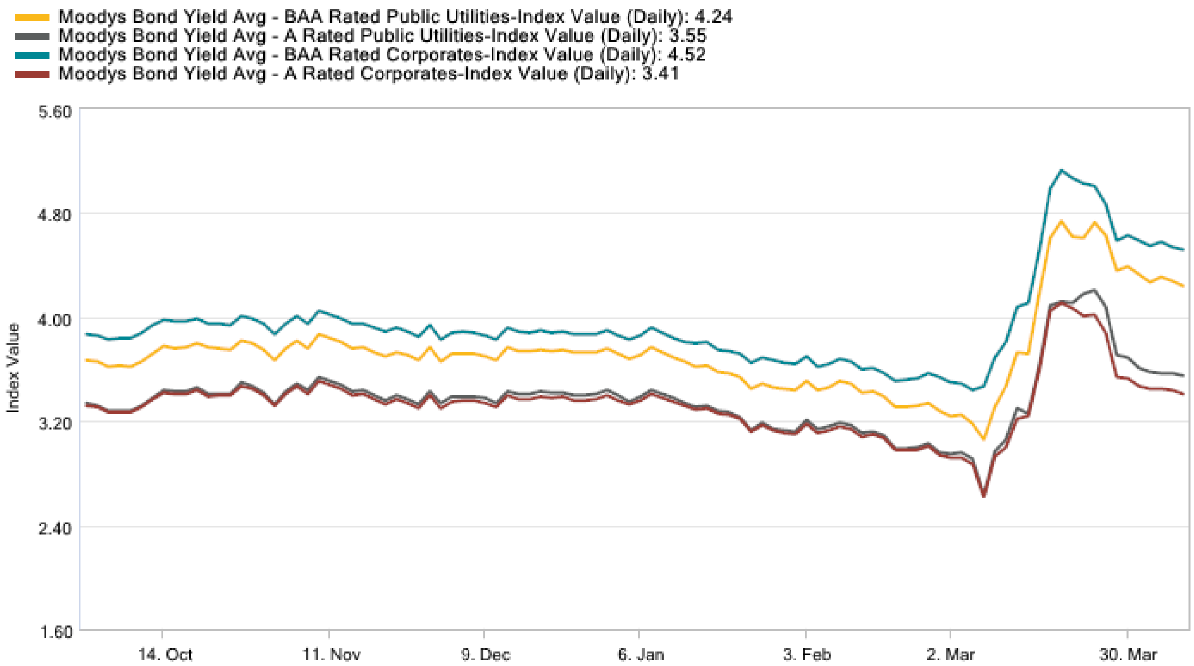
Q. What has happened to Missouri's pure-play regulated electric utility company bond yields since you prefiled your surrebuttal testimony?

A. They have declined. I reviewed over-the-counter (OTC) trades of two Ameren Missouri bonds and two Kansas City Power & Light ("KCPL") bonds. I chose the longest maturities possible with recent trading activity. Both companies had 30-year bonds that mature in 2048 and 2049. The table below provides the yields on the bonds a week or so before the credit markets tightened, the peak yield when bond markets seized, the last yield when I filed surrebuttal, the most recent yield now, and a range of the yields during the fall of 2019. As can be seen, recent OTC trades are now yielding below the range of yields during the fall of 2019, which captures the capital market data I analyzed to develop my original recommended ROE. As I noted before in my testimony, Ameren Missouri's 3.25% coupon bond issued on October 1, 2019 was the cheapest 30-year debt it has issued since 1952. This bond recently traded at an all-time low yield of 2.70%. This is clear evidence that not only are capital markets able to provide capital to utilities, but they are doing so at record low costs. Therefore, this supports my decision to return to my original 9.25% ROE recommendation.

Bond	Yield Before Significant Tightening	Peak Yield	Surrebuttal	Most Recent Trade	Fall 2019
UE–3.25% Coupon (2049 Maturity)	2.75% (March 10)	4.4% (March 18)	3.74% (March 25)	2.70% (April 14)	3.02% to 3.32%
UE–4.00% Coupon (2048 Maturity)	3.08% (March 10)	4.75% (March 19)	3.85% (March 25)	2.94%-2.98% (April 15)	3.17% to 3.32%
KCPL–4.125% Coupon (2049 Maturity)	3.31% (March 12)	4.53% (March 20)	3.95% (March 25)	3.05% (April 14)	3.15% to 3.44%
KCPL-4.20% Coupon (2048 Maturity)	3.27% (March 13)	4.30% (March 24)	3.4%-3.72% (March 25)	3.47% (April 3)	3.2% to 3.39%

Q. How do Missouri utilities' OTC bond yields compare to activity in broader bond indices, such as Moody's Public Utility Bond indices and Moody's Corporate Bond indices?

A. Moody's bond yield data through April 7, 2020 (most recent information I can retrieve through S&P Global Market Intelligence), also shows bond yields returning closer to the levels experienced during the fall of 2019, which captures the capital market data I reviewed for purposes of my initial allowed ROE recommendation of 9.25%. The graph below shows changes in Moody's 'A'-rated and 'Baa'-rated Public Utility and Corporate bond indices for the period September 30, 2019 through the most recent period available.



Although there are some slight differences in the absolute yields, the trends should not be that disparate between general corporate bond indices compared to the utility bond indices. Because more updated information is available on the Moody's corporate bond indices for 'Baa' and 'Aaa' rated bonds, I provide this information below:

As is apparent from the above charts, the strongest investment grade issuers (Aaa) are benefiting from a lower cost of debt capital as compared to the fall of 2019, whereas the weakest investment grade issuers (Baa) are starting to achieve a cost of debt capital that is close to parity with that in the fall of 2019. This implies that although debt markets have stabilized, investors are requiring a higher risk premium given the current uncertainty surrounding the economy. Consequently, the safer the investment, the higher the price investors are willing to pay for this safety.

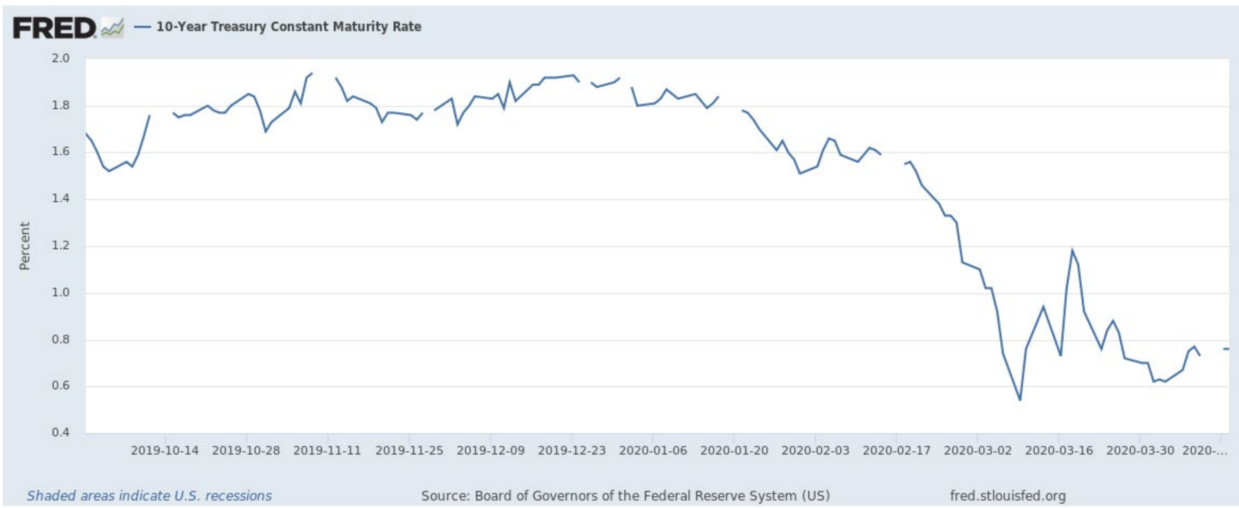
The Federal Reserve's ("Fed") and the Treasury Department have been taking coordinated steps to support credit markets. The Fed has announced that it will provide up to \$2.3 trillion in loans through nine lending programs. The Fed normally provides liquidity to the banking industry for purposes of ensuring companies have the ability to access debt capital, but because of the extraordinary situation in which the economy has come to an abrupt halt, the Fed, with the cooperation with the Treasury, is ensuring debt capital to both big and small companies. Perhaps the most consequential aspect of the Fed's intervention to utility stock and bond prices is the Fed's decision to backstop the debt of companies' that at least had an investment grade credit rating as mid-March 2020. [1] These steps have resulted in the recovery of investment grade corporate bond prices and even to some extent,

[1] Nick Timiraos, "Fed's New Loans Are Broadest Ever," *Wall Street Journal*, April 10, 2020, pp. A1 and A6.

high-yield bond prices. [2] Because utility stock prices are highly correlated to changes in investment-grade corporate bond yields, these steps have directly benefited utility shareholders.

Q. In your surrebuttal testimony you indicated that 10-year United States Treasury ("UST") bond yields were low, but volatile. How would you characterize them now?

A. Low and less volatile. See the following chart:



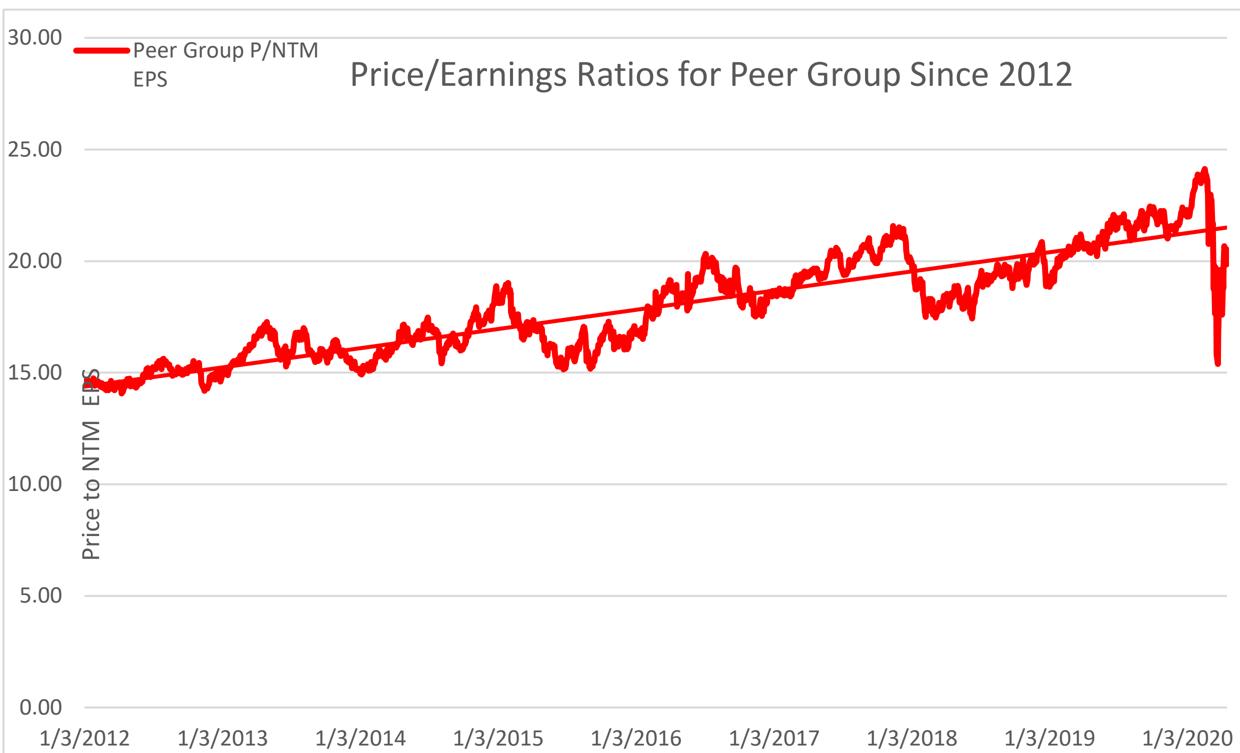
As can be seen in the above chart, over the last couple of weeks, the 10-year UST yield has stabilized in the 0.6% to 0.8% range. This is an extremely low long-term UST yield. Although there may be some uncertainty about the depth and length of a recession, it is clear that the Fed and Treasury are fully committed to supporting a low cost of capital environment, especially for investment grade companies. Although the spread between long-term treasuries and corporate bond yields remain higher than usual, during past cycles in which long-term treasuries remained low, this resulted in regulated utility stock prices being bid up to all-time high valuation levels (i.e. very cheap to issue equity to investors).

[2] Sebastian Pellejero and Sam Goldfarb, "Fed Moves Spur Rally in Corporate Bonds," *Wall Street Journal,* April 10, 2020, p. B11.

Over the long-term, it is reasonable to expect that this low yield, low cost of capital environment will continue to support high utility equity valuation levels.

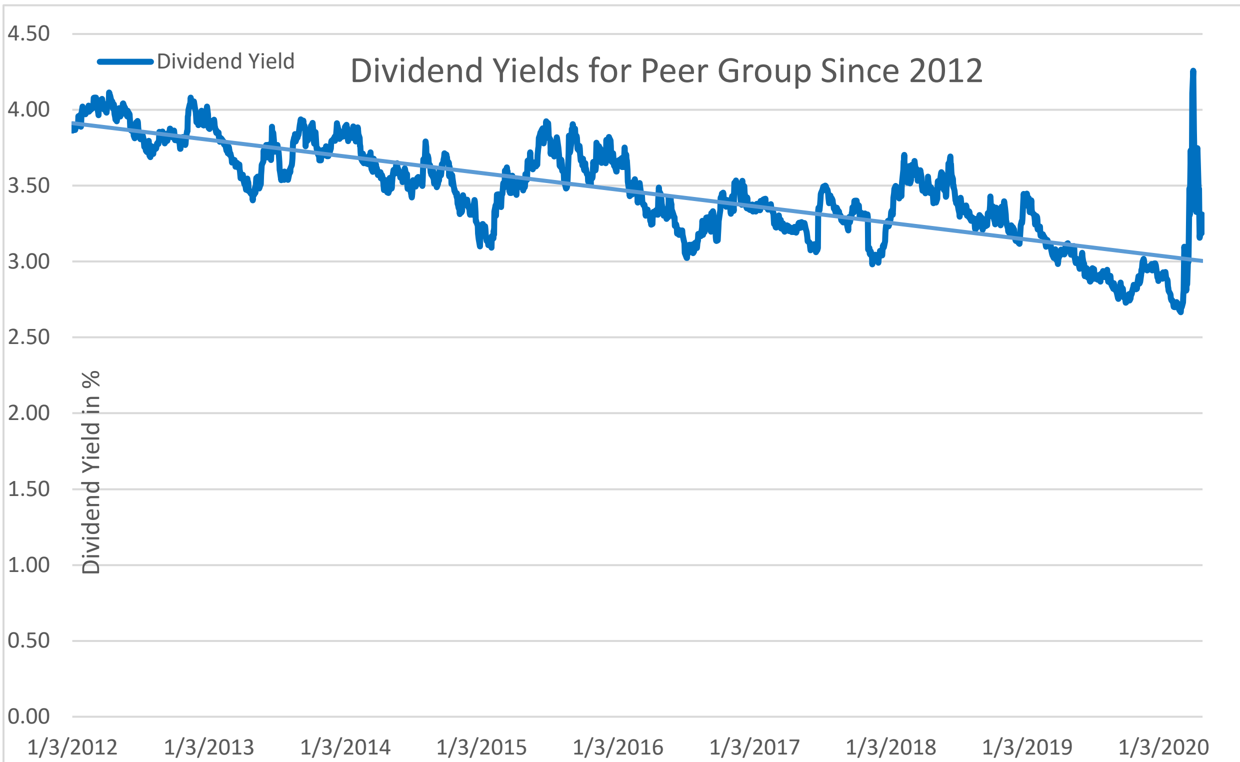
Q. What has happened to utility equity valuation levels since you prefiled surrebuttal testimony?

A. They have increased. As can be seen in the following graph, price-to-next-twelve-months (P/NTM) earnings per share (EPS) levels are once again above 20x. While not as high as the all-time highs of around 24x as recently as late January and early February 2020, these valuation levels are higher than those achieved in the 2014 to 2015 period, which is when this Commission determined an approximate 9.5% allowed ROE was reasonable for its electric utilities.



Q. Can you update the dividend yields for the electric proxy group?

A. Yes. Consistent with utility stock prices rebounding over the last couple of weeks, the dividend yields of the 2012/2014 Peer group declined. While not as low as they were during the fall of 2019, they are still below the yields for most of 2014 and 2015, except for a brief low at the time of around 3.1%. See the below graph that shows the impact on the dividend yields of the same proxy group used in the above P/E ratio graph:



Q. Can you provide investment community commentary about the stabilization of regulated electric utility company stocks?

A. Yes, and they corroborate my views. Barclays provided the following recent commentary on electric utility industry stock values:

> **As volatility ebbs out of the broader market, we revisit utility valuations and identify patterns within sector subgroups.**
>
> **Taken as a whole, utility PEs currently oscillate right around 5-year median valuations. After sorting into subgroups of like characteristics, however, several key trends emerge.** During this recent market turmoil, it is no surprise that

> companies with more defensive risk/reward propositions have outperformed and now trade above 5-year median PEs. The "comfort" group, which represents regulated utilities with particularly defensive qualities, has a current valuation well in excess of the group's 5-year median. Small and mid-cap utilities have echoed the performance of the Russell 2000 relative to broader market indices, underperforming the sector during the recent turmoil. Utilities that are not fully regulated include companies with energy or power market exposure. Earnings and cash flow associated with energy and power markets is inherently more volatile imputing a riskier profile. While the recent underperformance is understandable directionally, the valuation disparity brings potential opportunity as broader market volatility abates. Fully regulated utilities reflect the defensive qualities that the sector as whole has historically been known for, though earnings quality is not as strong as those in the "comfort group." While directionally this analysis is far from surprising as investors position defensively, we believe this visualization is helpful to understand the magnitude and consistency of these trends. All charts reflect a blended 24-month forward PE multiple.[3]

Consequently, fully regulated utility companies, as determined by Barclays, are trading at higher valuations than their 5-year medians, with the "comfort" group, which consists of Ameren Corp, CMS Energy Corporation, Xcel Energy Inc., WEC Energy Group Inc., Alliant Energy Corporation and Eversource Energy, trading well in excess of 5-year medians. The "comfort" group is generally viewed by the investment community as some of the highest quality, lowest-risk fully regulated utility companies in the electric utility industry.

Q. Do you have any final comments?

A. Yes. I have been diligent in following and analyzing utility capital markets over the last few weeks in order to provide proper and fair consideration to recent capital market conditions. However, when I have requested information as it pertains to the potential impacts of the current economic and financial conditions on Empire's primary debt financing source, LUCo, Empire has objected to such requests as being irrelevant to the rate case because it is not specific to Empire and the information is beyond the updated test year. Considering this is Empire's first rate case since the Commission conditionally approved APUC's acquisition of Empire, this lack of cooperation and transparency is

[3] Eric Beaumont, CFA, et. al., North America Power & Utilities, "UPDATE: Valuation Trends as the Dust Settles," Barclays Capital, April 16, 2020.

extremely disconcerting. Given that Empire is approximately 50% of LUCo's asset base, and therefore creates most of its long-term and short-term debt capacity, Empire's regulators have a right to full and unfettered access to APUC's and LUCo's corporate level financial documents and information at it relates to strategic financing decisions. The Commission should also note the hypocrisy of Mr. Hevert's and Mr. Timpe's testimony as it relates to the importance of Empire maintaining an equity-rich capital structure for unstable and strained markets. The only level where this matters based on APUC's financing strategies is at the LUCo debt platform. I would welcome APUC's officer's testimony as to why they don't emphasize the same conservatism at the LUCo debt platform since the Company witnesses emphasize the importance of such for setting Empire's revenue requirement

Q. Does this conclude your testimony?

A. Yes.

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OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric Company's Request for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in its Missouri Service Area	)))	Case No. ER-2019-0374

<u>OBJECTIONS TO OPC DATA REQUESTS (3047-3051)</u>

3047. In its response to OPC DR No. 3012, Empire indicated that its existing first mortgage bond private debt placements required Empire's debt to continue to be rated. Please provide a copy of the documents that identify this requirement.

(no objection)

3048. Have recent capital market conditions caused APUC to reevaluate the need for specific capital expenditures and/or the timeline of capital expenditures at Empire? If so, please specify which capital expenditures, the amount, and the timing.

OBJECTION: The Empire District Electric Company ("Liberty-Empire") objects to this data request ("DR") on the bases that it is overly broad and unduly burdensome and seeks information that is not relevant or reasonably calculated to lead to the discovery of admissible evidence in this proceeding, in that the request specifically pertains to "recent capital market conditions" outside of the adjusted test year and forward-looking plans by APUC.

3049. What type of events could trigger the Material Adverse Change (MAC) clause in LUCo's $500 million credit facility? Can these MAC events be cured by specific APUC action? Have recent capital market issues caused any concerns/issues with LUCo's access to liquidity?

OBJECTION: Liberty-Empire objects to this DR on the bases that it is overly broad and unduly burdensome and seeks information that is not relevant or reasonably calculated to lead to the discovery of admissible evidence in this proceeding, in that the request specifically pertains to "recent capital market issues" outside of the adjusted test year, hypothetical future events, and hypothetical future actions by APUC.

3050. Please indicate any changes anticipated to APUC's, LUCo's, and/or Empire's financing plans due to recent volatility in capital markets. For example, does APUC plan on using LUF for all of LUCo's debt financing needs? Is APUC considering the use of secured rather than unsecured debt at LUF? Is APUC considering issuing mortgage/secured debt directly at the operating subsidiary levels?

OBJECTION: Liberty-Empire objects to this DR on the bases that it is vague, overly broad, and unduly burdensome and seeks information that is not relevant or reasonably calculated to lead to the discovery of admissible evidence in this proceeding. The request specifically pertains to "recent volatility in capital markets," which would be outside of the adjusted test year. The request also specifically pertains to hypothetical future events, hypothetical future actions by APUC, and forward-looking plans by APUC. Further, the request asks for financing plans of APUC and LUCo unrelated to Liberty-Empire.

3051. If Empire needed to issue debt directly to third-party investors, does it need an issue and/or issuer credit rating? Please explain.

OBJECTION: Liberty-Empire objects to this DR on the bases that it is overly broad and unduly burdensome and seeks information that is not relevant or reasonably calculated to lead to the discovery of admissible evidence in this proceeding, in that the DR does not pertain to the adjusted test year and requests information on hypothetical future events.

Outside of the context of this rate case, the Company would be willing to sit down with OPC to discuss OPC's concerns related to recent market conditions and the operation of the Company.

/s/ Diana C. Carter
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