Exhibit No. 204P

OPC – Exhibit 204P
David Murray
Surrebuttal Testimony
File No. EF-2022-0155

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 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 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
David Murray
Utility Regulatory Manager

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

NOTARY PUBLIC STATE OF MISSOURI NOTARY SEAL

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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OF

DAVID MURRAY

EVERGY MISSOURI WEST

FILE NO. EF-2022-0155

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 previously filed rebuttal testimony in this case?

A. Yes.

Q. What are you addressing in your surrebuttal testimony?

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

CARRYING COSTS

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

A. Kimberly K. Bolin.

Q. What is her recommendation?

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

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

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

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

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

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

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

Q. Why?

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

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

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

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

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

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

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

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

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

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

A. In MO West's concurrent rate case, Case No. ER-2022-0130, Company witness Kirkland B. Andrews estimated MO West's embedded cost of long-term debt at 3.787%, as of May 31, 2022.[2]

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

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

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

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

A. No. MO West has acknowledged such customary financing practice—using short term debt to fund the Storm Uri costs—in its responses to data requests in its general rate case, Case No. ER-2022-0130.[3]

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

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

DISCOUNT RATE

Q. Which Staff witness recommended the discount rates used in Mr. Davis' financial model?

A. Mr. Davis.

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

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

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[3] *Id.*
[4] Davis Rebuttal, p. 6, l. 25 – p. 7, l. 5.

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

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

Q. Why?

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

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

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

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

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

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

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

A. Yes.

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

A. No. This discount rate is too high.

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

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

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

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

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

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

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

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

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

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

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

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

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

A. Yes.

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

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

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

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

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

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

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

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

A. 6.08%.

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

A. Yes.

Q. Can you summarize your surrebuttal testimony?

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

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

Q. Does this conclude your surrebuttal testimony?

A. Yes.