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| **Exhibit No.:** | _______________ |
| **Issue(s):** | Rate of Return/Capital Structure |
| **Witness/Type of Exhibit**: | Murray/Rebuttal |
| **Sponsoring Party**: | Public Counsel |
| **Case No**.: | ER-2024-0189 |

# 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 NOS. ER-2024-0189

** ______________________________________________ **

Denotes Confidential Information that has been redacted

August 6, 2024

# PUBLIC

## TABLE OF CONTENTS

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**OF**

**DAVID MURRAY**

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

**CASE NO. ER-2024-0189**

**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 Direct Testimony in this case?**

A. Yes.

**Q. What it the purpose of your testimony?**

A. To respond to the direct testimony of Evergy Missouri West's ("MO West") witnesses, Ann E. Bulkley and Kirkland B. Andrews, as it relates to rate of return ("ROR") and capital structure. I will also address Staff witness Seoung Joun Won's, PhD, direct testimony.

**Q. How will you approach the presentation of your rebuttal testimony?**

A. I will address capital structure first. Mr. Andrews recommends a pro forma estimate of MO West's capital structure as of the true-up period in this case, June 30, 2024. Dr. Won recommends a ratemaking capital structure consisting of 50% common equity and 50% long-term debt ("50/50"). I will then address Ms. Bulkley's and Dr. Won's return on equity ("ROE") recommendations.

## CAPITAL STRUCTURE

**Q. Can you summarize the other parties' capital structure recommendations for MO West?**

A. Yes. Mr. Andrews recommends a pro forma estimate of MO West's capital structure as of the true-up date, June 30, 2024, in this case. Mr. Andrews estimates MO West's capital structure at June 30, 2024 will consist of 52.04% common equity and 47.96% long-term debt.

Dr. Won recommends that MO West's authorized ratemaking capital structure be set at 50/50.[1] Dr. Won's recommended ratemaking common equity ratio is slightly lower than the approximate 52% ratio Evergy Inc. ("Evergy") targets for its utility subsidiaries.

**Q. Why does Evergy target an approximate 52% common equity ratio for its regulated utility subsidiaries?**

A. I am not sure, but Evergy's targeted common equity ratio is consistent with the 52% to 53% targeted for ratemaking by most of Missouri's other larger regulated utilities owned by holding companies.

**Q. Does Mr. Andrews' testimony provide his representation of MO West's actual capital structure as of the test year, June 30, 2023?**

A. Yes. Schedule KBA-1 provides Mr. Andrews' calculation of MO West's capital structure as of June 30, 2023. Mr. Andrews indicates MO West had a common equity balance of ** ____________ ** and a long-term debt balance of ** ____________ ** as of this date. Mr. Andrews arrived at his common equity balance by subtracting $168,969,590 million of goodwill from a common equity balance of ** ____________ **. Mr. Andrews' adjusted common equity balance and his long-term debt balance implies a capital structure consisting of 53.52% common equity and 46.48% long-term debt at June 30, 2023.

**Q. Were you able to verify Mr. Andrews' representation of MO West's common equity balance at June 30, 2023?**

A. Not from reviewing MO West's consolidated GAAP and FERC financial statements. MO West's GAAP financial statements prepared for its private debt investors indicate that MO West's common equity balance was ** ____________ ** (see Schedule DM-D-6, page 3 attached to my direct testimony). MO West's FERC financial statements as of June 30,

[1] Won Direct, p. 31, ll. 4-12.

2023, indicate that MO West's common equity balance was $1,590.9 million (see Schedule DM-D-6, p. 4 attached to my direct testimony).

**Q. What document/report did Mr. Andrews use to extract his common equity balance figure at June 30, 2023?**

A. Mr. Andrews used an internal financial report extracted from Evergy's Hyperion Financial Modeling ("HFM") software.[2] This internal financial report provides deconsolidated financial information for each of MO West's business units, which includes its regulated utility as well as its legacy non-regulated business units.

**Q. In what company do MO West debt investors purchase debt?**

A. MO West on a consolidated basis, not just the regulated division. Consequently, MO West's consolidated financial statements form the basis for its financial reporting, whether to its debt investors through consolidated financial statements created in accordance with GAAP or to the FERC in accordance with FERC accounting.

**Q. Do you agree with Mr. Andrews' representation of MO West's capital structure?**

A. No. The common equity balance shown in Mr. Andrews' schedule does not reflect the common equity balance reported on MO West's consolidated financial statements, whether these are publicly-available balance sheets reported in accordance with FERC accounting or confidential balance sheets reported in accordance with GAAP for MO West's debt investors. Mr. Andrews' representation of MO West's capital structure is also inconsistent with the financial statement information MO West provides to rating agencies for annual credit reviews.

[2] MO West's response to OPC Data Request No. 3005.

**Q. Considering the numerous sets of financial statements/internal financial reports that indicate different capital balances and goodwill amounts, is there a simple and reasonable way to determine a fair and reasonable ratemaking capital structure for purposes of setting MO West's authorized ROR?**

A. Yes. The Commission can simply determine the ratios of capital it considers consistent with the debt capacity afforded by the regulated utility subsidiaries. This ensures Missouri's ratepayers share in the benefits of reduced business risk afforded by Missouri's recent legislative initiatives. This reduced business risk allows Missouri utility companies to increase their financial risk (*i.e.* issue debt) without jeopardizing their current credit rating. In my experience, the most objective, fair, and reasonable approach to ensure the utility subsidiaries' ratemaking capital structure ratios capture such additional debt capacity, is to analyze the amount of consolidated leverage used by the holding company.

**Q. Has the Kansas Corporation Commission ("KCC") considered Evergy's consolidated capital structure in determining a fair and reasonable ratemaking capital structure for its subsidiaries with operations in Kansas?**

A. Yes. In Evergy's recently concluded Kansas rate cases for its subsidiaries, Evergy Kansas Central Inc. and Evergy Metro Inc., Docket No. 23-EKCE-775-RTS, the KCC's Staff developed its recommended ratemaking capital structures by imputing holding company debt to the subsidiaries. KCC Staff's recommended ratemaking capital structures consisted of a 48.16% common equity ratio for Evergy Metro and a 47.95% common equity ratio for Evergy Kansas Central.

**Q. Did Evergy litigate ROR in its recent Kansas rate cases?**

A. No. The parties executed a Unanimous Settlement Agreement on September 29, 2023, which the KCC approved. The settlement resolved all revenue requirement issues without specifying a capital structure or ROR for purposes of determining the revenue requirement (*i.e.* a "black-box" settlement).



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**Q. Did investors estimate the capital structure they believe was implied from the black-box settlement in Kansas?**

A. Yes. Most investors viewed the settlement as being consistent with a ratemaking capital structure consisting of approximately 50% common equity and 50% long-term debt.[3]

**Q. Was the KCC's Staff's recommendation to consider Evergy holding company debt in setting rates for Evergy's Kansas operations consistent with the KCC's policy for setting a fair and reasonable ROR?**

A. Yes. Despite certain investors expressing surprise about the KCC's Staff position regarding holding company debt, the KCC Staff's position was consistent with its past recommended ratemaking capital structures for companies using holding company debt to leverage their returns.[4] In fact, while the KCC Staff agreed with Evergy to use subsidiary capital structures for purposes of the Earnings Review and Sharing Plan ("ERSP") instituted in conjunction with the KCC's approval of the Great Plain Energy and Wester Inc. merger, the subsidiaries' capital structures were tethered to the potential that Evergy may use more holding company debt to lever its returns. Consequently, the KCC included a trigger in the ERSP that required, for purposes of determining shared savings with customers, that the Kansas subsidiaries' equity ratios be reduced proportionally if Evergy's consolidated common equity ratio was more than 2.5% lower than its Kansas' subsidiaries.

**Q. If the Commission sets MO West's ratemaking common equity ratio consistent with your recommendation, can Evergy adjust MO West's capital structure accordingly?**

A. Yes. MO West has not paid a dividend to Evergy since 2020. Evergy, instead of issuing holding company capital to fund dividends to Evergy's shareholders, could instead receive a dividend from MO West and allow MO West to issue subsidiary debt to fund its capital needs. Doing so would allow for a recalibration of MO West's capital structure to be consistent with a common equity ratio in the 47% to 48% range.

[3] Nicholas Campanella, et. al., "3Q23: Moving Past the Rebase," Barclays Capital, November 8, 2023, p. 4 and Steve Fleishman, et. al., "EVRG – Settles with Staff, as Chiefs fans and Swifties unite," Wolfe Research, October 2, 2023.
[4] Kansas Corporation Commission Docket No. 23-EKCE-775-RTS, Direct Testimony of Adam H. Gatewood, August 29, 2023, pp. 24-25.



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**Q. Ms. Bulkley testifies that MO West's requested ratemaking common equity ratio of 52.04% is reasonable because it is consistent with the common equity ratios of the utility operating subsidiaries of her proxy group. Are utility operating companies' capital structures a good proxy for market-based capital structures managed to achieve a lower cost of capital?**

A. No. Evergy is not unique in its use of holding company debt to optimize its consolidated capital structure. Considering the fact that all the ROR witnesses in this case are estimating the COE for MO West based on a proxy group of publicly-traded holding companies of other utility operating company subsidiaries, these are the capital structures that influence investors required returns on the publicly-traded equity.

**Q. For 2023, what was the average consolidated common equity ratio of Ms. Bulkley's publicly-traded proxy group?**

A. 41.79% excluding short-term debt and 40.89% including short-term debt.[5]

**Q. Does the higher holding company financial risk (*i.e.* use of debt) increase shareholders' required returns for companies included in Ms. Bulkley's proxy group?**

A. Yes. Higher debt ratios increase the amount of fixed-obligations that must be paid before shareholders receive residual cash flows/income. Therefore, if public-utility holding companies are optimizing their consolidated capital structures at the holding company level, although the COE may be higher, the increased use of lower-cost debt reduces the overall weighted cost of capital. This explains why most utility holding companies target credit metrics consistent with BBB ratings rather than ratings of A or above.

[5] See Mr. Murray's rebuttal workpapers for calculations.



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**Q. Are there any companies in Ms. Bulkley's proxy group that do not issue long-term debt at the holding company?**

A. Yes. Portland General Electric Company ("Portland") and IDACORP, Inc. ("IDACORP") do not issue long-term debt at a holding company. In fact, Portland does not have a holding company, but rather owns its electric utility assets directly.

**Q. What was Portland's average common equity ratio in 2023?**

A. Approximately 43.5% without short-term debt.[6]

**Q. What is the allowed ratemaking common equity ratio for Portland?**

A. 50%.

**Q. Why does the Oregon Public Utility Commission allow a higher common equity ratio for ratemaking than Portland's actual common equity ratio?**

A. At the time I drafted this testimony, I had not researched the reason for this discrepancy.

**Q. What was IDACORP's average common equity ratio in 2023?**

A. 52.53%.[7]

**Q. What is the allowed ratemaking common equity ratio for IDACORP?**

A. IDACORP last identified authorized ratemaking common equity ratio was 49.27% in a 2009 rate case in Idaho.

**Q. What are Portland's and IDACORP's S&P issuer credit ratings?**

A. 'BBB+' and 'BBB,' respectively.

**Q. What does the information on these companies demonstrate?**

A. That MO West's ratemaking common equity ratio does not need to be any higher than 50%. In fact, the fact that Portland is able to maintain a 'BBB+' credit rating despite having

[6] *Id.*
[7] *Id.*



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an actual 43.5% common equity ratio demonstrates the ability of pure-play utility companies to capitalize their low-risk regulated utility assets with significant proportions of leverage.

## RETURN ON COMMON EQUITY

*ANN E. BULKLEY'S RECOMMENDED ROE*

**Q. What is Ms. Bulkley's recommended allowed ROE for MO West?**

A. Ms. Bulkley recommends the Commission allow MO West an ROE anywhere in the range of 10.25% to 11.25%. Based on her range, she recommends a point ROE of 10.5%.[8]

**Q. What is the premise underlying Ms. Bulkley's recommended allowed ROE?**

A. Ms. Bulkley estimates the cost of equity ("COE") for MO West to be in the range of 10.25% to 11.25% based on her application of three primary COE methodologies: (1) the constant-growth discounted cash flow ("DCF") method, (2) the Capital Asset Pricing Model ("CAPM") – a standard CAPM and an empirical CAPM, and (3) a Bond Yield Plus Risk Premium analysis.

**Q. What is your general reaction to Ms. Bulkley's testimony regarding estimating the utility industry's COE?**

A. First, I disagree with her that the utility industry's COE is in the double digits. While estimating a COE for the utility industry this high may be consistent with the utility industry's attempt to increase authorized ROEs, they are not consistent with the discount rates, *i.e.* the COE, that investors use for purposes of estimating the intrinsic value of utility common equity. The Commission need look no further than the discount rates (*i.e.* COE) actually used by investors to dismiss the reliability of Ms. Bulkley's COE estimates.

Second, Ms. Bulkley has been filing ROR testimony in Missouri since 2020. The constant theme in her testimony has been that utility industry's COE will increase in future periods

[8] Bulkley Direct, p. 7, lns. 23-27.



P

when utility rates are in effect. Although the COE did increase since MO West's 2022 rate case, due to a contraction in utility stocks during 2023, Ms. Bulkley still projects the utility industry's COE will increase further. I am not sure utility stocks could do any worse than they did in 2023, but Ms. Bulkley continues to warn the Commission that methods such as the DCF are still underestimating the COE because utility stock prices may continue to decline after MO West's rates are changed in this case.[9]

Finally, while she devotes fifteen pages of testimony trying to convince the Commission that MO West is riskier than average utilities, she forgets that her proxy group contains companies that are exposed to competitive markets. Her opinions are also completely contradicted by Evergy's actual increased investment in its Missouri utilities. This increased capital spend is due directly to utility-friendly legislation passed in Missouri in recent years.

**Q. Do you have concerns about Ms. Bulkley's proxy group?**

A. Only to the extent she doesn't recognize or discuss the fact that some of her companies have significant exposure to non-regulated operations. Cyclical industries, such as energy companies, with exposure to changes in commodity prices are impacted to a much greater extent by variations in economic/market conditions. This explains why companies in cyclical industries typically have stock betas closer to one, which indicates that the equity risk associated with these industries are higher than for regulated utilities. For example, the consumption of commodities, such as energy, are highly correlated with the expansion and contraction of the economy. This explains why utility companies with exposure to unregulated commodity prices typically have higher betas than pure-play regulated utilities. The following companies included in Ms. Bulkley's proxy group have significant (greater than 10%) non-regulated business exposure at least as recently as 2023: Allete Inc. and NextEra Energy Inc. Unfortunately, Ms. Bulkley focuses on her perception that

[9] *Id.*, p. 7, lns. 15-20.

Missouri's regulatory ratemaking shortcomings as compared to her proxy group, cause MO West to have a higher cost of capital than the cost of capital of her proxy companies.[10]

**Q. Ms. Bulkley testifies that the fact that MO West is owned by Evergy does not affect her analysis of MO West's cost of capital.[11] Was this prudent on her part?**

A. No. MO West is inextricably linked to their parent company, Evergy. Evergy's financial strategies, such as capital structure management, directly impact MO West.

Evergy's cost of equity is based on the collective business risks of its various subsidiaries, approximately 33% of which is related to its electric utility assets in Missouri, as well as the financial risk it incurs at the consolidated level. Because Evergy's business operations are predominately regulated electric utilities (vertically integrated in both Missouri and Kansas) its capital structure and cost of equity are appropriate proxies for estimating MO West's cost of capital.

Therefore, because Ms. Bulkley did not consider Evergy in her assessment of MO West's cost of capital, I consider her cost of capital analysis to be incomplete.

**Q. Ms. Bulkley maintains that it is important to authorize MO West a ROR based on an ROE and capital structure that will allow it to attract capital on a stand-alone basis and within the Evergy system.[12] Did Ms. Bulkley compare her recommended ROR for MO West to Evergy's other systems?**

A. If she did, she did not provide such analysis in her direct testimony.

**Q. Can you provide Evergy's projected 5-year capital expenditure plan for MO West as compared to Evergy on a consolidated basis?**

A. Yes. Evergy projects investing $2.9 billion in MO West's electric utility system over the next five years. This represents 23.21% of Evergy's projected capital spend. As of

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[10] *Id.,* p. 54, ln. 9 – p. 63, ln. 2.
[11] *Id.*, p. 11, lns. 3-9.
[12] *Id.*



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December 31, 2023, MO West's net property, plant and equipment ("PP&E") represented 14.82% of Evergy's consolidated PP&E.

**Q. Can you approximate how much value this investment would create for Evergy's shareholders based on your recommended ROR compared to your estimate of MO West's cost of capital?**

A. Yes. I made the following assumptions in my analysis:

-MO West's cost of capital parameters:

-Common equity ratio – 47.2%

-Cost of equity – 8.5%

-Long-term debt ratio – 52.8%

-Current cost of long-term debt – 5.4%

-5 years of capex made in one lump sum;

-30-year depreciation period; and

-rates reset every year.

Based on these assumptions and applying my recommended authorized ROE of 9.5% to my recommended common equity ratio of 47.2%, Evergy would create $115,115,201 of additional shareholder wealth over the shareholder's original investment of $1.369 billion. To put it another way, if the Commission authorized MO West an ROE of 8.5%, Evergy's equity investment in MO West would not create additional returns over the COE to the shareholder.

**Q. How much shareholder value would an investment in KS of the same amount create for shareholders?**

A. Assuming a 50/50 implied capital structure from Evergy's KS settlement and a 9.4% ROE applied to 50% of the capital structure, a $2.9 billion lump sum investment with a 30-yaer



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life would create $141,677,650 of additional shareholder wealth over the shareholder's original investment of $1.369 billion.

**Q. What if the Commission adopted Staff's recommended capital structure?**

A. Under this scenario, an investment of $2.9 billion in MO West creates $152,497,828 of additional shareholder value.

**Q. Would MO West be able to attract capital from Evergy regardless of whether MO West is authorized a common equity ratio of 50% or 47.2%?**

A. Yes. Under either scenario, the investments create wealth for shareholders above their initial investment of $1.369 billion.

**Q. What equity value would be recorded on MO West's balance sheet at the time the project is funded?**

A. $1.369 billion. The original equity capital used to fund the project is recorded on MO West's balance sheet at cost rather than market value.

**Q. If MO West's new investments are expected to be allowed and earn a 9.5% ROE, and its COE is 8.5%, does this dynamic increase the market value of the original equity investment?**

A. Yes. Whether the Commission authorizes a 50% common equity ratio or a 47.2% common equity ratio, the market value of the equity is equal to principal investment ($1.369 billion) plus the additional shareholder wealth created through the 100 basis point spread between the COE and the ROE (~$115 million to $152 million). The resulting market-to-book ratio of the equity investment is in the 1.08x to 1.11x range, which is a function of earning a higher return than the required return.

**Q. More directly, would MO West's inability to earn its authorized ROE in recent years prohibit it from attracting capital to invest in its electric utility infrastructure?**

A. No. The Commission's ordered disallowances related to Crossroads impacted the value of Evergy's equity in MO West at the time those disallowances were factored into MO West's



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projected cash flows and earnings. These past rate adjustments do not define projected returns on current investments. As I demonstrated in my examples above, if the Commission authorizes an ROE higher than the COE, Evergy can create shareholder value simply by investing in its infrastructure.

**Q. Should MO West be immune to ratemaking disallowances in interest of attracting capital at lower costs?**

A. No. In fact, if imprudent management decisions cause a higher cost of capital, the company is not entitled to recover this higher cost of capital. As stated in *Bluefield:*

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, **under efficient and economical management,** to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. (emphasis added).[13]

Therefore, although utility rate setting bodies, such as this Commission, are constitutionally required to set rates based on a fair and reasonable authorized ROR, rate setting bodies have no obligation to adjust the ROR, or any other ratemaking treatment, to protect investors and charge ratepayers for a company's inefficient and uneconomical management. In fact, ratemaking bodies have a duty, as a surrogate for competition, to protect ratepayers from being charged higher rates due to poor management decisions. Therefore, to the extent MO West's cost of capital is higher due to imprudent management decisions, this increase in the cost of capital should be borne by shareholders, not ratepayers.

[13] *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, *43 S.Ct. 675, 67 L.Ed. 1176* (1923).



P

**Q. In attempting to encourage the Commission to authorize a ROR consistent with her recommendation, Ms. Bulkley provides examples of negative capital market reactions to other state commission decisions. Do any of these decisions involve the parent company of a Missouri utility?**

A. Yes. Ms. Bulkley discusses the Illinois Commerce Commission's ("ICC") decision to reject Ameren Illinois Co.'s ("AIC") multi-year rate plan proposal and authorize AIC an ROE of 8.72%.

**Q. Does her example support the reasonableness of your recommended ROR?**

A. Yes. As Ms. Bulkley testified, the ICC decision prompted investors to suggest/encourage Ameren Corp. to reallocate capital from AIC to Ameren's other jurisdictions. Ameren's other jurisdictions are Missouri and the United States' Federal Energy Regulatory Commission ("FERC"). Consequently, if anything, this example suggests the Commission should be careful not to over-incentivize investment in Missouri. Based on recent investor commentary/analysis, Missouri is currently considered a more investor-friendly jurisdiction than Kansas and Illinois.[14]

**Q. Did equity analysts lower their expectations for Ameren's EPS as a result of the ICC decision?**

A. Yes. For example, Wells Fargo lowered its forward annual EPS expectations for Ameren by approximately $0.20/year for each year from 2024 to 2027. Based on Ameren's P/E ratio of around 16.5x in the week prior to the ICC's decision in the AIC electric rate case, a 20-cent reduction in EPS accounts for a $3.30 decline in Ameren's share price. This compares to Ameren's actual stock price decline of around $6. Additionally, Wells Fargo lowered its projected long-term CAGR in EPS for Ameren from 7% to 6%, which also caused assignment of a lower value to Ameren's stock.

[14] Neil Kalton, et. al., "Figure of the Week: State Regulatory & Political Ratings," Wells Fargo, January 12, 2024.



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**Q. Did any other analysts express concern about Ameren's ability to achieve its long-term CAGR in EPS guidance of 6% to 8% after the ICC decision?**

A. Yes. Bank of America estimated that Ameren's long-term CAGR in EPS would trend down to 5% as a consequence of the ICC's decision.[15]

**Q. Did Ameren lower its guidance for its long-term CAGR in EPS?**

A. No. Ameren renewed its guidance of 6% to 8% long-term CAGR in EPS during its earnings conference call for the fourth quarter of 2023.[16]

**Q. How is this possible?**

A. Ameren reallocated at least $1.6 billion of capital expenditures it had intended to spend on its AIC systems to Ameren Missouri and Ameren Transmission. AIC's projected 5-year CAGR in its electric rate base declined from 7.4% to 2.3% and its projected 5-year CAGR in natural gas distribution rate base growth declined from 6.7% to 3.3%. Ameren Missouri's projected 5-year CAGR in rate base increased to 9.8% from 8.4%. Ameren Transmission Company's 5-year CAGR in rate base increase to 10.8% from 10.0%.[17]

**Q. Has Evergy acknowledged that it views the Missouri regulatory environment as more attractive for purposes of allocating capital?**

A. Yes. Evergy's CEO, David Campbell stated the following during Evergy's third quarter 2023 earnings conference call:

> As of now, the mechanisms are a little more constructive in Missouri in terms of reducing regulatory lag, so helping you earn your realized return, but we're going to be working on Kansas to see if their policy that reflect the objectives of our stakeholders as well as ours that we can move forward on, then I think can help to inform the capital plan.[18]

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[15] Julien Dumoulin-Smith, "Ameren Corporation – Downgrade to Neutral: Lower capital coming post Illinois decision," Bank of America, January 4, 2024.

[16] Ameren Corporation FQ4 2023 Earnings Call, February 23, 2024.

[17] "Transforming for Our Future," Ameren Third Quarter 2023 Earnings Investor Presentation, November 9, 2023; and "Powering a Reliable, Sustainable Tomorrow," Ameren Fourth Quarter 2023 Earnings Investor Presentation, February 23, 2024.

[18] Evergy Inc. NasdaqGS: EVRG FQ3 2023 Earnings Call Transcripts, November 7, 2023, p. 12.

**Q. Why is it important to consider utility companies' and investors' qualitative opinions for purposes of setting a fair and reasonable authorized ROR for MO West or any other Missouri utility for that matter?**

A. Because setting the authorized ROR much higher than Kansas or Illinois may cause over-allocation of capital to Missouri. As I explained earlier in my testimony, when the authorized ROR is set at a margin over the cost of capital, jurisdictions may be put in the unfair position of bidding against each other. While such situations are favorable to shareholders, they are not for utility ratepayers.

**Q. What is the best solution to avoid these potential bidding wars?**

A. Awarding a ROR based on each entity's actual cost of capital. If this parity is achieved, then shareholders receive compensation for their required return, rather than excess returns awarded. Companies would then choose projects that they project would earn more than their cost of capital based on the economics of the projects rather than choosing them based on the highest awarded returns.

*<u>INTERPRETATION OF MARKET CONDITIONS</u>*

**Q. Ms. Bulkley testifies that interest rates and utility share prices are inversely correlated, which means increases in interest rates will result in a decline in utility share prices.[19] Did this relationship hold true from 2020 to 2022?**

A. No. During extraordinary periods in which the Fed and U.S Congress have intervened in the markets, many typical relationships do not hold true. For example, while long-term bond yields declined to all-time low levels in the early period of Covid-19, utility stock valuation ratios did not increase consistent with these typical patterns. Consequently, I did not recommend significant decreases in authorized ROEs for Missouri utilities. On the flip side, in 2022 when long-term bond yields increased significantly, utility stock valuation ratios did not decrease consistent with these patterns, which caused me to still recommend authorized ROEs consistent with the low-rate period. However, as I testified in my direct

[19] Bulkley Direct, p. 23, lns. 18-20.



P

testimony, the typical inverse correlation to long-term bond yields emerged again in 2023, which caused a contraction in utility P/E ratios. The impact of this dynamic is fully captured in my current COE estimates, which while significantly higher than before 2023, are still below authorized ROEs.

**Q. Ms. Bulkley testifies that the views she provided and cited in the MO West's 2022 rate case materialized.[20] How long has Ms. Bulkley been predicting utility stock prices would likely decline?**

A. Since at least the 2020 MAWC rate case, which is the first case in which she sponsored ROR testimony in Missouri. Ms. Bulkley has consistently and repeatedly predicted that the utility industry's COE will increase because of potential increases in long-term bond yields. Her repeated predictions had to be realized at some point. This is consistent with the often-quoted adage that "economists have predicted 9 of the last 5 recessions." In fact, according to the Wall Street Journal's survey of economists in 2022, over 60% predicted a likely recession in 2023 due to the Fed's aggressive tightening of monetary policy in 2022.[21] Obviously, the economy did not experience a recession in 2023, but these expectations were factored into stock prices, with utility stocks outperforming the broader markets in 2022 despite the significant rise in long-term bond yields. For this reason, it is important for ROR witnesses to estimate the cost of capital based on current market prices, because they reflect investors' expectations.

**Q. Have these projections and relationships held true in recent years?**

A. Long-term bond yields did finally increase in 2022, but utility stock prices did not contract as typically expected. As I explained in my direct testimony, this breakdown in the typical inverse correlation was likely due to a couple of factors: (1) long-term interest rates increased from all-time lows during 2020 to 2021, which was largely attributed to the massive support and stimulus provided by The Federal Reserve ("The Fed") and US

[20] *Id.,* p. 24, lns. 4-16.
[21] Harriet Torry and Anthony DeBarros, "Economists Now Expect a Recession, Job Losses by Next Year: Majority think Federal Reserve will start cutting rates in late 2023 or early 2024," Wall Street Journal, October 16, 2022.



P

Congress and (2) investors feared The Fed's tightening would cause an recession in 2023, causing investors to rotate into defensive sectors, such as utilities.

**Q. How long has Ms. Bulkley been expressing her concerns that COE methods, such as the DCF, underestimate the COE because utility stock prices are likely to decline?**

A. Since at least early 2020 when she filed ROR testimony in the 2020 Missouri American Water Company rate case, Case No. WR-2020-0344.

**Q. Based on current market conditions, is it logical to project that current utility stock prices are likely to be higher than future utility stock prices, as Ms. Bulkley suggests?**

A. No. But as I have testified in previous rate cases before long-term interest rates increased, I am not a market prognosticator, nor do I consider it appropriate for ROR witnesses to attempt to be market prognosticators. We should simply be providing insight as to investors' expectations, which are already embedded in current utility share prices.

**Q. Did Ms. Bulkley's prediction of increased long-term bond yields eventually occur?**

A. Yes. After predicting that long-term bond yields were unsustainably low, which in her opinion caused utility stock prices to be unsustainably high, an increase in bond yields finally did occur, but not until three years after she began to predict this outcome.

**Q. What about utility stock prices contracting as a result of increases in bond yields?**

A. Utility stock prices' inverse correlation with long-term bond yields did not reoccur until late 2022.

**Q. Did Ms. Bulkley cite to a past Commission ROE determination in which it supported its 9.8% authorized ROE by citing to anticipated increases in interest rates?**

A. Yes. In supporting her view that multiple COE methods should be considered in setting an authorized ROE, Ms. Bulkley cites to the Commission's Report and Order in Spire Missouri's 2017 rate case, Case No. GR-2017-0215. In supporting its decision to authorize Spire Missouri a 9.8% authorized ROE the Commission cited "anticipated increasing interest rates" to support a higher ROE.



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**Q. What happened to long-term bond yields and utility stock valuation levels subsequent to the Commission's decision?**

A. As shown on page 8 of my direct testimony, long-term bond yields continued their steady decline until the onset of the Covid-19 pandemic. Over this same period, utility stock valuation levels, as measured by P/E ratios, continued their steady expansion, reaching all-time high valuation levels right before Covid-19. This period of three-to-four years covered the entirety of Spire Missouri's interval between its 2017 and 2021 rate cases. Consequently, I advise the Commission not to cite projected interest rates in either supporting a lower or higher allowed ROE.

**Q. Ms. Bulkley testifies that equity analysts expect the utility sector to underperform in 2024.[22] Does Ms. Bulkley imply this is a consensus view?**

A. Yes.

**Q. Is it?**

A. No.

**Q. Can you provide some examples of differing views?**

A. Yes. Guggenheim Securities, LLC stated the following about its outlook for the utility sector in 2024:

> The sector oversold going into '24 vs. '23 as valuation decline outpaced broad markets while interest rates rose; after a period of normalization into year-end, we see opportunity to revert. As stated above, we see the sector as 20%+ cheap, and we are making a case for a sector-wide upside call (i.e., no Sell ratings going into 24', with several Neutrals we highlight with upside bias should a catalyst bear fruit). [23]

Also, contrary to Ms. Bulkley's opinion that utility stock prices do not already reflect investors' expectations regarding changes in interest rates, Guggenheim also states the following regarding forward rates underlying current fair value stock price estimates:

[22] *Id.,* p. 25, ln. 4 – p. 26, ln. 2.
[23] Shahriar Pourreza, CFA, et. al., "24 Utilities Outlook: Utility Valuations Finally 'NSYNC' with Fundamentals? Buy Buy Buy…" Guggenheim Securities, LLC, January 22, 2024, p. 10.



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> **How do we arrive at our target utility multiple? Incorporating the forward yield outlook for corporate bonds of 5.3% for 2026 (see Figure 15) and the PEG ratio approach, we incorporate a blended valuation resulting in a 16x P/E for 2026E**; we believe the group should trade higher than what our bond regression shows in isolation (~3x premium vs. where the group currently trades) in light of a differentiated "growth" outlook based on a reversion to the mean PEG ratio in the LT, especially as utilities have demonstrated the ability to navigate 2023 headwinds with cost efficiencies, increased capex and modest programmatic equity issuance – **"Growth" continues to be a material driver with longer-term utility valuation levels vs. "Yield".** (bold in original).

Well Fargo's 2024 outlook for the utility sector was neutral. It stated the following:

> **Valuation - It's Mixed**
>
> *Bottom line: we do not view utilities as either overly expensive nor overly cheap.*
>
> Relative to long-term interest rates the group continues to screen expensive (Exhibit 4 depicts the group's valuation relative to the 10-Yr Treasury yield). Based on the historical relationship, the 10-Yr yield would need to decline to 2.5% in order to bring the valuation into alignment with the median. At the current 10-Yr yield, the P/E multiple that would bring the relationship back in line is 9.2x, or ~40% below the current P/E multiple of 15.5x. That being said, we point out that the sector's current P/E multiple is not out of bounds with how the group traded the last time the 10-Yr yield was between 4.0-5.0% (Exhibit 5). And during that period (2004-2007) the group's EPS growth outlook was lower (4-6% vs. 5-7% now)…
>
> …Relative to the S&P 500, utilities continue to screen attractive. The current relative P/E multiple of ~80% is well below the 15-yr average of 100-105%. We point out that prior to 2000, utilities traded at a relative P/E multiple of 70-80%. However, the EPS growth outlooks (~4%) were far lower than the current target growth rates of ~6%.[24]

Finally, Wolfe Research stated the following about its 2024 outlook for utilities:

> **Bullish for 2024.** Utilities typically bounce after worst years. Valuations are at buy levels. The Fed cycle looks timely – utilities o/p after tightenings and heading into easings. We see 10% total return intact. Risks are regulation, elections/IRA and an extended bull market.[25]

[24] Neil Kalton, et. al., "2024 Utility Outlook: Back to Square One," Wells Fargo, November 30, 2022
[25] Steve Fleishman, et. al, "Utilities & Power – Top 10 Things to Watch for 2024," Wolfe Research, January 15, 2024, p. 1.



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**Q. Regardless of the variety of equity analysts' views, do current utility stock prices already reflect investors' expectations of macro, industry and company-specific factors?**

A. Yes. COE estimation methods assume efficient capital markets, meaning utility share prices, and for that matter utility bond prices, reflect potential economic and business cycles over the long-term. Ms. Bulkley's attempt to overemphasize short-term sentiments is misguided. Utility investors already factor in the potential consequences of macro factors in the price they are willing to pay today. As many equity analysts also emphasize, despite business cycle swings, utility companies continue to plow ahead with capital expenditures that allow them to meet their guidance for long-term CAGR in EPS. The utility industry is the rare sector, and one of the reasons it is one of safest sectors, which is fairly immune to moderating capital expenditures during periods of slower economic growth.

**Q. But do you not rely on equity analyst information for your own analysis of the cost of capital?**

A. Yes, but not for purposes of "predicting" future stock prices. I analyze the information equity analysts include in their reports to ensure my inputs and assumptions for variables, such as intermediate to perpetual growth rates in my application of the DCF, are consistent with the methodologies employed by Wall Street analysts.

**Q. Do you agree with Ms. Bulkley's characterization as to why S&P downgraded MO West's S&P issuer/corporate credit rating?[26]**

A. No. First, Ms. Bulkley does not explicitly specify that MO West's credit rating was downgraded in conjunction with S&P's decision to downgrade Evergy's consolidated credit rating from 'A-' to 'BBB+'. As clearly stated in the attached report (Schedule DM-R-1), S&P's primary impetus for downgrading Evergy and its subsidiaries' credit rating by one notch was the fact that Evergy settled its Kansas rate cases at amounts that were less than S&P's base case scenario. Consequently, S&P projects that Evergy's consolidated

[26] Bulkley Direct, p. 7, lns. 11 – 14.



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credit metrics will be weaker than that which are consistent when an 'A-' credit rating. Because MO West is a Missouri-only utility, clearly the events impacting Evergy's KS operations are not directly responsible for the downgrade in MO West's credit rating. S&P's credit rating methodology typically assigns similar credit ratings to all companies within a corporate family, regardless of differences in each subsidiary's business risk and financial risks. Therefore, Ms. Bulkley's testimony is misleading in suggesting that MO West's credit rating was downgraded due to factors specific to MO West.

**Q. Does your DCF analyses, using current utility share prices, accurately and reliably capture the increase in utilities' COE due to contractions in their stock prices?**

A. Yes.

**Q. Is your COE estimate mis-specified because of your use of current utility share prices?**

A. No.

**Q. Are Ms. Bulkley's COE estimates mis-specified due to her biased view that long-term bond yields will either remain high or increase further?**

A. Yes. I am not aware of a consensus that long-term bond yields will remain high or increase even further. Even if they did, no one can be sure that utility share prices would contract further. Current share prices reflect investors' expectations of all factors which may impact stock prices, which includes changes in Fed Funds rates, long-term bond yields, recessions, recoveries, opportunity costs, etc.

**Q.** ** ________________________________________
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**Q. What was the spot yield on 10-year UST's at the time you prepared your rebuttal testimony?**

A. 3.8% as of August 2, 2024.

**Q. Does this mean you believe the utility industry's cost of capital will be lower in the future?**

A. No. As I testified earlier, it is not my role as a cost of capital witness to provide market prognostications. I adhere to the efficient market hypothesis (as should anyone employing cost of capital models/methods) which dictates that current market prices reflect investors' expectations of changes in economic, capital market and business conditions. MO West will likely file another rate case within the next two years as this has been its typical cycle. If the cost of capital increases or decreases in the interim, the Commission can adjust its authorized return accordingly based on updated market expectations at the time.

**Q. Can utility stocks perform much worse relative to the S&P 500 than they did in 2023?**

A. No. In fact, according to Wolfe Research utilities had the worst relative performance to the S&P 500 in 2023 than it had in the past 50 years. Consequently, while I am not a market prognosticator, I do recognize that the Fed's current monetary policy position is restrictive/tighter with all signs that it will begin to ease/loosen starting in September 2024. While doing so may ease pressure on long-term bond yields, because long-term bond yields, such as the 10-year UST reflect investors' expectations of average short-term rates over the next ten years, a reduction in the overnight lending rate (*i.e.* the Fed Funds Rate) will not have a direct impact on long-term yields.

**Q. Despite utility stock's historical underperformance last year, does Ms. Bulkley double-down on her consistent view that current utility share prices *still* understate the utility industry's COE?**

A. Yes. Ms. Bulkley testifies as follows on page 28, lns. 6-10 of her direct testimony:

> Because the cost of equity has increased since the Company's last rate proceeding, cost of equity estimates based in whole or in part on historical or current market conditions, as opposed to projected market conditions,

> may understate the cost of equity during the future period that the Company's rates will be in effect.[27]

**Q. What is Ms. Bulkley's purpose for repeatedly emphasizing over the last several years that the utility industry's stock prices are likely to decline in subsequent years?**

A. Because doing so was paramount to her objective of deemphasizing the very low implied COE derived from using the DCF methodology. Although her COE estimates using the DCF methodology were low relative to her estimates using methods such as the CAPM and risk premium methodologies, even her DCF estimates were upwardly biased due to misuse of financial metrics in her constant-growth DCF.

*DISCOUNTED CASH FLOW ASSUMPTIONS*

**Q. What is the most glaring mis-specification in Ms. Bulkley's constant-growth DCF analysis?**

A. Her opinion that utility investors expect perpetual annual stock price gains at parity with equity analysts' projected 3-5 year CAGR in EPS. For purposes of her mean constant-growth DCF COE estimate of 10.09%, she assumes the perpetual stock price appreciation will be 5.9%/year. Ms. Bulkley's assumption implies that utility investors expect approximately 58.5% of their total returns will be in the form of capital gains with the remaining portion achieved through dividend returns. Considering on average, utility companies distribute approximately 2/3 of their EPS in DPS, her assumption is illogical. Although admittedly a simplified test, simply flipping Ms. Bulkley's assumption to cause 58.5% of utility stock investors returns to be achieved from dividends results in a COE estimate of 7.17%. While lower than my own COE estimate, this implied COE is much closer to those used by investors than Ms. Bulkley's approximate 10% estimate.

**Q. Are you aware of any equity analysts that assume a utility's DPS can grow in perpetuity at the same rate as their own projected 3-to-5 year CAGR in EPS?**

A. No.

[27] *Id.,* p. 28, lns. 6-10.



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*CAPM ASSUMPTIONS*

**Q. Why are Ms. Bulkley's CAPM cost of equity estimates so high?**

A. Because she uses irrational expected market returns. Ms. Bulkley estimates a total compound annual market return for the S&P 500 of 12.56% for the foreseeable future (perpetually based on her use of a constant-growth DCF to estimate S&P 500 returns).[28] Subtracting long-term risk-free rates from Ms. Bulkley's estimated market return results in her market risk premium estimates of 7.78% to 8.46%.[29]

**Q. How is Ms. Bulkley able to achieve such high market risk premium estimates?**

A. Because she assumes that the S&P 500 can grow its earnings at a compound annual rate of 10.78% in perpetuity.[30]

**Q. Are you aware of any authoritative sources, academic or practical, that use Ms. Bulkley's approach for estimating market returns?**

A. No. I know of no authoritative source that suggests this is a rational or reasonable approach for purposes of estimating market returns. In fact, I know of several authoritative sources that recommend against using a growth rate higher than GDP for purposes of determining the long-term expected return for a broad index, such as the S&P 500.

**Q. What academic support are you aware of?**

A. The 2010 curriculum for Level III of the Chartered Financial Analyst ("CFA") Program discusses how analysts often use the Gordon growth model (synonymous with the constant growth DCF model used in utility ratemaking) to formulate the long-term expected return for the broader equity markets. In the case of a broad-based equity index, such as the S&P 500, it is reasonable to estimate the long-term potential capital gains for the index by using estimated nominal GDP over a long-term period. The curriculum specifically provides the following formula for estimating the constant growth rate with an explanation that follows:

[28] *Id.,* p. 41, lns. 16-19.
[29] *Id.*, Schedule AEB-4.
[30] *Id.,* p. 41, lns. 16-18.

> Earnings growth rate = GDP growth rate + Excess corporate growth (for the index companies)
>
> where the term *excess corporate growth* may be positive or negative depending on whether the sectoral composition of the index companies is viewed as higher or lower growth than that of the overall economy. If the analyst has chosen a broad-based equity index, the excess corporate growth adjustment, if any, should be small.[31]

Considering that the S&P 500's current dividend yield of approximately 1.69% and projected long-term growth in U.S. nominal GDP is around 4.0%, it seems that investment professionals' forecasts of long-term returns for the S&P 500 of around 7%[32] are consistent with the above-prescribed formula.

**Q. Are you aware of any common valuation metrics that dispute Ms. Bulkley's market growth rate expectations?**

A. Yes. A comparison of a broad equity market capitalization amount to that of the total size of the U.S. economy. This valuation metric provides a sanity check on potential growth for capital markets. Warren Buffett made it popular when he provided insight on how high the market, as measured by the Wilshire 5000, became valued as compared to U.S. GDP at the time of the "dot com" bubble around March 2000. At that time, the Wilshire 5000 was around 1.4x that of GDP. As of June 30, 2024, it was around 1.9x, which demonstrates investors are currently requiring lower market risk premiums than usual.

**Q. What would this ratio be in 50 years if the market grew at the 10.78% compound annual growth rate Ms. Bulkley suggests is appropriate?**

A. The Wilshire 5000 index would be approximately 45x times the GDP level. Based on the market capitalization of the Wilshire 5000 of approximately $54.47 trillion as of June 30, 2024, the Wilshire 5000 would have a market capitalization of $9.10 quadrillion in 50 years. U.S. GDP was $28.63 trillion as of the same date. Based on a 4.0% long-term growth rate for the U.S. economy, GDP would be approximately $203.46 trillion in 50 years. It is not rational to assume corporate wealth will become much larger than the

[31] 2010 CFA® Program Curriculum, Level III, Volume 3, p. 34.
[32] Murray Direct, p. 25, ln. 13.

economy in which it operates, let alone 45x the size of the economy. This explains why the CFA Program advises not using a perpetual growth rate much, if any, higher than the GDP growth rate of the economy(ies) in which a company operates.

**Q. Why are Ms. Bulkley's Empirical CAPM ("ECAPM") results higher than her standard CAPM results?**

A. The results are higher because Ms. Bulkley's ECAPM gives 25% weight to the unadjusted market risk premium and 75% weight to the utility beta adjusted market risk premium. Being that Ms. Bulkley's utility betas at least reduce her high equity risk premium estimates by 10% to 30%, because her ECAPM allows for a 25% weighting to an unadjusted risk premium, this amplifies the bias inherent in Mr. Bulkley's high risk premiums.

**Q. Does this mean that the larger the market risk premium estimate, the more widely divergent the ECAPM results will be compared to the standard CAPM?**

A. Yes.

**Q. Can you explain?**

A. Yes. Ms. Bulkley assumes a market risk premium of approximately 7.78% to 8.46% compared to more rational estimates of around 5.0% to 6%. If Ms. Bulkley had used a more reasonable market risk premium of 5.5%, her ECAPM adjustment would have been approximately 5 to 20 basis points lower as compared to her standard CAPM.

*<u>BOND YIELD PLUS RISK PREMIUM ANALYSIS</u>*

**Q. What are your thoughts on Ms. Bulkley's Bond-Yield-Plus Risk Premium ("BYPRP") analysis?**

A. Ms. Bulkley's BYPRP is a regression analysis of allowed ROEs to interest rates. Ms. Bulkley concludes from her regression analysis that because allowed ROEs haven't changed as much as interest rates, an adjustment needs to be made to recognize that regulators have been hesitant to adjust allowed ROEs as much as interest rates would suggest. This approach is circular in that the regression coefficient is dependent on



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commissions' regulatory decisions rather than on market required returns. As I testified in my direct testimony, the investment community recognizes that authorized ROEs did not decline along with the COE.

*CONSIDERATION FOR SPECIFIC BUSINESS AND REGULATORY RISK*

**Q. Ms. Bulkley devotes approximately 15 pages of direct testimony to justify her view that Evergy's 100% pure-play regulated vertically integrated electric utilities in Missouri cause its cost of equity to be higher than her proxy group.[33] Does any of Ms. Bulkley's testimony recognize that her proxy group has companies with significant non-regulated business-risk exposure?**

A. No. As I indicated when discussing Ms. Bulkley's proxy group, she includes the following companies that have significant non-regulated business exposure: Allete Inc. and NextEra Energy Inc. Non-regulated generation operations expose the companies to commodity market price volatility. While utility companies rely on commodities (*i.e.* natural gas, coal, nuclear fuel, renewable power projects, etc.), they are not exposed to gains and losses from changes in prices of commodities. This is not true for companies engaged in merchant power projects.

While I admit there are very few pure-play regulated utilities, let alone pure-play vertically-integrated electric utilities, to develop a larger proxy group, it is important to recognize that many of the proxy companies used to estimate the COE for a regulated electric utility do have this exposure. To only focus on the selected proxy companies' regulated operations, and perceived risks related to their regulatory ratemaking constructs, to attempt to justify an authorized ROE above the proxy group, should be duly noted as to the weight given to this comparative analysis.

[33] Bulkley Direct, pgs. 49-66.



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**Q. What is your response to Ms. Bulkley's discussion related to her views on MO West's specific business and regulatory risks?**

A. Ms. Bulkley essentially maintains that because MO West plans to invest more in its system over the next few years, customers should pay a higher ROR because of higher risk. Around 2021, at the behest of the activist investor group, Elliot Management, Evergy underwent a strategic change in its strategy to enhance shareholder value. As part of this strategic initiative, Evergy changed its strategy of issuing debt to buy back common stock to issuing capital to take full advantage of plant-in-service accounting ("PISA") ratemaking mechanism allowed in Missouri. Evergy's current and planned scale of investment in its Missouri electric utility systems will create a tremendous amount of value for Evergy's shareholders. As the scale of investment increases, the higher the allowed ROR over the cost of capital, the higher the net present value created for shareholders. Under this scenario, management is incentivized to pursue all projects it believes will be allowed in rate base because the mere process of investment causes an increase to shareholder wealth above the minimum required return. However, this excess shareholder wealth is derived at the expense of ratepayers. This is the economic rationale for attempting to set utility companies' ROR as close to the cost of capital as possible, because otherwise the scales are tilted in favor of inefficient investing for the sake of maximizing shareholder wealth.

**Q. Ms. Bulkley also claims that the elevated capital expenditures will cause pressure on MO West's credit ratings. She also states that PISA does not reduce MO West's cost of capital.[34] Does this make sense in light of investors initiative in 2022 to cause Evergy to cease buying back stock by issuing holding company debt and instead, invest in its utilities?**

A. No. A primary factor driving Evergy's change in strategy was the additional value Evergy could create for its shareholders by pursuing increased rate base growth in each of its jurisdictions, but specifically Missouri because of the incentives related to utility supportive legislative measures.

[34] *Id.*, p. 49, lns. 1-7 and p. 53, lns. 1-15.



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**Q. Did Ms. Bulkley attempt to minimize the favorability of the original PISA law in MO West's 2022 rate case?**

A. Yes. She had testified that because MO West was not assured it could continue to utilize PISA past 2023 (unless the Commission approved an extension through 2028) and because PISA limited MO West's compound annual growth rate ("CAGR") in retail rates to no more than 3%, this exposed MO West to additional risk than if these limitations weren't in place.

**Q. Has the PISA law been amended since MO West's 2022 rate case to lengthen the period in which Missouri utility companies can elect PISA without having to petition the Commission to do so?**

A. Yes. Missouri's legislature passed Senate Bill 745 during the 2022 legislative session. The amended PISA law allows Missouri electric utility companies to continue to use PISA through December 31, 2028, without being required to petition the Commission to do so. Additionally, only companies' base rates are subject to a CAGR rate cap of 2.5% under the amended law.

**Q. Does the amended PISA law include language acknowledging potential ratemaking consideration (through the allowed return) for business risk changes due to the ability to elect PISA?**

A. Yes. SB 764 specifically states the following:

> The commission may take into account any change in business risk to the corporation resulting from implementation of the deferrals in setting the corporation's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

**Q. Did Ms. Bulkley give any credit to the changes in the Missouri legislative and regulatory environment in estimating a fair and reasonable ROR for MO West?**

A. No.



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**Q. Did Evergy lobby the Kansas legislature in its 2024 session to authorize PISA for Evergy's Kansas utilities?**

A. Yes. Evergy claimed that Kansas needed to adopt PISA in order to attract capital investment in Kansas. Evergy maintained that because this mechanism is allowed in neighboring states (*e.g.* Missouri), authorizing PISA in Kansas would allow Evergy's Kansas operations to have "…competitive or equitable regulatory treatment and will encourage investment to encourage economic development and generation adequacy."[35]

**Q. What ROE did the KCC authorize Evergy's Kansas utilities before passage of PISA legislation?**

A. 9.3%.

**Q. What ROE did the MOPSC authorize Evergy's Missouri utilities before PISA was allowed?**

A. 9.5%.

**Q. What jurisdiction is currently more investor-friendly?**

A. Missouri.

**Q. How do you recommend the Commission explicitly consider MO West's reduced business risk related to its ability to elect PISA?**

A. By setting MO West's authorized ROR based on Evergy's more leveraged capital structure. In MO West's 2018 rate case, which occurred prior to the passage of the PISA law, MO West requested its authorized ROE be applied to a 51.75% common equity ratio. In this case, MO West requests its authorized ROE be applied to a 52.04% common equity ratio. This is illogical considering the fact that reduced business risk increases a company's debt capacity, while allowing it to maintain the same credit rating. Given that many Evergy investors consider Missouri's regulatory environment to be more shareholder-friendly than

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[35] State of Kansas House Committee on Energy, Utilities and Telecommunications, February 6, 2024, "Evergy Testimony (Chuck Caisley, Chief Customer Officer): HB 2527 – Proponent." See: https://kslegislature.org/li/b2023_24/committees/ctte_h_energy_utilities_and_telecommunications_1/documents/?date_choice=2024-02-06



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Kansas' regulatory environment, Evergy's Missouri ratepayers should be compensated for this reduced business risk by paying a ROR consistent with Evergy's more optimized capital structure, which had a common equity ratio below 45% as of March 31, 2024 and December 31, 2023.

*STAFF'S RECOMMENDED ROE:*

**Q. What is Dr. Won's recommended allowed ROE?**

A. Dr. Won recommends an ROE of 9.74%, which is the mid-point of his ROE range of 9.49% to 9.99%.

**Q. Can you summarize the analysis Dr. Won performed for purposes of his testimony?**

A. Yes. Dr. Won performed a COE analysis using two COE methods/models – a constant-growth DCF and the Capital Asset Pricing Model. Using these two COE methods, Dr. Won estimated the electric utility industry's COE to be in the range of 7.64% to 10.32%.

Dr. Won also performed a risk premium analysis which he classified as a bond yield plus risk premium (BYPRP) model. Dr. Won classified his BYPRP method as an "ROE" estimation approach rather than a COE estimation method. Dr. Won's indicated ROE using this approach was in the range of 9.73% to 9.75%.

**Q. What methodology did Dr. Won rely for purposes of developing his recommended ROE?**

A. His BYPRP method. He applied a +/- 25 basis point adjustment to his mean indicated ROE of 9.74% to arrive at a range of 9.49% to 9.99%.

**Q. Is Dr. Won's BYPRP methodology in this case different from those he applied in past rate cases?**

A. Yes.



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**Q. How so?**

A. In past rate cases, Dr. Won simply added a generic risk premium to a recent utility bond yield to estimate the COE. In this case, Dr. Won performed a regression analysis of bond yields to authorized ROEs from 2014 through early 2024 to determine the impact bond yields had on authorized ROEs.

**Q. Is Dr. Won's BYPRP analysis similar to Ms. Bulkley's risk premium approach?**

A. Yes. Ms. Bulkley compared authorized ROEs to bond yields. The key differences between her analysis and Dr. Won's analysis is the following:

- Dr. Won regressed authorized ROEs against utility bond yields, whereas Ms. Bulkley used 30-year UST yields;
- Dr. Won used data since 2014 whereas Ms. Bulkley used data since 1980;
- Dr. Won analyzed monthly interval data whereas Ms. Bulkley analyzed quarterly interval data.

**Q. Do you agree with Dr. Won that this type of risk premium analysis should not be characterized as a COE analysis?**

A. Yes. My own COE analysis since at least 2010 has consistently established that authorized ROEs are higher than the COE. I have also consistently and frequently provided corroborating information/analysis from the investment community and from utility companies' internal analysis that corroborate the fact that authorized ROEs are higher than the COE.

**Q. Considering such, what does Dr. Won's regression analysis prove about authorized ROEs since 2014?**

A. That they are "sticky" as investors often characterize them. Applying Dr. Won's regression equation to the lowest monthly bond yield of 2.77% since 2014 indicates an ROE of 9.6% would be appropriate. Applying the regression equation to the highest bond yield of 6.05% since 2014 indicates an ROE of 9.76% would be appropriate.

**Q. Considering the narrow range of only 16 basis points based on Dr. Won's regression analysis, is it logical to recommend an ROE range of 50 basis points?**

A. No. The Commission should disregard any ROE above 9.75%. However, considering my 9.5% ROE recommendation is still 100 basis points over the COE, I still recommend the Commission adopt my point recommendation.

## SUMMARY AND CONCLUSIONS

**Q. Can you summarize your main conclusions related to your rebuttal testimony in this case?**

A. Yes. MO West recommends the Commission set its authorized ROR based on an approximate 52% common equity ratio. Evergy is targeting a higher-cost capital structure for MO West than it targets for itself on a consolidated basis. Evergy's strategy is to optimize the use of debt at the consolidated level rather than at its subsidiaries. This strategy increases shareholder wealth at the expense of ratepayers. Before GPE and Westar merged, MO West's previous parent company, GPE, did not issue holding company debt. Under GPE's ownership, MO West and Evergy Metro funded GPE's dividend obligations and issued their own debt capital to fund liquidity needs. Under Evergy's ownership, Evergy uses holding company debt to fund dividends, causing MO West and Evergy Metro to function much less as a traditional stand-alone entity. Under GPE's ownership, MO West and Metro accepted the use of GPEs' consolidated capital structure for ratemaking because it was not more levered/optimized than the ratios maintained at the subsidiaries. Under GPE's ownership, MO West and Metro's authorized common equity ratios were typically around 50% or even lower. These ratemaking equity ratios are consistent with two companies in Ms. Bulkley's proxy group that either do not have a holding company corporate structure, Portland, or have a holding company corporate structure, but do not issue holding company debt. The most market-based capital structure is Evergy's on a consolidated basis. Therefore, the Commission should consider Evergy's common equity ratio to set a fair and reasonable ratemaking common equity ratio for MO West.

The Commission should not increase MO West's authorized ROE above 9.5%. While I agree with Ms. Bulkley that MO West's COE has increased since 2022, I do not agree it is above the previous authorized ROE of 9.5%. As I demonstrated in my capital budget example, Evergy can still create excess wealth for its shareholders when the COE is below authorized returns. Authorizing an ROE at significant margins over the COE creates inefficient incentives to invest in one jurisdiction over the other. Investors already view Missouri has a more investor-friendly jurisdiction compared to KS and IL. The Commission should not boost MO West's authorized return higher than it already is. Otherwise, Missouri runs the risk of overallocation of capital, which is funded at ratepayers' expense.

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

A. Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of Evergy Missouri West, Inc. d/b/a Evergy Missouri West's Request for Authority to Implement A General Rate Increase for Electric Service | ) ) ) ) ) | <u>Case No. ER-2024-0189</u> |

## <u>AFFIDAVIT OF DAVID MURRAY</u>

**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
Utility Regulatory Manager

Subscribed and sworn to me this 5th day of August 2024.

TIFFANY HILDEBRAND
NOTARY PUBLIC - NOTARY SEAL
STATE OF MISSOURI
MY COMMISSION EXPIRES AUGUST 8, 2027
COLE COUNTY
COMMISSION #15637121

Tiffany Hildebrand
Notary Public

My Commission expires August 8, 2027.