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Case No.: GR-2024-0106
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Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

John Cochrane

on behalf of

Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty

September 19, 2024

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LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. D/B/A LIBERTY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is John Cochrane. My business address is 200 State St, 9th Floor, Boston, Massachusetts. I am a Senior Managing Director in the Power, Renewables & Utilities practice at FTI Consulting, Inc. ("FTI").

Q. Are you the same John Cochrane who provided direct and rebuttal testimony in this matter on behalf of Liberty Utilities (Midstates Natural Gas) Corp. ("Midstates Gas", "Liberty" or the "Company")?

A. Yes.

II. PURPOSE

Q. What is the purpose of your surrebuttal testimony in this proceeding?

A. I will respond to the rebuttal testimony of Mr. Walters, who is representing Staff, on capital structure and return on common equity. I will also respond to the rebuttal testimony of Mr. Murray of the OPC, on capital structure, cost of debt, and return on common equity.

Q. Why are you not responding to Mr. Walters on the cost of debt?

A. Mr. Walters' recommended cost of debt, 5.58% in his direct testimony, represents my updated actual cost of debt for Midstates Gas as of December 31, 2023, and reflects the Commission-authorized long-term debt financings completed on December 15, 2023. The Company agrees with and accepts Mr. Walters' recommendation.

III. CAPITAL STRUCTURE AND COST OF DEBT

A. Response to Staff Rebuttal Testimony on my Recommended Capital Structure

Q. Has Mr. Walters updated his common equity ratio recommendation in his Rebuttal testimony?

A. No, he is still recommending a 50.0% common equity ratio.

Q. What are his concerns with your Midstates Gas 52.9% (updated to 52.5% based on actuals) common equity ratio recommendation as of December 31, 2023?

A. Mr. Walters states that I acknowledge the mean and median for my proxy group were both 50% common equity and 50% long-term debt, with a range from 37% to 61% for the common equity ratio. He further states my 52.9% (updated to 52.5%) exceeds the mean (50%), median (50%), and midpoint (49%) of my proxy group.

Q. Is that his only rebuttal comment to your common equity recommendation?

A. No. He also repeats the same selective quote from an October 25, 2023 Commission Order in Case No. WR-2023-0006 that he used in his Direct testimony. The quote he chose simply states that "the Commission finds that staff's proposed hypothetical capital structure of 50% common equity and 50% debt is appropriate in this case…." Mr. Walters equates a single Commission decision in a 2023 water utility rate case with setting a precedent for all utility common equity ratios, and more specifically Midstates Gas. He believes my initial recommendation of 52.9%, as well as Midstates Gas's actual common equity ratio of 52.5% as of December 31, 2023, should be disregarded, along with his own direct testimony evidence presented in Table CCW-2 on State Authorized Common Equity Ratios for natural gas distribution utilities.

Q. What did Table CCW-2 show?

A. The table showed that the average state utility commission authorized ROE for natural gas distribution utilities over an eleven year and five-month period ending May 31, 2024, was 51.80%, with a minimum of 49.79% in 2015 (next lowest year was 2017 at 51.13%) and a max of 52.72%. The more recent results for 2023 and 2024 were 52.45% and 52.25%. All of these results exceed his recommended 50% common equity ratio and further support my updated recommendation of 52.5%.

Q. How else do you respond to Mr. Walters' rebuttal testimony on capital structure?

A. In my direct testimony, I demonstrated that the average and median common equity ratios for my proxy group were 50.0% over a recent eight-quarter period, with a range of 37% to 61% for the group during that time. I also showed Midstates Gas's 13-month average and year-end 2022 common equity ratios of 61% and 56%. I then showed pro-forma results on December 31, 2023 of 52.9% common equity, which I have updated to actuals of 52.5% on December 31, 2023. I then stated that "my 52.9% common equity ratio is below the historical Company levels and within the range of my proxy group." My 52.9%/52.5% common equity recommendations were based on Midstates Gas's actual capital structure and supported by the range of the proxy group.

Q. Did you show any additional analysis supporting your common equity recommendation?

A. Yes, I showed the common equity ratios for LUCo, Midstates Gas's parent company, and APUC on December 31, 2022 (Direct Schedules JC-18 and JC-19) of 68.8% and 65.7%, respectively. Both of these ratios are higher than my recommendation for Midstates Gas. These ratios show that LUCo and APUC are financed more conservatively than Midstates Gas.

Q. What are your final comments on Mr. Walters' common equity recommendation?

A. Mr. Walters presents no new evidence for his 50% recommended common equity ratio in his rebuttal testimony. He ignores the actual common equity ratios of Midstates Gas at year-end 2022 and 2023, the actual equity ratios of Midstates Gas's direct and ultimate parents, which are higher, and finally the results from his own industry authorized ROEs in Table CCW-2. Therefore, the Commission should ignore his 50% recommendation.

B. <u>Response to OPC Rebuttal Testimony on my Recommended Cost of Debt and Capital Structure</u>

Q. Has Mr. Murray updated his common equity capital structure recommendation of 47.5% or 3.97% cost of debt?

A. No, he did not. In his Summary and Conclusion, he states "Liberty Midstates' capital structure is not market-based. Therefore, the appropriate ratemaking capital structure and cost of debt for purposes of setting Liberty Midstates' authorized ROR is that which is consistent with LUCo's typical 'targeted capital structure' and embedded cost of debt as of December 31, 2023." He further states the Commission should follow their prior decisions in Liberty Midstates' 2014 rate case, Case No. GR-2014-0152, in Liberty Water's 2018 rate case, Case No. WR-2018-0170, and The Empire District Electric Company's 2019 rate case, Case No. ER-2019-0374.

Q. Can you comment on Mr. Murray's statements above?

A. Yes, I will discuss later in my testimony his first statement that "Liberty Midstates' capital structure is not market-based". As for his other statements, his cost of debt recommendation is still based on his calculation of LUCo's embedded cost of debt of 3.97% on December 31, 2023. The only support for his capital structure recommendation is LUCo's "typical targeted capital structure", which I presume is the 47.5% he recommended in his direct testimony.

Q. Did you address his 47.5% "typical targeted capital structure" in your rebuttal testimony?

A. Yes. As I discussed, Mr. Murray's 47.5% recommendation is based on his interpretation of a September 2017 Liberty Utilities Fixed Income Presentation, which is seven years old and clearly out of date. It is of no relevance for a 2024 rate case for Midstates Gas. Mr. Murray has cited this 2017 presentation in past Liberty Missouri utility company cases to support his 47.5% common equity recommendation for Liberty-affiliated Missouri utilities. He doesn't point to or provide any analytical support for his recommendation in this case. The only common equity ratio calculations he performed were for LUCo for 2021-2023, using three different methods. His ratio results were 57.63%/50.14%/54.29% for 2021 based on Per Books, Adjusted and Adjusted and Excluding Short-Term Debt, 61.11%/57.29%/59.55% for 2022, and 60.38%/56.54%/61.39% for 2023. I also included corrected ratios due to some errors we found in Mr. Murray's calculations for 2022 and 2023. The corrected results for the Adjusted and Excluding Short-Term Debt ratios were 63.98% instead of 59.55% in 2022 and 66.90% instead of 61.39% in 2023. All of these results are significantly higher than Mr. Murray's 47.5% common equity ratio recommendation and more in line with my 52.9% (52.5% updated) recommendation.

Q. Did Mr. Murray provide calculations for Midstates Gas or APUC capital structure ratios as he has in the past?

A. No, he did not despite providing and using these calculations in past cases to support his recommendations. It should be noted his calculations utilizing similar methodologies have been used by the Commission to support their determinations regarding calculating capital structure ratios for Midstates Gas and other Liberty Missouri utility companies. Furthermore, it should be added that Mr. Murray has not performed these calculations for this case even though he references a number of those prior cases to support his recommendation within this case.

Q. Did Mr. Murray provide a reason for not providing his typical Midstates Gas and APUC calculations or using the results of his LUCo calculations?

A. Similar to his direct testimony, he did not. I continue to conclude he did not include or reference the LUCo calculations that he performed in Schedule DM-D-3 because the actual results, as I showed above for LUCo (and included in my direct and rebuttal testimonies for Midstates Gas and APUC), do not support his 47.5% common equity ratio recommendation. Therefore, he resorts to referencing a seven-year-old, out of date, irrelevant fixed income presentation to support his interpretation of what Midstates Gas's common equity ratio should be. Rather than presenting any new factual information or calculations to support his recommendation in his rebuttal testimony, he instead offers several misleading, inaccurate, and irrelevant statements on pages 2-8, which he claims support his recommendation and his incorrect assertion that "Midstates' capital structure is not market-based."

Q. Can you comment on his references to the Commission following their decisions in Midstates Gas's 2014 rate case, Missouri Water's 2018 rate case and The Empire District Electric's 2019 rate case?

A. Yes. In all those cases, which it should be noted are 5, 6 and 10 years old, the Commission looked at LUCo's adjusted capital structure to determine the common equity ratio for the Liberty Missouri utility. In this case, instead of following similar analysis which in some cases Mr. Murray himself used, Mr. Murray ignores the actual results of his only analysis for LUCo in DM-D-3 as I discussed above. Even though Mr. Murray does not perform any analysis for Midstates Gas and APUC, he asks the Commission to base its decision for Midstates Gas common equity ratio on a seven-year-old 2017 fixed income presentation that represents an opinion of Mr. Murray versus factual current evidence. If the same decision-making process is followed by the Commission as they did in the previously referenced cases, then my 52.5% updated recommended ratio should be approved and Mr. Murray's recommendation should be disregarded.

Q. Can you address Mr. Murray's additional statements on pages 2-8?

A. Yes, I will begin with page 2, line 19, where he poses the question, "Do the affiliate financing transactions [that] LUCo executes with Liberty Midstates Gas have a legitimate economic purpose other than creating an internally assigned capital structure and cost of debt?"

Q. Did Mr. Murray explain what this question means?

A. No, he did not. Additionally, I struggle to understand the purpose of the statement.

Q. Explain.

A. His response to the question above was "No". His support for that response is that "in the past Liberty Midstates' affiliate Promissory Notes matured months, if not years, before they were replaced with other affiliate Promissory Notes." His most recent example of this "illegitimacy" (the inappropriate use of this term was never explained by Mr. Murray) was a $25.6 million affiliate note that matured on August 1, 2022. The note's maturity was initially extended to May 1, 2023, and then again to December 15, 2023, when it was replaced. Mr. Murray believes "LUCo's primary goal through the extensions was to update Liberty Midstates capital structure ratios (reclassify short-term debt to long-term debt) and assigned costs of debt to support its application for a rate increase."

Q. Does Mr. Murray's support his "illegitimacy" claim or his original statement/question above?

A. No. First, the fact that the $25.6 million Promissory Note matured according to its terms in August 2022 and was extended twice to December 2023 is a perfectly legal financing transaction. This extension is fully allowed under the terms of the Promissory Note which was authorized by an Order from both the Commission and the Illinois Commerce Commission. Second, Mr. Murray fails to realize that Midstates Gas cannot simply issue new debt when it wants to. The Company needs approval from both the Missouri and Illinois public service commissions to issue new long-term debt. LUCo and Midstates Gas agreed to extend the maturity date to May 2023 and subsequently to December 2023, while awaiting long-term debt financing approvals which were ultimately received from the commissions. The financing applications were filed in 2023 for both jurisdictions. The Illinois Commission Order was received on December 14, 2023, after the Commission's approval in 2023, and $90.6 million of new long-term debt was priced at market rates and issued on December 15, 2023. Third, Midstates Gas replaced long-term debt with long-term debt regarding the $25.6 million Note, and the additional $65 million was needed to reduce short-term debt levels which had grown during 2022 and 2023 while the financing approvals were pursued with the respective commissions. This is not unusual and is a common practice amongst all utility companies.

Q. Does Mr. Murray continue his incorrect statements regarding the $25.6 million Note maturity?

A. Yes, he continues on page 3 with the question and answers (Q&A) starting on line 12 through page 4 line 8. His Q&A on lines 12-17 discusses how much money-pool borrowings Midstates Gas has outstanding on December 31, 2021 and 2022 and June 30, 2022. Money-pool borrowings through LUCo is how Midstates Gas is provided short-term debt financing before it obtains long-term permanent financing in the form of long-term debt and common equity, which are both provided by its parent LUCo. The money-pool has been approved by the Commission and all of the many other required state commissions where Liberty operates. The money-pool is simply the vehicle through which the Liberty utility subsidiaries obtain short-term debt financing. He then continues on in his Q&A on page 3 lines 18-22 asking “if the terms of the $25.6 million Promissory Note had been updated at its August 1, 2022, maturity date could the size of the Note been increased to pay down some short-term debt.” His answer was “Yes” and then in Q&A on page 3 lines 23-28 he states that “these events establish the illegitimacy of these internal transactions.”

Q. How do respond to Mr. Murray’s Q&A on page 3 lines 18-28?

A. Mr. Murray’s Q&A on page 3 lines 18-22 asks an obvious question that has an obvious answer. If Midstates Gas had Missouri and Illinois Commission approval to issue new long-term debt on August 1, 2022, could it have issued more than $25.6 million of Notes and paid down some short-term money-pool debt. The answer is an obvious yes, but the fact is Midstates Gas was unable to do so due to the need for Commission approvals. As a result, it extended the Note's maturity date to May 2023 at the same interest rate, rather than paying it off with additional floating-rate short-term money-pool debt. The Company subsequently filed financing applications in Missouri and Illinois in 2023, seeking authority to issue $90.6 million of new long-term debt. All these events are far from "illegitimate" and despite Mr. Murray's assertions, are simply normal course company financing decisions. His final Q&A on page 4, lines 1-8, once again states the obvious: that Midstates Gas issuing new long-term debt allows for the paydown of short-term money-pool debt ("internal capital transfers"), and that the interest rates between the two could differ, potentially impacting the revenue requirement.

Q. Do you have any comments on Mr. Murray's Q&A from page 4 lines 1-8?

A. Yes, short-term interest rates are typically different from long-term rates, with short-term rates usually being floating and long-term rates typically fixed. Additionally, new long-term debt can be used to pay down short-term debt if it is outstanding. I would also note that Mr. Murray has referred to intercompany short-term money-pool debt as "internal capital transfers," which I have never heard this term/phrase used in my many years of experience in finance and as a utility Chief Financial Officer.

Q. How do you respond to statements Mr. Murray makes on page 4, line 9 through page 5, line 23?

A. First, his stated short-term money-pool debt balances are correct. However, his 6% deferred gas costs on March 31, 2023 is incorrect. Based on the response to DR 59, the correct number should be 18%. Second, he states that he could not find the money pool balances in Midstates Gas's financial statements and that a note in the response to DR 59 states "always refer to the financial statements." The reason money-pool balances are not shown separately on the financial statements is because they are short-term affiliate transactions and under GAAP accounting, they are properly included in accounts payable. Mr. Murray has made this assertion numerous times in the past in Liberty Missouri utility company rate cases. As to the note in the response to DR 59, what Mr. Murray neglected to mention is that the response also included long-term debt, preferred stock, redeemable non-controlling interests, common equity, short-term debt in excess of CWIP and deferred gas costs, short-term debt, CWIP and deferred gas costs for APUC, LUCo and Midstates Gas for 2022 through 2023 by quarter. Therefore, there were many other items included in the response to DR 59 that would have been visible on the financial statements. Third, he refers to DM-R-1 regarding Midstates Gas's short-term debt representing 20% to 30% of its capital structure for year-end 2021 through year-end 2023 by quarter. The actual range is 7% to 30% and his short-term debt percentages have not been adjusted down for outstanding CWIP and deferred gas cost balances. Lastly, Mr. Murray neglects to mention that Midstates Gas's common equity ratios from the same Schedule DM-R-1 range from 50% to 60% which are significantly higher than his 47.5% common equity recommendation. Fourth, on page 5 lines 20-23 his Q&A asks whether any other utility company accountable to third party investors would ever have short-term debt balances in the 20% to 30% of total capitalization. His answer is "No", but he provides no factual support or references for that statement. Despite not providing any evidence, he concludes that "this situation demonstrates the inconsequential nature of LUCo's internal bookkeeping, at least from a cost of capital perspective." It is unclear what Mr. Murray means by this last statement. However, the facts and statements supporting it are incorrect for all the reasons I have stated above. All of his statements on pages 4 and 5 are irrelevant to determining the appropriate common equity ratio for Midstates Gas and should be ignored by the Commission.

Q. How do you respond to Mr. Murray's next set of statements regarding Midstates Gas at pages 6 through 7?

A. Starting on page 6 line 1 and continuing through page 7 line 28, Mr. Murray describes the recent December 15, 2023, $90.6 million 10-year intercompany debt financing Midstates Gas issued to LUCo. The actual issuance date and pricing was on December 15, 2023, and the Notes are dated that date. There was a minor error in Direct Schedule JC-17. The issue date for the new $25.6 and $65 million Notes should have been December 15, 2023, not December 14. The Illinois Commission Order came on the 14th of December. As to his statements on page 6 regarding the JP Morgan pricing schedule, the December 15, 2023 pricing for LUCo 10-year bonds **[redacted]** due to "the significant financial uncertainty related to APUC's investment and divestment strategies over the last couple of years," there is simply no mention of that anywhere in the JP Morgan pricing schedule pages and is wholly unsupported. As to his **[redacted]** he asks on Line 12 if these higher costs were assigned to Midstates Gas's affiliate notes issued in December 2023. His answer was "Yes", but Mr. Murray seems to have made an incorrect conclusion that the differences in LUCo bond yields in September 2023 versus the JP Morgan Index would still be the same in December 2023. There is no evidence presented anywhere in his rebuttal testimony or anywhere else supporting that statement.

Regarding his conclusion at page 7, lines 26-28 that APUC's internal promissory note assignment process does not follow the same careful consideration to reduce the cost of capital charged to its operating subsidiaries, somehow Mr. Murray reached this conclusion simply because APUC's acquisition of Kentucky Power was cancelled and therefore it didn't need $600 million of additional financing. This does not demonstrate careful consideration but rather common sense. Issuing $600 million of long-term debt without a stated need would be illogical. This was simply a routine and obvious company decision. Therefore, Mr. Murray's unfounded conjecture should be disregarded by the Commission.

Q. Please provide background on The Empire District Electric Company ("Empire") case, Case No. ER-2019-0374, referenced by Mr. Murray on page 8 of his rebuttal testimony.

A. On June 1, 2018, a $90 million intercompany note was issued to LUCo to replace a similar amount of long-term debt at Empire that had matured. The note was based on LUCo's most recent long-term financing which was March 24, 2017. The Commission in its Order in Case No. ER-2019-0374 concluded that (1) no market pricing was performed at the time of the issuance and that (2) the overall rate on the LUCo March 2017 financing of 4.53% was not appropriate because short-term debt had been borrowed by LUCo to fund the intercompany note. Therefore because of reasons (1) and (2), the $90 million note was treated as short-term debt.

Q. How has Liberty's Missouri utility companies priced intercompany long-term debt with LUCo since the 2019 decision in Case No. ER-2019-0374?

A. In subsequent Liberty Missouri utility company financing applications, all new intercompany debt issuances are priced at LUCo's market rates, based on pricing provided by investment banks, for the appropriate term of the debt on the day of issuance. This pricing mechanism has been approved by the Missouri Commission and was most recently utilized by Midstates Gas in December 2023 as Mr. Murray pointed out in his rebuttal testimony in DM-R-2. Therefore, Mr. Murray's mention of the Empire 2019 case and the debt pricing issue is out of date and no longer relevant and should be ignored by the Commission in making a determination in this case.

Q. At page 8, lines 10 and 11 of his rebuttal testimony, Mr. Murray states that the most effective method for the Commission to use to ensure Midstates Gas's customers are not charged for financing costs that are higher than cost or market rates is "by using LUCo's cost of debt and previous targeted capital structures to set Midstates Gas's authorized ROR." How do you respond?

A. His 47.5% common equity recommendation is solely based on his interpretation of a 2017 fixed income investor presentation that is seven years old. He ignores his own analysis for LUCo's capital structure results for 2021, 2022, and 2023 in DM-D-3 and DM-R-1, which supports my recommendation, and provides no analysis for APUC and Midstates Gas as was historically calculated and reviewed and approved by the Commission in the past cases he referenced within his rebuttal testimony. His entire capital structure support is based on misstatements and misrepresentations of the actual facts. Therefore, the Commission should ignore his recommendation and adopt my 52.5% common equity recommendation.

Q. Mr. Murray does not change his 3.97% cost of debt recommendation from his direct testimony. How do you respond?

A. As presented in his direct testimony, the 3.97% is based on his calculation of LUCo's embedded cost of debt on December 31, 2023. He provides no further support or evidence for this recommendation outside of additional misstatements and misrepresentations of the actual facts as I stated and addressed above. I instead presented multiple reasons in my rebuttal testimony as to why Mr. Murray's recommendation to use LUCo's embedded cost of debt is inappropriate. The 3.97% includes (1) debt actually issued directly to investors, and the proceeds directly used by other LUCo utility subsidiaries, (2) a substantial amount of LUCo and GP1 debt was issued prior to APUC's acquisition of Midstates Gas, (3) the 3.97% is based on LUCo's total debt outstanding of approximately $2.1 billion, not the $120 million currently outstanding at Midstates Gas, $90.6 million of which was issued on December 15, 2023, and (4) the actual pricing mechanism for the $90.6 million of debt issued on December 15, 2023, was approved by the Missouri and Illinois Commissions prior to the filing of this rate case. The resulting 5.774% coupon for Midstates Gas's long-term debt was based on market pricing on the date of issuance and was provided by a third-party investment bank as stated in the application and approved by the Commission. Based on factual evidence I have presented, Mr. Murray's cost of debt recommendation should be disregarded by the Commission.

IV. <u>RETURN ON COMMON EQUITY</u>

Q. What was your ROE recommendation for Midstates Gas?

A. My recommended range in my direct testimony was 10.43% to 11.28% with the midpoint and my recommendation of 10.78%. In my rebuttal testimony, my range and midpoint did not change, but the Company has decided movement to 10.0% is more appropriate in an effort to reduce issues in the case and lessen the overall rate increase impact on customers.

A. <u>Response to Staff's Rebuttal Testimony on my Recommended Return on Common Equity</u>

Q. Mr. Walters takes issue with your cost of equity recommendation asserting the low-end of my recommended range exceeds the average authorized ROE for natural gas utilities. How do you respond to such criticism?

A. Mr. Walters' recommended range is 9.0% to 9.9% and his midpoint is 9.45%. His range is based on constant growth DCF results ranging from 9.64% to 9.92%, DCF results based on sustainable growth rates of 8.47% to 8.58%, multi-stage DCF results of 7.93% to 8.10%, CAPM results of 8.76 to 11.03% and risk premium results of 9.83% to 10.19%. When you exclude the results of his sustainable growth rate DCF and multi-stage DCF, his range becomes 8.76% to 11.03% with a mid-point of 9.90%. These results are closer to my original recommendation and even closer to the Company's proposed 10.0% return on equity in my rebuttal testimony.

Q. Why are you excluding Mr. Walters' sustainable growth and multi-stage DCF results?

A. Mr. Walters criticizes my range and some of my specific results for being too high. Correspondingly I take issue with some of his results for being too low. As discussed in my rebuttal testimony, Mr. Walters 8.47% to 8.58% sustainable growth DCF and 7.93 to 8.10% multi-stage DCF results are lower than any State Commission Authorized ROE for a gas distribution utility over the last 45 years. There is also evidence provided in Mr. Walters' direct testimony in Table CCW-1 (Distribution of Authorized ROEs 2016-2024) that provides further support that the results of these two DCF analyses are too low. The lowest average ROE result was 9.47% and the range was 9.47% to 9.93%. These are all well above the results of his sustainable growth rate and multi-stage DCF results.

Q. Mr. Walters criticizes your constant growth DCF results. What are the sources for your and Mr. Walters' earnings growth rates?

A. I used Zacks, Value Line and Yahoo Finance for my gas proxy group while Mr. Walters used Zacks, SNL and Reuters for his sources for his multi-utility proxy group. My Value Line average growth rate was 7.64% with a range of 6.0%-10.0%, Yahoo 5.86% with a range of 2.8% to 8.3% and Zacks 5.63% with a range of 3.7% to 7.3%. Mr. Walters results for Zacks were 6.22% with a range of 5.0%-8.0%, SNL 6.59% with a range of 3.0% to 9.0% and Reuters 5.66% with a range of 2.7% to 10.8%. Mr. Walters and I both used Zacks but we then used two different additional sources. I will note that Mr. Walters used Value Line as the source for a number of his inputs in his sustainable growth rate DCF analysis, multi-stage and CAPM but for some reason didn't use Value Line as one of his sources for projected earnings growth rates in his constant growth DCF analysis.

Q. Are Value Line and Yahoo widely used by investors as sources?

A. Yes, they are as is Zacks.

Q. What can you conclude in terms of the different sources?

A. That there are many sources for investors for future earnings growth rate estimates. The range of estimates for each gas distribution utility is quite wide and there is no basis to conclude that one reputable analyst's estimate is any better or worse than another's. Finally, in terms of methodology, Mr. Walters simply averaged all his estimates and didn't take into consideration the range of variability in the estimates, which I did through my low, mid and high averages.

Q. Why do you think Mr. Walters asserts you should give more weight to your low estimate?

A. Simply because my low estimated average constant growth rate for my proxy group is 5.37%, which is below his average growth rates for his multi-utility proxy group of 6.02%-6.09%. My results using the 5.37% are closer to his results, which are lower. The fact remains there are many different sources and estimates available to investors for projected earnings growth rates and they all should be taken into account including the highs, lows, and mid-points.

Q. How do you address Mr. Walters' other comment on your constant growth rates exceeding the projected GDP growth rate of 4.14% he used in his multi-stage analysis?

A. I will further address Mr. Walters' use of the projected GDP growth rate of 4.14% later in my surrebuttal testimony but as to his specific statement regarding growth rates not being sustainable if they exceed the growth rate of GDP, that statement is subject to substantial debate. However, if you accept his premise that 4.14% is the proper long-term growth rate, which I do not, then that should be used as the growth rate in his constant growth analysis as well as mine since his average growth rates as well as my low, mid, high average growth rates all exceed the 4.14%. His multi-stage results, which use the 4.14%, are clearly too low (7.93%-8.10%) and if the 4.14% were used in his constant growth DCF analysis they would also produce results that are too low, 7.38%-7.71% (**Surrebuttal Schedule JC-1**). These results are even lower than his multi-stage and sustainable growth DCF results and clearly lower than any State Authorized ROE for a gas distribution utility in the last 45 years.

Q. Can you address Mr. Walters response to your multi-stage DCF analysis?

A. Yes. Mr. Walters believes my "projected GDP growth rate" is not market based and is my personal view. He uses a different source, Blue Chip Financial Forecasts, to determine his GDP projected growth rate and then provides some additional sources that he feels supports his 4.14%.

Q. How did you calculate your long-term growth rate?

A. I calculated the real GDP growth rate over the period 1929 to 2023 which averaged 3.18% and added average projected inflation of 2.32%. The result was 5.50%. I simply used actual results over a long period of time to determine a long-term perpetual growth rate versus his average of a survey of respondents.

Q. Can you further address Mr. Walters' criticism of your long-term growth rate?

A. Yes. As opposed to debating who is using the correct long-term growth rate estimate, because there is not an exact measurable one, I instead will simply look at the results of each multi-stage analysis. Mr. Walters' analysis results in a range of 7.93% to 8.10%, which is well below any State Authorized ROE for a gas distribution utility in the last 45 years, as shown in my rebuttal testimony. His result is also below historical results presented in his direct testimony in Table CCW-1 (Authorized ROEs 2016-2024). In contrast, my multi-stage analysis results in a range of 9.61% to 10.34%, with an average of 9.90%. My results are far more consistent with past State Authorized ROEs for gas distribution utilities, whereas Mr. Walters' are not. His projected long-term growth rate of 4.14%, clearly shown by his results does not make any sense.

Q. What are Mr. Walters' criticisms of your CAPM analysis?

A. He disagrees with my sole reliance on current 5-year beta estimates published by Value Line and he is concerned with my expected market return, which is used to derive my risk premium. In his direct testimony, Mr. Walters states "in my experience, the current proxy group average and median Value Line beta estimates of .85 are abnormally high and are unlikely to be sustained over the long-term." In his rebuttal testimony he states: "current Value Line betas are based on a five-year historical period which includes the unprecedented volatility and market prices caused by the onset of the COVID-19 pandemic in early 2020." He believes it is unreasonable to assume that those market prices and resulting volatility would resemble investor expectations going forward.

Q. How do you respond to Mr. Walters on your selection of beta?

A. For my beta selection, I used a source that is accessible to most investors: Value Line. Their betas are based on a five-year historical period, and investors make decisions today based on what Value Line reports. Investors are not concerned with whether the data covers 5 years, 3 years, or any other time frame. The simple response to Mr. Walters' criticism of my beta is that he prefers a lower beta to align with his lower CAPM results. Further, if you look at Direct Schedule CCW-14, page 2 Value Line betas have been at or above 0.82 all the way back to the second quarter of 2020. That is over four years ago and is enough time to clearly demonstrate a market change and new level for Value Line betas. His criticism should be disregarded by the Commission.

Q. Please respond to Mr. Walters' criticism of your expected market return.

A. Mr. Walters suggests my expected market return for the S&P 500 as of January 11, 2024 of 13.96% results in risk premiums that are too high, 9.77%, 9.43%, and 9.70%. He feels a range of 5.0% to 8.0% is supported by empirical evidence and cites Dr. Morin's Modern Regulatory Finance book published October of 2021 (Walters' Workpaper). Dr. Morin actually says there is a slight preference for the upper end of the range, i.e. 8% and the actual range cited on page 190 of the book says 6-8% not 5%-8%.

However, my market return was calculated as of January 11, 2024, when the S&P 500 was at $4,780. For three of his CAPM calculations, Mr. Walters calculated S&P 500 market returns as of May 31, 2024, when the S&P 500 stood at $5,278, an increase of over 10%. His expected market returns are lower at 12.09% and 12.28% than my 13.96% but given the increase in the S&P 500 and also the fact that I do not exclude any stocks in my CAPM calculations of the expected market return that is not surprising. His resultant market risk premiums of 7.90% and 8.10% are also high by his definition.

Q. What additional comments does Mr. Walters make on your expected market return calculation?

A. Mr. Walters takes issue with the expected growth rate portion of my expected market return, 12.46%. He says that 12.46% is unsustainable specifically when compared to his 4.14% multi-stage projected long-term growth rate. He takes issue with me not adjusting the S&P 500 index to remove stocks with growth rates above 20% and below 0%, as well as non-dividend paying stocks. His long-term growth rates were 10.30% from his FERC S&P 500 DCF analysis used in his CAPM analysis, not including the above-mentioned stocks and 10.60% when he includes all companies except for non-dividend paying ones. His results are also very high when compared to the same 4.14%. He criticizes my long-term growth rate as being too high, but his own results are also very high by his own statements, but he still uses them. For some reason he seems to believe that no long-term growth rate can exceed 4.14%. As I demonstrated earlier in my criticism of his multi-stage results and through a recalculation of his constant growth results using 4.14% as the constant growth rate, the results are illogical.

Q. Mr. Walters criticizes the historical period I selected to measure the risk premium as too short and suggests I did not explain why I selected that date. Can you respond to his criticism?

A. Yes. As explained in my direct testimony, a 15-year historical period is more than long enough to provide a meaningful relationship to determine an appropriate risk premium. Mr. Walters went back to 1986, an additional 23 years, but the result was still very similar to mine. His risk premiums compared to 30-year treasury rates ranged from 5.63% to 5.68%. My risk premiums ranged from 5.48% to 5.77%. The results are very close so Mr. Walters' criticism of my BYPRP analysis should be ignored by the Commission.

Q. How do you respond to Mr. Walters' criticism of the flotation cost adjustment?

A. Mr. Walters seems not to realize that Midstates Gas does not issue common stock to the public but rather its ultimate parent APUC instead. Therefore, Midstates Gas would not demonstrate issuance expenses. To represent an approximate flotation cost for APUC I used the same proxy group that determined my recommended ROE. The proxy group costs were not generic information but rather actual costs for actual common stock issuances by the companies. Mr. Walters' criticism of my flotation cost adjustment should be ignored by the Commission.

B. Response to OPC's Rebuttal Testimony on my Recommended Return on Common Equity

Q. What is Mr. Murray's first criticism of your ROE recommendation?

A. Mr. Murray begins by stating that Midstates Gas has an affiliate gas distribution company based in New Brunswick, Canada ("LUNB"). Mr. Murray states LUNB's ROE of 9.8%, common equity ratio of 45%, cost of debt of 3.315%, with a maturity date of February 14, 2050, and that LUNB's parent company LUCA is rated BBB. From this set of irrelevant facts for a Canadian regulated utility, he concludes that LUNB's common equity ratio of 45% "is consistent with the common equity ratios LUCo had communicated to investors and is consistent with the low business risk of its regulated utilities. Despite its small size (only 12,400 customers), and higher leveraged capital structure ratio and a 9.8% authorized ROE, LUNB was able to issue third-party debt at a reasonable cost consistent with its credit rating." He goes on to say "LUNB's market-based capital structure and cost of debt parameters refute not only my argument for a small size premium adjustment, but also my equity-rich ratemaking capital structure and unreasonably high affiliate cost of debt."

Q. How do you respond to Mr. Murray's statements?

A. First, LUNB is subject to regulation in Canada in the province of New Brunswick, Canada which is not comparable to Midstates Gas. In addition, Mr. Murray fails to account for the differences in Canadian utility regulation versus US state Commissions and more specifically Missouri. He has provided no evidence on how ratemaking and cost of service work in Canada. Second, Midstates Gas is 6.3x the size of LUNB, so not particularly comparable. Third, he mentions the cost of debt of LUNB is 3.315% and matures in February 2050. Mr. Murray neglects to mention that the debt was issued on February 11, 2020 by LUCA the parent and a non-utility company, not LUNB, and was used to finance the original acquisition of LUNB by APUC on October 1, 2019. The debt was issued four years and seven months ago, not recently. There has not been any debt issued by LUCA since that February 2020 issuance. In summary, Mr. Murray's comparison of a small Canadian regulated affiliate gas distribution company to Midstates Gas for purposes of determining ROE, capital structure and cost of debt are not reasonable or appropriate and his statements should be ignored by the Commission.

Q. What other criticisms does Mr. Murray have of your ROE recommendation?

A. First, he takes issue with my constant growth DCF analysis because the analyst growth rates I used are assumed to be constant into perpetuity. He specifically states in Q&A on page 12 lines 17-19 that he personally is not aware of any equity analyst that would assume a utility's DPS can grow in perpetuity at the same rate as their own projected 3-to-5-year CAGR in EPS. Second, he criticizes my multi-stage DCF analysis because of my 5.5% perpetual long-term growth rate, which is based on the historical real GDP annual growth rate from 1929 to 2023 plus a projected inflation factor. Even though Mr. Murray does not agree that utilities will grow at parity with GDP, he feels my 5.5% is too high and he suggests that based on several reputable sources a sustainable GDP growth rate for the US economy is around 4% and also that EIA, my source, estimates a CAGR in nominal GDP through 2050 of 4.25%. He states my mid multi-stage result would be 8.95% rather than 9.9% if I used his suggested 4.25% growth rate.

Q. How do you respond to these first two criticisms from Mr. Murray?

A. Mr. Murray's criticisms all seem to come back to his COE calculations of 8.5% as being the only answer. Any long-term growth rate selected, whether from a group of analyst earnings projections for a constant growth DC or for the third stage in a multi-stage DCF analysis, has to be low enough to achieve a result close to his COE, otherwise, in his view, it makes no sense. As I discussed and demonstrated in my rebuttal testimony, that assumption is inappropriate when you compare his results to authorized ROEs by state Commissions for gas distribution utilities over the last 45 years. The fact that Mr. Murray states that he isn't aware of any equity analysts that assume a DPS can grow in perpetuity at the same rate as their own projected 3-to-5-year CAGR in EPS is not supported since he provides no facts or empirical evidence from equity analysts that say whether they do or do not. As to the proper long-term growth rate for the multi-stage DCF, my response is similar to my rebuttal testimony. In reviewing his results (8.5% to 8.6%) or what he suggests my results should be (8.95%), they are unreasonable and lower than any authorized ROE for the last 45 years.

Q. What is Mr. Murray's criticism of your CAPM results?

A. He states my CAPM results are too high because my expected market return is not rational. My expected market return calculation result, based on the S&P 500 index as of January 11, 2024, is 13.96% and includes a 12.45% growth rate. The resulting market risk premiums based on Treasury rates at the time are 9.43% to 9.77%. He then states that he knows of no authoritative, academic, or practical source that uses my way of estimating market returns. He then refers to a 2010 curriculum for Level III of the CFA, which states that earnings growth rates = GDP growth rate + excess corporate growth (for the index companies). He offers this as his sole empirical support in rebuttal despite the fact that earlier he states that he does not agree with GDP as a representative measure for a long-term growth rate. He then goes on to state on page 16 lines 10-13 that "based on a June 30, 2024 dividend yield for the S&P 500 of 1.32% and a projected US nominal GDP of around 4% (no source provided), it seems that investment professionals' forecasts of long-term returns for the S&P 500 of around 7% may be a bit optimistic. The 7% is from his direct testimony at page 33 line 19.

Q. How do you respond to Mr. Murray's criticisms?

A. My method is similar to the FERC methodology which uses the S&P 500 index and performs a constant growth DCF analysis. The FERC method excludes non-dividend paying stocks and stocks with growth rates above 20% and below 0%. In my CAPM I do not exclude any stocks because the beta I use in my CAPM represents the entire market index, so I do not want to mix apples and oranges. Mr. Walters of Staff also uses the FERC CAPM methodology in his ROE testimony. He does exclude non-dividend paying stocks and companies outside the 0%-20% band but his projected growth rates as of May 31, 2024 were 10.30% to 10.60% but still high compared to Mr. Murray's benchmark.

Regarding his final statements on page 16 lines 10-13, I believe his 1.32% dividend yield plus 4% growth rate would result in an expected market return of 5.32% which he then says might seem a bit optimistic versus professional forecasts of around 7%. The cite for his investment professional forecasts of long-term returns for the S&P 500 of 7% is page 33 line 19 of his direct testimony. The actual line 19 refers to a sole reference to a Morningstar Equity Research report that he says applied a COE of 7.5% for purposes of its fair value estimate for Atmos Energy Corp's stock. A reference to one research report is hardly a collection of "professional forecasts". For all these reasons, Mr. Murray's CAPM rebuttal testimony should be ignored by the Commission.

Q. Does Mr. Murray criticize your BYPRP analysis?

A. Yes, he does. He states my approach is circular but he does not address the actual results which I demonstrated in my surrebuttal testimony earlier are comparable to Mr. Walters' BYPRP results. He also states that the investment community recognizes that authorized ROEs did not decline along with COE. I addressed that statement in my rebuttal testimony but again Mr. Murray postulates that COE is actually lower than authorized ROE's by State Commissions even though the resulting authorized ROEs are based on the same methodologies and assumptions. As I stated before, that statement should be ignored by the Commission.

Q. Mr. Murray criticizes your flotation cost adjustment and suggests at page 18 of his rebuttal that APUC plans to buy back common shares if it believes it can do so without having its credit rating downgraded from BBB. Does Mr. Murray provide any facts supporting his criticisms?

A. No, there are no cites to factual evidence that APUC actually made any of those statements, so once again as he did throughout his direct and rebuttal testimonies Mr. Murray proffers an unsupported conclusion. Furthermore, while it is true there have been no equity contributions to Midstates Gas, there have been equity issuances at APUC and just because Midstates Gas has not received any equity from APUC/LUCo recently does not mean they should not pay some of the issuance costs. APUC's issuances of common stock benefit all the utility subsidiaries of LUCo so they should all share in the cost. My flotation cost adjustment recognizes the cost of that benefit. Mr. Murray's comments should be ignored by the Commission.

V. CONCLUSIONS

Q. Can you state your conclusions?

A. The Commission should accept my recommended (1) common equity ratio of 52.5% based on December 31, 2023 actuals for Midstates Gas, (2) cost of debt of 5.58% based on a Commission approved pricing mechanism and actual market priced debt issuances on December 15, 2023 for Midstates Gas, and (3) a return on equity of 10.0% as proposed by the Company.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

VERIFICATION

I, John Cochrane, under penalty of perjury, on this 19th day of September, 2024, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ John Cochrane