Exhibit No. 318

OPC – Exhibit 318
David Murray
Direct
File No. ER-2024-0189

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

DIRECT 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

June 27, 2024

PUBLIC

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DIRECT TESTIMONY

OF

DAVID MURRAY

EVERGY MISSOURI WEST

FILE 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. By whom are you employed and in what capacity?

A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Utility Regulatory Manager.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the OPC.

Q. What is the purpose of your testimony?

A. To recommend a fair and reasonable rate of return ("ROR") for purposes of setting Evergy Missouri West's ("EMW") revenue requirement for its regulated electric utility operations.

Q. What experience, knowledge and education qualify you to sponsor ROR testimony in this case?

A. Please see the attached Schedule DM-D-1 for my qualifications as well as a summary of the cases in which I have sponsored testimony on ROR and other financial issues.

Q. What aspects of ROR will you address?

A. I will address a fair and reasonable allowed return on common equity ("ROE") and a fair and reasonable ratemaking capital structure.

Q. What is your main conclusion after analyzing EMW's specific financial situation as well as the current state of capital markets?

A. EMW's cost of capital has increased since its 2022 rate case. However, EMW's cost of equity is still below the 9.5% ROE EMW assumes was implied from its 2022 rate case.[1] Because the electric utility industry's current P/E ratios are similar to 2015 levels, when the Commission first decided a 9.5% authorized ROE was fair and reasonable for Missouri's electric utility companies, a similar allowed ROE is still fair and reasonable despite the recent increase in the electric utility industry's COE. EMW's authorized common equity ratio should be more consistent with Evergy Inc.'s ("Evergy") actual consolidated common equity ratios, which recently declined below 45% as of December 31, 2023, after Evergy issued $1.4 billion of additional holding company debt in December 2023.

Q. Before you discuss the details supporting your analysis, can you summarize the rationale for your conclusions?

A. Yes. Although capital structure and the allowed ROE are interrelated as to the ultimate impact on EMW's revenue requirement, I will first briefly explain my rationale for each component, separately.

I recommend the Commission set EMW's allowed ROE for its electric utility operations at 9.5% based on a range of 9.25% to 9.75%. During most of 2020 to 2022, utility stocks had not traded consistent with their typical negative correlation to changes in long-term bond yields. However, from the end of 2022 through recent periods, utility stock valuation levels resumed their typical negative correlation to interest rates. Utility stocks have been significantly underperforming the S&P 500 since the end of 2022. The S&P 500's P/E ratios during 2023 to 2024 period have been higher than modern historical averages, which implies a lower market risk premium than at the time of EMW's 2022 rate case. Based on my application of several cost of equity methods and corroborating information from

[1] Ives Direct Testimony, Schedule DRI-3.

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investors, I estimate the COE for regulated electric utilities to be around 8.5%, which is about 1% to 1.5% higher than my estimate in EMW's 2022 rate case.

I recommend that the Commission set EMW's authorized common equity ratio at 47.2% rather than the 52% ratio Evergy targets for MO West. Since EMW's 2022 rate case, Evergy has increased the amount and proportion of holding company debt compared to its consolidated debt levels. It appears Evergy plans to utilize more holding company debt to minimize the dilution of earnings to individual common equity shares from anticipated increased aggregate earnings it can achieve from its investment in its subsidiaries, which includes EMW. Evergy's ability to minimize dilution by employing such a strategy would be more costly to ratepayers if they are required to pay for a higher-cost capital structure than Evergy deems optimal for its consolidated capital structure. Based on its recent rate cases, Evergy appears to be targeting an approximate 52% equity ratio for ratemaking purposes. This equity ratio is similar to ratemaking targets for Missouri's other large electric utilities, such as Ameren Missouri and The Empire District Electric Company d/b/a Liberty Utilities ("Empire"). Considering investors' sentiment that the Missouri regulatory and legislative environment is becoming more investor friendly, this lowers the business risk for utility investments in Missouri. Specifically, as it relates to electric utility companies in Missouri, their business risk declined after they became eligible to elect the investor-friendly ratemaking mechanism referred to as plant in service accounting ("PISA"), which became effective on August 28, 2018.[2] Missouri's electric utilities' ability to elect PISA (without specific Commission authority) was extended to 2028 through an amendment to the PISA law in 2023. Additionally, electric utilities now have express legal authority to recover energy transition costs and qualified extraordinary costs by securitizing such costs (providing an immediate lump sum recovery of such costs via selling rights to a stream of cash flows to purchasers of the securitized bonds). EMW has taken advantage of both mechanisms. EMW's reduced business risk allows for greater debt capacity (*i.e.* financial risk), but instead of Evergy allowing EMW to use more debt in its capital structure, it is issuing more holding company debt.

[2] SB 564 resulted in the creation/modification of several Sections of Chapter 393 with the primary new subsection being Section 393.1400, RSMo.

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Q. Did you take any other matters into consideration when determining a fair and reasonable allowed ROE to apply to your recommended capital structure?

A. Yes. I recognize that EMW has affiliates that compete with it for capital. In my opinion, Evergy should choose projects between its Missouri electric utility operations and Kansas electric utility operations based on economic efficiency rather than which jurisdiction awards the highest ROR. The last Kansas Corporation Commission ("KCC") authorized ROE for Evergy's Kansas electric utility operations was 9.3% in 2018.[3] Evergy's most recent rate cases in Kansas were settled without specifying an ROE to determine revenue requirement. However, the parties did specify a 9.4% ROE for purposes of the transmission cost rider mechanism applicable to Evergy's Kansas operations. The settlement also did not specify an authorized capital structure, but investors viewed the settlement as generally consistent with approximately 50% debt and 50% equity used to set rates.[4]

FAIR RETURN ON COMMON EQUITY

Q. How did you determine the approach you would take to estimate a fair and reasonable allowed ROE for purposes of this case?

A. I reconciled the principles established in *Hope* and *Bluefield*[5] with modern financial models used to estimate the COE. While setting the allowed ROE based on the COE is at least theoretically sufficient to allow a company to attract capital in efficient markets, because average allowed ROEs have been set higher than the COE, this fact must be considered when determining a fair and reasonable allowed ROE. In fact, this Commission has set a "zone of reasonableness standard"[6] for purposes of setting an allowed ROE with the starting point for this zone of reasonableness ("ZOR") being a recent industry average

[3] Docket No. 18-WSEE-328-RTS.
[4] 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.
[5] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *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).
[6] *State ex rel. Missouri Gas Energy v. Public Service Commission,* 186 S.W.3d 376, 383 (Mo App. W.D. 2005)

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allowed ROE. Considering these principles, I first estimate EMW's current COE and then compare my current COE estimates to those I estimated in recent rate cases to determine if there has been a fundamental change in the cost of capital. My analysis also includes consideration of other recently authorized ROEs with specific consideration given to Evergy's implied ROE of approximately 9.3% to 9.4% for its Kansas electric utility operations.

Q. Based on your analysis, what is your estimate of EMW's COE?

A. 8.50% to 8.75%.

Q. Based on your analysis and awareness of capital market conditions, investor expectations and recent average allowed ROEs for electric utilities, what do you consider to be a fair and reasonable allowed ROE for EMW's electric utility operations?

A. 9.25% to 9.75%. My recommended allowed ROE is within the range of the Commission's typically defined ZOR range of 100 basis points above and below recent average authorized ROEs of approximately 9.66%[7] (*i.e.* 8.66% to 10.66%). After considering my COE estimates, the Commission's authorized ROE of approximately 9.5% for Missouri's electric utilities for rate cases decided in 2015, and the implied authorized ROE for Evergy's Kansas electric utility operations, I consider a 9.5% ROE to be fair and reasonable.

Q. How did you inform yourself for purposes of determining the best methods and approaches to use to estimate EMW's COE?

A. For purposes of this case, I reviewed Evergy's Board of Directors ("BOD") strategic financing and investment considerations since February 2022, as well as equity investment research reports covering Evergy and the utility industry for a similar period. After performing this research, I estimated EMW's COE by performing a company-specific COE analysis on Evergy, as well as a COE analysis on a broad electric utility industry proxy

[7] RRA Major Rate Case Decisions Quarterly Updates, April 19, 2024.

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group, with emphasis on companies within this broad group that are more concentrated in regulated utility operations.

Q. What specific COE models did you use?

A. I used a multi-stage discounted cash flow ("DCF") method, with specific emphasis on consensus analysts' estimated dividends and the modeled growth of dividends. When the DCF method is applied to dividends as the proxy for cash flow, it is more specifically defined as the dividend discount model ("DDM"). I also applied the Capital Asset Pricing Model ("CAPM") to both Evergy and the proxy groups. Finally, I performed simple and logical reasonableness checks to test the reasonableness of my COE estimates. These reasonableness checks recognize the basic characteristics of utility stocks, mainly being that they are perceived as yield/income investments by the investment community. One such reasonableness check is a straight-forward bond-yield-plus-risk-premium ("BYPRP") method included in the Chartered Financial Analyst ("CFA") Program curriculum.[8]

Q. Can you describe current capital market conditions as it relates to the electric utility industry in general and Evergy specifically before you discuss the details of how you specifically estimated EMW's COE?

A. Yes. This information should help provide some context as to the current state of utility capital markets. Considering the rapid and steep increase in interest rates from 2022 to 2023, which have caused utility debt costs to increase dramatically since 2020 to 2021, it is important to understand the context of authorized ROEs versus the cost of equity over a much longer period than just the last couple of years. It is for this reason that I will analyze and compare utility stock valuations and interest rates for most of the period since the financial crises and recession around 2008/2009.

[8] 2021 CFA Program – Level II Refresher Reading, Equity Valuation, p. 35.

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Q. What ROE had you recently recommended the Commission authorize for its large electric utilities?

A. I had consistently recommended the Commission reduce its electric utility authorized ROE from around 9.5% to as low as 9.0% in electric utility rate cases since as recently as 2022. The Commission's last authorized ROE for EMW was 9.7% in the 2012 rate case, Case No. ER-2012-0175. The Commission's last authorized ROE for Metro was 9.5% in the 2016 rate case, Case No. ER-2016-0285, which was consistent with the Commission's authorized ROE for Metro in its 2014 rate case, Case No. ER-2014-0370. The Commission's last litigated authorized ROE for a Missouri electric utility was 9.25% for Empire in Case No. ER-2019-0374. In the most recent EMW, Metro, Empire and Ameren Missouri electric rate cases, I recommended the Commission further reduce authorized ROEs to 9.0%. Although the COE has varied over much of the period since 2014, with a generally overall declining trend until 2022, I had consistently urged the Commission to lower the authorized ROE for its electric utilities by at least 25 basis points to recognize the systemic decline in the cost of capital over the period.

Q. Can you describe and illustrate recent and long-term changes in long-term bond yields?

A. Yes, long-term bond yields have increased dramatically over the last couple of years after declining to historically low levels during the period of the Covid-19 pandemic (2020 – 2021). In fact, during the Fall of 2023, investment grade utility bond yields and long-term United States Treasury ("UST") bond yields increased to their highest levels since 2010.

The below graph shows long-term bond yields since January 1, 2010. While the early stages of lower long-term interest rates in the first half of this decade were considered by some as potentially anomalous because of the Federal Reserve Bank's ("Fed") quantitative easing ("QE") programs[9] through October 2014, for the last half of the past decade, long-term interest rates continued an overall declining trend, until they reached all-time lows in

[9] QE involved three rounds of the Fed's direct intervention in bond markets beyond just lowering the Fed Funds rate. The Fed's QE programs had the express intent of reducing long-term interest rates.

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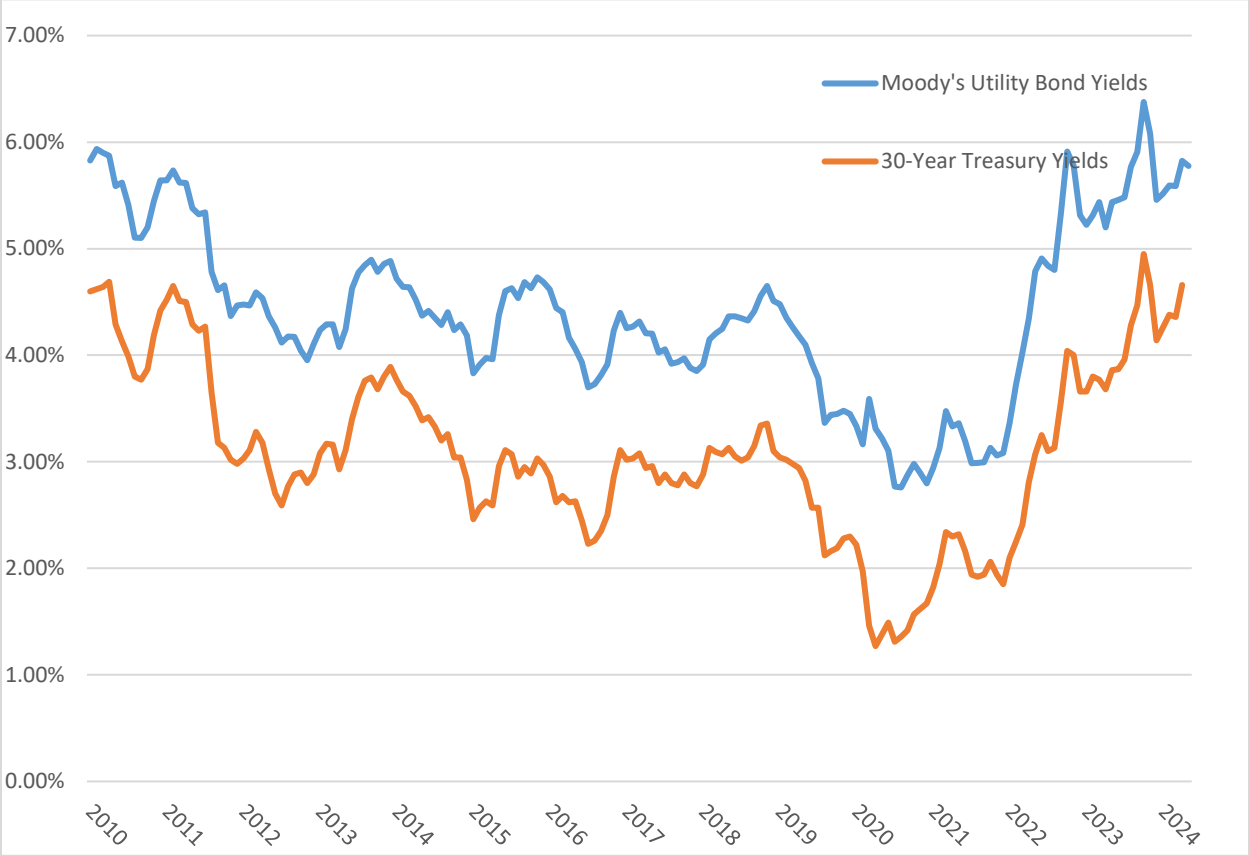
2020 and 2021. However, as I previously described, long-term rates have since increased dramatically, peaking in October 2023.



Average utility long-term bond yields had declined to modern all-time lows in the latter half of 2020 - levels not experienced since the late 1940s and early 1950s. But in less than three years, they more than doubled. Although more simplistic COE methods may imply that the COE for utilities whipsawed along with bond yields, utility valuation levels over this period do not support this notion. As I will explain in more detail later in my testimony, the post Covid-19 economic and capital market conditions have been atypical. This is likely a consequence of the Fed's and U.S. Congress's massive interventions through monetary and fiscal policies, respectively, during the Covid-19 pandemic.

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Q. Why is it typically important to evaluate trends in long-term interest rates when evaluating the utility industry's COE?

A. The investment community typically regards utility stocks as bond proxies/pseudo bonds, meaning that if long-term bond yields decline, then this typically causes regulated utility stock prices to increase. Although investors' total returns in utility stock investments do include some capital gains, because of the slow, but steady growth in earnings, utility companies have typically distributed approximately 2/3 of their earnings as dividends to shareholders, causing utility stocks to be characterized as yield investments. Therefore, changes in utility stock valuation levels have historically had a strong inverse correlation to changes in bond yields, *i.e.* as bond yields decline, utility stock prices increase.

Q. During the period April 2020 through August 2022, did utility stock valuations and bond yields provide traditional and consistent signals about utilities' cost of capital?

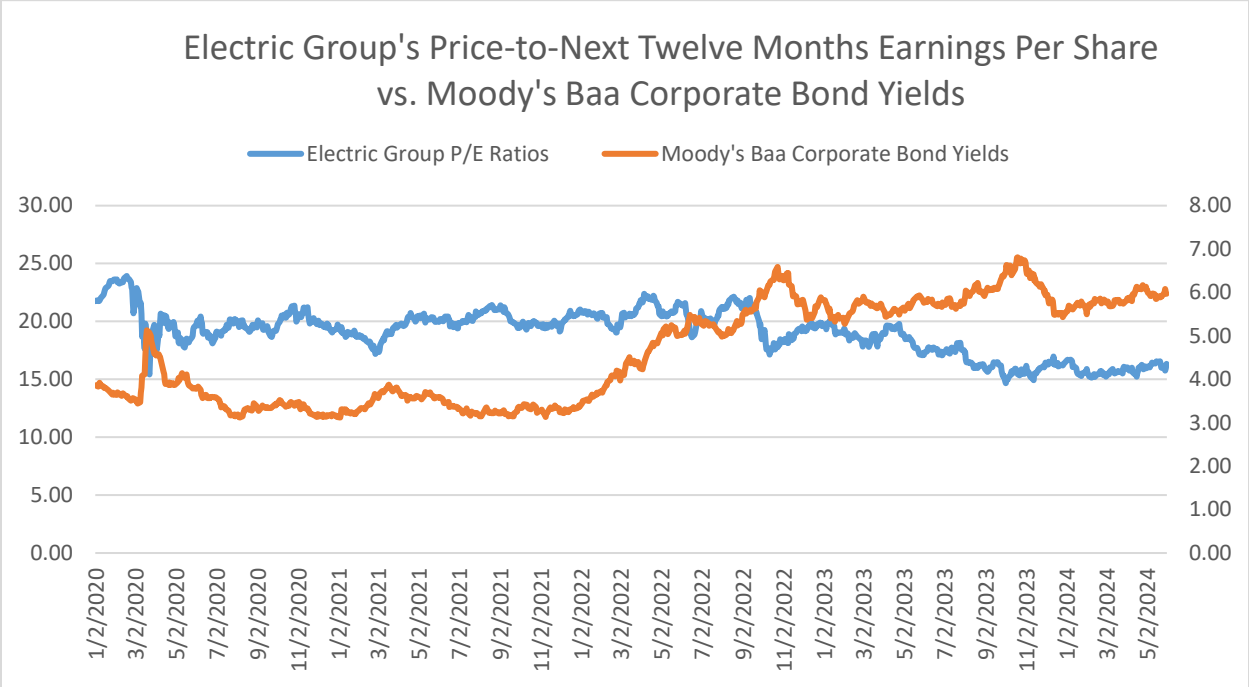
A. No. Following drastic and significant intervention by the Fed in monetary policy and the UST in fiscal policy in reaction to Covid-19 and its associated mitigation measures, the yield-to-maturity ("YTM") on utility and corporate bonds traded at 70-to-80 year lows. However, at the same time, broader utility stocks (mainly local natural gas distribution companies ("LDC") and electric utility stocks) underperformed the S&P 500. The same atypical trading pattern occurred as long-term bond yields began a dramatic increase in 2022. Utility stocks significantly outperformed the S&P 500 on a relative basis, despite long-term yields increasing through much of 2022. The increase in yields caused the S&P 500 to contract significantly, while causing only a slight decline in utility stock prices, allowing them to maintain similar P/E ratios as before the rapid increase in long-term interest rates.

Consequently, while the utility industry's debt costs fluctuated along with the macro changes in interest rates, the same was not true for the utility industry's cost of equity. For example, as I will discuss later in my testimony, use of the CAPM with standard assumptions, implied that the utility industry's COE fluctuated along with long-term bond yields since 2020, but such indications were not corroborated by utility equity market

valuations. However, recent contractions in utility P/E ratios indicate investors may now be expecting long-term bond yields to remain higher for longer.

Q. What about since August 2022?

A. Starting around mid-September 2022, electric utility P/E ratios finally resumed their more typical inverse correlation with long-term yields, as illustrated in the following chart:



During the all-time low bond yield environment, the utility industry was able to take advantage of these extremely low debt capital costs. For example, on April 20, 2021, EMW issued 10-year, $350 million dollar bonds at an annual coupon rate of only 2.86%. However, during this period, utility equity valuation levels did not increase in response to the decline in bond yields, which implied investors did not expect extremely low interest rates to be sustained. Similarly, as bond yields increased significantly in 2022, utility equity valuation levels did not contract as typically expected – perhaps because investors understood that the extremely low cost of debt during 2020 to 2021 was not likely sustainable. To illustrate the significant increase in utility bond yields, EMW issued 10-year, $300 million bonds on May 29, 2024, at a coupon of 5.65%, or almost double the cost from just three years ago.

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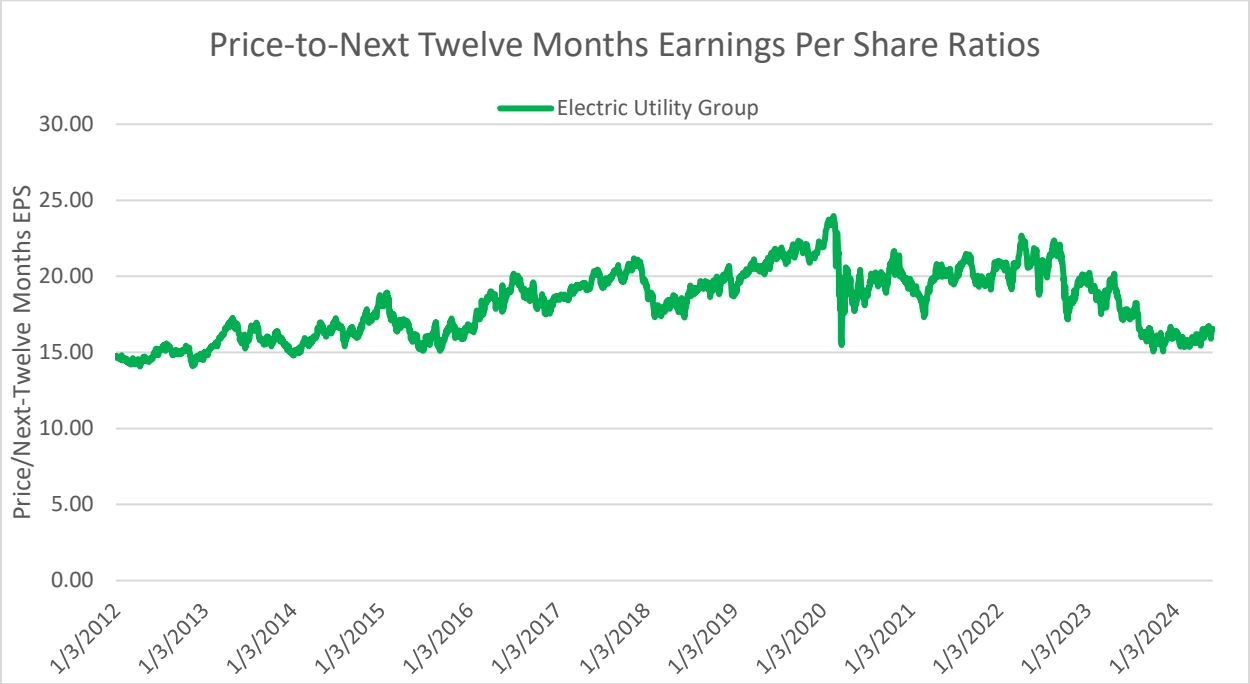
Q. What are recent implied yields on EMW's long-term debt?

A. EMW's two long-term debt issues with 8 to 10 years until maturity currently traded a yield-to-maturity ("YTM") of approximately 5.3% to 5.7%.

Q. Would you graphically illustrate the electric utility industry's price-to-next-twelve-months-earnings (P/E) ratios since January 1, 2012?

A. Yes. See the below graph:



As can be seen in the above graph, the electric utility industry's P/E ratios have been trading in the 15x to 16x range since the Fall of 2023. While this is lower than the electric utility industry's P/E ratios since the middle of the last decade (around 2015), it is generally higher than the electric utility industry's P/E ratios during 2012.

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Q. Why is it important to be aware of the historical context of the electric utility industry's P/E ratios?

A. Because the Commission deemed a 9.7% to 9.8% authorized ROE as fair and reasonable for Missouri's large electric utilities around 2012, whereas the Commission deemed an approximate 9.5% authorized ROE as fair and reasonable for Missouri's large electric utilities around 2015. Therefore, at least based on observing the time-series data on P/E valuations, despite recent increases in long-term bond yields, a 9.5% ROE appears to be fair and reasonable and supportive of EMW's ability to attract equity capital.

Q. Can you compare Evergy's P/E ratios to the electric utility industry for the period shown in the previous chart?

A. No. Evergy was formed on June 4, 2018 through the merger of Great Plains Energy and Westar Inc. Therefore, Evergy's P/E ratios can only be observed subsequent to this date.

Q. At what starting date is information available to you for Evergy's P/E ratio?

A. June 21, 2018.

Q. Would you compare Evergy's P/E ratio to the electric utility industry's and Ameren's P/E ratios since June 21, 2018?

A. Yes. The comparison follows:

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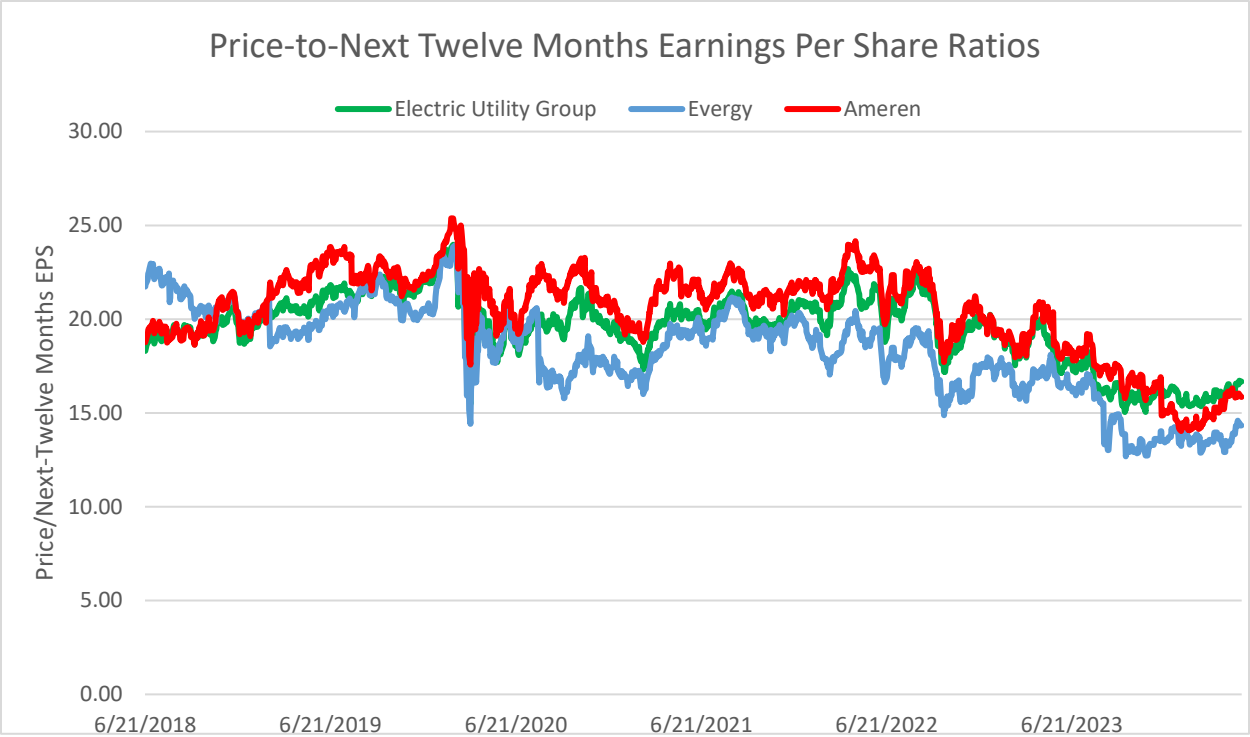

Evergy started trading at a premium to the electric utility industry when it was first formed, but then traded at a discount for much of 2019. After Elliott Management ("Elliott") issued a January 21, 2020 public letter to Evergy's BOD, Evergy's P/E ratio traded in line with the rest of the electric utility industry from approximately March 2020 through the end of July 2020. On August 5, 2020, when Evergy announced it would pursue a stand-alone strategy through its Sustainability Transformation Plan ("STP"), its P/E ratio immediately declined by approximately 3x (from around 20x to 17x). However, for most of 2021, Evergy's P/E ratios traded anywhere from in-line to a slight discount to the electric utility industry. Since the end of 2021, Evergy has consistently traded at a discount to the electric utility industry and Ameren.

Evergy's lower P/E ratios relative to the electric utility industry and Ameren implies Evergy's cost of capital may be slightly higher than the industry average and/or there is less confidence in Evergy's ability to grow its earnings and dividends consistent with industry averages. Investors had consistently discounted Evergy's past guidance of 6% to 8% long-term compound annual growth rate ("CAGR") in its earnings per share ("EPS") before Evergy formally revised its guidance downward.

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Q. When did Evergy lower its guidance for the long-term CAGR in EPS?

A. During its third-quarter 2023 earnings conference call on November 7, 2023. Evergy lowered its guidance for long-term CAGR of its EPS to 4-6% from 6-8%. Evergy's lowered EPS growth guidance occurred after it announced the settlement of its rate cases in Kansas on September 29, 2023. Although Evergy settled these cases, it settled for revenue requirements below investors' expectations.

Q. What are utility equity investors' reactions to the current interest rate environment?

A. Based solely on interpreting/evaluating utility stock price changes as compared to that of the broader market, stronger economic conditions and optimism about potential productivity benefits from artificial intelligence have been causing the S&P 500, especially constituents in the information technology sector, to significantly outperform the utilities sector. Until 2022, most utility equity analysts had projected that low interest rates justified a continued reduction of authorized ROEs. However, given the fact that long-term bond yields have remained higher since late 2022, now investors expect regulators to at least hold the line on awarded ROEs.

Q. Why would investors expect utility commissions to hold the line on authorized ROEs if the cost of capital has increased?

A. Because investors recognize that utility commissions did not reduce authorized ROEs as much was justified when the cost of capital was declining. Barclays recently indicated the following about authorized returns while the cost of capital was declining from 2010 to the early 2020s:

> **High Returns Unlikely as ROEs Sticky While Rates Were at Decade Lows**
>
> Simplistically, from 2010 to early 2020s long term risk free yields have only declined, while utility ROEs remained steady at an average 9.8% authorized rate on the electric side. Utilities were arguably over-earning during this timeframe in our view. We believe over a long term (10yr+) time horizon there should be a case for higher ROEs if risk free yields remain elevated or move higher, but we see it unlikely that regulated ROEs return to 12%+ levels anytime soon. This likely leads to an extended CoC [cost of capital]

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> crunch for the utility industry, which will pressure management teams' abilities to raise capex budgets materially in the five-year window. Please see our additional work below highlighting the CoC crunch.[10]

Q. What COE have equity analysts been using to estimate a fair price to pay for a utility stock in today's higher-interest rate environment?

A. A COE in the range of 7.5% to 8.25%. Wells Fargo applied a COE of 8% to Evergy's expected dividends when it recently estimated a fair price for Evergy's stock.[11] Morningstar applied a COE of 7.5% for purposes of its fair value estimate for Evergy's stock.[12]

Q. Can utilities still create value for its shareholders at a narrower spread between the COE and allowed ROEs?

A. Yes. Even at a narrower spread, as long as a company has the opportunity to earn more than its cost of capital, it will create value above the initial book value investment (*i.e.* investment in rate base for utility companies). The ratemaking principle of setting an authorized ROE at or near parity with the COE is that utility companies will only invest in projects that are expected to be economically efficient based on the merits of the projects rather than simply being authorized a return higher than the cost of capital (or a jurisdiction that authorizes a higher return than another jurisdiction). Morningstar's discounted cash flow analysis recognizes this principle should at least hold over the long-term. Specifically, as it relates to estimating growth in cash flows in the perpetuity stage, Morningstar states the following:

> Once a company's marginal ROIC [Return on Invested Capital] hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys

[10] Nicholas Campanella, et. al., "U.S. Power & Utilities: Initiating Coverage: Down but Not Out," Barclays, August 22, 2023, p. 23.
[11] Neil Kalton, et. al., "Earnings Roundup: ATO, EVRG, BKH & CPK," Wells Fargo, May 9, 2024.
[12] Travis Miller, "Evergy: Kansas Rate Settlement Reduces Regulatory Risk," Morningstar, October 9, 2023.

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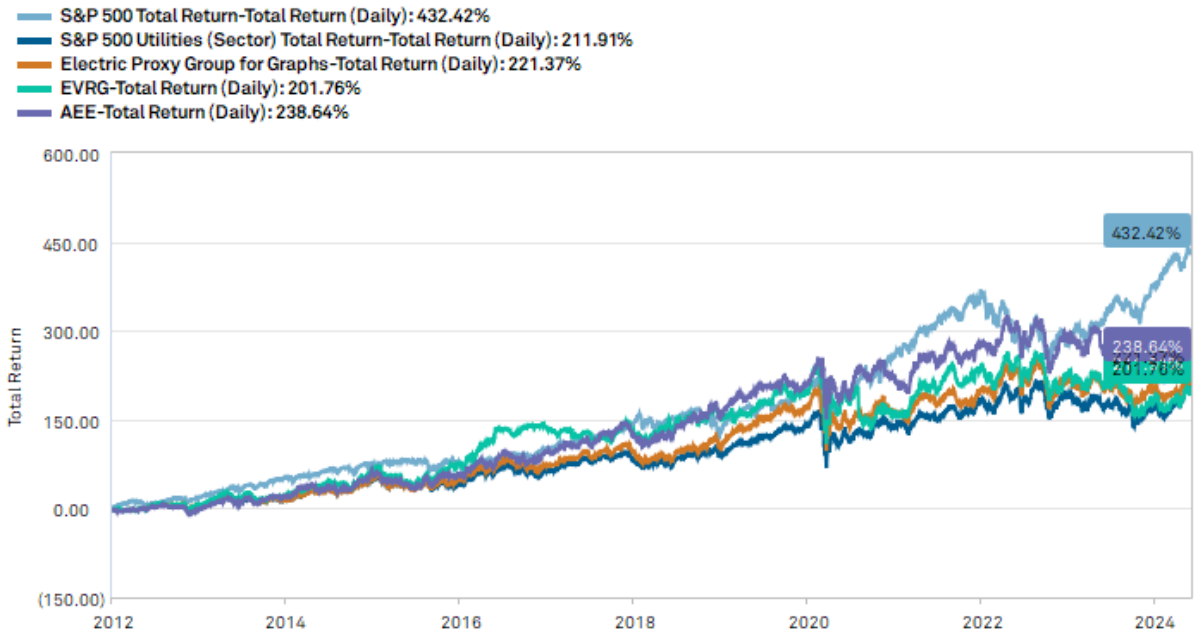
value and that any new investment provides a return in line with estimated WACC.[13]

Q. Can you provide information on how Evergy's shareholder returns have compared to its peers, Ameren and the S&P 500?

A. Yes. See the below chart for a graphic illustration of Evergy's total return as compared to an electric utility proxy group, EEI's Broad Electric Utility Proxy Group, Ameren, and the S&P 500.



Although Evergy is included in the above graph, the share prices before June 4, 2018, reflect that of Westar Energy, which did not include Great Plains Energy – the previous publicly-traded holding company for EMW and Metro. The key takeaways from the above chart is the fact that until the pandemic, the electric utility industry achieved total returns similar to the S&P 500 despite the fact that they typically do not achieve as high a proportion of their total returns from capital gains as compared to growth stocks. The utilities' high total returns over this period were largely due to the sustained long-term decline in interest rates over this period, which also caused higher capital gains for bond

[13] *Id.*

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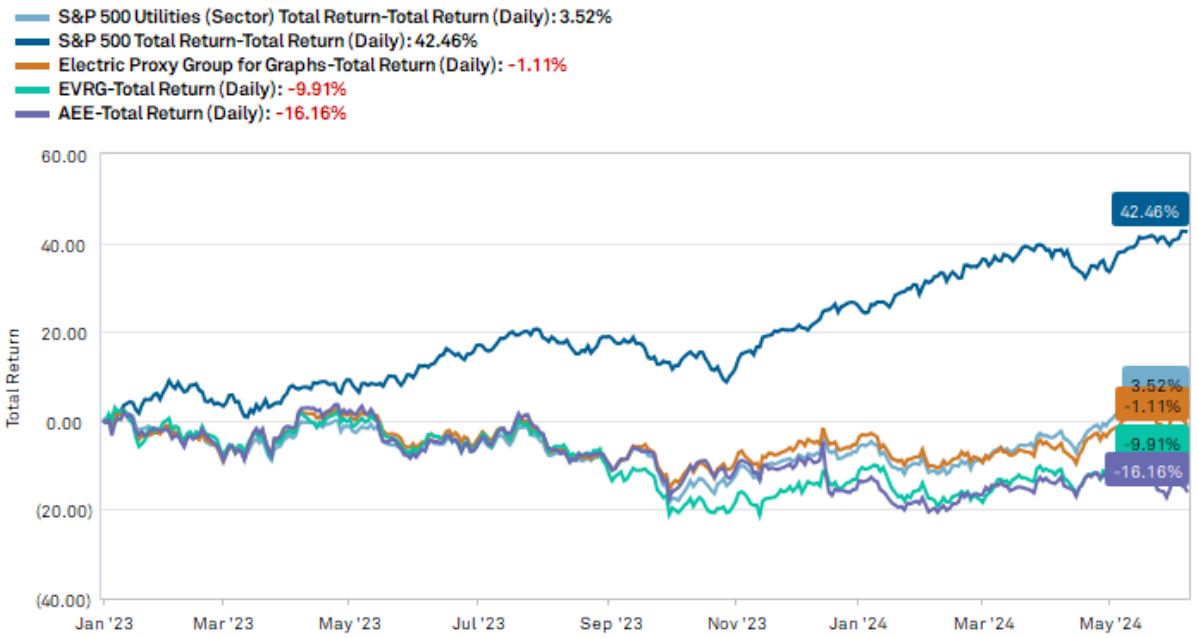
investments. Being that bond coupons are typically fixed, this clearly demonstrated that yield investments achieved capital gains mainly due to a decline in long-term yields. However, post the pandemic, and, more importantly, post the response of the Federal Reserve and the U.S. Congress to support the economy during the pandemic, aggressive stimulus measures caused the S&P 500 to significantly outperform the electric utility industry. This is largely attributed to the Fed providing a tremendous amount of capital market support, which caused negative real bond yields during much of this period. This had the impact of reducing the discount rates (*i.e.* COE) for the broader markets, which made potential future profits worth more in present value terms. However, becoming concerned about sustained inflationary pressures, the Fed began to aggressively tighten monetary policy, which caused investors to fear a recession in 2023. This explained utility stocks' stronger performance relative to the S&P 500 for much of 2022, despite increases in long-term bond yields.

However, since the beginning of 2023, the S&P 500 has significantly outperformed electric utility stocks. This is highlighted in the below chart which limits the period to January 1, 2023 to June 7, 2024:



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COST OF EQUITY METHODS

Q. Now that you have provided some context on changes in utility capital market conditions generally and Evergy specifically, can you discuss how you decided to approach your COE estimate for MO West in this case?

A. Yes. I performed a company-specific COE analysis on Evergy as well as a proxy group COE analysis. I used a multi-stage DCF approach and a CAPM. I then tested the reasonableness of my estimates by using simple reasonableness checks, such as the straight-forward bond-yield-plus-risk-premium ("BYPRP") method discussed in the CFA curriculum.

Q. How did you inform yourself as to reasonable and rational inputs for your COE approaches?

A. Being that the objective of a ROR witness is to emulate investors' approaches to analyzing and making investment recommendations as it relates to investing in utility stocks, I have made it a priority to review and analyze how equity research analysts determine a utility stock price estimate in practice. This has allowed me to test the theory of cost of capital estimation in utility ROR testimony as it compares to how utility stocks are actually valued. I have discovered investment analysts do use multi-stage DCF approaches to estimate fundamental values of utility stocks, and/or they use relative valuation techniques that compare a company's P/E ratios to averages for the industry and/or potentially a more tailored subset of peer companies. In my experience, professional equity ("Wall Street") analysts project long-term CAGR in EPS to determine whether a company's P/E ratio deserves a premium or a discount to its peers. Wall Street analysts DO NOT use these estimated long-term CAGRs in EPS for purposes of projecting a perpetual dividend growth rate, as some ROR witnesses suggest. When performing an absolute valuation analysis, such as a DCF/DDM, Wall Street analysts assume rational perpetual growth rates in the 2.5% to 3.3% range for electric utility companies. Finally, as I discussed earlier in my testimony, they estimate utilities' COE to be in the 7.50%-8.25% range.[14]

[14] *Id*.

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Q. What equity research firms cover Evergy's stock?

A. According to Evergy's website, the following firms cover its stock: Bank of America ("BofA"), Credit Suisse, Evercore ISI, Guggenheim Securities, Morningstar, Seaport Research Partners, UBS Equities, Wells Fargo Securities, and Wolfe Research ("Wolfe").[15]

Q. Why is it important to analyze this information to determine a fair and reasonable allowed ROE for Evergy?

A. Analyzing this information is important because these Wall Street analysts are the very individuals that underlie various consensus estimates widely considered by investors. ROR witnesses recognize the influence Wall Street analysts have on utility stock prices by the very fact that they use consensus EPS forecasts for purposes of estimating the COE.

Q. Did you review any of these firms' research for purposes of performing your cost of equity analysis and preparing your testimony?

A. Yes. I mainly relied on reports Evergy provided in response to Staff Data Request No. 0119. However, over my career I have established relationships with some firms/analysts who have distributed this material to me directly through their email distribution lists. These relationships were borne from my role as a regulator in which many of these analysts seek information related to Missouri's general and specific regulatory issues. I have also interacted with these analysts through my participation in organizations, such as the Society of Utility and Regulatory Analysts ("SURFA").

Q. How did you approach the multi-stage DCF/DDM analysis you performed on Evergy?

A. Schedule DM-D-2 attached to my testimony illustrates the primary logic and assumptions I used in my multi-stage approach. For the first stage (*i.e.*, the discrete stage) I used consensus analysts' discrete estimates for dividend per share ("DPS") through 2028. Evergy's consensus dividend payout ratio is projected to be 67.75% in 2028. Evergy's targets a dividend payout ratio in the range of 60% to 70%.[16] I then modeled an equal

[15] https://investors.evergy.com/investor-relations/stock-information/analyst-coverage
[16] Sustainability Transformation Plan, August 5, 2020, p. 11.

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percentage change in the annual payout ratio from this period until the terminal year, which is when I assumed that Evergy would converge to a dividend payout ratio necessary to ensure it retains sufficient earnings to sustain the assumed perpetual growth rate of 2.5% to 3.5%. Consequently, both Evergy's DPS and EPS annual growth rates gradually decline to my assumed perpetual sustainable growth rate in the range of 2.5% to 3.5%. Based on a terminal expected ROE of 9.50%, this results in terminal dividend payout ratios in the range of 63.16% (3.5% perpetual growth rate) to 73.68% (2.5% perpetual growth rate). My range of assumed perpetual growth rates range are consistent with the assumed rates used by Evercore ISI,[17] Wells Fargo[18] and **_____ _____ _ **

Q. What is your basis for an assumed terminal ROE of 9.5%?

A. In recent rate cases, I had assumed a terminal ROE of 9.25%, which was generally consistent with terminal ROE assumptions used by Wells Fargo (9.0%) and Evercore ISI (9.25%). However, due to recent sustained increases in long-term bond yields, and the fact that average authorized ROEs generally did not decline to 9% to 9.25% when the cost of capital was at all-time lows, I decided a 9.5% terminal ROE is a more reasonable assumption at this time.

Q. What does industry data suggest is a sustainable growth rate for a predominately regulated electric utility company, such as EMW?

A. I reviewed past actual historical industry growth rate data from the Moody's electric utility index,[20] a sample group of electric utility companies in which data was available from Value Line,[21] and commentary/analysis available from institutional investors/analysts.[22] This information supports a perpetual growth rate in the range of 2.5% to 3.5%. A perpetual growth rate within this range is also consistent with the "sustainable growth

[17] *Id.*
[18] Neil Kalton, Sarah Akers, and Jonathan Reeder, "DDM Analysis Supports Sector Valuation & Quality/Growth Trade," August 19, 2019, Wells Fargo.
[19] Evergy's response to Staff Data Request No. 117.
[20] Staff Cost of Service Report, Case No. ER-2011-0028, p. 18.
[21] *Id.*
[22] Discussed throughout this testimony.

model," which estimates EPS growth by multiplying an average long-term industry retention rate by an expected book ROE. Assuming the utility industry reverts to its long-term earnings retention rate of approximately 30% and allowed ROEs are maintained at around 9.5%, this supports a 2.85% perpetual growth rate if investment opportunities are available (9.5% allowed ROE multiplied by 30%).

Q. How does this compare to perpetual growth rates used by equity analysts to estimate fair prices for utility stocks?

A. This is fairly consistent with the perpetual growth rates used for purposes of estimating utility stock prices. For example, Evercore ISI uses a perpetual growth rate of 2.5% to 3.5% in its 3-stage DDM analyses of electric utility stocks.[23] Wells Fargo uses an average perpetual growth rate of around 3%.[24]

Q. How do these growth rates compare to EMW's rate base growth since 2010?

A. Based on MO West's estimated rate base through the true-up period in this case, the CAGR in its rate base is estimated to be approximately 3.6% since 2010.

Q. What cost of equity did you estimate for Evergy using the multi-stage approach?

A. Using Evergy's stock prices since January 1, 2024, and estimating prospective dividends using reasonable growth rates in the intermediate future as well as perpetually, the implied COE for Evergy is approximately 9.05% to 9.15% (see Schedule DM-D-2). This is approximately 150 basis points higher than my COE estimate of 7.45% to 7.75% in EMW's 2022 rate case.

[23] Durgesh Chopra, et. al., "A Look at US Electricity Consumption Forecast," Evercore ISI, June 9, 2024.
[24] *Id.*

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PROXY GROUP COST OF EQUITY

Q. Should you compare your estimate of Evergy's company-specific COE to the COE of a proxy group of other regulated electric utilities?

A. Yes. Investors frequently evaluate the attractiveness of a utility company's share price by comparing it to the average of a peer proxy group, whether it's based on a broader utility index or a custom proxy group.

Q. How did you approach selecting a custom proxy group for purposes of comparing Evergy's COE versus its peers?

A. I decided to analyze a broad proxy group of utilities classified as "regulated" and "mostly regulated" utilities by the Edison Electric Institute ("EEI").[25] Although I estimated a COE based on this broad electric proxy group, I also reviewed the companies EEI classifies as "regulated," but even these companies may have non-regulated operations that contribute to volatility to earnings and/or cash flows. Therefore, I reviewed the various business segments of each of these companies to determine which generally have had less than 10% of their operations exposed to competitive and international markets over the past five years, which was 17 companies. I also analyzed a subset of the EEI companies I have consistently followed in electric rate cases since 2012 (I use this group for the charts included in my testimony).

Q. Did you perform a multi-stage DCF analyses on these companies?

A. Yes. I applied the same principles as I did when applying the multi-stage DCF to Evergy. For the first stage (May 31, 2024 through June 30, 2028) I used Wall Street analysts' consensus DPS estimates to the extent they were available. For the second stage (June 30, 2028 through June 30, 2038), I allowed for a gradual decline from Wall Street analysts' projected 5-year CAGR in EPS to a sustainable perpetual growth rate of 3% starting on June 30, 2038. In order to estimate investors' anticipated annual DPS over the second stage, I determined consensus analysts' estimated dividend payout ratios as of 2028. I then

[25] EEI classifies companies as "Regulated" if at least 80% of their assets are dedicated to regulated utility operations.

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allowed the dividend payout ratios to gradually converge to a sustainable payout ratio of 68.42% starting in 2038. This payout ratio is consistent with the constant/sustainable-growth DCF theory that requires DPS, EPS and book value per share ("BVPS") to grow in perpetuity at the same rate. This payout ratio is consistent with the proportion of earnings utility companies should retain to sustain a 3% growth rate at a 9.50% book ROE.

My industry COE estimate based on application of the multi-stage DCF to the proxy group indicates a COE in the range of around 8.5% to 8.75%, which is around 150 basis points higher than my estimates in EMW's 2022 rate case (see Schedule DM-D-3, p. 1).

Q. How do your current multi-stage COE estimates for the electric utility industry compare to your multi-state DCF COE estimates for the electric utility industry during the 2014/2015 period in which the Commission first deemed a 9.5% authorized ROE to be fair and reasonable for Missouri's electric utilities?

A. My current multi-stage DCF COE estimate is approximately 100 basis points higher than my estimate for the electric utility industry in Ameren Missouri's 2014 rate case, Case No. ER-2014-0258.

Q. Have you changed anything in your multi-stage DCF approach that may cause slight differences in your electric utility industry COE estimates?

A. Yes. I refined my multi-stage approach starting in 2019 due to the fact that I gained access to more detailed analysts' estimates. I determined that I could use these more detailed estimates to more closely align the variables in the model with the assumptions underlying the constant-growth stage – the terminal stage of the model.

Q. Using the same multi-stage DCF approach you used prior to 2019, what do the results imply about the changes in the electric utility industry's COE since 2015?

A. The electric utility industry's current COE is about 80 basis points higher than when I did my analysis in Ameren Missouri's rate case in the 2014/2015 period.

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Q. Are there any other models that investors typically use to estimate the utility industries' COE?

A. Yes. In my experience, many Wall Street analysts use the CAPM to determine a discount rate, *i.e.* the COE, to apply to expected cash flows to the equity investor. The CAPM shows the potential impact of changes in interest rates on the cost of capital. Although COE estimates can be manipulated with the CAPM by using unreasonable market risk premium estimates, fortunately there are a variety of authoritative sources that provide equity risk premium estimates that can form the basis for a consensus view of reasonable risk premiums based on current capital market conditions.

Q. What is the underlying theory that supports the use of the CAPM to estimate the cost of equity for utilities?

A. The CAPM is based on capital market theory in which it is recognized that although the total risk of a company and/or industry consists of market ("systematic") risk and asset/business-specific ("unsystematic") risk, investors are only compensated for systematic risk because holding a diversified portfolio allows the investor to avoid unsystematic risk. Systematic risks are unanticipated events in the economy, such as economic growth, changes in interest rates, demographic changes, etc., that affect almost all assets to some degree. The required risk premium for incurring the market risk as it relates to the investment/portfolio is determined by adjusting the market risk premium by the beta of the stock or portfolio. The adjusted risk premium is then added to a risk-free rate to determine the cost of equity. The CAPM is typically expressed in equation form as follows:

$$K_e = Rf + \beta\,(RPm)$$

Where:
- K_e = the cost of equity for a security;
- Rf = the risk-free rate;
- β = beta; and
- RP_m = equity risk premium.

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For purposes of my CAPM analysis, I relied on Kroll's recommended equity risk premium of 5.0% provided as of June 6, 2024[26] and a range of realized historical equity risk premiums of 5.14% (geometric historical mean for 1926 through 2023) to 6.56% (arithmetic historical annual mean for the period 1926 through 2023) derived from data provided by Ibbotson Associates' Stocks, Bonds, Bills and Inflation database. Although each of these equity risk premium estimates use various methods and risk-free rates to arrive at their final estimates, I do not consider any estimate outside these to be consistent with the investment community's "consensus." I specifically used a market risk premium range of 5% to 6% to estimate the COE for the electric utility industry. One of the primary drivers of using a higher market risk premium versus a lower market risk premium is due to whether this market risk premium is applied to a normalized risk-free rate or a current risk-free rate (higher market risk premiums applied to lower current low risk-free rates). Long-term expected nominal market returns for the S&P 500 are as low as 7%.[27] Therefore, market risk premiums in the 5.0% to 6.0% range may actually be excessive for purposes of a CAPM analysis.

Q. What does the beta represent in a CAPM analysis?

A. Beta is statistically defined as the covariance of the returns on an asset (in this case an individual stock or group of stocks) with the return on the S&P 500 divided by the variance of the returns on the S&P 500. This statistical measure is intended to provide investors with insight regarding expected volatility of a security (or portfolio of securities) as it relates to market volatility. A beta of less than one implies less expected volatility than the market with the trade-off of a lower expected return than the market. The reverse is expected for a beta greater than one.

[26] https://www.kroll.com/-/media/kroll-images/pdfs/kroll-lowers-its-recommended-us-equity-risk-premium-effective-june-5-2024.pdf

[27] First Quarter 2024 Survey of Professional Forecasters, Philadelphia Federal Reserve Board (Feb. 9, 2024), https://www.philadelphiafed.org/surveys-and-data/real-time-data-research/spf-q1-2024 and John Bilton et al., *2024 Long-Term Capital Market Assumptions: Time-tested projections to build stronger portfolios,* J.P.Morgan (October 17, 2023), https://am.jpmorgan.com/us/en/asset-management/adv/insights/portfolio-insights/ltcma/

Q. Have utility stock betas exhibited a wide range since the onset of the Covid-19 pandemic?

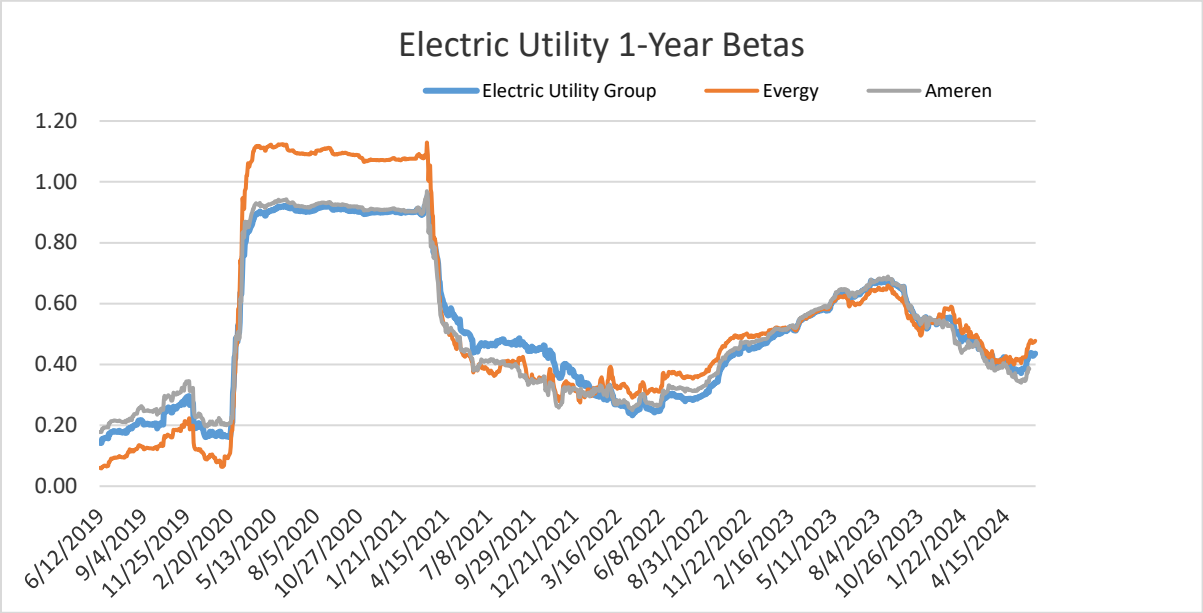
A. Yes. During Empire's and Ameren Missouri's 2019 rate cases, electric utility 5-year stock betas had declined to quite low levels of around 0.55. At the time I sponsored testimony for the Empire and Ameren Missouri 2021 utility rate cases, electric utility 5-year stock betas had increased to around 0.80. Electric utility 5-year stock betas are currently approximately 0.93 for the broad EEI proxy group and around 0.88 for more pure-play regulated electric utilities. Specifically, Evergy and Ameren currently have current five-year historical betas of 0.91 and 0.86, respectively.

Q. What was the primary cause of the increase in utility stock betas?

A. The spike in utility stock betas occurred when the market plummeted at the onset of the pandemic in March 2020. It is quite common for all securities, both higher-risk and lower-risk securities, to move in tandem during significant market corrections. Because betas measure the relative volatility of a company or a portfolio as it relates to the market, if all securities rapidly decline at the same time, this causes all betas to converge toward one. For example, the semiconductor equipment industry typically have betas that significantly exceeds one. However, when all securities declined at the start of the pandemic, the semiconductor equipment industry's betas decreased towards one. After the stock market data associated with the synchronized decline of equity markets during March and April of 2020 began to drop off of 1-year beta calculations, the semiconductor equipment industry's betas started to increase back to their normal higher levels.

Q. How much have electric utility one-year raw betas changed over the last couple of years due to the market contraction at the onset of the pandemic?

A. Please see the following chart for one-year raw betas since mid-2019:



Q. How do you interpret the one-year raw beta data shown in the chart?

A. Evergy's stock price during 2020 was volatile due to speculation regarding a potential strategic transaction with another utility company. On August 5, 2020, Evergy announced that it was pursuing a standalone plan rather than a strategic transaction. This caused a sudden decline in Evergy's stock price by approximately $10 during a couple of trading days. Based on Evergy's stock price of around $65 at the time, this was about a 15% decline. Therefore, this speculation caused Evergy's beta to skew higher during much of 2020. After August 2021, Evergy's 1-year betas became more consistent with the electric utility industry and Ameren. Therefore, recent betas do not imply Evergy's risk level is much different than that of the industry.

As it relates to the broader implications for risk of investing in the electric utility industry, while the 1-year betas briefly declined closer to the lower levels achieved before the onset of the Covid-19 pandemic, they steadily increased from mid-2022 to mid-2023. Since mid-2023, they have declined to levels more typical of the electric utility industry over time.

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Q. Did you determine longer-term electric utility betas which exclude the abnormal situation which occurred during the broad market decline at the onset of the Covid-19 pandemic?

A. Yes. I determined the electric utility betas based on data for the last four years, which captures the market dynamics of the period impacted by monetary and fiscal policies in response to Covid-19, but excludes the market swoon in March 2020. These betas are much more in line with typical historical adjusted betas of around 0.7 for the electric utility industry.

Q. Based on your CAPM analysis using four-year betas, what is the estimated COE for Evergy and the proxy groups?

A. My CAPM COE analysis indicates that Evergy and the electric utility industry currently have a COE generally in the 8% to 8.5% range based on market risk premium estimates in the 5 to 6% range. (*see* Schedules DM-D-5).

Q. Are there any other reasonableness tests to show your COE estimates are rational and logical?

A. Yes. First, as I indicated earlier in my testimony, a simple rule of thumb the Chartered Financial Analyst ("CFA") suggests in its curriculum to estimate the COE is to add 3% to 4% risk premium to a company's bond yield to provide a fairly simple, but objective cost of equity. Being that the investment community views utility stocks as bond surrogates/substitutes, it is logical and reasonable to not add a risk premium any higher than 3% to the bond. Simply adding a 3% risk premium to recent YTMs of EMW's long-term bonds of around 5.3% to 5.7% implies a COE of approximately 8.3% to 8.7%.

Second, one just needs to think about the basic characteristics of utility stocks, which is that investors typically view them as yield investments. An analysis performed by Alliance Bernstein (an equity research firm) showed that between 1974 to 2010, approximately 68% of returns from utility stocks were from the income received through dividends, with the

remaining from capital gains.[28] However, with some electric utility companies targeting lower dividend payout ratios, at least in the near-term, in order to fund higher capital expenditure programs related to grid modernization and renewable generation projects, it is reasonable to expect a larger share of returns may be in the form of capital gains. But a fundamental change in the basic characteristics of electric utility stocks is highly unlikely. Even if assuming electric utility stocks generated 50% of returns from capital gains over the long-term, this translates into an 8% required return based on the current average electric utility dividend yield of approximately 4%. If Evergy investors were able to achieve 50% of their total return from capital gains over the long-term, this implies a total return of approximately 10% based on its current dividend yield of approximately 5%.

Q. Based on your analysis and understanding of Evergy's COE, the electric utility industry's COE, investor expectations on allowed ROEs, average electric utility authorized ROEs and Evergy's authorized returns for its Kansas electric utility operations, what would be a fair and reasonable allowed ROE range in this case?

A. 9.25% to 9.75% with 9.5% being consistent with historical dynamics.

Q. Considering you estimate EMW's COE at around 8.5%, why do you consider a 9.5% authorized ROE reasonable?

A. While it certainly may be a worthwhile debate to quantify the amount of "premium," if any, over the COE that is fair and reasonable to allow a utility, the Commission has repeatedly communicated in its orders that it needs to consider average authorized ROEs in setting a fair and reasonable ROE for its Missouri utilities. As it relates to this instant case, I believe the fact that although the cost of capital has increased during the last couple of years, an authorized ROE of 9.5% still allows EMW to create shareholder value simply by investing in rate base since a 9.5% ROE is higher than the Company's COE.

[28] Hugh Wynne, Francois D. Broquin, and Saurabh Singh, "U.S. Utilities: Our Dividend Growth Model Identified Utilities Poised to Pay More," May 20, 2011, Bernstein Research.

CAPITAL STRUCTURE

Q. Will you briefly explain capital structure?

A. Capital structure represents how a company's assets are financed. The typical capital structure consist of common equity, long-term debt, and short-term debt. Although short-term debt is a typical component of a utility company's capital structure, if it is fully supporting construction work in progress ("CWIP"), then it typically is excluded from the rate making capital structure and reflected in the allowance for funds used during construction ("AFUDC") rate.

Q. Has Evergy been using short-term debt to support any other EMW assets other than CWIP?

A. Yes. EMW has been rolling over short-term debt to support extraordinary fuel and purchased power costs incurred during Storm Uri. Subsequent to Storm Uri, EMW incurred additional excess fuel and purchased power costs which have been financed with short-term debt. I will explain these issues in more detail later in my testimony.

Q. What capital structure do you recommend for purposes of setting EMW's rate of return (ROR)?

A. I recommend a ratemaking capital structure that consists of 47.2% common equity and 52.8% long-term debt. My capital structure recommendation is based on my analysis of Evergy's and EMW's quarterly capital structures from the beginning of the test year (July 1, 2022) through the update period (December 31, 2023). My recommended capital structure ratios consider the interdependency of Evergy and its subsidiaries' capital flows. For example, despite the fact that EMW's per books capital structure has consisted of approximately 20% short-term debt since it incurred extraordinary costs related to Storm Uri, for purposes of managing its capital structure for ratemaking, Evergy focuses only on EMW's long-term capital balances (*i.e.* common equity and long-term debt) to target a common equity ratio of around 52% for ratemaking purposes. Evergy manages its own internal accounting records (not available to the public) for purposes of targeting the capital structure it desires for purposes of setting its authorized ROR. If EMW's consistent

balance of short-term debt were included in its ratemaking capital structure, this would lower the proportion of common equity ratio by around 10% (*e.g.* from 52% to 42%).

Q. What is the basis for your recommended ratemaking capital structure?

A. My recommended capital structure for EMW is consistent with Evergy's consolidated capital structure. Including short-term debt, Evergy's equity ratio has been approximately 43% to 44%, declining to around 42% at December 31, 2023. Excluding short-term debt, Evergy's long-term capital ratios had been approximately 48% common equity and 52% long-term debt, declining to 44.7% common equity and 55.3% long-term debt at December 31, 2023, after Evergy issued $1.4 billion of holding company debt in December 2023.

As I will explain later in my testimony, as part of its conditional approval of the Westar Energy Inc. and Great Plains Energy Inc., the Kansas Corporation Commission ("KCC") ordered a condition which discouraged Evergy from using holding company leverage. This condition incentivized Evergy to limit the difference in its consolidated common equity ratio compared to that of its Kansas subsidiaries to no more than 2.5%. Considering the effectiveness of this condition in limiting Evergy's use of holding company leverage, I recommend EMW's common equity ratio be set based on adding 2.5% to Evergy's December 31, 2023 common equity ratio of 44.7%, which is the basis for my recommend 47.2% ratemaking common equity ratio.

Q. Why did you not rely on EMW's per books capital structure for your capital structure recommendation for this case?

A. Because it is inconsistent with the financial risk inherent in Evergy's consolidated capital structure. In EMW's rate cases since 2016, the parties have disputed the integrity of EMW's capital structure. For purposes of settlement in Case No. ER-2018-0146, some parties agreed that EMW's capital structure as of December 31, 2017, should be adjusted by $169 million of goodwill. However, EMW's common equity ratio before this adjustment was not specified in the agreement.[29]

[29] Case No. ER-2018-0146, Non-Unanimous Stipulation and Agreement, September 19, 2018.

Q. What is goodwill?

A. Goodwill represents the excess amount of the purchase price for a company and/or assets that cannot be reconciled to the existing book value of these assets. For example, most publicly-traded utilities' stock prices are valued higher than the book value of the equity shown on utilities' balance sheets. When a company acquires a utility at a price that is typically even higher than the target utility's market capitalization before the announced acquisition, then the value of the target company is booked on the acquirer's balance sheet at the purchase price. To the extent the book value of tangible and intangible assets do not reconcile to the purchase price, the balance is classified as a goodwill asset.

Q. Why is it important to consider the interaction of goodwill and per books common equity as it relates to analyzing EMW's capital structure?

A. Because in EMW's 2018 rate case, Staff witness Jeffrey Smith had proposed making an adjustment to EMW's consolidated GAAP balance sheet ratios at June 30, 2018, which contained a common equity balance of $1.323 billion[30] as compared to Company witness Darren Ives, who proposed making an adjustment to a common equity balance of ** _____ _____ ** at June 30, 2018.[31]

Q. Were you able to identify the source document Mr. Smith used to determine his common equity balance?

A. Yes. Mr. Smith relied on EMW's consolidated balance sheets the Company provided in response to Staff Data Request No. 0298 in Case No. ER-2018-0146.

Q. Were you able to identify the source document Mr. Ives relied on for his common equity balance?

A. No. But apparently his source was an internal financial report that deconsolidates EMW's consolidated capital structure.

[30] Case No. ER-2018-0146, Smith Surrebuttal, p. 13, lns. 1-3
[31] Case No. ER-2018-0146, Ives Rebuttal, p. 14, lns. 13-14.

Q. Were there any publicly-available balance sheets for EMW at June 30, 2018?

A. Yes. EMW files Form 3-Qs with the FERC quarterly. Form 3-Qs represent EMW's consolidated financial statements on a quarterly basis.

Q. What common equity balance was identified for EMW in its June 30, 2018 Form 3-Q?

A. $1.17 billion.

Q. What goodwill amount was reflected in EMW's June 30, 2018, FERC Form 3-Q filing?

A. $169 million, which is recorded under FERC Account No. 186, Miscellaneous Deferred Debits.

Q. If the goodwill balance were deducted from the $1.17 billion of equity reported on EMW's FERC Form 3-Q, what was the indicated common equity ratio on June 30, 2018?

A. 48.13%, which is fairly similar to Mr. Smith's recommended common equity ratio of 47.43% in that case.

Q. What common equity balance was reported on EMW's consolidated GAAP balance sheet at June 30, 2023 and December 31, 2023?

A. ** _____ ** at June 30, 2023 and ** _____ ** at December 31, 2023.

Q. What goodwill balance was reported at both dates?

A. ** _____ **

Q. What common equity balance was reported on EMW's consolidated FERC balance sheets at June 30, 2023 and December 31, 2023?

A. $1,590.9 million at June 30, 2023 and $1,646.5 million at December 31, 2023

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Q. What goodwill balance was reported at both dates?

A. $169 million.

Q. Why is the GAAP financial information classified as confidential, but the FERC financial information is not?

A. I am not entirely sure, but utility company financials filed with FERC are generally public documents. I presume because EMW is not registered with the Securities and Exchange Commission ("SEC") because it does not have publicly-traded debt or equity, this allows EMW to maintain confidentiality of its financial statements. However, EMW's private debt investors require EMW to provide its consolidated GAAP financial statements as part of the covenants in their indentures.

Q. Are EMW's debt investors provided EMW's deconsolidated financial statements, which is apparently the information EMW relies on for determining it ratemaking capital structure recommendation?

A. Not that I am aware of.

Q. What common equity ratio did EMW consider implied based on the agreement in Case No. ER-2018-0146?

A. **_____ **

Q. What's your basis for this conclusion?

A. Mr. Klote's testimony and schedules filed in EMW's securitization application, Case No. EF-2022-0155.

Q. In this case, what does EMW expect its equity ratio will be as of the true-up period, June 30, 2024?

A. 52.04%.

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Q. Which EMW financial statements does Evergy present to rating agencies for purposes of assessing EMW's creditworthiness?

A. Their consolidated financial statements. Not the deconsolidated financial statements EMW's witnesses have relied on for their recommended capital structures.[32]

Q. Did Evergy recently increase the amount of holding company long-term debt in its capital structure?

A. Yes. Evergy issued $1.4 billion in convertible debt on December 5, 2023. This caused the percentage of holding company long-term debt to increase to 25.27% of total consolidated leverage at December 31, 2023 from 15.71% at September 30, 2023.

Q. What was the percentage of holding company debt at September 30, 2023 if you include Evergy's $500 million term loan and $112.9 million of commercial paper outstanding at the same date?

A. Approximately 20%.

Q. How did Evergy's issuance of $1.4 billion of holding company debt impact Evergy's consolidated capital structure?

A. Including short-term debt, Evergy's common equity ratio was 42.19% at December 31, 2023, as compared to 43.36% at September 30, 2023. Excluding short-term debt, Evergy's common equity ratio was 44.7% at December 31, 2023, which compared to its 48.95% common equity ratio at September 30, 2023.

**Q. ** _____

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A. _____

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[32] EMW's response to Staff Data Request No. 18.

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[redacted] **

[33] Evergy Inc.'s August 29 – 31, 2023 Board of Directors Strategy Session, p. 352.
[34] *Id.*, p. 353.

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Q. Did Evergy have any incentive to limit the amount and percentage of holding company debt until recently?

A. Yes. A condition of the Kansas Corporation Commission's ("KCC") approval of the Great Plains Energy and Westar Energy Inc. merger was to institute an Earnings Review and Sharing Plan ("ERSP"). The KCC understood that the newly formed entity, Evergy, could attempt to accrue additional earnings for its shareholders by using more leverage at the holding company level as compared to its subsidiaries. Consequently, if Evergy's consolidated common equity fell below 47.5%, then each Kansas subsidiary's common equity ratio would be reduced by a proportional amount for purposes of determining potential bill credits to customers for the ERSP.[35] Therefore, if Evergy's holding company debt exceeded more than 2.5% of its total consolidated capital structure, then Evergy would have been required to share more merger savings with ratepayers.

Q. When did Evergy's ERSP expire?

A. At the time Evergy's KS new rates took effect.

Q. Has Evergy expressed an intent/desire to optimize EMW's capital structure?

A. No. Based on the approximate 52% common equity ratio Evergy has targeted for its operating utility company subsidiaries, including EMW, over the last several years, it appears that Evergy is doing so mainly for purposes of achieving a higher authorized common equity ratio for purposes of justifying a higher revenue requirement to charge ratepayers.

Q. Is this practice consistent with Missouri's other large utility companies?

A. Yes. Missouri's other large utility companies, such as Ameren Missouri, Spire Missouri and Liberty's various Missouri operating utility subsidiaries, target ratemaking common equity ratios of approximately 52% to 54%.

[35] Docket No. 18-KCPE-095-MER, Order Approving Merger, Attachment A, May 24, 2018, pgs. 18-22.

Q. Does Evergy's capital structure support a goodwill asset?

A. Yes. Evergy's assets include $2.336 billion of goodwill.

Q. If you removed this goodwill from Evergy's common equity balance, what is Evergy's tangible common equity ratio?

A. Around 37% with short-term debt and 41% without short-term debt.

Q. What is EMW's embedded cost of debt at December 31, 2023?

A. According to EMW's response to Staff Data Request No. 106, it is 4.009%.

Q. Do you agree with the Company's calculation methodology to determine the embedded cost of debt?

A. Yes. The Company determined the embedded cost of debt using a weighted-average yield-to-maturity, which is a reasonable approach for determining the cost of debt.

Q. What was Metro's embedded cost of debt at December 31, 2023?

A. 4.3492%.

Q. Was the calculation methodology the same as for EMW?

A. Yes.

Q. Does EMW have a better credit rating than Metro?

A. No. Moody's assigns EMW a 'Baa2' rating whereas it assigns Metro a 'Baa1' rating, which is one notch better. S&P assigns EMW a 'BBB+' rating whereas it assigns Metro an 'A-' rating.

Q. What are Evergy's current issuer/corporate credit ratings?

A. Moody's assigns Evergy a 'Baa2' rating. S&P assigns Evergy a 'BBB+' rating.

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Q. Considering it has a one notch lower credit rating, why is EMW's embedded cost of debt lower than Metro's embedded cost of debt?

A. A couple of factors. First, EMW issued 38.58% of its outstanding debt in the 2020 to 2021 period when bond yields were extremely low (Metro issued 13.24% of its outstanding debt during this period). Additionally, the weighted average maturity on EMW's debt (8.5 years) is almost six years shorter than the weighted average maturity on Metro's debt (14.4 years). Typically, the shorter the tenor on debt, the lower the coupon rate on the debt due to a required term risk premium, which compensates investors for the uncertainty of changes in short-term rates over the period of the long-term bond investment.

Q. How do Metro and EMW's costs of debt compare to Evergy's consolidated cost of debt?

A. Evergy's consolidated cost of debt is 4.285%.

Q. What is the cost of Evergy's holding company debt?

A. 4.0306%.

Q. Are there other factors that should be considered in determining a fair and reasonable capital structure and cost of debt for EMW?

A. Yes. EMW has carried a significant amount and percentage of short-term debt since February 2021 when it funded extraordinary costs related Winter Storm Uri ("Storm Uri"). As can be seen on pages three and four of Schedule DM-D-6, EMW has consistently had a high proportion of its capital structure supported by short-term debt (both third-party debt and affiliate debt). EMW's short-term debt balance almost tripled during the first quarter of 2021 (an increase in funds received from short-term debt of $525 million), which is the period in which EMW incurred over $300 million in extraordinary energy costs during Storm Uri. "Related party" payables also increased by $200 million so these funding sources were more than adequate to cover Storm Uri costs.

Q. Did the Commission address EMW's financing costs for "carrying" Storm Uri costs until it could issue securitized bonds authorized in MO West's securitization case, Case No. EF-2022-0155?

A. Yes. The Commission ordered that EMW be compensated for financing Storm Uri costs based on MO West's embedded cost of long-term debt of 5.06% as of June 30, 2018. It was factually impossible for this point-in-time embedded cost of long-term debt to have been related to financing Storm Uri.

Q. Did you compare EMW's short-term debt balances since it incurred Storm Uri costs to determine if EMW refinanced the short-term debt with long-term capital?

A. Yes. In response to Staff Data Request No. 104, EMW provided monthly short-term debt balances for the period 2021 to 2023. EMW also provided monthly balances of assets typically funded by short-term debt (e.g. construction work in progress and fuel and purchased power), which included the Storm Uri costs. The average balance of short-term debt over the period since MO West incurred Storm Uri costs was approximately 98% of the average balances of costs assigned to Storm Uri, CWIP, and other excess fuel and purchased power costs.

Q. Did you estimate how much excess carrying costs were charged to ratepayers by allowing EMW to recover carrying costs based on the embedded cost of long-term debt as compared to the average cost of short-term debt over this period?

A. Yes. I estimate that ratepayers were overcharged by approximately $20 million for carrying costs as compared to actual carrying costs over the period EMW carried Storm Uri costs.

Q. Are you proposing this money be clawed back from EMW?

A. No. This would constitute retroactive ratemaking. However, this issue should certainly be considered in determining a fair and reasonable ratemaking capital structure for purposes of setting EMW's allowed ROR.

Q. How did Evergy provide the funds EMW needed to finance Storm Uri over the last three years?

A. Through both third-party short-term debt and money pool (*i.e.* affiliate) borrowings. The average percentage of short-term debt provided through Evergy's money pool was 15.77% ($83.4 million) over the period since short-term financing was needed to fund Storm Uri costs.

Q. Why are these factors important to consider for purpose of authorizing a fair and reasonable capital structure for ratemaking?

A. Evergy's credit quality is derived from its ownership of its regulated utility subsidiaries. Evergy's use of this credit quality allows Evergy access to liquidity under a $2.5 billion master credit facility for Evergy and its subsidiaries. Evergy's current sublimit borrowing capacity under the master credit facility is $200 million.[36] As recently as December 31, 2021, Evergy had a sublimit borrowing capacity of up to $700 million. According to the terms of the master credit facility, Evergy can unilaterally adjust each company's borrowing sublimits provided the sublimits remain within minimum and maximum sublimits as specified in the facility.[37]

Q. Can you provide an example of how the holding company's issuance of capital distorts the normal capital flows expected if the utility subsidiaries were truly stand-alone companies?

A. Yes. Evergy paid its shareholders $147.6 million in dividends for the fourth quarter of 2023. However, none of Evergy's subsidiaries distributed a dividend to Evergy during this quarter. Therefore, Evergy had to finance this deficiency at the holding company level. Typically, Evergy had issued short-term debt to finance the deficiency in funds needed to pay dividends. It appears this was how Evergy financed the funds needed for dividends in the fourth quarter of 2023, but because Evergy issued $1.4 billion of holding company debt during the same quarter of the dividend deficiency, it is difficult to reconcile the sources and uses of funds for this quarter. According to EMW's response to OPC DR 3013, Evergy

[36] Evergy's SEC Form 10-Q Filing, March 31, 2024, pp. 34-35.
[37] *Id.*

used the proceeds from the $1.4 billion issuance to reduce the amount of short-term debt outstanding at Evergy and its operating subsidiaries and to repay Evergy's $500 million Term Loan Facility it had issued to provide liquidity while MO West was still carrying the costs incurred to during Storm Uri. If Evergy did not issue holding company capital to finance dividends or lend money to its subsidiaries through the money pool, then regulated utility subsidiaries would do such financing with third parties on a stand-alone basis. While issuing holding company capital is efficient and less costly for shareholders, this model comes at an expense to ratepayers through higher accruals in AFUDC and carrying costs for other assets.

Q. Did EMW's previous parent company, Great Plains Energy ("GPE"), issue holding company debt to finance its subsidiaries?

A. No. While GPE had access to $200 million of short-term debt through its shared credit facility with Evergy Metro and Evergy MO West, it rarely and minimally accessed such.

Q. Did Metro and MO West consistently access commercial paper markets?

A. Yes.

Q. Did Metro and MO West consistently provide sufficient dividends to GPE to fund dividends to GPE's common and preferred shareholders?

A. Yes. As shown on Schedule DM-D-9, Metro and EMW typically paid dividends to GPE that usually exceeded the amount of funds GPE needed to pay dividends to its common and preferred shareholders.

Q. Why is this an important consideration for purposes of evaluating fair and reasonable financing costs charged to Metro and MO West's ratepayers?

A. Because instead of Metro and MO West funding a consistent dividend to support dividends to Evergy's shareholders, and issuing commercial paper to fund its own capital expenditure needs, Evergy is issuing holding company capital to ensure dividends are fully funded. This distorts the original expectation for stand-alone electric utility companies to balance its capital allocation based on its own anticipated capital needs.

Q. When was the last time EMW distributed dividends to Evergy?

A. EMW has not paid a dividend to Evergy since the fourth quarter of 2020.

Q. You testified that Evergy executed a $500 million Term Loan Facility to provide additional liquidity while EMW carried the Storm Uri assets on its books. What is the basis for your opinion?

A. Evergy's internal records. Evergy provided the following explanation for extending its Term Loan Facility by one year:

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Q. What do you consider the best approach to sort through the alternative sets of financial statements, methods, and potential adjustments to make to EMW's capital structure for ratemaking purposes in this case?

A. Take guidance from Evergy's targeted and actual consolidated capitalization ratios to assure EMW's capital structure is based on the most optimal use of leverage (*i.e.* debt). While I understand the Commission has shown a preference for using a subsidiary capital structure if that subsidiary issues all of its own debt (or in the case of Spire Missouri, at least all of its long-term debt, but not short-term debt), due to the numerous affiliate capital transfers that occur (money pool transactions) and Evergy's propensity to manage liquidity at the holding company level, I do not have confidence that the utility subsidiaries' capital structures are a consequence of arms-length transactions intended to optimize the subsidiary capital structure for purposes of minimizing the ROR charged to ratepayers and preserving the subsidiaries' credit capacity (*i.e.* not letting the parent company take borrowing capacity and lower costs of capital from its subsidiaries).

[38] Evergy Inc.'s May 1, 2023 Finance Committee Meeting, p. 36.

Q. Do you have an example of commentary that supports your view that Evergy manages its subsidiary capital structures to those authorized by the Commission?

A. Yes. Moody's stated the following about MO West's capital structure in an April 29, 2021 Credit Opinion:

> The company plans to fund its elevated capital expenditures with a balance of internally generated cash flow, incremental debt and money pool borrowings, **adjusting dividends as needed to maintain the utility's regulatory allowed capital structure.**[39] (emphasis added)

Q. What common equity ratio does Evergy appear to be targeting for its utility subsidiaries?

A. 52%. Evergy's requested ratemaking common equity ratios for its utility subsidiaries have been as follows for rate cases since 2022:

- Evergy Metro Missouri: 51.19% Case No. ER-2022-0129
- Evergy Missouri West: 51.81% Case No. ER-2022-0130; 52.04% Case No. ER-2024-0189
- Evergy Kansas Central: 52.04% Docket No. 23-EKCE-775-RTS
- Evergy Metro Kansas: 52.00% Docket No. 23-EKCE-775-RTS

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[39] Cardona, Jillian, et. al., "Evergy Missouri West, Inc. – Update to Credit Analysis," Moody's Investor Services, December 21, 2023.
[40] Evergy's Financing Committee of the Board, February 26, 2024, p. 36.

Therefore, absent a showing that Evergy is managing its subsidiaries' capital structures to optimize the lowest reasonable third-party cost of capital, the Commission should adjust EMW's proportion of long-term capital components to be more consistent with that of Evergy on a consolidated basis.

Q. Does Ameren Missouri target the same common equity ratio for ratemaking purposes?

A. Yes. Ameren Missouri has consistently targeted an approximate 52% common equity ratio for its requested authorized ROR for rate cases over approximately the last ten years.

Q. Is it prudent for a utility subsidiary's capital structure to remain constant over time?

A. No. Changes in capital market conditions and business risk should consistently and constantly be evaluated to determine the most cost efficient balance of capital and timing for capital issuances. As clearly stated in Evergy's internal records, Evergy's BOD and Finance Committee are primarily focused on ** _____ _____ **

Q. Does Evergy plan to keep a constant common equity ratio despite capital market conditions?

A. No. Evergy does not plan to issue new common equity through 2026. Evergy, consistent with other utility companies, is hesitant to issue new common equity at current lower valuation levels. Evergy's vested interest in lowering its third-party cost of capital at the parent company is the most appropriate market-based proxy to guide the Commission in setting a fair and reasonable ratemaking capital structure.

Q. What corroborating information supports your position that Evergy's Missouri subsidiaries' business risks are lower due to its ability to recover a return on and of investments between rate cases through PISA?

A. First, by the very fact that as part of Evergy's decision to pursue the STP initiative, Evergy increased its planned capital expenditures by $438 million for its Missouri systems. According to Elliott's open letter to Evergy in 2020, the allocation of capital to investment

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in Missouri would create more shareholder value than Evergy's previous share buyback program.[41]

Second, both Moody's and S&P have consistently cited the PISA ratemaking mechanism as a credit positive factor as it relates to Evergy's Missouri utility companies, Ameren Missouri and Empire. In fact, Moody's lowered Ameren Corp's Funds from Operations ("FFO")/debt[42] threshold to 17% from 19%, which means that Ameren Corp can incur more leverage as it compares to cash flow and still maintain its current credit rating of 'Baa1' (functional equivalent of S&P's 'BBB+'). One of the primary reasons Moody's cited for allowing Ameren Corp to have a lower FFO/debt threshold (*i.e.* use of more leverage) was "improved regulatory construct in Missouri facilitating meaningful rate base growth and reducing regulatory lag [PISA]."[43] Considering the fact that EMW is projected to have the highest rate base growth of all of Evergy's subsidiaries over the next several years, it is just and reasonable to set the authorized capital structure with a ratio of debt Evergy targets at the consolidated level. Recognizing this lower business risk by including a higher debt ratio in the capital structure ensures Evergy's Missouri ratepayers receive credit for Evergy's reduced risk profile afforded by the legislative opportunity to receive a return on and of plant placed in service between rate cases.

Q. Why does giving consideration to Evergy's long-term equity ratio appropriate for setting EMW's allowed ROR?

A Evergy allocates capital around its companies to target and achieve ratemaking common equity ratios. The most objective and practical measure of the capital structure that captures the debt capacity of Evergy's regulated utility assets, is that of Evergy on a consolidated basis. Consequently, I recommend EMW's ratemaking common equity ratio be set no higher than 2.5% above Evergy's consolidated common equity ratio at December

[41] Elliott's January 21, 2020 letter to Evergy's Board of Directors.
[42] FFO/Debt (as generally referenced by most evaluating credit worthiness) is the credit metric that receives the most weight by both Standard & Poor's (S&P) and Moody's. This metric provides insight as to how much sustainable cash flow the operations generate as it relates to the amount of fixed obligations, which includes traditional debt, but also other obligations such as capital leases. The higher the ratio, the less financial risk implied by the ratio. Moody's more specifically defines FFO/debt as "Cash flow from Operations – Pre Working Capital to Debt". However, I will generally refer to each as FFO/debt.
[43] "Update to Credit Analysis," Moody's Investor Service, March 29, 2019, p. 2.

31, 2023, which is the basis for my recommended ratemaking common equity ratio of 47.2%.

SUMMARY AND CONCLUSIONS

Q. Can you summarize your main conclusions and views as it relates to an authorized ROR in this case?

A. EMW ratepayers deserve consideration for the fact that they are now charged for plant placed in service in between general rate cases, as well as paying a fixed surcharge for the next fifteen years to allow EMW to recover $307.8 million of Storm Uri costs. In competitive markets, if a company is able to reduce its business risk and have more assurance of achieving its expected returns, its debt capacity increases. Consideration for such lower business risk can be achieved by reducing the awarded ROE and/or reducing the authorized common equity ratio. EMW's lower business risk due to PISA and securitization support a higher amount of leverage in its authorized capital structure. In order to further enhance shareholder wealth, Evergy rather leverage this lower business risk at the holding company level, which is unfair to ratepayers. The Commission can correct Evergy's financial strategy, which unfairly rewards shareholders at the expense of ratepayers, by considering Evergy's market-based capital structure in setting a fair and reasonable ratemaking capital structure for EMW. Therefore, the Commission should apply my recommended 9.5% authorized ROE to a 47.2% common equity ratio.

Q. Does this conclude your testimony?

A. Yes.

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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	)))))	Case No. ER-2024-0189

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

David Murray, of lawful age and being first duly sworn, deposes and states:

1. My name is David Murray. I am a Utility Regulatory Manager for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct 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 27th day of June 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.