

FILED
October 22, 2024
Data Center
Missouri Public
Service Commission

Exhibit No. 320

OPC – Exhibit 320
David Murray
Surrebuttal and True-Up Direct
File No. ER-2024-0189

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

SURREBUTTAL
and
TRUE-UP 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.

**

September 10, 2024

PUBLIC

TABLE OF CONTENTS

Testimony	Page
True-Up of Long-Term Debt Cost and Capital Structure	2
Ann Bulkley's Rebuttal Testimony	3
Won's Rebuttal Testimony	13
Summary and Conclusions	17

SURREBUTTAL AND TRUE-UP DIRECT TESTIMONY

OF

DAVID MURRAY

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

CASE NOS. ER-2024-0189

1 **Q. Please state your name and business address.**

2 A. My name is David Murray and my business address is P.O. Box 2230, Jefferson City,
3 Missouri 65102.

4 **Q. Are you the same David Murray who previously filed Direct and Rebuttal Testimony in**
5 **this case?**

6 A. Yes.

7 **Q. What is the purpose of your testimony?**

8 A. To update the cost of long-term debt through the true-up date for Evergy Missouri West,
9 Inc. (“MO West”). Additionally, I analyzed the most recent financial statement
10 information available for Evergy, Inc. (“Evergy”) and MO West to determine if I should
11 update my initial capital structure recommendation. Because Evergy’s capital structure
12 has become slightly more levered (*i.e.* higher percentage of long-term debt), I now
13 recommend MO West’s ratemaking capital structure be premised on a 46.37% common
14 equity ratio compared to my initial recommendation of 47.20%. I discuss this updated
15 information throughout this testimony.

16 **Q. To which witnesses’ rebuttal testimonies will you reply as it relates to your surrebuttal**
17 **testimony?**

18 A. MO West’s witness Ann E. Bulkley’s rebuttal testimony as it relates to my capital structure
19 and return on common equity (“ROE”) recommendation and Staff witness Seoung Joun
20 Won’s, PhD as it relates to my capital structure recommendation.

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

2 A. First, I will provide my true-up recommendations. Then, I will address Ms. Bulkley's
3 rebuttal testimony. Finally, I will address Dr. Won's rebuttal testimony.

4 **TRUE-UP OF LONG-TERM DEBT COST AND CAPITAL STRUCTURE**

5 **Q. What was MO West's embedded cost of long-term debt as of June 30, 2024?**

6 A. 4.34%.

7 **Q. Do you recommend MO West's authorized ROR be set based on the 4.34% embedded
8 cost of long-term debt?**

9 A. Yes.

10 **Q. Did you analyze Evergy's and MO West's financial information through June 30,
11 2024, to determine if you should update your recommended ratemaking capital
12 structure?**

13 A. Yes.

14 **Q. Has your review and analysis of this financial information caused you to update your
15 recommended ratemaking capital structure for MO West?**

16 A. Yes.

17 **Q. What is your updated recommended ratemaking capital structure?**

18 A. 46.37% common equity and 53.63% long-term debt.

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

20 A. As shown on page 1 of Schedule DM-S-1, Evergy's consolidated capital structure has
21 become slightly more levered since the December 31, 2023, update period. After I adjusted
22 Evergy's capital structure to exclude MO West's approximate \$323 million of securitized
23 debt and short-term debt, Evergy's common equity ratio was 43.87% at June 30, 2024.
24 Consistent with the adjustment I made in my direct testimony, I added 2.5% to Evergy's

1 common equity ratio to arrive at my recommended ratemaking common equity ratio of
2 46.37% for MO West.

3 **Q. Have you attached schedules to this testimony to show the analysis you performed for**
4 **purposes of updating your ROR recommendation?**

5 A. Yes. Schedules DM-S-1 through DM-S-3 show my analysis and my updated ROR
6 recommendation.

7 **ANN E. BULKLEY’S REBUTTAL TESTIMONY**

8 **Q. Ms. Bulkley testifies that there is no basis for your position that utility companies are**
9 **authorized ROEs higher than their COE.¹ What is your basis for your opinion?**

10 A. My own COE analysis. However, I also have consistently provided information from
11 investor sources over the last fifteen years, which corroborate my position. Additionally,
12 Goldman Sachs and Morgan Stanley advised Evergy’s Strategic Review & Operations
13 Committee (“Strategic Committee”) created for purposes of evaluating whether Evergy
14 should continue as a stand-alone company or pursue a strategic transaction with another
15 utility. In providing this advice, ** _____

16 _____
17 _____
18 _____
19 _____
20 _____ **2

21 **Q. When did Evergy’s financial advisors perform their analysis of Evergy’s potential**
22 **value as stand-alone company?**

23 A. Evergy’s financial advisors presented their analysis to Evergy’s Strategic Committee in
24 July 2020.

¹ Bulkley Rebuttal, p. 44, ll. 11-12.

² Case No. ER-2022-0130, Murray Direct Testimony, Schedule DM-D-3.

1 **Q. What were average authorized ROEs for vertically-integrated electric utilities in**
2 **2020?**

3 A. 9.55%.

4 **Q. Does an approximate **** _____
5 _____
6 _____ **

7 A. Yes.

8 **Q. Are there any other financial metrics that are often evaluated to determine if a**
9 **company or portfolio of companies are earning more than their cost of capital?**

10 A. Yes. Market-to-book ratios above one generally establishes that a company is creating
11 value for its shareholders by earning more than its cost of capital.

12 **Q. Why?**

13 A. The simplest example to illustrate this dynamic is a bond valuation example. If a 30-year
14 United States Treasury (“UST”) bond is issued today at a coupon consistent with the
15 current yield-to-maturity on 30-year UST bonds (4.1%), then the value of the bond is
16 exactly equal to the \$1,000 principal balance of the bond. If the market cost of debt
17 increases to 4.5% in one year, investors would only pay \$935.57 for the 4.1% coupon bond
18 in order to ensure they receive the current market yield of 4.5%. The market-to-book ratio
19 of the 4.1% bond is 93.56%. Conversely, if the market cost of debt decreased to 3.7% in
20 one year, investors would pay \$1,070.77 for the 4.1% coupon in order for the seller to be
21 compensated for the lower coupons on newly-issued bonds. The market-to-book ratio of
22 the 4.1% bond is 107.08% in this scenario. These same principles apply to the book value
23 (original issue price) of common stock.

1 **Q. How so?**

2 A. Justified price-to-book ratios are determined through the following formula, which is
3 premised on using discounted cash flow analysis:³

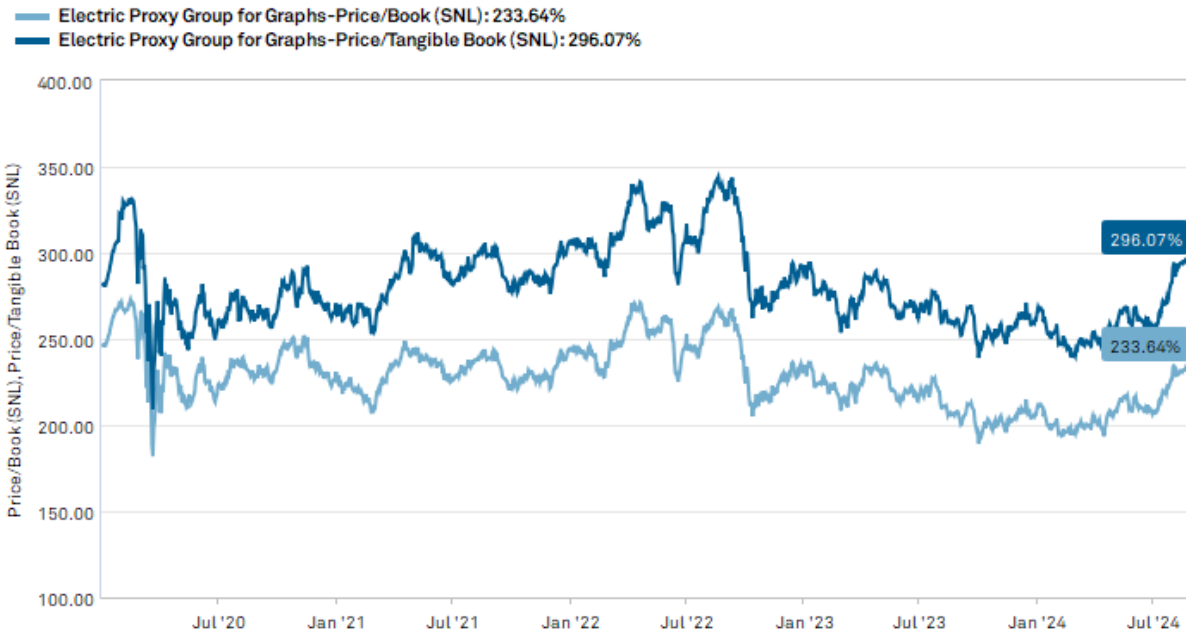
$$P_0/B_0 = (ROE - g)/(r - g)$$

4
5
6 Where: P_0 = price/market value at period 0
7 B_0 = book value at period 0
8 ROE = expected return on common equity
9 g = growth in earnings
10 r = cost of common equity

11 If expected earnings are higher than the cost of common equity, then the justified
12 market/book ratio is greater than one and vice versa.

13 **Q. Can you provide the market-to-book ratios of the electric utility group you analyzed
14 in your direct testimony?**

15 A. Yes.



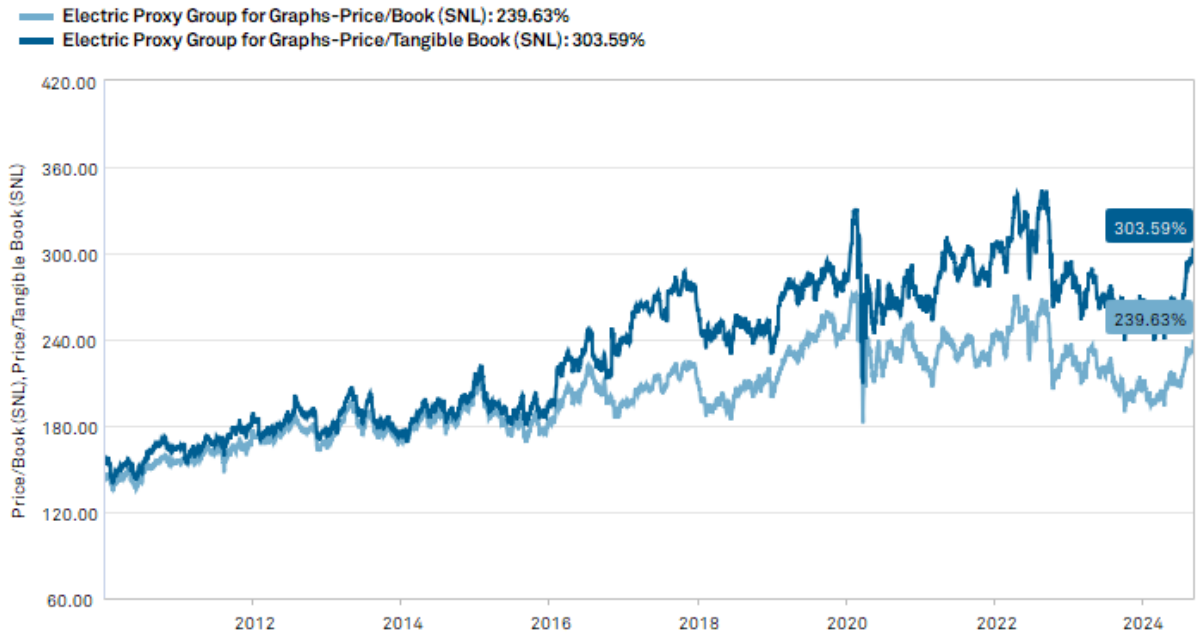
16

³ Refresher Reading, 2024 CFA® Program, Level 2, p. 45.

1 As can be seen, the market-to-book ratios are greater than 2-to-1 since January 1, 2020.
2 Because publicly-traded utility companies typically have engaged in mergers and
3 acquisitions, similar to Evergy, the book value of companies' common stocks may include
4 an allowance for goodwill (purchase price over the book value of the assets). After
5 deducting goodwill from the book value of the common stock, the market-to-book ratios
6 have been in the 2.5x to 3x range. The electric utility industry's lofty price-to-book ratios
7 support my position, and those of investors and financial advisors, that authorized ROEs
8 are higher than the COE.

9 **Q. In your direct testimony, you cited Barclay's commentary/analysis that recognized
10 that authorized ROEs did not decline along with the cost of capital since 2010. Do
11 electric utility price-to-book ratios over this period support Barclay's view?**

12 **A. Yes. See the following chart showing electric utility price-to-book ratios over this period:**



13
14 As shown, the P/B ratios for the electric utility group gradually expanded from 2010
15 through 2020 as the cost of capital declined, but authorized ROEs remained “sticky.” The
16 fact that current authorized ROEs of around 9.6% still justify P/B ratios of 2.4x to 3x,
17 supports at least maintaining MO West's authorized ROE at its current level of 9.5%.

1 **Q. Does Ms. Bulkley accurately describe your multi-stage DCF analysis in her rebuttal**
2 **testimony?⁴**

3 A. No. Ms. Bulkley testifies that the first stage of my multi-stage DCF analysis estimates
4 projected dividends per share (“DPS”) through 2028 based on equity analysts’ projected
5 earnings per share (“EPS”) growth rates through 2028. This is incorrect. The DPS
6 estimates through 2028 are consensus equity analysts’ discrete DPS estimates through
7 2028. The objective of my multi-stage DCF analysis is to discount the proper metric, DPS,
8 based on equity analysts’ discrete DPS estimates for as many periods as they are available.
9 After the discrete stage, I then impute DPS estimates by starting with equity analysts’
10 estimates of 5-year CAGR in EPS and then allow for a gradual decline over the next ten
11 years until the perpetual growth stage, at which time companies would adjust their dividend
12 payout ratios (DPS/EPS) to ensure they do not have to access external equity markets (*i.e.*
13 the sustainable growth stage).

14 **Q. Ms. Bulkley claims that your multi-stage DCF analysis is less reliable than a constant-**
15 **growth DCF analysis using equity analysts’ projected long-term growth in EPS as the**
16 **constant growth rate.⁵ What is her basis for her position?**

17 A. She testifies that because the utility industry is a mature industry, equity analysts’
18 consensus projected long-term CAGR in EPS are likely to be consistent with an expected
19 constant growth rate in perpetuity.

20 **Q. In your experience reviewing and analyzing equity analyst research, have you ever**
21 **discovered a utility equity analysis that assumes a utility’s DPS will grow in perpetuity**
22 **at the same rate as a projected 3-to-5-year CAGR in EPS?**

23 A. No.

⁴ *Id.*, p. 49, ln. 17 – p. 50, ln. 9.

⁵ *Id.*, p. 51, ln. 9 – p. 52, ln. 19.

1 **Q. In your experience reviewing and analyzing equity analyst research, what version of**
2 **the DCF is used for purposes of estimating the intrinsic value of utility stock?**

3 A. A multi-stage DCF or more specifically a multi-stage DDM (dividend discount model).

4 **Q. Is Ms. Bulkley correct that equity analysts' projected 3-to-5-year CAGR in EPS is**
5 **stable over time?**

6 A. No. Evergy is the simplest example of the significant changes that occur in analysts'
7 projected 3-to-5-year CAGR in EPS. Since Evergy was created in June 2018 through the
8 merger of Great Plains Energy and Westar Inc., equity analysts' consensus estimates of
9 Evergy's projected 3-to-5-year long-term CAGR in EPS has been as low as 5.07% on
10 March 29, 2024 and as high as 8.48% on December 31, 2019. Simply put,
11 constant/perpetual growth rates should not change much over time. In fact, Evergy itself
12 does not use widely divergent perpetual growth rates in its own valuation analysis for
13 purposes of testing the carrying value of its goodwill asset. In 2021, Evergy used a **
14 _____ ** perpetual growth for its analysis.⁶ In 2023, Evergy used a perpetual growth rate
15 of ** _____ ** for its analysis.⁷

16 **Q. Is a perpetual growth rate of approximately 2.5% to 3.5% consistent with utility**
17 **companies rate base growth during periods of maintenance-level capital**
18 **expenditures?**

19 A. Yes. Before Ameren Missouri was able to elect plant in service accounting ("PISA") in
20 2018, Ameren Corp. communicated to investors that its investment in Ameren Missouri
21 was limited to maintenance-level capex. Before Ameren Missouri elected PISA, its CAGR
22 in rate base was in the range of 2.2% to 3% for the period 2010/2011 to 2019.⁸

⁶ Evergy Missouri West's Response to Staff Data Request No. 0117.

⁷ *Id.*

⁸ Case No. ER-2021-0240, David Murray Direct Testimony, p. 22, lines 13-20.

1 **Q. Ms. Bulkley suggests the perpetual growth rate in your multi-stage DCF analysis**
2 **should be at parity with expected long-term growth in the U.S. economy.⁹ Do you**
3 **agree?**

4 A. No. The simplest way to illustrate the fallacy of Mr. Bulkley's suggestion that electric
5 utility industry growth will converge to GDP growth in the long-term is to consider the
6 impact of the appropriate application of this logic to the S&P 500 index. Because the S&P
7 500 index is considered a proxy for the U.S. stock market, it is logical that the expected
8 long-term growth of the S&P 500 would be constrained by the expected growth in GDP.
9 However, because on average, the companies in the S&P 500 tend to have better growth
10 prospects than the electric utility industry, the dividend payout ratio and the dividend yield
11 is lower. This fact implies that the growth rate for electric utilities should be lower than
12 an aggregate growth rate, (*i.e.*, GDP) used for the U.S. market (*i.e.*, the S&P 500). Adding
13 Ms. Bulkley's suggested GDP growth rate of approximately 5.5% to her determination of
14 a 1.58% dividend yield for the S&P 500, results in a market COE estimate of approximately
15 7.1%. Because electric utilities have a higher dividend yield due to the fact that they have
16 a higher dividend payout ratio and lower growth expectations than the S&P 500, adding
17 the same GDP growth rate of 5.50% to Ms. Bulkley's determination of an average 4.36%
18 dividend yield in her "90-day Constant Growth DCF" analysis, results in a COE estimate
19 of approximately 9.86%. These results are illogical based on the well-accepted and
20 supported understanding that the regulated utility industry is the lowest-risk sector in the
21 S&P 500.

22 **Q. Regardless of your disagreement with Ms. Bulkley that electric utilities' EPS and DPS**
23 **can grow in perpetuity at the same rate as GDP, are there contradictions in her**
24 **approach to estimating nominal GDP growth over the long-term?**

25 A. Yes. Ms. Bulkley cites to several sources that provide projected inflation figures over the
26 long-term. However, instead of relying on the same source for projected sustainable

⁹ Bulkley Rebuttal, p. 52, ln. 20 – p. 55, ln. 2.

1 growth in GDP over the long-term, she used historical GDP growth from 1929 to 2023 as
2 a proxy for projected GDP growth.

3 **Q. Which of Ms. Bulkley’s sources also provide projected nominal GDP data?**

4 A. The Energy Information Administration (“EIA”). The EIA directly estimates real GDP
5 and the GDP Chain-Type Price Index, which when combined, provides a direct estimate
6 of nominal GDP. For the period through 2050, EIA estimates a CAGR in nominal GDP
7 of 4.25%.

8 **Q. How do you respond to Ms. Bulkley’s criticism that your CAPM COE estimates are**
9 **mis-specified because your market risk premium estimates of 5.0% to 6.0% cause**
10 **unreasonably low COE estimates?**

11 A. She not only disagrees with me, but also Bank of America’s (“BofA”) view on a reasonable
12 COE estimate under a higher long-term interest rate environment. BofA stated the
13 following in an equity research report in published in October 2023, when long-term
14 interest rates peaked in the fall of 2023:

15 **On a spot basis with 9.5-9.6% after-tax authorized ROEs in 3Q23, this**
16 **is meaningfully higher than the cost of equity from the capital asset**
17 **pricing model for most utilities in the 8.5-9.0% range.** The 5% 30Yr US
18 Treasury has compressed returns for utilities which have back-levered but
19 we do not foresee a meaningful increase in allowed ROEs back above 10%.
20 We continue to believe that California will not increase the allowed rate of
21 return for the electric utilities due to the continuation of the extraordinary
22 event from covid and the related policy responses.¹⁰ (bold in the original).

23 **Q. The above quote does not specify the variables such as beta and the market risk**
24 **premium. Why do you claim that this information corroborates the reasonableness**
25 **of your inputs to your CAPM analysis?**

26 A. Because the end-result of BofA’s estimates are similar to my COE estimates for the electric
27 utility industry, whether it’s through my use of the CAPM, multi-stage DCF, or my simple
28 BYPRP methodology. Although my CAPM COE estimates were closer to 8.5% rather

¹⁰ Julien Dumoulin-Smith, et. al, “Utilities in a 5% Treasury World: Who has a plan to withstand the pain? 3Q Preview,” Bank of America Securities, October 20, 2023.

1 than 9%, 30-year United States Treasury yields were at 5% when BofA performed its
2 CAPM analysis. At the time I performed my analysis, they were around 4.5%. Since I
3 filed my testimony, they have declined to 4.1%. Therefore, considering the recent decline
4 in long-term interest rates and increases in electric utility stock prices, it is logical to
5 conclude that BofA's CAPM COE estimates would currently be lower.

6 **Q. Is it not Ms. Bulkley's position that the COE for electric utilities has increased since**
7 **she filed direct testimony in this case on November 30, 2023?**

8 A. Yes.¹¹ It should be evident by this round of testimony that Ms. Bulkley and I disagree on
9 how to interpret capital market conditions and their impact on utilities' cost of capital. My
10 opinions are corroborated by investors while hers are not.

11 **Q. Considering the fact that utilities' cost of equity increased since 2022, why would**
12 **investors not expect authorized ROEs to increase as well?**

13 A. Because as BofA's comments address, authorized ROEs are still "meaningfully" higher
14 than the COE. As I testified in my rebuttal testimony, if authorized ROEs are higher than
15 utilities' COE, then utilities can create shareholder value by merely investing in its rate
16 base and achieving a return over its cost of equity.¹² If utility commissions authorized
17 ROEs below their cost of equity, as occurred in the early 1980s, utility company managers
18 impaired shareholder value by continuing to invest, which caused market-to-book ratios to
19 decline below one.

20 **Q. Ms. Bulkley testifies that the "rule of thumb" COE estimate you provide is too**
21 **simplistic and inconsistent with other risk premiums Dr. Won used in past rate cases.**
22 **Can you provide the full context of the Chartered Financial Analyst ("CFA")**
23 **Program curriculum which explains this reasonableness check?**

24 A. Yes. The specific language from the CFA Program curriculum is as follows:

25 *4.3.2 Bond Yield Plus Risk Premium*

¹¹ Bulkley Rebuttal, p. 12, lines 16 – 20.

¹² Murray Rebuttal, p. 11, line 3 – p. 13, line 4.

1 For companies with publicly traded debt, the **bond yield plus risk**
2 **premium method** [bold in original] provides a quick estimate of the cost
3 of equity. The estimate is

$$4 \quad \text{BYPRP cost of equity} = \text{YTM on the company's long-term debt} +$$
$$5 \quad \text{Risk premium}$$

6 The YTM on the company's long-term debt includes

- 7 ■ a real interest rate and a premium for expected inflation, which are also
- 8 factors embodied in a government bond yield; and
- 9 ■ a default risk premium.

10 The default risk premium captures factors such as profitability, the
11 sensitivity of profitability to the business cycle, and leverage (operating and
12 financial) that also affect the returns to equity. The risk premium in
13 Equation 13 [above] is the premium that compensates for the additional risk
14 of the equity issue compared with the debt issue (recognizing that debt has
15 a prior claim on the cash flows of the company). In US markets, the typical
16 risk premium added is 3%–4%, based on experience.¹³

17 **Q. Ms. Bulkeley testifies that in past rate cases, Staff has recommended higher equity risk**
18 **premiums to add to a company's or companies' own bond yield for purposes of this**
19 **test of reasonableness. Was Staff's suggested risk premiums of 3.5% to 6.0% based**
20 **on the above-defined approach?**

21 A. No. As I testified in Missouri American Water Company's 2020 rate case, Case No. WR-
22 2020-0344, Staff added estimated market risk premiums, derived from studies comparing
23 market returns to US Treasury Bond yields.¹⁴ Because US Treasury Bond yields are lower
24 than company-specific bond yields, mainly due to no default risk premium required on a
25 US Treasury Bond, these higher risk premiums should not be applied to corporate bond
26 yields. It is clear from the CFA Program curriculum that the 3% to 4% is based on a typical
27 equity risk premium over a company's own bond yield.

¹³ Refresher Reading, 2021 CFA Program, Level II, Reading 25, p. 35.

¹⁴ Case No. WR-2020-0344, David Murray Rebuttal Testimony, p. 48, lns. 3-24.

1 **WON'S REBUTTAL TESTIMONY**

2 **Q. Dr. Won disagrees with your recommended ratemaking common equity ratio of**
3 **47.2%. He testifies that MO West's capital structure is more appropriate for setting**
4 **MO West's ROR, as long as it is based on his interpretation of the target for MO**
5 **West. What was Dr. Won's basis for concluding that Evergy targets a 50% common**
6 **equity ratio for MO West?**

7 A. MO West's response to Staff Data Request No. 0110 which restated Company witness
8 Kirkland B. Andrews Direct Testimony stating that Evergy targets a common equity ratio
9 of just over 50%.¹⁵

10 **Q. Did Mr. Andrews define "just over 50%?"**

11 A. No.

12 **Q. Did Evergy's recent requested ratemaking common equity ratios in this case, the 2022**
13 **Missouri rate cases, and the 2023 Kansas rate cases establish that Evergy desired its**
14 **ratemaking capital structures be set at around 52%?**

15 A. Yes. Mr. Andrews' direct testimony in this case projected MO West's common equity
16 ratio would be 52.04% as of the true-up period, June 30, 2024. Evergy requested
17 approximate 52% common equity ratios in its 2023 Kansas rate cases.

18 **Q. **** _____
19 _____
20 _____

21 A. _____
22 _____
23 _____
24 _____
25 _____ **

¹⁵ MO West's Response to Staff Data Request No. 0110.

1 **Q. Based on MO West’s approach to calculating its ratemaking capital structure, what**
2 **was its capital structure ratios as of the true-up period, June 30, 2024?**

3 A. Almost exactly 50% common equity and 50% long-term debt, assuming the exclusion of
4 short-term debt (*see* Schedule DM-S-5).

5 **Q. Why did Evergy adjust MO West’s common equity ratio to 50% rather than its**
6 **original target of 52% as of the true-up date?**

7 A. I am not sure, but on behalf of MO West’s ratepayers, I express my appreciation to Evergy
8 for adjusting MO West’s requested ratemaking common equity ratio to a more reasonable
9 level.

10 **Q. Does this mean you are abandoning your recommended ratemaking capital structure**
11 **premised on adding 2.5% to Evergy’s consolidated capital structure?**

12 A. No. ** _____
13 _____
14 _____ **

15 **Q. Dr. Won cites to four factors that may be considered for purposes of evaluating the**
16 **independence of subsidiary’s capital structures versus that of its parent company.**
17 **Are these factors definitive as it relates to a potential binary decision of choosing a**
18 **subsidiary versus a parent company capital structure?**

19 A. No. While each of these factors can be considered independently, it is also important to
20 consider the interdependence of each of these factors and the underlying rationale for each
21 of the factors. For example, it is important to understand the rationale for parental
22 guarantees and whether diversification into non-utility operations causes the consolidated
23 parent company capital structure to be more or less comparable regarding the regulated
24 utility subsidiaries’ debt capacity.

25 **Q. Is Dr. Won correct that MO West issues its own debt?**

26 A. Yes. Each subsidiary issues its own long-term debt and even commercial paper to third-
27 party debt markets. However, as is evident from significant increases in Evergy’s money

1 pool transactions, as well as a significant amount of holding company short-term
2 borrowings, the boundaries are not clearly defined.

3 Evergy's issuance of commercial paper is causing the lines to be blurred as to the third
4 guideline as well. Although Evergy already had double leverage, *i.e.* long-term debt
5 outstanding at the holding company and subsidiary level, the long-term debt had been
6 issued to buy back common stock. While this leverage was not used to purchase common
7 equity in the subsidiary, its use has the same impact on the consolidated company's
8 financial risk.

9 In December 2023, Evergy issued an additional \$1.4 billion of holding company debt at a
10 coupon of 4.5%, for a total outstanding balance of holding company debt of \$3 billion.
11 Evergy used a portion of these proceeds to repay a \$500 million term loan facility it issued
12 in February 2022.¹⁶ Evergy used \$200 million of the \$500 million term loan facility to
13 fund a common equity infusion into MO West in the first quarter of 2022. Under affiliate
14 transaction rules, MO West should only be charged for the cost of the capital used to make
15 such an equity infusion. Consequently, if the Commission adopts MO West's per books
16 capital structure, \$200 million of MO West's common equity should be assigned a 4.5%
17 cost because this is the cost of these funds to Evergy. These financing transactions are an
18 example of a lack of significant financing separation as it relates the third guideline.

19 **Q. Should the consideration of Evergy's consolidated capital structure in setting MO**
20 **West's ratemaking capital structure be dependent on reconciling specific uses of**
21 **Evergy's financing proceeds to capital infusions into MO West?**

22 A. No. As demonstrated by MO West not distributing a dividend to Evergy since the fourth
23 quarter of 2020, MO West is retaining all earnings for reinvestment. Retained earnings is
24 included in MO West's common equity balance. Instead of relying on its subsidiaries to
25 fund dividends to shareholders, Evergy issues holding company capital (mainly short-term
26 debt) to do so. Under this financing strategy, Evergy can claim that it did not use lower-
27 cost debt to finance common equity infusions into its subsidiaries. However, but for
28 Evergy's ownership and control of its regulated utility subsidiaries, it would not have the

¹⁶ Evergy Inc.'s Form 10-K Filing, December 31, 2023, p. 129.

1 ability to access lower-cost debt markets to finance the payment of dividends. Under this
2 scheme, Evergy’s subsidiaries are not being funded as if they were truly standalone entities.
3 While such actions are efficient and maximize shareholder value, this strategy is more
4 costly to ratepayers.

5 **Q. Does the fact that Evergy does not guarantee MO West’s debt issuances establish that**
6 **MO West’s capital structure is managed consistent with its low business risk?**

7 A. No. This guideline needs to be considered carefully as to the interpretation of the need for
8 a parental guarantee and the interaction of this guideline with the fourth guideline –
9 whether a consolidated enterprise is diversified in non-utility operations. A holding
10 company that only owns regulated utility subsidiaries (considered a pure-play regulated
11 utility) derives its creditworthiness from the low-risk profile of its regulated utility
12 subsidiaries. In fact, when selecting comparable companies to estimate the COE for MO
13 West’s 100% vertically-integrated electric utilities, the goal is to select publicly-traded
14 holding companies that are mostly confined to regulated utility operations. The COE for
15 these holding companies should then be a function of the low business risk associated with
16 the regulated subsidiaries AND the financial risk (*i.e.* use of debt in the capital structure)
17 contained in the consolidated capital structure.

18 **Q. Dr. Won testifies that because Evergy is not diversified into non-utility operations,**
19 **this supports the use of MO West’s capital structure rather than a ratemaking capital**
20 **structure more consistent Evergy’s consolidated capital structure.¹⁷ Do you agree?**

21 A. No. If a holding company’s operations are largely confined to regulated utilities, then the
22 proportion of debt maintained at the consolidated level provides the most objective and
23 transparent view as to managements’ opinion of an economic, yet stable proportion of
24 leverage the low business-risk profile of its utility assets can sustain. If a holding company
25 also had significant non-regulated operations, then one would expect the holding company
26 to balance the higher business risk of the non-regulated operations by targeting a less
27 leveraged capital structure than its regulated utilities could support. This had been

¹⁷ Won Rebuttal, p. 36, ln. 3 – p. 38, ln. 5.

1 Algonquin Power & Utilities Corp.’s historical strategy for capitalizing its regulated and
2 non-regulated subsidiaries.

3 Evergy is predominantly a pure-play regulated vertically-integrated electric utility. Its
4 ability to target a higher proportion of leverage on a consolidated basis is due to its
5 regulated utility subsidiaries’ low business risk.

6 **Q. In MO West’s 2022 rate case, did Company witness Ms. Bulkley argue that Evergy’s**
7 **non-regulated investments discredited consideration of Evergy’s consolidated capital**
8 **structure for MO West’s ratemaking capital structure?**

9 A. Yes. In MO West’s 2022 rate case, Ms. Bulkley attempted to discredit the relevance of
10 Evergy’s consolidated capital structure by emphasizing that Evergy *is* diversified by having
11 a minor investment interest in Transource Energy, LLC, which is involved in the
12 development of competitive electric transmission projects, among other non-regulated
13 activities.¹⁸ This was in stark contrast to Dr. Won’s emphasis in MO West’s 2022 rate case
14 that “in 2020, Evergy Inc.’s non-utility assets and revenue are less than 1.0% of Evergy
15 Inc.’s total assets and total revenue. This not concerning because Evergy Inc.’s non-utility
16 operations are **insignificant**” (emphasis added).¹⁹

17 **SUMMARY AND CONCLUSIONS**

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

20 A. Yes. As it relates to capital structure, Evergy clearly plans to use more holding company
21 debt to leverage the returns authorized for its subsidiaries. Evergy’s ability to profit from
22 this strategy depends on the Commission ignoring this leverage in setting a fair and
23 reasonable ratemaking capital structure to set MO West’s ROR. Evergy’s debt capacity is
24 directly derived from its ownership and control of its regulated utility subsidiaries.
25 Evergy’s new strategy occurred subsequent to Elliot Capital’s insistence that Evergy
26 undergo a strategic review to determine how to maximize Evergy’s shareholder value.

¹⁸ Case No. ER-2022-0130, Bulkley Rebuttal, p. 16, lns. 10-13.

¹⁹ Case No. ER-2022-0130, Won Rebuttal, p. 35, lns. 1-4.

1 Energys new strategy is in contrast to MO West's previous parent company's (Great Plains
2 Energy) strategy to not issue holding company debt, but rather allow its subsidiaries to
3 fund their own liquidity needs by issuing their own short-term debt and still distribute
4 dividends to GPE. Consequently, MO West's previous parent company, GPE, did not
5 object to using its consolidated capital structure for ratemaking. Energys holding
6 company financing activities increase the risk of affiliate financing transaction abuses.
7 Therefore, the Commission should at least consider Energys use of leverage in setting a
8 fair and reasonable ratemaking capital structure for MO West.

9 As it relates to an authorized ROE, the evidence is clear that authorized ROEs have at times
10 significantly exceeded the COE. While it is also clear that the electric utility industry's
11 COE has increased since MO West's 2022 rate case, it is still below my recommended
12 authorized ROE of 9.5%. Considering such, MO West can still attract capital and create
13 shareholder value by investing in its system.

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

15 **A. Yes.**

