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REGULATORY REVIEW DIVISION

UTILITY SERVICES – FINANCIAL ANALYSIS

REBUTTAL TESTIMONY

OF

ZEPHANIA MAREVANGEPO

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2014-0370

Jefferson City, Missouri
May 2015

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ZEPHANIA MAREVANGEPO
KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2014-0370

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1 A. No. Staff's recommended allowed ROE was premised on a more conservative
2 estimate of the decline in the COE of approximately 25 to 75 basis points for reasons
3 explained in the Staff Report.¹

4 Q. Do you have any additional corrections?

5 A. No.

6 **EXECUTIVE SUMMARY**

7 ***Staff's Rate of Return Testimony:***

8 Q. Would you please recap Staff's ROR testimony?

9 A. Yes. The COE has declined since KCPL's last rate case in 2012 (Case No.
10 ER-2012-0174). Staff exhaustively demonstrated in the "Staff Report" *–by updating the*
11 *multi-stage COE study/ analysis it performed for purposes of estimating KCPL's COE back*
12 *in 2012 (Updating Approach)* – that the COE for KCPL declined by approximately **100 basis**
13 **points.**² Staff also backdated the multi-stage COE analysis it performed for purposes of
14 estimating KCPL's current COE (*Backdating Approach*). Results from the *Backdating*
15 *Approach* showed that KCPL's COE declined by approximately **90 basis points**, –
16 *i.e. comparing the 2014 COE results, based on the 2014 comparable group of companies, to*
17 *what the results would have been had Staff used the same proxy group in 2012 to estimate*
18 *KCPL's COE.*³

19 ***Mr. Hevert's Rate of Return Testimony:***

20 Q. Would you please summarize Mr. Hevert's ROR testimony?

¹ Staff Report, ER-2014-0370, page 32 – lines 18 through 29.

² Staff Report, ER-2014-0370, page 51 - vi. Update of Multi-Stage DCF Analysis on the Proxy Group from the 2012 Rate Cases.

³ Staff Report, ER-2014-0370, page 51 - vii. Backdating of Multi-Stage DCF Analysis on the Current Proxy Group Cases.

1 A. Yes. Mr. Hevert recommended an allowed ROE of 10.30%, which was based
2 on an estimated COE range of 10.20% to 10.60%. Mr. Hevert derived this range from
3 various COE estimates determined by applying the following COE methodologies: (1) the
4 Discounted Cash Flow (“DCF”) method, using both the constant-growth and the multi-stage
5 forms; (2) the Capital Asset Pricing Model (“CAPM”); and (3) the Bond Yield Plus Risk
6 Premium method. Although Mr. Hevert claims that his use of several methods allows for a
7 more reliable COE estimate, Staff will demonstrate that Mr. Hevert’s inputs into these
8 methods are consistently unreasonable. No matter how many methods a witness uses, if
9 the inputs are consistently unreasonable, the collective results of these methods will also
10 be unreasonable.

11 ***Mr. Ives’ Regulatory Policy Testimony:***

12 Q. Would you please summarize the issues from Mr. Ives’ regulatory policy
13 direct testimony to which Staff will be responding?

14 A. Yes. Mr. Ives blames the Missouri regulatory framework, which he states
15 does not allow for certain alternative regulatory mechanisms, for KCPL’s inability to earn its
16 authorized ROEs since 2007 and also the negative view KCPL gets from the investment
17 community.

18 Staff disagrees with Mr. Ives’ position that Missouri’s regulatory framework is the
19 primary cause for KCPL’s authorized ROE vs. earned ROE woes. As the saying goes, *there*
20 *are two sides to every coin*, and other Staff expert policy witnesses will be addressing
21 specific issues that they believe caused KCPL to fail to earn its authorized ROEs.

1 UPDATES TO STAFF'S TESTIMONY

2 Q. Did Staff update its COE study for purposes of preparing this rebuttal
3 testimony?

4 A. Yes. Due to the contraction of the regulated utilities' forward price-to-
5 earnings ("P/E") multiples from the end of January 2015 to date, Staff wanted to ensure that
6 its recommendation to reduce KCPL's allowed ROE to a range of 9.0% to 9.50% was still
7 justified. Based on the updated capital market information, Staff's estimate of the decline in
8 KCPL's COE is now 80 to 90 basis points lower rather than the 90 to 100 basis points Staff
9 had estimated in its direct testimony. Therefore, Staff still considers its recommended
10 allowed ROE to be fair and reasonable. In addition, considering the capital markets have
11 become even more favorable to electric utilities since the Commission's recent determination
12 that an allowed ROE of 9.53% for Ameren Missouri was fair and reasonable, Staff believes
13 the Commission is more than justified in authorizing an allowed ROE of no higher than
14 9.53% for KCPL. Even after considering the recent P/E contraction, what is still notable is
15 that the current forward P/E multiples for Edison Electric Institute's ("EEI") regulated
16 electric utilities of 17.3x is still higher than it was in 2012 (approximately 16.3x on average).⁴

17 The current forward P/E multiples (17.15x on average) for the same proxy group that
18 Staff used in its "2012 KCPL cost of equity study" reflect higher valuation levels when
19 compares to the average forward P/E multiples of 14.12x in 2012.⁵

20 Consequently, Staff still believes that an analysis and interpretation of the
21 circumstantial evidence supports Staff's position that KCPL's COE has declined since 2012.
22 Staff recommended in the Staff Report that KCPL's allowed ROE should be lowered based

⁴ SNL data based on EEI regulated electric utilities.

⁵ Based on SNL data.

1 on Staff's conservative estimate of a reduced COE range of 25 to 75 basis points applied to
2 an average of the Commission's authorized ROEs of 9.70% and 9.80% for KCPL and
3 Ameren Missouri, respectively.

4 **STAFF'S RESPONSE TO MR. HEVERT'S DIRECT TESTIMONY**

5 Q. Before you summarize Mr. Hevert's testimony, did Staff attempt to apply its
6 *Backdating Approach* to Mr. Hevert's current COE study?

7 A. Yes. Staff backdated the data for the comparable companies included in
8 Mr. Hevert's 2014 multi-stage COE study, which were also included in Mr. Hevert's 2012
9 multi-stage COE study in the Ameren Missouri rate case, Case No. ER-2012-0166.⁶
10 Not surprisingly, the analysis produced an implied COE decline of approximately 45 to 62
11 basis points. In other words, a reduction based on backdating Mr. Hevert's analysis supports
12 lowering KCPL's allowed ROE to a range of 9.10% to 9.25%.

13 Q. For purposes of Staff's *Backdating Approach*, did Staff update Mr. Hevert's
14 multi-stage DCF analyses to reflect significant capital market changes that occurred through
15 the end of 2014 and early 2015?

16 A. No. Mr. Hevert typically updates his analysis when he files rebuttal
17 testimony. This updated rebuttal testimony should capture more recent capital market data.
18 Instead of updating his analysis for him, Staff will respond to his updated analysis in
19 surrebuttal testimony. Consequently, Staff's quantification of the change in the Mr. Hevert's
20 COE estimates may be different.

⁶ Staff also excluded Empire District Electric Company because FactSet data was not available for 2012; and Otter Tail Corporation because as Mr. Hevert noted in the 2012 Ameren Missouri rate case, they did not have meaningful financial data for purposes of performing a multi-stage DCF cost of equity.

Zephania Marevangepo
Rebuttal Testimony

1 Q. Does Mr. Hevert's direct testimony reflect or at least acknowledge that
2 KCPL's cost of equity has declined since KCPL was authorized an ROE of 9.70% by the
3 Commission in KCPL's 2012 rate case, Case No. ER-2012-0174?

4 A. No. Since the Commission last determined an authorized ROE of 9.70% was
5 fair and reasonable for KCPL in 2012, KCPL's COE in particular and all regulated utilities'
6 COE in general has declined due to increased equity valuations caused by a general decline
7 in interest rates. Despite this evidence, Mr. Hevert recommends the Commission increase the
8 allowed ROE for KCPL to 10.30%.

9 Q. Did Mr. Hevert sponsor ROR testimony in KCPL's last rate case?

10 A. No.

11 Q. Did Mr. Hevert sponsor ROR testimony in Missouri at about the same time as
12 KCPL's last rate case?

13 A. Yes. He sponsored ROR testimony in Ameren Missouri's rate case in 2012,
14 Case No. ER-2012-0166.

15 Q. What was Mr. Hevert's COE estimate in the Ameren Missouri 2012 rate case?

16 A. 10.50%.

17 Q. Does this imply that Mr. Hevert acknowledges that there has been at least
18 some relative decline in the COE for electric utility companies?

19 A. Yes. Mr. Hevert's 10.30% recommendation in this case and 10.40%
20 recommendation in Ameren Missouri 2014 rate case appear to accept that there has been a
21 decline in electric utilities' COE since 2012.

22 Q. Was Mr. Hevert's COE estimate adopted by the Commission in the Ameren
23 Missouri 2012 rate case?

1 A. No. The Commission did not accept Mr. Hevert's COE recommendation
2 using a 9.80% return on equity instead.

3 Q. Would you please explain the specific debt and equity market conditions that
4 support a decline in utilities' cost of capital since 2012?

5 A. The 6-month (January through June 2012) average yield for 30-year public
6 utility bonds in 2012 was approximately 4.94% compared to the most recent 6-month
7 average of 4.11%.⁷ This translates into a decline in utility cost of debt of 83 basis points.
8 While some may claim that the decline in utility bond yields has been due to aggressive
9 monetary policy, this argument is losing credibility because when the Fed terminated its
10 bond buyback program most analysts had predicted that interest rates would increase at the
11 end of 2014. The exact opposite happened, they unexpectedly decreased, which caused
12 price-to-earnings ratios of utility stocks to reach historical highs. Although the utility P/E
13 ratios declined in February 2015 due to a rebound of interest rates, interest rates have seemed
14 to moderate and based on recent 10-Year Treasury yields of below 2 percent, are still at
15 levels that Goldman Sachs believes justifies utilities trading at a premium to the S&P 500.
16 Although the Federal Reserve may begin to increase the Fed Funds rate before the end of the
17 year, the Fed Funds rate directly impacts short-term capital costs, which are not the costs that
18 are reflected in a utility's allowed ROR.

19 Upon assessing the above debt market conditions, Staff also established that the
20 declining long-term interest rates caused an increase in the price of regulated utility stocks as
21 investors saw the opportunity cost of being invested in debt as opposed to utility stocks was
22 much higher than historical spreads justified. Consequently, the macro conditions have had a

⁷ Based on Bonds Online data.

1 much larger impact on utility stock prices than any industry or company-specific factor have
2 had in recent years. A lower required return on equity, i.e. a lower discount rate, has caused
3 investors to place more value on utility dividends.

4 Limiting my scope to the time period beginning in 2012 to present, Staff presented in
5 its direct testimony how the demand for and valuation of (*as measured by forward P/E*
6 *ratios* for electric utility stocks in general) continued to increase to levels above long-term
7 historical averages through the end of January of this year. While a contraction in utility
8 stock prices and/ or forward P/E ratios occurred during February, the current valuation levels
9 for regulated utilities are at levels still considered to be higher than historical averages and
10 also higher than 2012 levels.

11 Simply put, the cost for utility companies to issue stock is low and the cost for an
12 investor to buy utility stock is high, which translates into a lower required return on equity.
13 A lower equity discount rate applied to the same stable expected cash flows from the electric
14 utility industry has caused investors to consider a fair price to pay for utility stock to be
15 higher than was the case when interest rates were higher and alternative return prospects
16 were more favorable. Table 1 below presents the increasing trend of P/E ratios for regulated
17 utilities, all electric utilities, and Staff's 2012 & 2014 COE study proxy companies since
18 2012. Table 2 presents the declining trend of dividend yields for EEI's *regulated* electric
19 utilities, all EEI electric utilities (diversified, mostly regulated and regulated); and Staff's
20 2012 & 2014 COE study proxy companies since 2012:

21
22
23 *continued on next page*

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Table 1.

COMPARISON OF FORWARD P/E RATIOS				
	2012	2013	2014	2015
Regulated Utilities	16.30%	16.85%	18.51%	17.26%
All Electric Utilities	16.29%	16.92%	18.56%	17.50%
2012 Proxy Group	15.24%	15.41%	17.85%	16.39%
2014 Proxy Group	15.62%	16.63%	18.40%	16.78%

**forward P/Es show an increasing trend from 2012 to current*

Note : All ratios are as published by SNL

Table 2.

COMPARISON OF DIVIDEND YIELDS				
	2012	2013	2014	2015
Regulated Utilities	4.33%	4.06%	3.40%	NA
All Electric Utilities	4.32%	4.00%	3.34%	NA
2012 Proxy Group	4.23%	4.06%	3.42%	NA
2014 Proxy Group	4.18%	3.99%	3.37%	NA

**Dividend yields show a declining trend from 2012 to current*

Note : All ratios are as published by SNL

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In light of the above-established relationships between interest rates and regulated utilities' P/E ratios (relative valuation measures); and between P/E ratios and dividend yields, Staff provided an analysis that was furnished in Staff's report that sought to quantify the effect of these relationships on COE since 2012. Consequently, Staff estimated a conservative decline in COE in the range of 25 to 75 basis points since the Commission authorized KCPL an allowed ROE of 9.70% and Ameren Missouri an allowed ROE of 9.80%. For sake of consistency and fairness, Staff recommended that the reduced COE be applied to the midpoint of the Commission's allowed ROEs of 9.70% and 9.80%, which resulted in Staff's recommended allowed ROE of 9.25% for KCPL.

Zephania Marevangepo
Rebuttal Testimony

1 Q. Would you please compare Mr. Hevert's ROE recommendation with
2 recommendations of other witnesses in this case and, also, the national authorized
3 ROE averages?

4 A. Mr. Hevert's 10.30% ROE recommendation is higher than Staff's 9.25% and
5 Mr. Gorman's 9.10% by 105 basis points and 120 basis points respectively.⁸ Mr. Hevert's
6 10.30% ROE recommendation is also 63 basis points higher than the average ROE
7 authorized for electric utilities (9.67%) in the first quarter of 2015.⁹ The RRA average
8 authorized ROE for electric utilities in the first quarter of 2012 was approximately 10.30%
9 and 10.10% for the 2012 calendar year (*excluding the Virginia surcharge/ rider generation*
10 *cases from the data*).

11 Q. Besides noting Mr. Hevert's failure to recognize that KCPL's COE
12 has declined more than his recommendation would imply since 2012, are there any
13 specific issue(s) that you believe exaggerated Mr. Hevert's COE study and/ or his
14 recommended ROE?

15 A. Yes.

16 Constant DCF: While Staff respectfully understands that the equity analysts'
17 projected 5-year compound annual growth rate ("CAGR") in Earnings per Share ("EPS") are
18 meant to provide investors information on companies' near-term growth prospects, Staff

⁸ Mr. Gorman is the COE expert witness for Missouri Industrial Energy Consumers and Midwest Energy Consumers' Group.

⁹ Regulatory Research Associates (RRA), Regulatory Focus, Major Rate Case Decisions—January-March 2015, published on April 13, 2015:

The average return on equity (ROE) authorized electric utilities was 10.37% in the first quarter of 2015... We note that the data includes several surcharge/rider generation cases in Virginia that incorporate plant-specific ROE premiums. Virginia statutes authorize the State Corporation Commission to approve ROE premiums of up to 200 basis points for certain generation projects (see the Virginia Commission Profile). Excluding these Virginia surcharge/rider generation cases from the data, the average authorized electric ROE was 9.67% in the first quarter of 2015 versus 9.76% in 2014.

1 opposes Mr. Hevert's assumption that such growth rates represent investors' assumed
2 perpetual growth of utilities' Dividends Per Share ("DPS") in context of a constant-growth
3 DCF analysis. Mr. Hevert's constant-growth DCF method assumes that the initial cash flow
4 (dividend) component will continue to grow at the rate of the equity analysts' projected 5-
5 year CAGR in EPS into perpetuity *-i.e. exceeding the period (5-year timeframe) to which the*
6 *estimates rightfully apply.*

7 Consequently, the use of equity analysts' projected 5-year CAGR in EPS estimates
8 (5.64% average), *which are usually higher than long run actual earnings (approximately*
9 *3%) and also higher than projected nominal Gross Domestic Product ("GDP") projections*
10 *for the U.S economy (approximately 4.32%),* as perpetual growth rates of cash flows for his
11 proxy companies inflated Mr. Hevert's constant-growth DCF results.

12 Multi-stage DCF: Mr. Hevert's multi-stage DCF method assumes a perpetual
13 nominal¹⁰ GDP growth rate of 5.65%, which he conveniently based on a historical (1929-
14 2013) real GDP growth rate input of 3.27% and a forward inflation rate input of 2.31%. In
15 his direct testimony, Mr. Hevert delicately expressed ignorance of the existence of publicly
16 available long-term forward real GDP projection values. Thus, Mr. Hevert justified the use of
17 historical data *for the real rate portion* of his inflated projected nominal GDP growth rate.¹¹
18 To set the record straight, analyst projections for long-term real GDP rate data exist and are
19 publicly available.¹² The consensus long-term nominal GDP projection, based on projected
20 real GDP and inflation, is approximately 4.32%; and not greater than 5% by any means. Even
21 Mr. Gorman's multi-stage perpetual growth rate of 4.60% acknowledges that the U.S.
22 projected nominal GDP is not greater than 5%.

¹⁰ Nominal Rate – Real Rate plus Inflation.

¹¹ ER-2014-0370, Robert Hevert Direct Testimony, filed on October 30, 2014, page 24 –lines 10 through 12.

¹² J.P. Morgan Asset Management and Federal Reserve.

1 Staff opposes the convenient application of such a mix-and-match approach (*of using*
2 *historical data and forward projections*) to estimate a forward perpetual nominal GDP
3 especially from a witness who ceaselessly touted throughout his direct testimony the
4 superiority of analysts' earnings growth rate forecasts in predicting stock prices.¹³ Staff,
5 therefore, notes that Mr. Hevert's multi-stage results were conveniently inflated to justify a
6 higher allowed ROE for KCPL.

7 CAPM: Mr. Hevert's CAPM cost of equity results (10.64%-12.09% range) were
8 primarily driven by his unreasonably high and flawed *ex-ante (forward-looking)* market risk
9 premiums (approximately 10.35% on average). As one may wonder – *How on earth did*
10 *Mr. Hevert produce such extremely high market risk premiums?* The answer lies in his use
11 of expected returns for the S&P 500 that cannot be corroborated by any reputable investment
12 source. Mr. Hevert's computation of the S&P estimated required market return (*i.e., the*
13 *estimated cost of equity of the entire U.S equity market –as measured by the S&P 500 index*
14 *companies*) was based on Mr. Hevert's irrational assumption that the S&P 500 will achieve
15 capital gains in perpetuity at the same rate as equity analysts' projected 5-year CAGR in
16 EPS.¹⁴ Staff knows of no third-party investment source that estimates market returns in
17 this fashion.

18 Bond Yield Risk Premium: Mr. Hevert's results were largely driven by his
19 assumption that long-term authorized ROEs represent the market's required returns from the
20 RRA list of regulated electric utilities. As Staff explained earlier, authorized ROEs should
21 not be viewed as synonymous with the market's required returns. Authorized ROEs are

¹³ ER-2014-0370, Robert Hevert Direct Testimony, filed on October 30, 2014, page 18 –lines 3 through 19 and page 19 –lines 1 through 4.

¹⁴ Mr. Hevert relied on his constant DCF method and the same assumptions that Staff denounced earlier to compute his inflated market returns.

1 usually higher than the cost of equity mostly due to policy decisions that various
2 commissions in different jurisdictions may choose to adopt. Thus, one may review authorized
3 ROEs for purposes of determining what investors may use to model cash flows, but not for
4 purposes of estimating the market's required returns.

5 **STAFF'S RESPONSE TO MR. IVES' DIRECT TESTIMONY**

6 Q. How do you wish to respond to Mr. Ives' general testimony that KCPL has
7 been unable to earn its authorized ROE from 2007 to 2013 due to the nature of Missouri's
8 regulatory framework and/ or the absence of certain alternative regulatory mechanisms?¹⁵

9 A. While Staff acknowledges the fact that KCPL does not have the various
10 alternative regulatory mechanisms, which Mr. Ives highlighted on pages 3 and 11 of his
11 direct testimony, Staff believes Mr. Ives did not provide the complete story regarding
12 KCPL's inability to earn its allowed ROEs, such as the fact that KCPL was allowed to
13 receive \$183.4 million of cash flow above traditional ratemaking during the period of its
14 Alternative Regulatory Plan, in exchange for considerations, such as not seeking a fuel
15 adjustment clause until no earlier than June 1, 2015.¹⁶ Staff witnesses that are more familiar
16 with the details of this plan and other reasons for KCPL's under earnings will elaborate on
17 these issues.

18 Q. How do you wish to respond to Mr. Ives' claim, on page 3, lines 11 and 12,
19 that investors expect that earned returns will be reasonable in relation to allowed returns?

20 A. Staff notes that, if circumstances assumed in the rate case come to fruition,
21 then it is reasonable to assume that investors expect the earned ROEs would approximate

¹⁵ ER-2014-0370, Darrin Ives Regulatory Policy direct testimony, page 4, Table – Earned ROE vs. Authorized ROE.

¹⁶ Staff's Cost of Service Report filed in Case No. ER-2014-0370, page 173

1 authorized ROEs. However, this rarely happens, due to various moving parts that occur post
2 rate case implementation.

3 Additionally, Mr. Ives accepts in his response to Staff's Data Request No. 0367.1(3)
4 that, under the KCPLL Regulatory Plan under Case No. EO-2005-0329, the Missouri
5 regulatory framework extended credit supportive mechanisms to KCPL and they were
6 viewed favorably by the investment community. However, Mr. Ives notes that the
7 temporary credit supportive mechanism ended in 2011. Therefore, this begs the questions –
8 *How then with such a favorable regulatory outcome did KCPL fail, at least from 2007 to*
9 *2011, to achieve its authorized outcome as portrayed by the graph on page 3 of Mr. Ives'*
10 *direct testimony?*

11 Q. In the same response mentioned above, Mr. Ives noted that the equity
12 investors consider today's regulatory environment and not temporary credit supportive
13 mechanisms that ended in 2011. How do you wish to respond?

14 A. The investment community recognizes that the lack of cost recovery options
15 combined with modest load growth will create a continued drag on their earnings trajectory
16 over time. And such recognition is factored by the investment community in their low
17 baseline price objective.¹⁷ Below are excerpts from Wolfe Research and J.P. Morgan reports:

18 Wolfe Research report¹⁸

19 **Guidance and EPS growth target send confident message**

20 Last year's results and management's outlook are the manifestation of
21 a turnaround story that began in late 2012, when current management
22 took over after years of disappointing results.

¹⁷ Data request no. 0367.1, Bank of America Merrill Lynch.

¹⁸ Wolfe Research, Great Plains Energy, Love it when a turnaround plan comes together, February 27, 2014.

1 **Lag persists but potential to narrow; regulatory/legislative efforts**
2 **key**

3 In recent years, GXP has historically under-earned its allowed ROE by
4 well over 150bp primarily due to the structural regulatory lag in MO.
5 In 2013, GXP reduced the lag to 50bp, helped by rate relief. With its
6 large La Cygne coal retrofit project and rising transmission costs and
7 property taxes, the lag is expected to widen. However, there is
8 visibility to EPS uplift in 2016 with new rates. Meanwhile, there is
9 potential upside to our 2014-15E, as GXP is seeking regulatory and
10 legislative measures to mitigate lag.

11 J.P. Morgan report¹⁹

12 **Investment Thesis**

13 Great Plains' earnings growth rate has the potential to accelerate in the
14 2016-2017 timeframe should the company be able to control cost
15 inflation, implement favorable lag-reducing mechanisms and
16 successfully execute a major rate case in 2015.

17 **Valuation**

18 Our \$26 December 2014 price target is based on a 15.0x P/E multiple
19 on 2016 EPS, which is a discount to the pure regulated peer group
20 average P/E multiple, adjusted for interest rate risk. The discount is a
21 result of mild commodity exposure, integrated utility operating risk
22 and limited jurisdictional and geographic diversity.

23 Q. With regards to the investment community commentary above, does Staff
24 believe there are other reasons as to why KCPL may have failed to achieve its allowed
25 ROEs?

26 A. Yes. While it is clear from the Wolfe report that the investment community
27 has gained confidence with the new management that took over in late 2012, Staff can detect
28 vestiges of the investment community's lack of confidence with the preceding management.
29 All else equal, if management consistently fails to contain costs and beat expectations, the
30 investment community's reaction will eventually be reflected in lower earnings guidance,

¹⁹ J.P. Morgan, Great Plains Energy, Coal Unit Outage Weighs on 1Q; Transmission Cost, Property Tax relief Now Likely Not Until 2016, May 11, 2014.

1 discounted stock prices and ultimately higher COE *—due to the heightened overall company*
2 *risk profile*. The key question becomes whether this is due to Missouri regulatory limitations
3 or due to management's inability to control costs or both. While Mr. Ives focused on
4 investors' views on the regulatory structure in Missouri, he failed to provide testimony
5 regarding investors' opinions and concerns about KCPL's management and the credibility of
6 that management. For example, JP Morgan stated the following in a May 16, 2013, research
7 report on GPE:

8 Our upgrade to OW [Over Weight] was predicated on fair major
9 **rate case outcomes affirming the generally constructive MO and**
10 **KS regulatory environments** and a gradual operational improvement
11 after several tough years of cost challenges. Decent case outcomes
12 were achieved, clearing the regulatory runway through 2015, though a
13 lack of aggressive cost control and weak load growth have continued
14 to prevent outperformance, in our opinion.

15 [emphasis added]

16 An example of investors' concerns about GPE's credibility was stated in the following
17 Caris & Company report published on February 28, 2012, when discussing management's
18 inability to meet its guidance:

19 Given two disappointments in 7 months, management's credibility will
20 hurt the valuation of the stock.

21 While Staff acknowledges that the investment community does cite to the lack of various
22 regulatory mechanisms in Missouri when assessing the quality of an investment in GPE's
23 stock, they have also clearly been concerned about management's ability to manage costs and
24 in some cases, whether management had been transparent about the reasons why it did not
25 meet certain expectations.

1 Q. In light of the investment community commentary above, do investors
2 perceive KCPL's regulatory environment as more or less supportive of investment than other
3 regulated peers?

4 A. Based on the commentary Staff reviewed, Missouri regulatory jurisdiction is
5 considered in the range of average to below average as compared to its peers. GPE's P/E
6 multiples have been consistently below that of its peers. While some of this discount can be
7 attributed to lack of some regulatory mechanisms, particularly a fuel adjustment clause, GPE
8 has been a company that has had many variables changing over the last several years. It was
9 expending a considerable amount of capital on construction for Iatan II and Iatan I
10 environmental, during this construction it acquired electric utility assets from a financially
11 strained Aquila in 2008, its service territory had a contraction in load due to the recession in
12 2008 and 2009, and investors lacked trust in its management. While Staff understands that
13 the investment community may prefer to see more automatic adjustments for certain costs in
14 rates, KCPL has been affected by many other variables as well some of which within the
15 control of its management. Respecting the criteria for allowing specific recovery
16 mechanisms, several other Staff expert witnesses are filing rebuttal testimony in this case.

17 Q. Did Staff validate Mr. Ives' claim that the investment community attributed a
18 quantified adjustment resulting from regulatory lag?

19 A. Yes. Depending on the prevailing circumstances, it can range from 50 to
20 150 basis points. Wells Fargo's analysts project 50 to 75 basis points in a lower earned ROE
21 in 2016 EPS due to regulatory lag. Below is an excerpt from Wells Fargo Equity research:

22 **Our '15E & '16E EPS are \$1.50 & \$1.86.** Our '15E EPS results in an
23 earned ROE of 8.1% (~150 bps of lag) on historical rate base of \$5.7B
24 and the previously approved equity ratio of 52.1%. Our '16E EPS
25 results in a much improved 9.0% ROE on YE '15 rate base of \$6.5B

1 based on a 50.3% equity ratio (50-75 bps lag). Other assumptions
2 underlying our '16E include \$0.07 of non-regulatory costs and \$0.02
3 from TranSource. Absent regulatory support (property tax rider, SPP
4 transmission expense in fuel clause), we'd be concerned that EPS
5 could be flattish between rate cases (similar to '14A & '15E after rate
6 relief in early '13.)²⁰

7 Q. In addition to the equity investors' views discussed above, has KCPL
8 discussed its understanding of rating agencies (S&P and Moody's) view of the Missouri
9 regulatory environment?

10 A. As noted in the Staff Witness Cary Featherstone's rebuttal testimony, KCPL
11 concurs with Moody's and S&P's justification for the credit rating upgrades of Great Plains,
12 KCPL and GMO. Below, is an excerpt from Cary Featherstone's rebuttal testimony, which
13 was originally extracted from a representation made by Mr. Kevin E. Bryant (Great Plains'
14 and KCPL's then Vice president of Investor Relations and Strategic Planning and Treasurer)
15 during a Board of Directors meeting and from minutes to the Audit Committee of the Boards
16 of Great Plains, KCPL, and GMO meetings:

17 **Moody's cited a constructive regulatory environment that**
18 **continues to provide adequate cost recovery as one of their**
19 **rationales for the upgrade.**

20 Standard & Poor's Rating Services ("S&P") also raised the
21 credit ratings of Great Plains Energy, KCP&L and GMO by
22 one notch **due to continuation of the regulated utility**
23 **business model with supportive cost recovery.**

24 Q. Irrespective of Staff's discussion of the investment community's views about
25 the regulatory environment in Missouri, what is Staff's position regarding the need for the
26 various ratemaking mechanisms discussed by Mr. Ives?

27 A. See Staff's Policy Witness rebuttal testimony for a full discussion of the rate
28 mechanisms proposed by KCPL.

²⁰Wells Fargo Securities, Equity Research, Great Plains Energy Incorporated, February 26, 2015.

1 SUMMARY AND CONCLUSIONS

2 Q. Would you please summarize the conclusions of your rebuttal testimony?

3 A. Staff's backdating of both Mr. Hevert's and Mr. Gorman's multi-stage DCF
4 analyses illustrate Staff's fairly conservative recommendation to lower KCPL's allowed ROE
5 to 9.25%. However, the absolute value of Mr. Hevert's COE recommendation (10.30%) fails
6 to reflect a fair and reasonable lowering of KCPL's 2012 authorized ROE of 9.70%.

7 Staff's current recommended allowed ROE of 9.25% is 45 basis points below
8 KCPL's allowed ROE and is also fair and consistent as related to Staff's recent
9 recommendation in the Ameren Missouri rate case.

10 While Mr. Ives claims that KCPL has not been able to achieve its authorized ROEs
11 from 2007 to 2013 due to lack of various alternative regulatory mechanisms, Staff finds it
12 inconsistent that KCPL decided to present two pieces of contradictory evidence that
13 contemporaneously (1) praises the Missouri regulatory framework for the positive and credit
14 supportive treatment it received from the Commission in the 2005 Comprehensive Energy
15 Plan case and yet (2) criticizes the very same framework for its inability to earn authorized
16 ROEs during a period (2007 – 2013) in which KCPL was afforded special ratemaking
17 treatment through an agreement various parties, including Staff, accepted as reasonable if
18 other considerations were offered by KCPL.

19 Q. Does this conclude your rebuttal testimony?

20 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

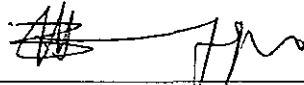
In the Matter of Kansas City Power & Light)
Company's Request for Authority to)
Implement a General Rate Increase for Electric)
Service)

Case No. ER-2014-0370

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.


Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 19 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Zephania Marevangepo

Subscribed and sworn to before me this 7th day of May, 2015.

D. SUZIE MANKIN Notary Public - Notary Seal State of Missouri Commissioned for Cole County My Commission Expires: December 12, 2016 Commission Number: 12412070
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Notary Public