BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.	))))	**File No. ER-2010-0356** Tariff No. JE-2010-0693

FEDERAL EXECUTIVE AGENCIES' POST HEARING BRIEF

COME NOW the Federal Executive Agencies ("FEA"), by and through counsel, pursuant to the Public Service Commission of the State of Missouri's ("Commission") Rules of Practice and Procedure, 4 C.S.R. 240-2.075, in the service area of KCP&L Greater Missouri Operations Company ("the Company") hereby submits this Post Hearing Brief in the above-referenced docket.

SUMMARY OF THE FEA ARGUMENT

Regarding return on equity ("ROE"), the FEA, together with Ag Processing, Inc. and Sedalia Industrial Energy users Association, presented direct, rebuttal, and surrebuttal testimony of Mr. Michael Gorman. Mr. Gorman is a managing principal with the firm of Brubaker & Associates, located in Chesterfield, Mo. The FEA respectfully requests that the Commission adopt Mr. Gorman's recommendation to grant the Company an ROE of 9.65%. In Mr. Gorman's testimony, his recommendation for an ROE of 9.65% is based on the return of the results of three different analyses: (1) Discounted Cash Flow ("DCF"), (2) Risk Premium, and (3) Capital Asset Pricing Model ("CAPM") studies. Mr. Gorman has developed his recommended ROE of 9.65% by carefully considering the application of each of these three well-established ROE methodologies often relied on by this Commission.

DCF

In order to reach a recommendation on the appropriate ROE, both Mr. Gorman and Company witness, Dr. Hadaway, performed three versions of the DCF analysis. The different versions of the DCF model included the constant growth, sustainable growth, and the multi-stage growth DCF models. As noted on page 6 of Mr. Gorman's rebuttal testimony, Mr. Gorman found the growth rate included in the constant growth model to be unreasonably high, which resulted in an inflated DCF return estimate for both Mr. Gorman's and Dr. Hadaway's constant growth DCF studies. The sustainable growth rate was used in a constant growth formula, which was tied to earnings retention, and a growth rate created from external sales of stock. The growth rate from the sustainable growth rate produced a growth rate lower than that currently projected by analysts, which provides additional confirmation that analysts' three- to five-year growth rate estimate is not a reasonable estimate of long-term sustainable growth.

Moreover, the multi-stage growth DCF model could produce reasonable results if the long-term steady state growth rate estimate is reasonable. Mr. Gorman concluded that the growth rate used in his model was reasonable, but the long-term steady state growth rate used by Dr. Hadaway was not reasonable. Thus, the appropriate DCF return estimate centers on the appropriate long-term sustainable growth rate estimate used in the DCF model. The long-term sustainable growth rate estimate proxy used by both Mr. Gorman and Dr. Hadaway focuses on a forecast of future gross domestic product ("GDP") growth. Mr. Gorman used a GDP growth rate that focused on a consensus economists' published GDP growth rate over the next 10 years. In contrast, Dr. Hadaway's GDP growth rate forecast was based on historical data, which was manipulated using a methodology that is only available in Dr. Hadaway's testimony.

The significant difference is that the consensus of published economists believes that future GDP growth will be 4.75% per year, while Dr. Hadaway believes the growth rate will be 6% per year. The consensus economists' projected growth that Mr. Gorman focused on is more appropriate than Dr. Hadaway's growth for the following several reasons.

First and foremost, a published economists' GDP growth forecast is available to the investment community and most likely reflective of their outlook in making investment decisions. Hence, this growth rate estimate is likely included in investors' determination of appropriate valuation of the stocks underlying the DCF studies. Naturally, this GDP growth rate better considers investors' expectations, and produces more accurate estimates of investors' current return requirements. In contrast, Dr. Hadaway's manipulation of historical data is not available to investors, and can only be found in his testimony for this rate case proceeding. Dr. Hadaway's GDP growth rate is fundamentally flawed because it reflects an inflation rate outlook that is not consistent with the general market view. Dr. Hadaway's position is not likely reflective of investors' outlooks, and is unlikely to reliably estimate the investor-required return. There is simply no basis for Dr. Hadaway's inflated inflation outlooks, and therefore his GDP growth rate should be given no weight in this proceeding.

RISK PREMIUM

Dr. Hadaway's equity risk premium is unreliable, whereas the FEA contends that Dr. Gorman's equity risk premium is reasonable for the following several reasons. Mr. Gorman's equity risk premium is based on a current assessment of the risk differentials between equity investments and bond investments in arriving at how much additional return an investor requires currently to invest in stocks versus bonds. This method of estimating an appropriate equity risk premium is consistent with current academic literature, which makes Mr. Gorman's equity risk premium more reasonable than Dr. Hadaway's equity risk premium. Mr. Gorman's risk premium study produced a return on equity of 9.58%, whereas Dr. Hadaway's risk premium study produced a return of 10.72%. Dr. Hadaway's risk premium is based on an equity risk premium range of 4.25% to 4.39%, whereas Mr. Gorman's equity risk premium range of 3.03% to 4.59%. In contrast, Dr. Hadaway's method of estimating an equity risk premium is based purely on a simplistic relationship between nominal interest rates and equity risk premiums. Academic literature does not support this simplistic relationship, which highlights how Dr. Hadaway's methodology is severely flawed.

CAPM

Although Dr. Hadaway has performed CAPM studies for testimony in other rate cases, Dr. Hadaway did not perform a CAPM study in this case. CAPM analysis produces meaningful information; thus, Mr. Gorman included a CAPM return estimate in this proceeding. The FEA contends that Dr. Hadaway intentionally excluded an analysis that produces meaningful information to estimate current market-required returns because the results were too low. Thus, the Commission should consider his ROE recommendation to be highly biased and overstated. However, it is most likely that the CAPM return estimate is low due to the current low market capital costs. By Dr. Hadaway's exclusion of the CAPM return estimate, it had the effect of overstating Dr. Hadway's ROE recommendation.

CONCLUSION

The FEA respectfully requests that the Commission reject Company witness Dr. Hadaway's recommendation to grant the Company an ROE of 11.00%. Dr. Hadaway's recommendation seems to have been developed arbitrarily, disregarding the aforementioned well-established ROE methodologies. Dr. Hadaway seems to have premised his entire argument for an 11.00% ROE upon the application on the DCF and Risk Premium studies. Please note that Dr. Hadaway excluded the CAPM results from his analysis, since he believed that the CAPM results were too low. The FEA respectfully requests that you focus on Mr. Gorman's testimony, and his recommendation for an ROE of 9.65%, which is based on the return of the results of three different analyses: (1) Discounted Cash Flow ("DCF"), (2) Risk Premium, and (3) Capital Asset Pricing Model ("CAPM") studies. Mr. Gorman has developed his recommended ROE of 9.65% by carefully considering the application of each of these three well-established ROE methodologies often relied on by this Commission, which makes Mr. Gorman's testimony and positions on the issues far more accurate, reasonable and reliable.

Respectfully submitted this 24th day of March, 2011.

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CERTIFICATE OF SERVICE

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