STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Evidentiary Hearing
February 7, 2017
Jefferson City, Missouri
Volume 7

In The Matter of Kansas)
City Power & Light)
Company's Request For) File No. ER-2016-0285
Authority To Implement A)
General Rate Increase For)
Electric Service,)

RONALD D. PRIDGIN, Presiding
DEPUTY CHIEF REGULATORY LAW JUDGE
DANIEL Y. HALL, Chairman,
STEPHEN M. STOLL,
SCOTT T. RUPP,
WILLIAM P. KENNEY
MAIDA J. COLEMAN,
COMMISSIONERS

REPORTED BY:
Matthew Behlmann, CCR
Missouri CCR # 1208
Midwest Litigation Services
711 North Eleventh Street
St. Louis, Missouri 63101
(314) 644-2191

A P P E A R A N C E S

For the Staff of the Missouri Public Service Commission:

Mr. Kevin Thompson
Public Service Commission
200 Madison Street
P.O. Box 360
Jefferson City, Missouri 65102
(573) 751-3234

For the Office of Public Counsel:

Mr. Timothy Opitz
Office of the Public Counsel
200 Madison Street
P.O. Box 2230
Jefferson City, Missouri 65102
(573) 751-5324

For KCP&L Company:

Mr. Roger Steiner
Kansas City Power & Light Company
1200 Main Street
Kansas City, Missouri 64105
(816) 556-2314

Mr. Karl Zobrist
Mr. Joshua Harden
Dentons US, LLP
4520 Main Street, Suite 1100
Kansas City, Missouri 64111
(816) 460-2400

For MECG:

Mr. David Woodsmall
Attorney at Law
308 East High Street, Suite 204
Jefferson City, Missouri 65101
(573) 797-0005

PROCEEDINGS

JUDGE PRIDGIN: Good morning. We are on the record. This is resuming the hearing in ER-2016-0285. I am Ron Pridgin, regulatory law judge assigned to preside over this hearing. It is February 7th, 2017. We are in the Governor Office Building, Jefferson City, Missouri. It's about 8:33 a.m. Mr. Zobrist, you were saying?

MR. ZOBRIST: Judge, good morning. Prior to going on the record, I conferred with council for Staff, for Public Council, and for MECG, observing that there were three issues set for this morning, Return on Equity, Capital Structure, and Cost of Debt. Some of the witnesses are duplicative.

Council agreed that we would take all of these witnesses at once, in the sense that Mr. Hevert, for the company, would go on first on return on equity. Then Mr. Bryant from the company to talk about capital structure and cost of debt. Those were the company's witnesses.

Then we would move to Staff witnesses on all three issues. Then to Public Council. Then to MECG. I believe that is agreeable to other counsel.

JUDGE PRIDGIN: Any comments or objections?

MR. WOODSMALL: I guess the only follow-up on that is, we are going to do one opening statement on all three issues, instead of taking them separately.

JUDGE PRIDGIN: I show on my list of witnesses, Dr. Woolridge is not available today. He will testify another day.

MR. THOMPSON: On the 22nd, I believe.

JUDGE PRIDGIN: Okay. And I understand we are going to try to get through return on equity, capital structure, cost of debt, today. Then the parties, if time allows, would like to continue negotiations. Is that correct?

MR. ZOBRIST: That's right, Judge.

JUDGE PRIDGIN: Anything further from counsel, before we proceed to opening statements on cost of capital? Alright. Mr. Zobrist, when you are ready, sir.

OPENING STATEMENT

MR. ZOBRIST: Thank you, Judge. May it please the Commission? Karl Zobrist on behalf of Kansas City Power & Light Company. I presented you with an outline, six pages of my opening statement. I am not going to project it. I thought it might be easier if you just kind of looked along.

The first page is a summary of the cost of equity estimates by the three return on equity ROE experts in the case. And there are two columns for Mr. Gorman, who presented his recommendations on behalf MECG in direct and rebuttal.

Dr. Woolridge on behalf of Staff. Then Bob Hevert on behalf of the company. The interesting thing that I would like to point out to you is that we are now in a period of moderate but steady economic growth in the United States. We see this reflected in the recommendations of the experts in this case.

Both Mr. Hevert and Mr. Gorman revised their projections in their rebuttal testimony. Most notably, Mr. Gorman raised his overall recommendation from a 9.0 percent to a 9.20 percent. The risk premium actually went up 30 basis points from 9.20 to 9.50. And his overall discounted cash flow recommendation moved from 8.8 percent, up 20 basis points to 9.0 percent.

Dr. Woolridge did not revise his projections. Mr. Hevert's range remains the same. But if you look in the final column on rebuttal, his constant growth also went up for discounted cash flow, as did his multi-state growth.

If you turn to Page 2, with regard to

growth rate, which is one of the issues that we typically debate seriously and in detail, this reflects what is going on in the economy today. What we are seeing is job creation. We are seeing a rise in the stock market. We are seeing modest but steady inflation, that is actually hitting 2 percent. If you recall from our past cases, inflations struggled to get near 2 percent. We have actually, I think in the fourth quarter of 2016, exceeded inflation of 2.0 percent. Slightly above.

And of course, the Federal Reserve Board most significantly has begun a steady rise in interest rates. The most recent one that occurred in December of 2016. The evidence seems to be that the Federal Reserve Board will probably raise interest rates once or twice, and maybe three times, in 2017. All of this is reflective of the growth in the economy that we are finally beginning to see.

There are actually changes that are happening more current, and in the very recent past, the last couple of months, but we did see it in the early part of 2016. For example, if you look at the bottom of Page 2 on the growth rates, Mr. Gorman's Stage 1 growth rate, if you look at Footnote 3, that 5.41 percent was as of November 30th. Just 30 days later, and again based upon updated economic information, it increased to 5.52 percent.

So this is all good news for the American economy. But what it indicates for a company like Kansas City Power & Light is that the cost of capital is going to go up. And so this is an appropriate case to look at return on equity, and the cost of capital issues.

Turning to Page 3, capital structure is more of a contested issue in this case, than it has been in prior ones. In part, that reflects the success of Kansas City Power & Light's sister company, KCP&L Greater Missouri Operations Company, which we call GMO. As well as activities that have occurred at the holding company.

KCP&L proposes to use its actual book capital structure, as of the end of 2016, after true up. This reflects the actual cost of capital of this company, and not the holding company. And not some hypothetical structure based upon adjustments. This will insulate KCP&L's operations, and its customers, from activities at the parent company, Great Plains Energy, such as the proposed acquisition of Westar.

There is really no need to use the Great Plains Energy capital structure, given the improved credit profile that we are seeing at GMO, which since 2013 has really established its stand-alone ability to finance its own operations. I would saying that using KCP&L's actual capital and cost structure is consistent with at least one prior KCP&L rate case decision back in 2010, where the Commission had rejected Staff's effort to adjust KCP&L's debt, as a result of lower cost GMO debt.

So we think the logical and simple thing to do is to adopt the actual capital structure of Kansas City Power & Light. Now turning to Page 3, Staff favors the continued use of the capital structure of GPD, based on prior rate cases where GMO had higher equity rates, so it made sense to use the capital structure of the holding company.

Staff actually agrees that it is desirable to use a utility's own costs to set its revenue requirements, but argues that KCP&L and GMO have been managed on what it calls a consolidated basis. We disagree with that. Mr. Bryant, the chief financial officer of KCP&L is here today to tell you and explain, as he has in his testimony, how each utility has been managed in its own best interest.

Staff's position would either result in using GPE's actual capital structure as of the end of

2016, which is very high in equity at 54 percent, or adopting a hypothetical structure that does not exist. The proposal, I believe, is as of June 30th, with certain adjustments.

KCP&L's actual capital structure is much more balanced than that of GPE, of December 31 of last year. And it actually reflects its costs and its financial structure at the present time. And of course earnings, if you adopted GPE's capital structure, as of the end of 2016, would be much higher than any of the ranges of return on equity that are under consideration, based upon the testimony of the expert witnesses in this case.

Public Council has a third proposal. And that is favoring GPE's capital structure, as of September 30th, but with adjustments that reduce the equity by GMO good will by $169 million, as well as excluding certain long-term debt, current maturities from debt.

So again, we have adjustments made to a proposal. Whereas, what the company is proposing is what its actual capital structure is. All of these words are summarized on Page 5, where you see that the common equity has projected for KCP&L is just under 50 percent. We believe that the true-up figures will show it's a little below 50 percent, at 49.72 percent, with long-term debt per true-up at 50.28 percent.

Now MECG has provided testimony on the cost of capital, return on equity, and does not take a position on this. But Gorman, the expert for MECG, does use this capital structure in his analysis. In fact, Mr. Gorman states in his direct testimony that the capital structure and the common equity ratio that KCP&L proposes is in line with the common equity ratio for the electric utility industry, as has been authorized by regulatory commissions.

I summarize Staff and OPC's proposals below. Staff's would have an equity of 49.2 percent, long-term debt a little over 50 percent. Again, this is as of June 30th, 2016, with an adjustment for redemption for stock. And similarly, OPC has actually higher equity than any of the other parties in this case. Again, with the adjustments that I mentioned.

Finally, the cost of debt that we propose is 5.51 percent. Again, MECG takes no position on this issue, but again uses this figure in its calculation of the overall weighted cost of capital. Staff uses a percentage of 5.42 percent, based upon an issue that we've had, as far as how to calculate the costs to issue this debt.

They have said that there is some double counting that was done by KCP&L. We dispute that. But we say if you either use the yield to maturity formula, or the simple interest amortization formula, we are okay with either. Just be consistent. Our proposal on the year to maturity is 5.51 percent. The simple interest amortization is a little bit lower at 5.59 percent. Either of those figures would be agreeable to Kansas City Power & Light.

Public Council does not make a recommendation on cost of capital. Pardon me. On cost of debt. So thank you for your time. If there any questions, I would be glad to respond.

CHAIRMAN HALL: No questions. Thank you.

JUDGE PRIDGIN: Mr. Zobrist, thank you. Opening from Staff?

MR. THOMPSON: Thank you, Judge.

JUDGE PRIDGIN: Mr. Thompson, when you are ready, sir.

OPENING STATEMENT

MR. THOMPSON: My visual aid presents the numbers that are in dispute today, which you have already heard about from Mr. Zobrist. Staff's expert, Dr. Randal Woolridge, recommends an ROE of 8.65 percent, based on his analysis of market conditions and the cost of capital, and the expectations of investors.

Mr. Gorman for MECG recommends 9.20 percent. And Mr. Hevert for the company recommends 9.90 percent. That is a span of 125 basis points from Staff's point recommendation to Mr. Hevert's point recommendation. And each of those basis points is worth approximately $205,000. $205,000. In the area of capital structure, as you just heard from Mr. Zobrist, Staff recommends the use of the consolidated capital structure of Great Plains Energy.

The specific values are 49.20 percent equity and 50.80 percent debt, versus the company's recommendation of 49.88 percent equity and 50.12 debt. And as for the cost of debt, again as you just heard, Staff recommends 5.42 percent, which I believe is GPE's cost of debt. And the company recommends 5.51 percent.

If you have looked at the reconciliation, and I am confident that you have, then you will note that the company requested $90 million in additional revenues on an annual basis. Staff's case, after a thorough audit, is that they are already over-earning by $13 million a year. That's a huge difference.

It is not common for Staff to come in with a negative case. It doesn't happen very often. We were in this room not really so very many months ago, listening to the Missouri Industrial Energy Consumers, as they sought to prove an over-earnings case against Ameren Missouri. I know that many of you will recall that.

Staff's witness, at that time, testified that you really just can't measure over-earning without doing a full audit. A full rate case audit. Because there is just so many things that have to be evaluated. So many things that have to be calculated. And as I recall, he provided an exhaustive list of those items.

Well, today, Staff tells you this company is over-earning by $13 million, and that is after an exhaustive rate case audit, where every factor has been considered. Now those numbers will change with true-up, but I don't think Staff's case is going to go positive.

Why would this company come in and ask for a rate increase, when it doesn't need one? I think you have to wonder that. Certainly, Staff is wondering that. And I think the elephant in the room is the proposed acquisition by Great Plains Energy of Westar Energy in Kansas.

The media has reported, and the file information that we have seen supports the fact that is a very, very large purchase for that company. Very large. So given that Great Plains Energy's only source of income is its two operating companies, Kansas City Power & Light, which is before you today in this case, and its sister company referred to as GMO.

You also heard Mr. Zobrist refer to it. When viewed in the context of that proposed purchase, and the very large borrowing that is necessary to support that purchase, you can see that there is every reason for this company to try to maximize its revenue. Because it will then maximize the contribution that it makes to its parent.

That is why Staff is proposing the use of GPE's consolidated capital structure, and GPE's cost of debt, because this company is a puppet of GPE. It is wholly owned by that holding company. And everything it does is turned to the purposes of that holding company. And that is the reason why it should be viewed as part of that consolidated unit.

As Mr. Murray has testified, that's how the financial community views it. That's how the bond raters view it. There is no ring fencing. There is no real separate of Kansas City Power & Light from its parent. So they are considered by Standard & Poor's, for example, as a single entity.

Dr. Woolridge has used the well-known and accepted techniques of financial analysis, with studies of current market conditions and prices of shares of a representative group of companies, to determine that 8.65 percent is the appropriate return on common equity for this company. I hope the Commission will take Staff's evidence seriously, and return a result that is in line with the recommendations that Staff's experts are going to bring to you. Thank you, very much.

CHAIRMAN HALL: No questions. Thank you.

JUDGE PRIDGIN: Mr. Thompson, thank you.

MR. THOMPSON: Thank you.

JUDGE PRIDGIN: Public Council? When you are ready, sir.

OPENING STATEMENT

MR. OPITZ: May it please the Commission? Good morning. I intend to be very brief. First, as to the capital structure. In the company's last rate case, this Commission concluded that the appropriate capital structure is the GPE consolidated capital structure to set rates. And the Commission did so in the case prior to that, ER-2012-0174.

Public Council asks the Commission to continue that practice, that it was cited in its last case as its historical practice to use the actual capital structure of GPE when setting rates. I will note that council for the company said that Public Council had September 30th as our date for the GPE capital structure. We would be willing to go to the December actual capital structure for GPE.

However, it is our position that good will should continue to be removed, as has been past Commission practice, and past recommendations by other witnesses. On the topic of ROE, Public Council offers Mr. Chuck Hyneman as a witness. His testimony is not recommending a particular ROE point or a range.

However, he responds and disputes KCP&L's evidence that the regulatory environment is such that there is a reason for the Commission to authorize an ROE. Based on his testimony, and the documents he cites to his testimony, Missouri is approximately in the middle. It is not a bad regulatory environment for a company to operate in.

Of the witnesses offering specific ROE recommendations, only the company's witness recommends to increase the ROE. Public Council believes that this increase is excessive and should be rejected. Instead, the Commission should authorize an ROE in the range of 7.9 percent to 8.75 percent, as recommended by Staff's witness.

I would ask you that when considering where to select a point in that range, to keep in mind the ultimate affordability of rates, as it impacts customers. As you heard yesterday in the opening statement of MECG, and as you may have read in Staff's revenue requirement testimony commenting on the economic considerations, from 2007 to 2015, the increase in weekly wages in Missouri counties for the KCP&L service area is about one-fourth of the increase of its electric rates.

If KCP&L receives its 10.7 percent increase requested in this case, the weekly wages for those KCP&L customers would be less than one-fifth of the increase in the electric rates. So I would ask that when you are looking at a place within that range, to keep that affordability to customers in mind. With that, I am happy to answer any questions.

CHAIRMAN HALL: No questions. Thank you.

JUDGE PRIDGIN: Mr. Opitz, thank you.

MR. OPITZ: Thank you, Judge.

JUDGE PRIDGIN: Opening from MECG? Mr.

Woodsmall, when you are ready, sir.

OPENING STATEMENT

MR. WOODSMALL: Thank you. Good morning, Commissioners. I kind of goofed up, and I didn't bring my flash drive for my PowerPoint presentation. I have handed it out, so we will just do it the old-fashioned way and walk through the paper version. Again, my name is David Woodsmall on behalf of Midwest Energy Consumers Group.

As Mr. Zobrist said, we weighed in on one of the three issues, return on equity. Our witness here today is Mr. Gorman. You are obviously very familiar with him. The Commission has seen him in dozens of cases over the last 10 to 15 years. Slide 2, I just threw out some quotes from past Commission orders, in which they discuss Mr. Gorman's credibility and his credentials.

They use words like, reliable, and most understandable, and balanced analysis. The Commission has relied on Mr. Gorman's analysis repeatedly in setting an ROE. Slide 3. So how does that compare with the company's witness. The Commission has been exposed to Mr. Hevert's testimony in several recent cases as well. They used words like excessive and too high.

They point out specific flaws in his analysis. Most particularly, they talk about his growth rates are excessive and too high. And can't lead to a reasonable ROE recommendation. So on Slide 4, Mr. Gorman's analysis -- and it is important here to recognize the date as which he performed this analysis.

He did it an analysis in his direct testimony. Then he updated that in his rebuttal testimony. He did that on December 16th. And that is an important date to remember. You may recall that the Federal Reserve increased interest rates by 25 points on December 14th. So he did his updated analysis two days later. So it reflects all the impacts of that interest rate increase. Anything else beyond that, is purely speculative.

On Slide 5, he then goes into an analysis to point out the flaws in the company's analysis. Here are some quotes from recent Commission orders, in which they talk specifically about Mr. Hevert's DCF analysis, and the problems he has. Well, he hasn't fixed those problems here.

One of the things that is unique about Mr. Gorman's testimony, and I talk about this on Slide 6, is that he attempts to go in and fix the flaws in the company's ROE analysis. So on Slide 6, you see a table where he went in and tried to fix the growth rates that the Commission has said are too high. And previously said are excessive.

You see here by using more reasonable growth rates, the company's DCF analysis goes from 8.9 to 9.7 percent, down to a range of 8.2 to 8.9 percent. So just some simple fixes on the DCF analysis to adjust the growth rates, leads to a much more reasonable DCF analysis.

Slide 7, he attempts to do the same thing on Cap M. First off, on Slide 7, he talks about the problems with the Cap M analysis. I have got some quotes here from his rebuttal testimony. Slide 8 he shows, well, here is what happens to the Cap M, when we put in some reasonable inputs. And you can see all the numbers drop dramatically.

Slid 9, the same thing on risk premium. He talks about some assumption on implicit and Mr. Hevert's analysis regarding the correlation between risk premiums and interest rates. He says that those are flawed. There is not a direct relationship. On Slide 10, he fixes those problems.

Again, just like in the other ones, you see a significant drop in the ROE recommendation, if you use reasonable assumption. So ultimately on Slide 11, he talks about, what's the bottom line? He says, corrections to Mr. Hevert's studies or use of more balanced market base information supports a return on equity for KCP&L in the range of 9.0 to 9.5. That's important.

He does his own analysis, and Mr. Gorman comes out at 9.2. He then takes Mr. Hevert's analysis and puts in reasonable assumptions, and comes out to 9.0 to 9.5. Not a lot of difference there. On Slide 12, I had some other considerations for you. Backing up, I spent most of my time talking about the problems in KCP&L's analysis, and how it is flawed. I don't intend to discuss the merits of Mr. Gorman's analysis. You are obviously very familiar with his analysis from previous cases.

If you have questions, this really gets into the weeds of financial study. But if you have questions, I would urge to ask him. The man is brilliant on these matters. I would urge you to ask him questions about it. On Slide 12, some other considerations to keep in mind when you set an ROE.

First off, as Mr. Opitz said, KCP&L is the only party here today that says you should increase the ROE. No one else believes that. And let's look at what the Kansas Corporation Commission did. Just last year, the KCC authorized a return of 9.3 percent for KCP&L, with a fuel adjustment clause. Well, last year you authorized a fuel adjustment clause for KCP&L.

So why should there be a difference now? Why should you stay at 9.5 percent when they now have a fuel adjustment clause? Their risk dropped because of the FAC, and their ROE should drop. So look at that. KCC set an ROE of 9.3. There is really no significant difference. Obviously, the same capital structure. The same people managing. There is no significant difference to explain why Missouri should be 20 basis points higher than Kansas.

Secondly, Mr. Gorman points Pages 9 and 10 of his direct testimony, quote, authorized returns on equity for electric utilities have been steadily declining over the last 10 years, unquote. Finally, Mr. Hevert's recommendation is 9.75 to 10.5. And I will show you a data request later, which shows that over the past five years, his analysis has typically been about 73 basis points high.

So his analysis is inflated by 73 basis points. So you take it right in the middle of his range, 10.0, and then deduct 73 basis points, you are at 9.25. Mr. Gorman is at 9.2 KCC is at 9.3. We seem to be converging on a singular point here.

Slide No. 13, another unique aspect of Mr. Gorman's analysis is his test to determine if his ROE recommendation complies with Supreme Court guidance. The Supreme Court, a hundred years ago, gave guidance on how to set an ROE in the Bluefield case from 1923. And this is a quote, the return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate under efficient and economical management to maintain and support its credit, and enable it to raise the money necessary for the proper discharge of its public duties.

So a couple things there. They need to be able to raise capital. And need to be comparable with what's being earned by others. It needs to maintain confidence in the company. So unique to Mr. Gorman's testimony is he does a financial integrity test. He goes in and runs metrics that the S&P runs when they set credit ratings.

He does these at a 9.0 ROE. And he shows here that on a 9.0 ROE, they meet all these metrics to maintain their current investment grade credit rating. So it ensures financial soundness. It ensures their ability to attract capital. Only Mr. Gorman's analysis does this test to ensure that his recommendation is consistent with Supreme Court guidance.

Given that a 9.0 ensures or is compliant with Supreme Court Guidance, anything higher than that would be excessive. So certainly 9.9, as the company recommends, is very excessive. That's all the comments I have. If you have any questions, I am willing to take them now.

CHAIRMAN HALL: I have no questions. Thank you.

JUDGE PRIDGIN: Thank you. I believe our first witness will be Mr. Hevert. Let me clarify with counsel. We are going to go Hevert, Bryant for KCP&L. Murray for Staff. Mr. Hyneman for Public Council. Mr. Gorman for MECG. And those are the witnesses for today.

MR. ZOBRIST: That's correct.

JUDGE PRIDGIN: Thank you. Anything further, before Mr. Hevert takes the stand? Okay. Come forward to be sworn, please, sir.

* * * * *

ROBERT HEVERT,

of lawful age, produced, sworn and examined, says:

DIRECT EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Good morning, Mr. Hevert.

A. Good morning.

Q. Would you state your full name for the record please?

A. My name is Robert Hevert. My last name is spelled H-e-v, as in Victor, e-r-t.

Q. And where are you employed?

A. I am a partner with Scott Madden, Incorporated.

Q. And Mr. Hevert, did you cause to be prepared direct testimony with schedules, rebuttal testimony with schedules, and surrebuttal with schedules, in this case?

A. Yes, I did.

Q. Do you have any corrections to any of the direct rebuttal or surrebuttal?

A. I have two. My apologies. These are typographical errors. The first is on my rebuttal testimony, Page 62, Line 8, there is a reference to a 9.6 percent premium-based estimate. That should be 9.2 percent. I apologize for that. And then in my surrebuttal on Page 5, Line 17, right after the parenthetical one there is an extraneous word, the, t-h-e, which should be stricken.

Q. All right. If I were to ask you the questions set forth in those three pieces of testimony, would your answers be as good?

A. Yes, they would.

Q. And this testimony was prepared and sworn to you by you to be true?

A. Yes, it is.

MR. ZOBRIST: Judge, at this point, I offer Exhibit 127, 128, and 129, and tender Mr. Hevert for cross-examination.

JUDGE PRIDGIN: Any objections? Hearing none, 127, 128, and 129 are admitted into evidence. Let me verify, I have looked around the room, and I don't see any other counsel here today to, except for KCP&L Staff, Public Council, and MECG. Am I missing anyone? All right. We will see if we have any cross-examination. MECG, any cross?

MR. WOODSMALL: Very briefly, Your Honor.

CROSS-EXAMINATION

QUESTIONS BY MR. WOODSMALL:

Q. Good morning, sir.

A. Good morning.

Q. Do you recall me asking you a date request in this case, identified as Data Request 5.1, asking

for your recommendations in prior cases?

A. I do.

MR. WOODSMALL: Your Honor, may I approach the witness?

JUDGE PRIDGIN: You may.

Q. (BY MR. WOODSMALL) I want to ask you if you can identify that?

A. Yes. This is my response to that request, as of that date, September 16th.

MR. WOODSMALL: First off, Your Honor, can I label this as Exhibit 655?

JUDGE PRIDGIN: You may. I was going to verify and make sure that is right. I was going to take your word for it on the exhibit number. Bear with me just a moment. Yes. I show it as 655. Thank you.

MR. WOODSMALL: Okay.

Q. (BY MR. WOODSMALL) In Exhibit 655, a comparison of the recommendations you've made in the last five years in cases around the country, as well as what was the ultimate ordered ROE; is that correct?

A. That's right. And I would say, just to be clear, there have been cases -- excuse me. Some of these cases have been finalized by now. So where it says, ongoing for one or two of them, there have been final decisions.

Q. Okay. But for the ones that are reported would you agree, subject to check, that the ordered ROE averages about 73 basis points less than your final recommended ROE?

A. Less than the final recommended ROE. That may be true. Of course, my recommendation, as in this case, is with respect to the entire range. I suspect that if you were to look at the range, we would find cases in which the authorized return was within my range, or very, very close to my range. But as opposed -- excuse me. As to your question regarding the authorized return, relative to the point estimate, I don't disagree with that.

Q. Thank you.

MR. WOODSMALL: Your Honor, I would offer Exhibit 655.

JUDGE PRIDGIN: 655 has been offered. Any objections?

MR. ZOBRIST: No objections.

JUDGE PRIDGIN: 655 is admitted.

MR. WOODSMALL: Thank you, Your Honor. No further questions.

JUDGE PRIDGIN: Thank you, Mr. Woodsmall. Public Council, any cross?

MR. OPITZ: Briefly, Judge. May I have permission to cross from my seat?

JUDGE PRIDGIN: You may. Yes.

CROSS-EXAMINATION

QUESTIONS BY MR. OPITZ:

Q. Good morning.

A. Good morning.

Q. Do you have a copy of your surrebuttal testimony with you?

A. I do.

Q. At Page 11 of your surrebuttal.

A. Yes. I am there.

Q. Lines 11 through 14, you are responding to Dr. Woolridge's comments on your bond yield risk premium; is that correct?

A. Yes, it is.

Q. And you quote his testimony that says, your risk premium -- your bond yield risk premium analysis is a gauge of Commission behavior, and not investor behavior; is that correct?

A. That's correct.

Q. So does your method measure Commission behavior, or does it measure investor behavior?

A. It principally measures investor behavior. And I will tell you why. All of the cases in which I have been involved are based on market-based data. The same types of models, the same types of issues, the same types of market considerations that are at issue in this proceeding. All Commissions, of course, have discretion as to how they view that date. As to how they apply the models. As to the decisions that they arrive at, based on that data.

But it is principally a matter of market data. The second point is that Commission decisions are important to investors. And that is one reason why we often see them reported in SEC disclosure documents. Principally Forms 10-K. If they were not of interest to investors, it would not rise to the level of disclosure, and would not be included there. So I believe that authorized returns certainly are a measure of investor behavior.

I agree with you that they are set by commissions. I do not believe that they are a gauge principally of Commission behavior, and not investor expectations or requirements.

Q. On Page 14 of your surrebuttal testimony, I guess the sentence begins on Page 13. You state that the risk premium model results should be considered an industry average ROE estimate.

A. I'm sorry. Where are you?

Q. So the sentence beginning at 13, and continuing onto 14 of your surrebuttal testimony.

A. Okay. I may have slightly different pagination. What does the sentence read?

Q. The sentence begins, I do agree, however, that the risk premium model results should be considered and industry average ROE estimate.

MR. OPITZ: Your Honor, may I approach?

JUDGE PRIDGIN: I was going to say. I could give Mr. Hevert a copy of the surrebuttal that has been admitted. But you may approach.

THE WITNESS: I appreciate that.

MR. OPITZ: It is the beginning of the sentence (Mr. Opitz gestured).

THE WITNESS: Thank you.

Q. (BY MR. OPITZ) So in your testimony you use the term, industry average ROE estimate. When you are considering the industry, are you talking about as viewed by commissions or as viewed by investors?

A. I think they are very close to one in the same. When we look at the returns that are authorized by commissions, they are based on models. Those models are based on proxy companies. Proxy companies are meant to be a measure of comparable firms. Firms that are comparable to the subject company.

If we focus on the electric utility industry, and if we were to focus more specifically on vertically integrated electric utilities, then it would be a measure of industry. Both from the perspective of investors, and from the perspective of commissions.

Q. So if you look at Page 15 of your surrebuttal, at Lines 4 and 5 -- are you there?

A. I hope so. We will find out.

Q. In that section, you indicate that you believe there is a difference between measures of commission behavior, as opposed to measures of investors' return expectations. Do you agree with that?

A. So the sentence I have reads, I disagree with Dr. Woolridge's position that authorized returns are not meaningful because they are measures of commission behavior, as opposed to measures of investors' return expectations. So what I am saying is that I view the two as the same.

Q. Okay. So you believe -- is your recommendation a measure of commission behavior, or is it a measure of investor behavior?

A. My recommendation is a measure of investor required returns.

MR. OPITZ: That's all the questions I have. Thank you.

JUDGE PRIDGIN: Cross from Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION

QUESTIONS BY MR. THOMPSON:

Q. Good morning, Mr. Hevert.

A. Good morning, Mr. Thompson.

Q. It's nice to see you again. Welcome back to Missouri.

A. Well, it's always nice to be here.

Q. Mr. Hevert, you understand that there is some cross that we need to do. And that lawyers are not just inherently evil. You are being compensated for your testimony today; isn't that correct?

A. I am being compensated. Yes.

Q. And you've traveled here from I believe Massachusetts, isn't that correct?

A. Home of the New England Patriots. Yes. That's right.

Q. That's a sore subject here. And your expenses in making this trip, you would expect those to be reimbursed by your employer, would you not?

A. Reasonable expenses.

Q. Reasonable expenses. Okay. Is this the

first time you've testified on ROE this year?

A. It is not.

Q. It is not. How many times, before this, have you testified on ROE this year?

A. In 2017, one other time.

Q. One other time. Where was that?

A. Virginia.

Q. Virginia. And if you can recall, how many times did you testify in 2016, on ROE?

A. I could not tell you off-hand. It was a fair number.

Q. It was a fair number. More than 10?

A. More than 10.

Q. More than 20?

A. In the 20-range, I would guess.

Q. In the 20-range. Okay. So you were traveling quite a bit?

A. I was traveling quite a bit. Yes.

Q. Now on any of those trips, on any of those occasions, did you testify on behalf of the staff of a regulatory commission?

A. I have not. And it's not because I am opposed to doing so. In all candor, I have never been asked.

Q. And did you testify on any of those

occasions on behalf of a consumer advocate?

A. Same answer.

Q. How about on behalf of an industrial -- an association of industrial customers?

A. On rate of return issues?

Q. Yes, sir.

A. No. The same answer. Again, it's not that I am opposed. I simply never have been asked.

Q. And on any of those occasions, was your ROE recommendation not the highest one before the Commission?

A. Was my recommendation not the highest? I doubt that would be the base. If it were not, I think -- as I mentioned, I have not testified for consumers' council attorneys general industry groups, because I have a different view as to the models, the application of models, and investor required returns, than they typically do. So it's not surprising that I have not been asked to testify on their behalf. And it's not surprising that my recommendation is different than the others. And higher usually.

Q. Okay. And would you be surprised if another witness at one of these proceedings offered a recommendation that was higher than yours?

A. No.

Q. Now in your rebuttal testimony, you've had occasion to reflect on the fact that reasoned judgment is a component in making a recommendation as to return on equity?

A. I would say that is not simply in my rebuttal testimony. That's always a consideration, even as I draft direct testimony.

Q. Would you agree with me that there is a subjective aspect to what you do?

A. I would say it slightly differently. There is subjectivity involved, but I look at the issue more as the application of informed judgment. The application of experience. That may appear to be subjectivity. I agree that setting a cost of equity is not an entirely empirical exercise.

Q. Okay. So other experts might make other choices with respect to inputs; isn't that correct?

A. And that's usually why we are here. That's right.

Q. In fact, would you agree with me that the range of recommendations before the Commission today are based on the use of different inputs by different witnesses?

A. That's a very good point. I think all of us tend to use the same types of models. And differences that arise in our recommendations, arise from the application of the models, the assumptions we make, and how we interpret market date, both quantitative and qualitative market data.

Q. Now the goal of your analysis is to determine the return that an investor would require; isn't that correct?

A. That's correct.

Q. So your investors wouldn't be very happy at 8.65 percent, would they?

A. I am not sure what you mean by, my investors. I don't have any personally. But I think my testimony is that investors in a company, such as KCP&L, require a return in the range of 9.75 percent to 10.5 percent.

Q. Okay. So what does it mean if the Commission awards an ROE lower than the one you've recommended, and the company is still able to raise capital?

A. I think what it means is that markets are always forward looking. And there are actually several parts to that question. I will try to answer this as succinctly as possible. But first, investors in markets are always forward looking. And if a return was authorized lower than that which was requested, investors will understand that. They will look at it. They will look forward to what may be the next rate filing. That's one thing.

Second, we always have to keep in mind that there is a distinction between debt and equity investors. Debt investors have protections afforded to them that equity investors do not. The ability to raise capital may be different on the debt and the equity side.

Third, I always get a little bit nervous when people just say, raise capital. Because having done it myself, I know that raising capital is a complicated business. There are many aspects to it. There is the cost rate. There is the ability to access markets when markets become constrained. There are the terms at which you can raise the capital.

So yes, a company may be able to raise debt. The terms at which they raise it may become more difficult. Their ability to raise it during constrained markets may become more difficult. And equity investors may take a more stringent view of commission decisions than do debt investors.

MR. THOMPSON: Thank you very much, Mr. Hevert. No further questions.

JUDGE PRIDGIN: Mr. Thompson, thank you.

Any bench questions? Mr. Chairman?

QUESTIONS FROM THE BENCH

QUESTIONS BY CHAIRMAN HALL:

Q. Good morning.

A. Good morning.

Q. I assume that you are familiar with Hope and Bluefield Standards that we are applying here today?

A. Yes, sir. I am.

Q. Do you believe that the 8.65 being recommended by Staff violates those standards?

A. Well, let me first say that any opinion I give is of course not a legal opinion. It's my view as to how investors view the Hope and Bluefield Standards, in this context.

I do not believe 8.65 percent meets the Hope and Bluefield Standards. In particular, I don't think it meets the Comparable Risk/Comparable Return Standard. I think it would be stressful, as it relates to the Capital Attraction Standard.

Q. So to follow up on some of the questions from Staff counsel, what do you believe would happen to the company if the Commission were to award that ROE?

A. I think several things likely could happen.

First, to put it in context, we have never seen an authorized return of 8.65 percent for a vertically integrated electric utility. I don't believe we've seen one that low for a distribution-only utility.

Q. Let me stop you for a second. When you say, we have not seen one, what does that mean?

A. It simply has not been observed in the market. If we look back at the roughly 1,400 cases that we reviewed data for from regulatory research associates, where they report authorized returns, there has not been one as low as 8.65 percent.

So you would see from the market's perspective, their view that there is a very significant departure from practice. Not just at this commission, but across all commissions. The second point is that investors have many alternatives available to them.

If they see a return of 8.65 percent for a company with the same risk as KCP&L, and they can go to -- I will give you the far end example. FPL, which recently was authorized a return of 10.55 percent. Of course, capital will flow from one to the other. Even if we were to look at North Carolina, and also South Carolina, which recently authorized returns of 9.9 and 10.1 percent. Clearly, capital would flow from a

company with 8.65 to 9.9 and 10.1 and 10.55 percent.
Q. Do you believe that there could be a credit downgrade?
A. I am always reluctant to speak for the rating agencies. But having -- again, having spent part of my career raising capital and sitting across from the rating agencies, I think they would react very strongly. We don't know how they would react, because have never seen a return that low before.
But when you consider the fact that the regulatory environment, from Moody's perspective, represents about 50 percent of the weight that they applied in arriving at their ratings determinations, a return that low would have to put significant pressure on the rating. If only for the qualitative considerations.
Then you get to the quantitative considerations. The ability to generate cash flow with an 8.65 percent return. It's obviously very constrained. It would be very diluted. So I think the rating agencies would react. Yes.
Q. Is it accurate that ROE's have been trending down for vertically integrated utilities, over the last 10 years?
A. I think we have to parse the data a little

bit. If you were to look --

Q. Let's not parse the data. Let's just say generally over the 10-year time period, is it safe to say that the ROE's have been going down?

A. If you started 10 years ago and look at today, then yes. Ten years ago they were higher than today. Two years ago they were not really higher than today. But 10 years ago, yes, I agree.

Q. So you would say in essence it is not a straight line decline?

A. It's not a straight line decline. And over the past two years, it has really become quite level.

Q. So do you believe that the 9.3 awarded the company by the Kansas Commission was outside the mainstream?

A. I very respectfully disagree with that return. It is low. It would be the second or third lowest return authorized for a vertically integrated utility.

Q. And how did the market react to that?

A. We saw a couple of things. We saw the regulatory research associates, for example, react quite invidious. Quite negatively. Noting that the return was very low. The credit ratings did not change. But again, that's where we have to be sure that we draw the distinction between debt and equity. It's so often hard to look at whether rating -- excuse me. Credit ratings change, and then infer from that, that there is no change in the cost of equity. But as I understand it, those were the reactions.

Q. So am I correct when I draw a couple of conclusions. One, over the last 10 years, ROE's have gone down. Two, generally, the credit ratings of those utilities have been stable or gone up. And then the value of utilities has gone up over that time period. Is that all true?

A. The returns have fallen. Yes. I agree with that. Value of utilities have gone up and down a lot during that time period. We saw them move up in the mid-2016's. They reached their peak when interest rates hit their low. We have seen them lose a fair amount of value since then, as interest rates increased. So the value --

Q. When interest rates increased in 2016?

A. When interest rates hit their low, the 30-year treasury yield hit its low of about 2.15 percent in July of 2016.

Q. So you have seen a dramatic reduction in the value of utilities since the beginning of 2016?

A. Mid-2016. We have seen utilities

underperform the market, depending on the index you choose. Depending upon the timing you choose, by anywhere from say 10 to 25 percent, during that period. The issue was, of course, that at that point in time when interest rates were that low, investors were looking for dividend paying equities.

They were looking for some form of yield. As interest rates started to increase, we saw those valuations, which were very high, were at risk. As interest rates increased, people moved out of the utility market. And that is a scenario that has played itself out time and again.

Now again, as to your last question, the decline over the course of 10 years. Yes. Of course, returns have declined. They have declined with the secular reduction in interest rates over that period. But what my focus is on, and I think the investor's focus is on, is where the market is now. Where it has been recently.

And the very dramatic acceleration in the increase in interest rates over the past five or six months. Let me just put that in perspective. From August through December, again, interest rates increased -- the 30-year treasury increased by about 85 basis points.

If you look at that increase, say going back to 1990, that 85 basis point increase of four months, in terms of the just percentage basis point increase, that is in the top 98th percentile of all four-month periods. It is the highest percentile increase of all four-month periods. So it was a dramatic and very quick acceleration and increase in interest rates.

Q. Do you agree with Moody's that the higher evaluation of utilities can be attributed to the reduced -- well, to the reduction in risk of the utility industry?

A. You know, I had seen that from the March 2015 Moody's report. I don't know that Moody's ever drew a line from one to another in that report. What Moody's did note in that report was that -- and that was in March of 2015, I believe. That's when that report came out.

Q. That is correct.

A. And after that, we saw what we just talked about. Interest rates began to increase. Utilities lost value. So I think that the relationship between trackers and the cost of equity is one that is difficult to quantify. You have to look at the types of trackers that are generally available.

But Moody's also noted in that report, two things. One was the effective bonus appreciation on cash flow. And that was helping maintain credit ratings. And the other was the exposure to interest rate risks that utilities had at the time, and we have seen that now play out.

Q. You also provided testimony on capital structure; is that correct?

A. Yes, I did.

Q. And did you also provide testimony on capital structure in KCP&L's last rate case?

A. Boy, I don't recall, as I sit here. I would not be surprised if I did.

Q. Well, is the company's position that in setting the capital structure, the Commission should use KCP&L's specific data; is that correct?

A. Yes, sir.

Q. And that would be a break from prior Commission treatment on that issue, since at least 2010; is that correct?

A. That's my understanding. Yes.

Q. So why are you asking us to break six years or precedent?

A. That's a great question. To me, the issue of the -- setting the company-specific capital structure by reference to the parent company, the consolidated capital structure, works. The consolidated capital structure works when it is reasonably representative of how the operating utility will finance itself. And it is consistent with industry practice.

Where there is not much of a difference between the consolidated capital structure and the operating capital structure --

Q. By difference, do you mean numerically?

A. Either numerically or in terms of the types of assets that are being financed. Then there is really no reason. It's not all that objectionable to look at one versus the other. But when you have a separate utility capital structure, the company raises its own debt.

It has its own credit ratings. It has a capital structure that is highly consistent with industry practice, both in terms of how we see companies actually capitalizing themselves, based on their financial data. And based on the equity ratios that are returned -- excuse me. That are authorized.

Then I think the operating capital structure is very appropriate. It is the one, after all, that is supporting the assets that are part of the rate base that are supplying service. So my view is that when the consolidated capital structure is consistent with the operating company and is consistent with industry practice, then there is really not much of a difference.

Q. But everything that you've just described has been accurate, I would assume, since 2010. So the company is taking a different position now, and I am trying to figure out why that is?

A. I think you probably want to talk to Mr. Bryant about the company policy on that. But what I will say is that to me, and again, just because I spent time both raising capital and investing capital for a utility, I can tell you that what is important is matching the capital that is being raised with the assets that it's investing. That happens most directly at the operating company level.

Q. Okay. One more question. Again, maybe this should be directed at Mr. Bryant. If you want to defer to him on that on this issue, I understand. In Mr. Zobrist's opening, he indicated that one of the reasons why we should adopt the KCP&L data for use in setting the capital structure is that it will insulate KCP&L operations and customers from activities at the parent holding company, Great Plains Energy, such as

its proposed acquisition of Westar Energy. Can you explain that to me?

A. Well, I will explain what I know. I think it probably is a good question for Mr. Bryant as well. The -- if you look at the acquisition of Westar, the financing plan right now calls for about half of the capital to be raised in connection with the transaction to be debt, and about half to be a combination of common and preferred equity. So it is roughly half and half.

On top of that, there will be debt from Westar that would be assumed by TPE, once the transaction is closed. As a consequence of the assumption of that debt, there would be a more highly leveraged, more debt in the capital structure.

Part of the issue is being sure again -- again, from my perspective, that what we are trying to do is match the capital that is being raised at the operating company with the assets that are being financed and providing utility service.

So I look at the operating company as the proper one for the purpose of being sure that the capital structure is prudent. It is consistent with industry practice for operating utilities.

Q. So when Mr. Zobrist said insulation, it's

not to protect rate payers from that debt, it actually is to give shareholders the benefit of that increased equity?

A. I am not sure I see it that way. I think what we are saying is that by -- at least what I am saying. Again, Mr. Bryant I am sure will have a perspective as well. What I am saying is that when you look at how operating companies capitalize themselves, it is generally 50/50. Half debt and half equity. It has been that way because that --

Q. And that's in this country. It is different in other countries, right?

A. It is different in other countries. Right. But it's roughly 50/50 in this country. And it has been that way for quite some time. If you move to more highly leveraged capital structure, you cannot say that, well, we are going to add more debt, but the cost rates stay the same.

As you add more debt, the cost of equity goes up. So I think by using the utility industry -- excuse me. The operating company capital structure. You are both using one that is sound and prudent and consistent with industry practice for financing utility assets. And it ensures proper cost rates. Neither too high nor too low for the rate payers. So

I think it does provide important protections for rate payers.

CHAIRMAN HALL: No further questions. Thank you.

THE WITNESS: Thank you.

COMMISSIONER STOLL: No questions. Thank you.

JUDGE PRIDGIN: Mr. Kenney?

COMMISSIONER: Thank you.

QUESTIONS FROM THE BENCH

QUESTIONS BY COMMISSIONER KENNEY:

Q. Good morning.

A. Good morning.

Q. I really just have one question. It was kind of based off of a couple answers that you gave Chairman Hall. In your surrebuttal, you had a chart, Page 4. You said that the average authorized ROE for vertically integrated utilities since 2013, and average was 9.86 percent?

A. Right.

Q. My question is, in the last year, say 2016; has that trended downward or stayed the same?

A. No. It has generally stayed about the same. If we look over the past two years, it has generally stayed the same. We have seen a couple of returns that are somewhat higher. I mentioned Florida at 10.55, South Carolina at 10.1, and North Carolina 9.9. So we have seen a couple of data points higher.

Q. And lower too? In order to have an average, you are going to have to have some lower?

A. There were some lower. Right. But what we are starting to see now are returns higher than they had been. We were starting to see individual observations higher than any others we had seen over the past couple of years.

Q. But it is not trending upwards, it is just kind of steady?

A. I think that's fair. I have actually tried to put a trend line through it, and it is hard to say whether that line is meaningful. So I would conclude that it has been about even for the past two years. Not going down. But perhaps not really going up.

Q. Do you have an idea of how many rate cases that would be over this four years? Approximate range?

A. Over four years?

Q. Well, since 2013.

A. Since 2013, I --

Q. Well, that's what your chart was based on?

A. Yeah, it was.

Q. Page 4 of your surrebuttal.

A. Yeah. Let me look. It's probably in the range of about 70 cases. The 2015, the average was about 9.75. In 2016, 9.77. So about the same over '15 and '16.

Q. So it has dropped down a little bit from '13 and '14?

A. A little bit from '13 and '14. About the same as '15 and '16.

MR. KENNEY: Thank you, very much.

JUDGE PRIDGIN: Mr. Rupp.

EXAMINATION

QUESTIONS BY COMMISSIONER RUPP:

Q. Good morning.

A. Good morning.

Q. Has the company struggled, or have they been able to attract capital in the last couple years?

A. Again, I would defer to Mr. Bryant on that. But I know the company has been able to have its credit ratings affirmed. And when we say, raised capital, I know that it has been able to raise debt. And recently did raise some equity.

Q. So you were just talking about the average rate on Page 4. It was 9.86. So currently, they were able to raise capital at a lower ROE than the average?

A. I would agree with that. Again, I would go back to what I said earlier though. That markets are always forward looking. And I think when the rating agencies and when equity investors decide to take a position in either debt or in equity, they are looking forward and making assumptions as to what their returns are going to be, at that point.

Q. How do investors view fuel adjustment clauses? Do they increase or decrease the risk to the company?

A. I think they view them as universal. And so from an investor's point of view, the question is, does a fuel adjustment clause in this company change the risk profile, relative to the alternatives. And because they are nearly universal, from an investor's point of view -- from an equity investor's point of view, where it would have an effect is if there were not a fuel adjustment clause.

From a credit perspective, fuel adjustment clauses again are universal, or nearly universal. And certainly do reduce some volatility that are important to the rating agencies. But we always again have to draw the distinction between debt and equity investors.

Q. And the ROE the company is currently

operating under, what was the ROE previous to that, for the previous rate case?

A. I can't recall.

Q. Was it higher or lower?

A. It was higher.

Q. It was higher?

A. Yes.

Q. The investors would view the not having of an FAC as a risk, because it is universal. But in the previous rate case, the ROE was reduced, and an FAC was granted?

A. Right. But I think we have to look at the factors in play. The market conditions. Everything that is in play, at the time. So I think I would look at it nearly as the converse, what would have happened had the FAC not been put in place.

Q. So if an FAC has been granted, and therefore you are removing that risk to the company because it is universal, and everyone has one, or should have one. And they are attractive capital, both debt and equity. So why would the company need to raise their ROE?

A. Because we are competing still with other companies. Other companies have FAC's. Other companies have rate mechanisms in place. Other companies have returns that on average are between 9.75 and 8.75 percent over the past few years. Always competing for capital with other companies. So it is important to keep that in mind.

Secondly, whereas we talked about the fact that there had been a long-term decline in interest rates. I think we can say that we are starting to turn the corner on that. We are starting to see an increase. I talked a minute ago about effectively a historic increase in interest rates, over a very brief period of time.

We see the financial community expecting three more increases in the Federal Funds Rate by the end of the year. We see expectations of long-term interest rate increases. So I think we are starting to see a fundamentally different capital market than we have seen over the past 10 years.

Q. So when you are looking at the risk premium, which is -- what is the definition of that? So basically, my safe investment with the US Treasury Bond, versus the spread of what the market is getting. I am trying to remember.

A. That is basically right. So the difference between the cost of equity and treasury yield.

Q. So if the interest rates are rising, what

is the correlation between -- so the floor of my risk calculation is rising, how does that -- this is hard to say. But how does that not decrease the risk premium, or just make it static?

A. That's a great question. The interest rate increases. Let's say the interest rate goes up by 100 basis points. The risk premium would fall, but not by as much as interest rates increase. So on net, there is an increase in the cost of equity.

Q. Have there been periods of time where there has been increasing interest rates, which brought up the floor of the risk premium calculation, but yet you've seen increased market expectation and demands, where that risk premium was actually growing out of proportion from the interest rate?

A. There may have been. You can see a situation in which you've got a very sudden change in macroeconomic conditions. So interest rates are increasing, but they are increasing because of expectations of stronger, higher, more sustained macroeconomic growth. So you could see that scenario in which both the interest rate and the risk premium would increase.

I think that would -- that would be something that could happen. It is not something that

I have sort of modeled. I have seen the opposite. I have seen as interest rates go way down, because of the fear people have, the equity risk premium gets incredibly large. But I think from my perspective, while that is a plausible scenario, it's not one that we have modeled.

Q. So you made the comment that the decline in interest rates, money is flowing to utilities. And then I am paraphrasing on your thought. Increasing interest rates, the money is flowing out of. You said something to that effect. I am not putting words in your mouth. Something to that effect. How does the risk premium follow those ins, outs, and flows, and have those been measured over time?

A. I think -- well, just to go back to the premise. The premise is that when interest rates are low -- again, let's go back to June and July 2016. Shortly after the Brexit vote, for example, when a 30-year treasury hit 2.15 percent. It was so low that people were willing to take on equity risk in order to get some yield. Something better than 2.15 percent.

So they would go into dividend paying stocks. Consumer staples. Utilities. They did so, and really increased the valuation. So for example, whereas utilities would normally trade at a price to earnings multiple discount of say 15 percent to the market, now they are trading at a premium of 20 percent to the market.

As soon as interest rates start going up and yield is available elsewhere, people start moving away. And because evaluations were so high, the reduction in value at that time, as they started rotating out of that sector and into other investments, the valuations fell. And we've seen that a couple of times in the past couple of years.

As to the risk premium, I think generally the same situation would follow. Which is that interest rates increase, the risk premium probably falls. It just doesn't fall as much as the interest rates increase. So on balance, the cost of equity goes up.

Q. So if you follow that, and your risk premium does fall, but at the same time the valuation of utilities is coming down, wouldn't then that signal that ROE's would be starting to come down, with those two scenarios?

A. You would mean the ROE's are going up. As the prices start to fall; it means that people are discounting them at a higher rate. They are expecting a higher return. So as the prices start to fall, it means that the return that is being required is going up. And then that would be consistent with the increase in interest rates.

Q. And you made the comment, I think earlier, that a utility that had an 8.65 might not get any capital, but the one that has 10, that's where the capital is going to flow. At what point do we enter an echo chamber of it doesn't matter what the valuations say, it is a compilation of ROE's granted by state commissions, and the chasing of the money that's what is driving the sliding up and down?

A. That's a very good question. People have pointed to what they will refer to as the circular nature of an analysis of looking at returns authorized for one company, versus those that are available elsewhere. There are two responses to that.

One is that the I don't, and I don't think anyone uses these types of authorized returns as the really primary method of setting a return. We look at other methods as well. I think that's what happens in all jurisdictions. People just don't look across state lines and see what others are authorizing. They look at the models and they look at market based data, and make determinations that way.

On the other hand, it simply is a fact that returns that are authorized represent returns that are available to investors elsewhere. So that's my understanding of why this commission would set a zone of reasonableness by reference to returns that are available in other jurisdictions. It just makes sense that if there is an opportunity to invest elsewhere at a higher return, investors will go there.

Q. So someone offered in their opening testimony the State of Kansas Commission was granted at 9.3 percent, and why should we be any different than the neighbors that share that? Can you comment on why, if we are not looking at what other jurisdictions are doing, refute that we should be at 9.3 percent because Kansas is?

A. Because Florida is at 10.55. If we are going to look at one jurisdiction, the one jurisdiction that is authorized the lowest return, we can also look at the one jurisdiction that is authorized the highest return. Investors are not restricted to invest in capital and utilities that provide service in Missouri or Kansas. They can look anywhere.

Q. Is there a statistical study, and has anyone looked at the performance of a utility's stock price, in reference to their ROE, and compared that

over the industry at a whole, during the same time frame?

A. Looking at price performance relative to authorized returns?

Q. You know if investors can invest in Florida.

A. Uh-huh.

Q. So you would make that assumption that if they have a 10 percent ROE that equity and capital is just going to be pouring into there, and there should be some type of correlation in the performance of the company as well. Has anyone looked to say that there is definitive data that shows the higher the ROE the higher the performance in the stock price?

A. I don't know that there is a study that has looked at authorized returns versus stock prices. I am just trying to think methodologically how that would work. We certainly look at studies that measure risk in stock prices. And risk to some extent is taken into account in authorized returns. So that is certainly one thing. But as to looking at the issue, I am not aware. It's an interesting question.

Q. I am just thinking out loud. I am not asking you to do it. I am just curious with all the era of big data and data analytics in there, I figured

there's got to be a think tank out there that's thrown this into a computer somewhere.

A. You just gave me a new line of business.

Q. There you go. There you go?

MR. RUPP: I think that's all. Thank you.

JUDGE PRIDGIN: Thank you. Commissioner Coleman?

COMMISSIONER COLEMAN: No.

JUDGE PRIDGIN: Any recross, based on bench questions? MECG?

MR. WOODSMALL: Yes. Very quickly.

RECROSS EXAMINATION

QUESTIONS BY MR. WOODSMALL:

Q. You were asked some questions by Chairman Hall about -- he was talking about ROE declining and credit ratings being the same or increasing. Do you recall those questions?

A. I do.

Q. At Page 11 of Mr. Gorman's direct, he has a charge that shows credit rating changes over the past I guess six years. Do you recall that?

A. I'm sorry, what date of his direct?

Q. Page 11.

A. Yes. I see that. Thank you.

Q. And it shows in 2013, of all the rating

changes, 75 percent of them were upgrades. In 2014, 97 percent were upgrades. 2015, 70 percent were upgrades. Do you recall that?

A. I do. And I will say this subject to check. Of course, Moody's and Standard & Poor's both did what has often been referred to as the universal upgrade in the utility sector. It wasn't necessarily specific, but there was an upgrade throughout the entire industry, at that time.

Q. But we have seen is during this period of time where ROE's were declining and then flattening out, we did see primarily upgrades; is that correct?

A. Sure. But let's just be sure. I think we have all agreed that interest rates changed over that time period. There is a corresponding change in returns. Again, when we look at the more recent time period, even Mr. Gorman's data will tell you from 2015, 2016, the authorized returns have remained about the same.

Q. Okay. You were asked some questions about KCP&L attracting capital over the last couple years. Do you recall that?

A. I do.

Q. And my understanding, in the last rate case, the Missouri Commission authorized an ROE of

9.5; is that correct?
A. Yes. That's right.
Q. And the Kansas Commission a 9.3 ROE?
A. That's correct.
Q. Do you also understand that KCP&L has issued debt and equity over the last year; is that correct?
A. When you say KCP&L has issued equity, what do you mean by that?
Q. I'm sorry. GPE.
A. Yes. I'm aware of that.
Q. And that was done primarily to finance the Westar Acquisition?
A. The equity issuance?
Q. Yes.
A. Yes. I understand that.
Q. So they were able to attract capital for that purpose, at those ROE's?
A. Those were the prevailing ROE's. But I will say it one more time, markets are forward looking.
Q. Okay. Finally, you were asked some questions by Commission Rupp. He was talking about a comparison to Kansas. You mentioned that the flip side of the coin is a comparison to Florida. Do you

recall that?

A. I do.

Q. Does KCP&L have any operations in Florida?

A. No. But that does not mean investors can't look to Florida to invest.

Q. And KCP&L does have operations in Kansas; is that correct?

A. Right. Investors do not have to look to Kansas to invest.

Q. When KCP&L raises capital, do they raise capital as one entity, or do they raise capital Missouri-specific and Kansas-specific?

A. As a single entity.

Q. So would it be fair to say then that by authorizing an ROE of 9.3, Kansas was driving KCP&L down, relative to Missouri?

A. 9.3 is lower than 9.5, if that's your question.

Q. So Missouri is propping up Kansas? Missouri doesn't get a lower -- doesn't -- let's scratch that.

MR. WOODSMALL: I have no further questions. Thank you.

JUDGE PRIDGIN: Mr. Woodsmall, thank you. Mr. Opitz?

MR. OPITZ: Briefly, Judge.

RECROSS EXAMINATION

QUESTIONS BY MR. OPITZ:

Q. Do you recall the chairman asking about your testimony in the last case, regarding capital structure?

A. I do. Yes.

Q. And I believe your answer was that you couldn't recall, sitting here today, whether you had offered that testimony; is that right?

A. That's right.

Q. But you did offer testimony in that case?

A. I did. Yes.

MR OPITZ: Judge, I have a reference to his direct testimony from that case. It was admitted as Exhibit 115 in ER-2014-0370. I ask that Commission take judicial notice of that exhibit.

JUDGE PRIDGIN: I understand that you want the Commission to take judicial of that report and order?

MR. OPITZ: Of that exhibit in that case file. It would be his direct testimony in that case.

JUDGE PRIDGIN: Alright.

MR. OPITZ: And it's listed as Exhibit 115.

JUDGE PRIDGIN: Any objections?

MR. THOMPSON: Staff objects.

JUDGE PRIDGIN: On what grounds?

MR. THOMPSON: Relevance.

JUDGE PRIDGIN: Overruled.

MR. OPITZ: Thank you, Judge.

JUDGE PRIDGIN: Cross from Staff?

MR. THOMPSON: No questions. Thank you.

JUDGE PRIDGIN: Redirect?

MR. ZOBRIST: Just briefly, Judge.

REDIRECT EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Mr. Hevert you were asked by Public Council about the risk premium estimates that you discussed, I believe on Pages 13 and 14 of your rebuttal?

A. Yes.

Q. What were the ranges of your risk premium?

A. In my rebuttal testimony, the range of my risk premium estimate was -- I looked at it a couple different ways. But for settled-only cases, it was 9.81 percent to 10.28 percent. And for fully litigated cases, it was 10.12 percent to 10.41 percent.

Q. Thank you. Now you were asked by Mr. Thompson about the Kansas Corporation's Commission return on equity that was set at 9.3 percent, correct?

A. Yes.

Q. Did you testify in that case?

A. I did.

Q. And what was your recommendation in that case? Do you recall?

A. I believe it was -- the low end of my range was -- I don't want to guess. I'm sorry.

Q. Let me ask you this. Were there regulatory mechanisms in place when the Kansas Commission was considering KCP&L's rate case, at that time?

A. Yes.

Q. And in addition to the fuel adjustment clause, what other rate mechanisms were in existence in Kansas, that are not in existence in Missouri?

A. Well, there were transmission costs. That's one that comes to mind.

Q. Was there also a property tax flow-through that was authorized by Kansas?

A. Yes. That's correct.

Q. Now Commission Kenney, I believe, was asking you about national averages of returns on equity, and you stated, I believe, in 2015 it was 9.75 percent, in 2016 it was 9.77 percent; is that correct?

A. Yes. That's right.

Q. And those are national averages of all

regulatory commission's adjudicating rate cases in the United States?

A. Yes. For vertically integrated companies.

MR. ZOBRIST: That's all I have, Judge. Thank you.

JUDGE PRIDGIN: Commissioner Rupp?

COMMISSIONER RUPP: Sorry guys. I hate to do this.

FURTHER BENCH QUESTIONS

QUESTIONS BY CHAIRMAN RUPP:

Q. This is more just an education question. But you said -- you mentioned the universal upgrade by Standard & Poor's. Can you tell me, what was the economic climate, and what was the driver behind that?

A. I really couldn't tell you what the driver was behind it. I think Moody's was looking at all the utilities at the same time. Looking at mechanisms that were in place, again, from the perspective of debt holders. As a consequence, the vast majority of rated utilities were increased by; I believe it was one notch.

Q. What year was that?

A. 2012 time frame.

COMMISSIONER RUPP: Thank you. That's all.

JUDGE PRIDGIN: Any recross, based on those bench questions? Redirect?

MR. ZOBRIST: No questions, Judge.

JUDGE PRIDGIN: Thank you. Excuse me, Mr. Hevert, thank you very much.

THE WITNESS: Thank you.

JUDGE PRIDGIN: You may step down.

MR. ZOBRIST: And may he be excused, Judge?

JUDGE PRIDGIN: Any objections? You can be excused. Thank you very much. It looks like the next witness is Mr. Bryant. We will see how long Mr. Bryant's testimony goes, and try not to break in the middle of a witness. But we will see how long this goes. If need-be, we may need to take a break around 10:30 or so. We'll see how long this testimony takes. Mr. Bryant, if you will come forward to be sworn, please, sir.

* * * * *

KEVIN BRYANT,

of lawful age, produced, sworn and says:

DIRECT EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Good morning.

A. Good morning, Mr. Zobrist.

Q. Please state your name.

A. Kevin Bryant.

Q. And where are you employed?
A. I am employed at KCP&L as a senior vice-president and chief financial officer.
Q. And Mr. Bryant, did you prepare, in this case, direct testimony, rebuttal testimony, and surrebuttal testimony?
A. I did.
Q. Do you have any corrections to the answers that were set forth in those three exhibits?
A. I do not.
Q. And those have been marked as Exhibits 106, 107, and 108; is that correct?
A. That is correct.
Q. If I were to ask you those questions, would your answers be set forth in those three exhibits?
A. Yes, sir.
Q. Okay.
MR. ZOBRIST: Judge, I have no further questions. And I move the admission of Exhibits 106, 107, and 108.
JUDGE PRIDGIN: Any objections? Hearing none, Exhibits 106, 107, and 108 are admitted into evidence.
MR. ZOBRIST: And I tender Mr. Bryant for cross-examination.

JUDGE PRIDGIN: Mr. Zobrist, thank you. Cross-examination, MECG?

MR. WOODSMALL: No questions.

JUDGE PRIDGIN: Public Council?

MR. OPITZ: No questions, Judge.

JUDGE PRIDGIN: Staff?

MR. THOMPSON: No questions. Thank you, Judge.

JUDGE PRIDGIN: Thank you. Any bench questions? Mr. Chairman?

CHAIRMAN HALL: I think just a few.

QUESTIONS FROM THE BENCH

QUESTIONS BY CHAIRMAN HALL:

Q. Good morning.

A. Good morning, Chairman.

Q. I am going to ask you a couple questions that I asked Hevert. And that is I would like to better understand your testimony -- I'm sorry. On Page 4 of your direct.

A. Sure.

Q. And it's language that was parroted by Mr. Zobrist in his opening today. And I am still trying to better understand it. Lines 8 through 12, where you make the argument that using the KCP&L specific capital structure will insulate utility operations and

customers from activities such as the Westar acquisition.

A. Sure.

Q. I am trying to get a better understanding for that.

A. Sure. I think Mr. Hevert gave one piece of what my response would be. Certainly if you use a higher leverage capital structure for utility rate making, you expect a higher equity return, just because of the correlation between higher debt and risk. But I think this is also meant to speak to the fact that holding company activities could take on a number of forms.

So for example, if the holding company got involved with a business, and its resulting equity ratio was higher than what we have traditionally seen, the 50/50 capital structure that utilities have been financed, and that's our plan to finance utilities.

You could then have a higher equity ratio at the holding company. Which by that extension, we would not expect that to be used for utility rate making. So it is meant to proxy that the matching of the cash structure used for rate making should correspond to the capital in which is raised to finance that activity.

Q. So give me a scenario where that type of insulation would enure to the benefit of rate payers?

A. So in that latter example, if the resulting holding company activity resulted in a 60 percent equity ratio --

Q. Let's be specific to the Westar acquisition.

A. Sure. So the Westar acquisition obviously is an elephant in the room. This rate case is focused on the historical activity of KCP&L. For the Westar acquisition, however, we have issued more equity to finance the acquisition of Westar, and resulted in a higher equity ratio, then we would expect KCP&L's utility rates to be set on that equity ratio.

Q. So under what circumstances could a decision by this Commission, in this case, adopting KCP&L's position on capital structure enure as a benefit to rate payers, in connection with the Westar acquisition?

A. With this specific transaction, as financed?

Q. Yes.

A. Again, I think I'd go back to the matching of KCP&L's rates, and cap structure for rate making, consistent with how its assets were financed. Westar

-- the acquisition of Westar really has nothing to do with KCPF providing service to KCP&L.

I think what the better mechanism to protect KCP&L customers has been through the ring fencing provisions in the settlement that OPC and Staff has provided in the variance waiver case. Which is a much more effective way to address protecting KCP&L's customers.

Q. Has KCP&L had any difficulty attracting capital, either data or equity?

A. No. KCP&L has really had no trouble attracting. I think if you look across the utility sector, utilities have generally had favorable access to the capital markets. The price at which that capital is accessed has been affected, based on different utility and different company specifics.

So even though you are able to access the capital market, the price for stock would potentially be impacted with a lower stock price, or for debt with a higher interest rate. So I think we see in our sector access to capital, it's the cost of that capital that is more such to volatility.

Q. Have you, or anyone at the company provided any calculations on the increased cost of capital, as a result of the reduction in ROE over on the Kansas

side?

A. Not that I'm aware of.

Q. Is that calculation even possible?

A. Are you referring to the -- let me make sure I understand your question. Are you referring to the 93 ROE?

Q. Yes, I am.

A. I think it's possible.

Q. So how would you go about doing that? First, has that calculation been done? If you are aware?

A. Not that I'm aware of.

Q. How would you do that calculation?

A. I would take the difference between the 9.3 and the 9.5 that is currently in KCP&L's rates. If that's your proxy. Or the 9.9 that we have sought in this case. Then apply it to the equity ratio that we proposed in this case. Then apply that to the rate base that KCP&L currently has in service.

Q. Well, that would -- that would -- that formula could be used to determine the reduction in the revenue requirement?

A. Correct.

Q. But how would you calculate any additional cost of attracting capital, as a result of that

reduction?

A. I see your question. I apologize. Maybe I answered a different question. So that one is harder to do. The place where I would start, if you look at the stock prices for a company like Great Plains that is based 75 percent currently in Missouri and 25 percent in Kansas, and compare us to the proxy group of firms that, for example, Mr. Hevert mentioned.

You will see that historically Great Plains has traded at a discount to its peers on a price-earnings multiple basis. So for example, in the 2015 and 2016 time frame you saw price earning multiples with the stock price as a multiple of the utility's earning per share in the 17 to 18 times range.

Great Plains has traded in the 16 to 17 times range, which is a one-turn discount on a stock price basis. Now how you would apply that to capital attraction, we have not done that. I am certain a very astute firm like Mr. Hevert's firm could conduct such a calculation. But that's a reasonable way to proxy the discount for different utilities.

CHAIRMAN HALL: No further questions. Thank you.

THE WITNESS: Thank you.

COMMISSIONER STOLL: No questions.

QUESTIONS FROM THE BENCH

QUESTIONS BY COMMISSIONER RUPP:

Q. Everything is static. Let's say your proposal for a rate increase was submitted, all the numbers that KCP&L has previously submitted. The only change was the Staff, OPC, and Consumers' Council structure on equity and capital. How much does that change the amount of revenue increase that you are asking for?

A. I don't have that exact calculation. But if you look through the year-end true-up date, the equity ratio for KCP&L would be about 50 percent. If you looked at the current -- and you're comparing the utility versus the wholesale; is that correct?

Q. I am trying to get a ballpark figure in my head of when it boils down to all these many decisions we have to make. On this decision, what is the dollar amount impact to the whole revenue requirement, the few basis points between them? If there is a calculation that would say, this would change the revenue requirement or the amount of increase by this amount of dollars?

A. And you are talking to the difference between the utility capital structure and the holding company?

Q. I am talking about the difference between the recommendation from Staff, OPC, and your company's?

A. So if you use through the true-up date of December 31st, what we have proposed is an equity ratio of about 50/50. If you use the actual cap structure which the different parties had proposed, through the year end true-up date, that's about 54 percent equity ratio. We can do that calc, as I get off the stand. But that would be the basis for the difference.

What the different parties have proposed in this case is to make adjustments based on a June 30 true-up date, and a September 30 true-up date, which gets you to roughly, with those adjustments and if you agree with those adjustments, at 50/50 cap structure, closely commencing with where KCP&L's year-end actual cap structure is through 12/31/2016. I gave you a lot of words.

Q. It was a very informative answer. I just want to make sure I am articulating my question. If I look at the KCP&L capital structure at the end of the true-up period, which is 49.88 percent common equity and 50.12 long-term debt, and take all of your

assumptions, except you change those numbers and swap them to Staff, OCP, and CCM's consolidated capital structure at 50.8 percent long-term debt and 49.2 percent common equity; what does that change? All the other information the same. What is the dollar amount difference?

A. I don't know that. I would expect it to be fairly close. But you are comparing apples to oranges, in terms of true-up dates and adjustments that are being made. If you use the same ratios, I would expect it to be fairly close.

Q. Fairly close, are we talking 17 bucks, are we talking $1.7 million?

A. Certainly bigger than 17 bucks. I don't think it would be as wide as the $1.7 million, but I would have to run a quick calc to confirm that.

Q. And anyone that would like to give you any ballpark, or to try to put a dollar amount to all of these many decisions that we have to make in this.

A. Sure.

COMMISSIONER RUPP: Thank you.

JUDGE PRIDGIN: Commissioner Coleman, any questions?

COMMISSIONER COLEMAN: No.

JUDGE PRIDGIN: Any recross, based on bench questions?

MR. WOODSMALL: Briefly, Your Honor.

RECROSS EXAMINATION

QUESTIONS BY MR. WOODSMALL:

Q. Good morning, sir.

A. Good morning, Mr. Woodsmall. Good to meet you finally.

Q. You too. Thank you. Would you agree with the concept that the cost of debt increases as ROE decreases?

A. The cost of debt increases as ROE decreases?

Q. Yes.

A. So debt increases. I think Mr. Hevert went through that. I certainly would agree with how he described that.

Q. Okay. And again --

A. Not one-for-one. Not at the same rate. But there is a correlation.

Q. Sure. But there is a correlation?

A. Absolutely.

Q. And would you agree that you raise debt for KCP&L as a whole, not Missouri-specific and Kansas-specific?

A. That's correct.

Q. Okay. So you don't raise debt for Missouri with an ROE of 9.5, and then raise debt separately for Kansas with an ROE of 9.3?

A. We don't. We don't raise debt that way.

Q. You raise debt with a total company that has an ROE somewhere between 9.3 and 9.5?

A. Yes, sir.

Q. Okay. Given the concept then that ROE increases as costs of debt decreases -- or cost of debt increases as ROE decreases; are Missouri customers somehow insulated from the higher cost of debt that comes from Kansas having a 9.3 ROE?

A. I think Missouri customers pay the cost of debt that it takes to raise that capital for KCP&L.

Q. So Kansas coming in at 9.3 causes Missouri rate payers to have a higher cost of debt?

A. It certainly contributes to the investor mentally. Investment methodology.

Q. And you have done nothing to insulate Missouri rate payers from that higher cost of debt?

A. Nothing specifically, other than the commitments to maintain equity ratios at the utilities and the holding company.

Q. So what is happening in Kansas is certainly causing a higher cost of capital for Missouri rate

payers?

A. It could contribute. There certainly would be other factors in Kansas that could also go the other way.

Q. Okay.

MR. WOODSMALL: No further questions. Thank you.

JUDGE PRIDGIN: Thank you. OPC?

MR. OPITZ: No, Thank you, Judge.

JUDGE PRIDGIN: Staff?

MR. THOMPSON: Thank you, Judge.

RECROSS EXAMINATION

QUESTIONS BY MR. THOMPSON:

Q. Do you recall the questions that Commissioner Rupp was asking you?

A. Yes, sir.

Q. And he was asking you if you could quantify the effect of a capital structure choice that the Commission has to make?

A. Yes, sir.

Q. Are you familiar with the reconciliation that Staff filed in this case?

A. I am not, but I am sure Staff conducted one.

Q. Would you be surprised if I told you that

Staff valued the capital structure issue at $2.2 million?

A. Mr. Thompson, you are credible. I would take you at your word.

Q. You wouldn't have any reason to quarrel with that figure?

A. I trust that calculation is correct.

Q. Thank you.

MR. THOMPSON: No further questions.

JUDGE PRIDGIN: Mr. Thompson, reconciliation, could you let him know where you are getting that number?

MR. THOMPSON: That number is from Line 6 in the column headed, cutoff 6/30/2016.

JUDGE PRIDGIN: Thank you. Any redirect? I'm sorry. Any redirect?

MR. ZOBRIST: Pardon me.

REDIRECT EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Mr. Bryant, on Mr. Thompson's question, you have not reviewed the reconciliation, have you?

A. I have not. I was taking Mr. Thompson at his word.

Q. And I will do that as well. But there are other witnesses, such as Mr. Klote, who have reviewed

the reconciliation and may be able to respond to Staff's questions; is that fair?

A. Sure. Mr. Klote and Mr. Ides (phonetic), will be here either later this week or next week.

Q. Now let me go back to the question that Mr. Woodsmall asked you about cost, and what Mr. Hevert testified about that. If the cost of debt is increasing because interest rates are increasing, what effect would that have on the cost of equity?

A. As Mr. Hevert indicated, it should raise the cost of equity.

Q. That's because the costs that -- go ahead.

A. The cost of equity doesn't decrease at the same rate at which the cost of debt increases, due to interest rate increases.

Q. There may be, as I think he said, a narrowing spread. But the costs are both going up, correct?

A. That's correct.

Q. Now I believe in response to Chairman Hall's questions about stock price comparisons, you were stating that Great Plains Energy trades below its peers at a rate of 16 to 17?

A. Yeah. That's going from memory. But in the 2015 to 2016 time frame, that is my recollection.

Q. So your testimony is that Great Plains energy is trading below its peers, as an average, correct?

A. That's correct. For the same level of earnings, Great Plains Energy stock price is lower than its comparable peer average.

Q. And with regard to the capital structure that you are recommending to the Commission, this is one that would not require adjustments, based upon either good will or examining the long-term maturity of debts, or other, for example, redemptions of preferred stock?

A. That's correct. We propose the actual KCP&L cash structure at year-end 2016.

MR. ZOBRIST: No further questions, Judge.

JUDGE PRIDGIN: Thank you. Mr. Bryant, you may step down.

THE WITNESS: Thank you, sir.

JUDGE PRIDGIN: And this looks to be a convenient time to break. I am showing the clock at 10:25. Let us take 15 minutes. We will then go on with Mr. Murray at 10:40. We are off the record.

(WHEREIN, a brief recess was taken.)

JUDGE PRIDGIN: Thank you. We are back on the record. I understand the next witness will be Mr.

Murray. Then we will go to Mr. Hyneman and Mr. Gorman. Then adjourn for the day. Just kind of a tentative road map, I am understanding we will move on to depreciation tomorrow, and fuel adjustment clause. And then we will see about incentive compensation, if that is something that the parties may be able to either work out or move.

MR. STEINER: I think that's issue between Staff and the company. Talked to Staff, and they are okay with not doing that issue tomorrow that is in our proposed settlement. We will do that later in the week. Public Council, I believe, is also okay with that change in schedule.

MR. PRIDGIN: So what I'm hearing is that we will finish up cost of capital today, and move on to depreciation and fuel adjustment clause tomorrow.

MR. STEINER: That's correct.

JUDGE PRIDGIN: Anything further before Mr. Murray takes the stand? Mr. Murray, if you will come forward to be sworn please.

* * * * *

DAVID MURRAY,

of lawful age, produced, sworn and examined says:

DIRECT EXAMINATION

QUESTIONS BY MR. THOMPSON:

Q. Good morning, Mr. Murray.

A. Good morning.

Q. How are you employed?

A. I am employed with the Missouri Public Service Commission as a utility regulatory manager in the financial analysis unit.

Q. Mr. Murray, are you the same David Murray that prepared or caused to be prepared a contribution to Staff's direct revenue requirement report, I think marked as Exhibit 200, rebuttal testimony marked as Exhibit 220, and surrebuttal testimony marked as 221-HC?

A. I only specifically sponsored testimony for rebuttal and surrebuttal.

Q. So you did not contribute to the report?

A. I provided information to Staff's ROE witness, Dr. Randy Woolridge.

Q. Thank you for that clarification. Do you have any corrections to your testimony?

A. Yes. On my rebuttal testimony, Page 10, Line 7, strike out credit facilities. Otherwise, everything else is okay.

Q. And that's your only correction?

A. Yes.

Q. Now with that correction in mind, if I was

to ask you those questions today, would your answers be the same?

A. Yes.

Q. And is it your testimony that the contents of your pre-filed testimony, with that correction, are true and correct, to the best of your knowledge and belief?

A. Yes.

MR. THOMPSON: I move for the admission of Exhibits 220 and 221-HC.

JUDGE PRIDGIN: Any objection? Hearing none, 220 is admitted, and 221-HC is admitted.

MR. THOMPSON: I tender Mr. Murray for cross-examination, Judge.

JUDGE PRIDGIN: Mr. Thompson, thank you. Public Council, questions?

MR. OPITZ: No cross, Judge.

JUDGE PRIDGIN: MECG?

MR. WOODSMALL: No, thank you.

JUDGE PRIDGIN: Kansas City Power & Light.

MR. ZOBRIST: Thank you, Judge.

CROSS-EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Mr. Murray I have no questions for you on return on equity. I have some questions on capital

structure and cost of debt. Did you read Mr. Gorman's direct testimony in this case?

A. Yes.

Q. Do you agree with Mr. Gorman that the equity debt ratio that a company proposes is in line with the electric utility industry, as authorized by regulatory commissions in setting rates?

A. I think 50 percent equity ratio is a good approximation for averages.

Q. And in this case, the company has proposed common equity of 49.98 percent, and debt of 50.12 percent, correct?

A. That is correct.

Q. Now Staff in this case endorses the use of the Great Plains Energy capital structure, correct?

A. Yes.

Q. But it does not endorse the current capital structure, as the end of the true-up period, December 31, 2016; is that correct?

A. Yes.

Q. And as I understand it, as contained in the Staff report, and perhaps in your testimony as well, Staff is proposing to use Great Plains Energy's structure as of June 30, 2016, with an adjustment that reflected the redemption of preferred stock in August

of 2016?

A. Yes.

Q. And that recommendation has not changed through rebuttal or surrebuttal, correct?

A. That is correct.

Q. And if the Commission were to use Great Plains Energy's capital structure, as it exists today, that would result in a common equity of approximately 54 percent, correct?

A. I haven't looked at those numbers. I just saw what numbers Mr. Bryant providing in his testimony. I haven't verified those numbers.

Q. Is it fair to say that to your knowledge, Staff has never recommended a capital structure that would have common equity in the range of 54 percent?

A. I don't believe that's true.

Q. You think that it has?

A. I believe for gas cases it is done a little differently with short-term debt taken out, because of gas purchases and inventory being supported by short-term debt. Removal of that short-term debt from the capital structure, which can make up almost 10 percent of the capital. In effect, those long-term capital ratios, which would make it somewhat different from what you expect with electric utilities.

Q. And that's just what I was saying. And I should have clarified. In terms of vertically integrated electric public utilities, 54 percent common equity would be a relatively unusual high number?

A. I will go back to before my time, which has been quite a while now, I think the last time there might have been an equity ratio that approached 60 percent was back when St. Joe Power & Light was an independent company. I don't even remember what the recommendations were then.

Q. Thank you. Let me ask you a couple questions about the issuance of debt. KCP&L issue its down debt?

A. Yes.

Q. And does GMO, KCP&L's sister company, issue its own debt?

A. It has since 2013. Before then, it did not.

Q. And you confirm in your surrebuttal at Pages 1 and 2 that since 2013 GMO has issued its own debt?

A. It just issued debt in 2014. As far as long-term debt, I think that's the only long-term debt its issued since 2013. It was in 2013.

Q. And that was three issuances of debt, Series A, Series B, Series C, that totaled $350 million?

A. That sounds correct.

MR. ZOBRIST: May I approach the witness, Judge?

JUDGE PRIDGIN: You may.

Q. (BY MR. ZOBRIST) Mr. Murray, I have handed you what I've marked as Exhibit 149, which are excerpts from the 2013 Great Plains Energy Annual Report. I've just given you excerpts, because it relates to the GMO debt. Do you have that before you, sir?

A. I do.

Q. And at Page 90 of this excerpt, under the heading of GMO Senior Notes, are those the three senior notes that you and I were just referring to?

A. That is correct.

Q. And am I correct that these senior notes are not guaranteed by the holding company, Great Plains Energy?

A. Yes.

Q. Now are you familiar with Standard & Poor's reports that have been issued on KCP&L and GMO?

A. I am.

Q. Mr. Murray, I have handed you what I have marked as Exhibit 150 & 151, which are respectively S&P Global Rating Research Reports on KCP&L Company, and KCP&L Greater Missouri Operations Company; is that correct?

A. Yes.

JUDGE PRIDGIN: Mr. Zobrist, could I interrupt to make sure which one is which?

MR. ZOBRIST: Yes, sir. Kansas City Power & Light is Exhibit 150.

JUDGE PRIDGIN: Thank you.

MR. ZOBRIST: And the KCP&L GMO is Exhibit 151.

JUDGE PRIDGIN: Thank you. Sorry to interrupt.

Q. (BY MR. ZOBRIST) Mr. Murray, is it correct that S&P does issues individual reports on each of these two regulated public utilities?

A. Yes.

Q. And on Page 5 of Exhibit 150, the KCP&L exhibit, is it correct that there is a ratings score snapshot at the top of that page, and then certain ratings below?

A. There is.

Q. And then on Exhibit 151 for GMO, there is a

similar series of ratings that begin at the bottom of Page 4, and then carry over to the top of Page 5; is that correct?

A. That is correct.

Q. Now on the KCP&L exhibit, 150, it states that the competitive position is strong; is that correct? On Page 5?

A. That is correct.

Q. And by contrast with GMO, which is Exhibit 151, at the top of Page 5 it says, competitive positions as satisfactory?

A. Yes.

Q. And then below that it takes about the anchor credit rating. Do you see that?

A. I do.

Q. What is an anchor credit rating?

A. An anchor is a credit rating that assumes a possible stand-alone situation, which they do not. But they don't rate them based on their stand-alone credit profile. But it is the anchor based on their assessment of the business risk and financial risk. Then they come up with the anchor. And then they decide whether or not they should modify it, for the various factors discussed in the modifier. Then also take one more step and modify it for the credit profile.

Q. And the anchor rating for KCP&L on Exhibit 150 is A-minus. And for GMO on Exhibit 151 it is Triple B, correct?

A. That is correct.

Q. And similarly, the stand-alone credit profiles that Standard & Poor's has assigned to these two companies are different as well, correct?

A. Yes. But they assign them the same credit rating.

Q. Well, the stand-alone credit profile. That's what I meant to say.

A. I know. But that's not the rating. But I understand what you are saying. Yes. That is hypothetically what it could be if it was a stand-alone company.

Q. And for KCP&L it is an A-minus, and for GMO it's a Triple B?

A. Hypothetically, that is the stand-alone credit profile. Correct.

MR. ZOBRIST: Judge, I move the admission of Exhibits 150, 151, and 149.

JUDGE PRIDGIN: Any objections? Hearing none, Exhibits 149, 150, and 151 are admitted.

Q. (BY MR. ZOBRIST) Now Mr. Murray, by virtue

of the correction that you made to your surrebuttal, you agree that GPE continues to guarantee some of GPE's debt, and its commercial paper program, but not all of its credit facilities, correct?

A. That is correct.

Q. Okay. Let me move on to some questions regarding cost of debt. Staff, as I understand, recommends not using KCP&L's actual cost of debt; is that correct?

A. That is correct.

Q. And the recommendation difference between Staff and the company relates to how issuance expenses, discounts, and premiums are calculated, as I understand your position?

A. Well, that's a very small part of the difference. The biggest part of the difference is the fact that Staff is recommending Great Plain Energy's cost of date. The calculation makes up about two basis points. Two to three basis points difference for the calculation.

Q. So the major point of disagreement is whether you use the capital structure of the operating company or the holding company?

A. That is correct. As far as all the debt in those entities.

Q. And so is it fair to say that what you are actually doing is taking the company's actual operating structure, KCP&L, and setting it aside and using the holding company as a proxy?

A. When I say, the holding company, it's the consolidated holding company. It's not just the holding company capital. It includes debt issued at GMO, debt issued at KCP&L, and debt issued by GPE.

Q. Now in the past, is it correct, as I believe you testified in either rebuttal or surrebuttal, that you have advocated that the Commission proxies for the debt, for example, of KCP&L and Greater Missouri Operations Company?

A. I think I did whenever Great Plains Energy first acquired the Aquila, Missouri electric utility properties. And it was because of the struggle of the nuances that came with Great Plains Energy assuming a very high cost of debt, I think maybe in the 11 to 13 percent range. So everybody was trying to determine what was fair and reasonable, because that was obviously not a cost associated with the safety of the regulated utility assets.

Q. Now in GMO's 2009 rate case, which was Number ER-2009-0090, you stated that it was appropriate to use the Empire District Electric

Company's embedded cost of debt for GMO, because it is based on actual debt issuances of a predominantly Missouri regulated company, with an investment grade rating. Does that sound correct?

A. That sounds correct. It was seven years ago, but that sounds consistent with philosophy at the time.

Q. We can introduce the exhibits, but would you accept my representation that, that is David Murray's surrebuttal at Page 25, submitted to the Commission on April 9th, 2009?

A. If you could show it to me.

Q. Sure.

A. It sounds correct with my philosophy, but that is nine years ago.

MR. ZOBRIST: Judge, I am going to spare the Commissioners seeing all of this stuff, but I think we can get this.

Q. (BY MR. ZOBRIST) It's on Page 25.

A. That is exactly correct.

Q. And the Commission didn't have to decide the issue in that case, because we settled that case, right?

A. I don't recall. I don't recall if we settled that case.

Q. But in any event, that was your position in that case?

A. Yes.

Q. Now in GMO's next rate case in 2010, you made a similar recommendation, didn't you, that the Empire capital structure be used as a proxy for GMO's debt?

A. I don't think I recommended the Empire's capital structure. Maybe Empire's debt cost. Like I said, we are going back quite a few years though. It is difficult for me to remember exactly how we approached these.

Q. And I've got a copy of that. So let me show that to you as well. I believe what you stated was that you recommended that Empire be used as a proxy for GMO's debt in the 2010 case, which was Number ER-2010-0356. And that case was decided, correct?

A. I believe so. KCP&L had a lot of cases during the last few years. I don't recall which ones settled, and which ones didn't.

Q. Mr. Murray, I am not going to mark this as an exhibit. But it is excerpts of the Commission's report in an order dated May 4th, 2011 in case Number ER-2010-0356. Can I ask you please to turn to Page

151?

A. I'm on there.

Q. And in Paragraph 416 it states, Staff recommends that the Empire District -- pardon me. The Empire Electric District be used as a proxy for GMO's debt on the senior notes at 6.36 percent?

A. Yes. The Empire District Electric Holding Company. The publicly traded entity's cost of debt was 6.36 percent. And I recommended that be used as a proxy for GMO. That's correct.

Q. And on the next page, the Commission declined to use that, correct? Looking at Paragraph 419.

A. That is correct.

Q. In fact, the Commission stated, quote, Staff's recommendation that the Commission use the cost of debt of the Empire District Electric Company is not reasonable, as Empire's debt does not reflect the cost of GMO, correct?

A. That is what it says. Correct.

Q. Pardon me. Then on the next page, on Paragraph 421 it states; the Commission finds that at this time the use of a consolidated debt structure, which was not specifically proposed by Staff, is not necessary, correct?

A. That's what it says. That's correct.

Q. And the Commission found that issue in favor of GMO?

A. I believe that was GMO's position. Yes.

Q. Now in KCP&L's 2010 case, you propose that GPE's issuing short-term debt and loaning the funds to GMO was unfair to Kansas City Power & Light rate payers, and you proposed a hypothetical assignment of certain senior notes to KCP&L. Do you recall that?

A. I think I just recommended the consolidated cost of capital. So if you want to -- I don't know if I would characterize that as a hypothetical assignment, because it was just evenly assigned to both Kansas City Power & Light and GMO.

Q. Let me just show you again excerpts from that report and order, which was issued April 12th, 2011. Mr. Murray, if you look at Paragraph 360, which is on Page 125 of this excerpt, it states, in his true-up rebuttal, Mr. Murray expanded on his theory suggesting two alternative figures, based upon a hypothetical assignment of $250 million at 2.75 percent, senior notes that Great Plains Energy issued solely for the benefit of GMO in August 2010, correct?

A. That is an accurate reading. Yes.

Q. And that proposal was rejected by the

Commission on the next page in Paragraph 362; is that correct?

A. That is correct.

Q. And in fact, the Commission stated in its report and order that there is no reason to engage in hypothetical debt assignment for KCP&L, and no reason at this late time to consider a consolidated cost of debt proposal, which has not been properly presented to the Commission, correct?

A. That is correct. I would like to make clear this has to do with the consolidated debt cost, not the consolidated capital structure.

Q. Right.

A. I just want to make sure everybody understands that.

Q. And then in the 2012 rate cases of GMO and KCP&L, which were heard together in Case No.'s ER-2012-0174 and 0175, you also recommended some downward adjustments in the interest rates of three notes that had been issued by Great Plains Energy; is that correct?

A. Yes.

Q. And I've got the copies of these orders, but the Commission did not accept your recommendation, and found that they were unpersuasive and speculative;

is that correct?

A. I don't remember their terms. I believe I provided evidence to show the rationale for it. But if they used speculative, you can show that to me. I know they didn't accept my argument.

Q. Before you I have placed excerpts from the report and order in those 2012 cases. And if you turn to the final page, Page 27, about the middle of the page, just below the chart it states, in support Staff argues that its adjustments align GMO's cost of debt with KCP&L. KCP&L's rating staff argues would also be GMO's, but for the misdeeds of Aquila. Hence, this is one of several Aquila Legacy matters. Is that correct?

A. Yes.

Q. And then in the next paragraph the Commission concluded, Staff's arguments are unpersuasive. Their basis, what GMO would look like if in the past they referred to speculation?

A. That is what it says.

Q. Okay. Finally, as far as the overall cost of debt, if the Commission decides to use KCP&L's actual cost of debt in this case, the 5.49 percent cost, under the simple interest amortization method that Bryant set forth on his table in Page 5 of his

rebuttal. That is acceptable to Staff; is that correct?

A. The simple amortization method. Yes, that is acceptable.

Q. Thank you.

MR. ZOBRIST: Judge, nothing further.

JUDGE PRIDGIN: Mr. Zobrist, thank you. Any bench questions? Mr. Chairman.

QUESTIONS FROM THE BENCH

QUESTIONS BY CHAIRMAN HALL:

Q. Good morning.

A. Good morning.

Q. On Page 8 of your rebuttal testimony, you say at Line 19, it was obvious that GPE was financially managing the two subsidiaries to achieve the lowest overall capital cost for GPE as a consolidated entity. Do you see that?

A. Yes.

Q. Why do you believe that it was obvious?

A. There's a lot of complexity and history to Great Plains Energy, and after it acquired GMO. But GPE had to issue debt on behalf of GMO, and then through affiliate loan transactions. Some of those debt issuances were not consistent with what you would expect for a debt issuance that would have occurred at the subsidiary level with a regulated utility, such as doing at least a 10-year tenor.

You will very rarely, if ever, see a long-term debt issuance at the subsidiary level that is less than 10 years. And more recently, a lot of companies are issued 30-year tenors. So very plain, when you issue debt at the holding company level to finance activities or to accommodate, in this situation GMO --

Q. Let me stop you for a second.

A. I'm sorry.

Q. No. I am interrupting you. I should say, sorry. But what's the time frame you are talking about right now?

A. 2011 and 2012.

Q. Okay. Keep going?

A. It was 2.75 percent cost of debt. And a lot of this information is detailed in the testimony that Mr. Zobrist discussed. They also issued debt that was basically a remarketing of debt that was part of equity units. And these equity unites were fair esoteric type of capital issuances. And that capital was issued, because at the time Great Plains Energy was close to being downgraded to junk bond status.

Q. So are we still in the 2011 and 2012 time

frame?

A. Yes. This is a refinancing of the equity units. When they refinanced the equity unites, they had the option of retiring it, or issuing additional subordinated debt at the Great Plains Energy level.

Q. Okay. So after the 2011 and 2012 time frame, do you continue to believe that GPE was financially managing two subsidiaries to achieve the lowest overall capital cost for GPE as a consolidated entity, or are you talking specifically about that 2011 and 2012 time frame?

A. I am trying to think of some of the capital issuances that have occurred since 2012. I mean obviously they allocate capital, like from in 2015, Kansas City Power & Light didn't pay any dividends. And you know GMO paid all the dividends that were being provided to Great Plains Energy.

So when it comes to trying to manage the capital structure of the consolidated entity, Great Plains Energy, it's recognized specifically by Standard & Poor's, and others that invest in Great Plains Energy, that it is the consolidated capital structure that is going to be the most consequence to equity investors when they invest in Great Plains Energy.

And also when they invest in the debt of the subsidiaries. So my position is yes, they continue to reallocate capital for the best interest of Great Plains Energy. I will say it also has to do with trying to manage the capital structures for rate making purposes.

Because GMO had a fairly high equity ratio, even after the adjustment for good will. And they recognize that. And that's why they completely shut off any dividends coming from Kansas City Power & Light, and have GMO supply all the dividends to bring their capital structure to have less equity.

And basically, bring them more in line with the consolidated level. Because that's ultimately -- specifically before there are any significant transactions that may take place, there really is not reason in Staff's opinion that the Great Plains Energy capital structure should be that much different from the GMO or KCP&L capital structure.

So in my opinion, the overall capital cost that the company is most concerned about, and I have seen from financing decisions from internal memorandums and boards meetings, is focusing on Great Plains Energy.

Q. And to be perfectly clear, there is nothing

inappropriate about those types of transactions? I mean they are transparent, and you are not alleging that there is anything improper, but you are just saying that on the basis of those transactions, it appears to you that it makes sense to apply a consolidated capital structure because it is functioning as one entity?

A. I am not trying to imply that there is anything inappropriate about how they are managing Great Plains Energy and their family of companies. I would expect them to focus on what is best for Great Plains Energy, which is where their shareholders own their shares in the company.

Q. So when Great Plains Energy is managing their two subsidiaries in such a manner, I assume there are winners and losers within GMO and Kansas City Power & Light, and their respective rate payers?

A. According to the company, Mr. Bryant, he feels that Kansas City Power & Light would be subsidized by GMO if we did -- if we used the Great Plains Energy consolidated capital structure. And his rationale for that is that because if you just look at the debt that is issued at Kansas City Power & Light, without thinking about any of the other factors as to why they might have issued a longer tenor debt at

KCP&L, versus GMO.

But just look at what is on the books. If you assign some of the lower cost debt at GMO to KCP&L, KCP&L rate payers will be subsidizing the GMO rate payers. I have a big disagreement about that, because KCP&L -- and these credit ratings, if you are downgraded a notch, or even down to junk, it takes quite a while to restore that credit rating.

And Staff has felt very strongly about the fact that Kansas City Power & Light rate payers, during the period of the comprehensive energy plan for construction of Iatan-II and retrofits at Iatan-I provided over 100 million of additional rates, over and above the traditional cost of service to specifically target a Triple B-Plus credit rating for Kansas City Power & Light.

And so my opinion, and I believe Staff as a whole, is that is a subsidy that you may not be able to directly measure, but it was a real additional cash flow that Kansas City Power & Light paid to try to preserve Kansas City Power & Light's credit rating. And at the same time during that comprehensive energy plan, when they were providing additional cash flow, they made the acquisition of Aquila, which had some significant financial effects.

Q. So just in general, it was -- it was protecting -- well, so again, let me ask that question again. Which set of rate payers were benefiting, and which set of rate payers were possibly facing a detriment?

A. In my opinion, Kansas City Power & Light's rate payers were facing a detriment because of all the accommodations that were being made for GMO because of the financial strength that GPE had through KCP&L's cash flow contributions, up until at least -- well, through 2008. But obviously targeting the Triple B-Plus credit rating.

That made a lot of these activities possible for Great Plains Energy to help stabilize. And I don't want to take away from that. That's very commendable. They should be commended for stabilizing this utility that unfortunately had the non-regulated debt attached to the regulated utility axis, because they acquired Aquila. They wouldn't acquire the assets separately without the debt.

Q. So turning to Page 10 of your rebuttal. And you note, and you have spoken to this a couple times already today as well. That S&P uses a consolidated capital structure for purposes of assigning KCP&L a credit rating?

A. Yes.

Q. And I think I know the answer, but I would like to hear it from you. Why do they do that?

A. I am sorry for the pause here. They repeatedly indicate that they do not -- I have the exact language here in the testimony. But they repeatedly indicate that they do not view the insulation separation of the entities from each other, or from the holding company, as being adequate to support stand-alone credit rating assignments.

As we pointed out earlier, there is a stand-alone hypothetical credit rating from Standard & Poor's, but they do not view the separation to be significant enough to give true stand-alone credit rating assignments.

Q. That's actually where I was headed next. On Page 4 of your surrebuttal, where you take that quote, from S&P's May 31st, 2016 report, where there -- the report says that there is no meaningful insulation measures in place. What would those meaningful insulation measures look like?

A. I am just going to be quite frank. I think this is over my expertise level. I mean there are many things that would have to go into place that would require legal and structural, and even governance types of requirements, to achieve this.

Staff had tried in I think 2001, with the -- excuse me. With the restructuring cases for Great Plains Energy and Laclede Group, when they formed the holding company, to put measures in place. But the communications we've had with rating agencies is that if it doesn't have the weight of law, or some type of consequence, if they violate some of the structural and regulatory and legal insulations measures, they won't recognize that as justifying a stand-alone credit rating.

Q. And is that treatment by S&P similar for American Water and for Ameren?

A. Missouri American doesn't even have a credit rating. Missouri American doesn't issue its own debt. So I wouldn't even consider that to be comparable. For Ameren Missouri and Ameren Illinois, that is correct. Standard and Poor's does not recognize any meaningful insulation measures to assign them their own stand-alone credit rating.

Q. And what is the purpose of these hypothetical stand-alone credit ratings? Credit profiles?

A. Actually, I think they just started doing them within the last two or three years. Maybe since

2013 or 2014. I think maybe just to give an indication of what they could be if they didn't put them under the family group of companies.

At one time, they didn't -- I couldn't even find the subsidiary financial information on Standard & Poor's website, or in their research reports. So I think it's just to indicate what it could be, and that they did assess it. As far as how much weight it gets, there is no doubt that Moody's and S&P don't necessarily agree on the appropriate methodology on how much weight each one gets.

Q. And the capital structure that Staff is recommending here is consistent with the capital structure it recommended -- it has recommended in Empire rate cases, Missouri American rate cases, generally, correct?

A. Yes. Empire District Electric just held at the Empire District Electric publicly traded level, so Empire District Electric is Empire District Electric Company. It is not a subsidiary of Empire District Electric. So the holding company capital structure is Empire District Electric. If that makes sense.

With Missouri American, yes. I think that is one of the clearest situations where the company is not even issuing its own debt, and hasn't done so since 2006. So we recommend American Water's capital structure.

Unfortunately, previous Commissions have not ruled on that, because those cases have settled. It's been quite some time since I think a case -- but also for Laclede Gas and Laclede Group, yes, that is correct.

Q. And Ameren?

A. Ameren is the only -- until this case, and until they started issuing holding company debt --

Q. When you say, this case, which case are you referring to?

A. The current pending case, ER-2016. The pending case. I don't remember the last four digits. But yes, Ameren Missouri and Ameren, have had typically fairly consistent leverage situations.

Ameren did not issue much, if any, holding company debt. That has changed. They started doing that in November of 2015. And so that's why we are taking a look at it. And you know, discussing the issue in that case as well.

Q. A couple of places in your written testimony, you indicate that using the stand-alone capital structure would increase the revenue requirement?

A. It would increase the revenue requirement. It depends on --

Q. In this case. That's what I am talking about. I want to make --

A. Actually, I think we said it would decrease the revenue requirement initially. Because that's a lower cost of debt. GMO has about 5 percent cost of date. KCP&L has about a 5.5 percent cost of debt. So the consolidated cost of debt ends up being 5.42 percent. So the cost of debt different actually outweighs the increase in the equity ratio. That's fairly rate that it happens, but it happens. It happened in this case.

Q. Where is that in your testimony?

A. I think I provided an estimate in the rebuttal. This was based on Staff's rate base. Original rate base estimate. If you look at Page 8 of my rebuttal testimony, Footnote 4, where I provide an estimate of about $786,000. That may change. Those were based on previous numbers. I believe we are supposed to have folks from the company and Staff get together and address that question that you had earlier.

Q. I guess I'm confused. On Page 7, going to Page 8, the use of GPE's consolidated capital

structure produces approximately one million lower revenue requirement, as compared to that produced using KCP&L's capital structure and capital cost. And then I don't understand. You reference the footnote there, but is -- the revenue requirement would be decreased by using GPE's consolidated capital structure?

A. Yes. I'm sorry if I misunderstood the question. Yes. That is correct.

Q. Okay. If that was reversed, if it in fact for whatever reason would in fact increase the revenue requirement to use the Kansas City Power & Light capital structure; would your position change?

A. For Kansas City Power & Light, yes, it would.

Q. So in this case -- so that is in essence the number one thing driving your opinion?

A. Yes. For Kansas City Power & Light. That's correct. Because they were one entity supporting a Triple B-Plus credit rating until Great Plains Energy embarked on all these other transactions.

I don't know what Kansas City Power & Light would look like right now, but I have a -- if you look to the hypothetical stand-alone credit profile of an

A-minus, if they weren't affiliated with Great Plains Energy, it's hard to say how much lower the capital costs could have been. But I would venture to say that if they were assigned an A-minus credit rating, they would have lower credit costs.

Q. I guess I'm just trying to be sure I understand what is driving your opinion. So it's not really a function of the fact that the two entities -- that the two subsidiaries are being managed in such a way as to achieve the lowest overall cost capital for GPE, the most significant act for you is that if we were to employ the KCP&L capital structure, that would increase the revenue requirement of KCP&L rate payers?

A. Yes.

Q. I think I got it. Thank you.

A. Thanks.

JUDGE PRIDGIN: Commissioner Stoll, questions? Commissioner Rupp, when you are ready, sir.

QUESTIONS FROM THE BENCH

QUESTIONS BY COMMISSIONER RUPP:

Q. Following up on your last exchange with the Chairman. I want to make sure I understand what is driving you. Early on when you were being questioned by Council, you talked about the 2009 rate case, and

you referenced a few times, yes, that was consistent with my philosophy. Consistent with my philosophy. However, your last exchange with the Chairman did not seem to have a philosophical motivation behind it. It was more, how do we get the lowest number for the capital -- lowest number for rate base for the pending rate case.

A. If I can use that 2009, and what I can remember from those cases, as an example. In 2009, clearly, I stripped out all the GMO debt, because that would have unfairly had a higher cost of capital assigned to KCP&L rate payers. So even though Great Plains Energy was trying to manage the finances issued debt on behalf of GMO to restore the ability of GMO to issue a debt on its own, clearly the transaction would have caused KCP&L to have a higher revenue requirement.

And at that time, Great Plains Energy was trying to manage its capital costs to the lowest point possible to go ahead and hopefully successfully execute on its plan to restore GMO to financial stability. Clearly, that capital cost was higher than what was reasonable for Kansas City Power & Light. Kansas City Power & Light, it had only been about a year or two since they acquired GMO. So you didn't have as much uncertainty, as far as the years that have gone past, as to what KCP&L could have looked like, if it wasn't associated with Great Plains Energy. Now you have about eight or nine years.

What would KCP&L have looked like if it had not been affiliated with Great Plains Energy. I would say, yes, I believe the benefit of the doubt should go to Kansas City Power & Light rate payers, as to whichever one is lowest. Because of the fact that they supported the high credit rating, that they deserve that consideration.

Q. So is it your philosophy when you approach a pending rate case, to structure the debt structure to find the lowest revenue requirement for the rate case?

A. Not -- in this case situation, because of Kansas City Power & Light, and the significant amount of cash that it contributed over and above the cost of service to maintain a Triple B-Plus credit rating during the 2005 and 2010 period, which had debt issuances that are still on their books today.

And subsequent to that period of time, almost being downgraded to junk bond status because they acquired GMO. And we also had the financial crisis. There is many uncertainties.

If Kansas City Power & Light had been assigned the stronger credit rating that the rate payers paid to support, during that time period, there were other utilities that were able to continue to function without being afraid of being downgraded to junk bond status, during the 2008 and 2009 financial crisis.

The financial impact on Kansas City Power & Light customers, after the fact, is very hard to measure. But I do believe that because of the fact that the rates were set higher than a traditional cost of service, which is over 100 million, over that period, that they collected above the cost of service. KCP&L rate payers should be given the burden -- should be given the benefit of the doubt.

Q. So I understand when you look at rate cases you look at all the different facts. But that is different than your philosophy. You stated what your philosophy was. That's why I am asking it. So a yes or no question. Is your philosophy, when you approach a rate case, to attempt to find the lowest cost for rate base for the rate payers?

A. No. Not in general. No.

COMMISSIONER RUPP: Thank you.

JUDGE PRIDGIN: Commissioner Coleman?

COMMISSIONER COLEMAN: Nothing.

JUDGE PRIDGIN: Any recross, based on bench questions from Council?

MR. OPITZ: No thank you.

JUDGE PRIDGIN: MECG?

MR. WOODSMALL: No questions.

JUDGE PRIDGIN: KCP&L?

RECROSS EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Mr. Murray, back in 2006 and 2007, when Kansas City Power & Light proposed a comprehensive energy plan, that was approved by the Commission, correct?

A. I believe it was 2005. But yes. It was a stipulation among the parties.

Q. And that comprehensive energy plan contemplated the construction of Iatan-II, correct?

A. It did.

Q. And the construction of certain renewable energy resources, some wind turbines; is that correct?

A. That's correct.

Q. And contemplated improvements to the Racine Units 1 & 2; is that correct?

A. I think it contemplated. I don't remember if that was executed or not. I know Iatan-I, definitely.

Q. I mean this was a comprehensive plan that the company came to the Commission with, and stated that in exchange for certain financial assurances to maintain their credit rating, that they would forgo a fuel adjustment clause for 10 years, correct?

A. I believe that was part of the negotiation. Yes.

Q. It was a critical part of the negotiation, correct?

A. I don't know how critical it was. There was a lot of negotiation there.

Q. And that stood in place for 10 years, and Kansas City Power & Light's credit rating was not downgraded; is that correct?

A. Well, I would have to look. Because I remember Great Plains Energy was on the verge of being downgraded to junk. So I believe that Kansas City Power & Light was Triple B when Great Plains Energy was on the verge of being downgraded to junk status.

Q. And at the same time that the comprehensive energy plan was approved, and the stipulation agreement by the Commission, Aquila became, as a result of their financial difficulties -- and I should say what remained of Aquila became KCP&L Greater

Missouri Operations Company, correct?

A. Yes.

Q. And that acquisition by Great Plains Energy was presented to the Commission and it was approved, correct?

A. It was.

Q. So all of this history that you are going through, this was under the surveillance of the Commission, and the Commission in a series of rate cases, and that acquisition case, and in monitoring the comprehensive energy plan, made decisions in regard to the capital structure, and return on equities, in both of these companies, correct?

A. I don't think they had to debate the Great Plains Energy capital structure, because we all recommended the Great Plains Energy capital structure. So I don't know how much they debated this issue, other than the cost of debt.

Q. Well, and as I went through in my cross-examination, a number of the adjustments that you proposed, they were rejected. 100 percent of those adjustments that were proposed had the goal to lower the cost of debt, when you thought that was appropriate in your opinion, correct?

A. That's correct.

Q. And I think it was the Chairman that asked you about the equity units in that 2011 Kansas City Power & Light case. The Commission rejected your proposal to adjust the price of those equity units that were sold as well, correct?

A. I think the cost was 13.59 percent. Yeah, I tried to recommend an adjustment to lower that. They rejected that. That's correct.

Q. Right. And that was in the April 12, 2011 report and order in the Kansas City Power & Light Case ER-2010-0355, correct?

A. I don't remember which case that was in. I just remember the equity units and the cost.

Q. And your recommendation in that case was to subtract 245 basis points from the cost of those equity units?

A. I think I recommended a cost of equity units in the 11 percent range. Yes.

Q. And those equity units were issued in the midst of the Great Recession, at the time, correct?

A. They were issued because Great Plains Energy was on the verge being downgraded to junk status. Yes.

Q. And the Commission found that the transaction that the company had engaged in was

appropriate, and there would be no adjustment to those equity units, as they were sold?

A. They did not adjust the cost of the equity units. That's correct.

Q. Now I believe in response to the Chairman's question about insulation, you talked about the stipulations that Staff and Office of Public Council have entered into, correct?

A. I don't think I talked about stipulation. Are you talking about the stipulation agreement with the transaction?

Q. Well, with regard to the affiliate transaction case, the DOCCA EE 2017-0113. Is that what you were referring to?

A. I don't remember discussing anything with that stipulation agreement.

Q. Were you involved in the negotiations related to stipulation that Staff entered into with the company?

A. Early on. Not towards the end.

MR. ZOBRIST: That's all I have, Judge. Thank you.

JUDGE PRIDGIN: Any redirect?

MR. THOMPSON: Thank you, Judge.

REDIRECT EXAMINATION

QUESTIONS BY MR. THOMPSON:

Q. Mr. Murray, do you have up there Exhibit 150 that Mr. Zobrist handed you a copy of, and which was admitted?

A. I have 151. Yes. I do have 150.

Q. And you would agree with me that's the S&P Global Ratings Research Report on Kansas City Power & Light Company?

A. It is.

Q. I wonder if you can take a look at Page 3. At the top of Page 3, do you see an ochre colored box at the top there?

A. Yes.

Q. And it is headed, Outlook Negative, isn't it?

A. Yes.

Q. I wonder if you could read the paragraph under that heading?

A. The outlook on KCP&L reflects the outlook on parent Great Plains Energy, Incorporated. The negative outlook on GPE and its subsidiaries reflects the potential for lower ratings if GPE's financial risk profile, which will deteriorate due to the financing used in the proposed acquisition of Westar Energy does not improve after the transaction closes, funds from operations to total debt, is well over 13 percent after 2018.

Q. Does this exhibit in fact illustrate the very thing that you have testified too, that S&P considered Kansas City Power & Light through the lens of its parent?

MR. ZOBRIST: Objection. Leading and suggestive.

JUDGE PRIDGIN: Overruled.

A. It basically explains their consolidated family group of a rating process, where they rate these subsidiaries based on their consolidated analysis of the consolidated holding company, along with all of its other operations. And its capital structure.

Q. (BY MR. THOMPSON) And with respect to the questions that the Chairman asked you, and also the ones that Commissioner Rupp asked you, if the Commission were to adopt the capital structure advocated by the company in this case, and if the Commission were to adopt the cost of debt advocated by the company in this case; would the result be higher rates for rate payers?

A. Yes.

Q. Thank you.

MR. THOMPSON: I have no further questions.

JUDGE PRIDGIN: Thank you. Mr. Murray, thank you very much. You may step down. I believe the next witness will be Mr. Hyneman. And Mr. Thompson, I think we had some folks having a tough time hearing your questions. If you could make sure your mike is on.

MR. THOMPSON: I apologize, Judge.

JUDGE PRIDGIN: Thank you.

MR. THOMPSON: I'll do that.

JUDGE PRIDGIN: Thank you.

* * * * *

CHARLES HYNEMAN,

of lawful age, produced, sworn and says:

DIRECT EXAMINATION

QUESTIONS BY MR. OPITZ:

Q. Mr. Hyneman, would you state and spell your name for the record please?

A. Charles R. Hyneman. H-y-n-e-m-a-n.

Q. And where are you employed, and in what capacity?

A. I am employed by the Missouri Office of the Public Counsel as chief counsel.

Q. Are you the same Charles Hyneman who pre-filed direct, rebuttal, and surrebuttal testimony

marked as OPC Exhibits 302, 303, 304-HC, and 304-NP?

A. Yes, I am.

Q. Do you have any corrections to make to that testimony?

A. I do not.

Q. If I were to ask you the same questions that are posed in your pre-filed testimony, would your answers be the same?

A. Yes.

Q. And your answers are true and correct, to the best of your information and belief?

A. Yes.

MR. OPITZ: With that, Judge, Public Council moves to enter Exhibits 302, 303, 304-HC, and 304-NP into evidence, and tenders the witness for cross-examination.

JUDGE PRIDGIN: Thank you. Any objections? Hearing none, Exhibits 302, 303, and 304 HC & NP are admitted into evidence. Cross-examination, Staff?

MR. THOMPSON: I have no questions. Thank you, Judge.

JUDGE PRIDGIN: MECG?

MR. WOODSMALL: I have no questions. Thank you.

JUDGE PRIDGIN: Thank you. Kansas City

Power & Light?

MR. ZOBRIST: No questions, Judge.

JUDGE PRIDGIN: Okay. Thank you. Any bench questions? Mr. Chairman?

QUESTIONS FROM THE BENCH

QUESTIONS BY CHAIRMAN HALL:

Q. Good morning.

A. Good morning.

Q. Looking at your rebuttal testimony, you note that Kansas City Power & Light has underperformed the other utilities, electric utilities in Missouri, and speculate that the reason for that is poor management?

A. Well, actually, I compare the earnings of KCP&L to Ameren Missouri. And general financial status of the other utilities, such as Greater Missouri Operations. And I did not, in my testimony, attribute that to poor management. I said KCP&L needs to consider that there are other factors, other than the regulatory environment, which they seem to assign all blame for their earnings, and to look at the management performance of the company to see if it bears some of that responsibility.

Q. So you can't identify a particular management decision action, policy, program, of any

sort that you would contend constituted poor management.

A. Yes, I can. In fact, I have been testifying for the Staff, and now with the OPC, over a period of 10 years, that KCP&L continues to incur excessive and unreasonable and imprudent management expenses, that increases the cost of service. That's been a continuing issue.

Q. And you believe that is the reason why KCP&L is not performing as well as other Missouri --

A. I think that it is part indicative of that, but there are many reasons you can contribute to that. One of them could be the acquisition of GMO. Aquila was a distressed entity when acquired by Great Plains Energy. And I know there is a lot of talk in the industry about problems with that acquisition.

When you see KCP&L management actions, as far as having opportunity to acquire transmission assets, which are going to have a high ROE return, and they decide to transfer out of the utility operations, and into non-regulated operations.

You continue to see KCP&L taking regulated transmission revenues. And moving that out of the case. Not giving credit to the utility. So it's more of a mindset and an attitude than I could contribute any specific dollar amount in earnings to a specific action.

Q. And you believe that the regulatory environment in Missouri is generally favorably?

A. Yes. And I think over a long history. In fact, Union Electric filed witness testimony in a 2007 case, and it was very praising of the Commission and the regulatory environment, which the Commission created, which allowed Ameren UE to have very good earnings during that time. And that was during the 2006 time frame. And my research indicates that ROA, even in 2012, found that the Missouri regulatory environment was right in the middle of all commissions. That continues today, through 2016. So the Missouri commission is right where it needs to be, as far as regulatory utilities. It is not too excessively pro-shareholder, or pro consumer.

CHAIRMAN HALL: Thank you.

JUDGE PRIDGIN: Any questions?

COMMISSIONER COLEMAN: Nothing.

JUDGE PRIDGIN: Any recross based on bench questions? Staff?

MR. THOMPSON: No thank you, Judge.

JUDGE PRIDGIN: MECG?

MR. WOODSMALL: Very briefly, Your Honor.

RECROSS EXAMINATION

QUESTIONS BY MR. WOODSMALL:

Q. Good morning, Mr. Hyneman.

A. Good morning.

Q. You were asked some questions by the Chairman about anything you could point to at KCP&L regarding management. Do you recall those questions?

A. Yes.

Q. Are you aware of a Staff analysis in the last case regarding KCP&L's ANG cost?

A. In the last rate case?

Q. Uh-huh.

A. I'm aware of analysis performed in that case. I don't know if that was by Staff.

Q. What were those analyses? What did they show?

A. I don't remember specifically.

Q. Do you recall whether the Commission ordered a management audit to be done of KCP&L in the last case?

A. I do. They ordered Staff to do that management audit. I don't believe that was based on a recommendation in this matter.

Q. And in fact, OPC has reached a settlement with KCP&L in the context of the EE docket. Do you

recall that?

A. I am not sure. Which docket is that?

Q. It's the affiliate transaction waive associated with the Westar transaction.

A. Yes.

Q. And do you recall whether that settlement -- it's not approved yet, but provides for a certain amount of money to be put up by KCP&L and GMO to conduct a management audit by an outside expert?

A. I don't believe it has. It may. I don't recall a specific amount of money. I know there was an agreement to do an affiliate transaction on it, not a general management audit, as a result of that.

MR. WOODSMALL: No further questions. Thank you.

JUDGE PRIDGIN: KCP&L?

MR. ZOBRIST: No questions, Judge.

JUDGE PRIDGIN: Redirect?

MR. OPITZ: No thank you, Judge.

JUDGE PRIDGIN: Thank you, Mr. Hyneman. Thank you very much. You may step down. I believe Mr. Gorman will be our last witness for the day.

MR. WOODSMALL: Your Honor, MECG calls Mr. Michael Gorman?

MR. ZOBRIST: Judge, could we take just

five minutes so I can get reorganized?

JUDGE PRIDGIN: Certainly. We will take a -- we will just resume right at noon.

MR. ZOBRIST: Great. Thank you.

JUDGE PRIDGIN: You're welcome. We will go off the record.

(WHEREIN, a brief recess was taken.)

JUDGE PRIDGIN: We are back on the record. Mr. Gorman, let me ask you to raise your right hand and be sworn, please.

* * * * *

MICHAEL GORMAN,

of lawful age, produced, sworn and says:

DIRECT EXAMINATION

QUESTIONS BY MR. WOODSMALL:

Q. Good morning, Mr. Gorman.

A. Good morning.

Q. Could you state your name for the record, and who you are employed by?

A. My name is Michael Gorman. I am employed BAI.

Q. And who retained you for this case?

A. The Midwest Energy Consumers' Group.

Q. And did you cause to be filed what has been marked Exhibits 650, your direct testimony, 651,

rebuttal testimony, and 652, surrebuttal testimony?

A. I did.

Q. And is that testimony true and accurate, to the best of your knowledge?

A. It is.

Q. And if I were to ask you the same questions, would they be the same?

A. Yes.

Q. Do you have any corrections to make?

A. I do not.

MR. WOODSMALL: With that, Your Honor, I move for the admission of Exhibits 650, 651, and 652, and tender the witness for cross-examination.

JUDGE PRIDGIN: Thank you. Any objections? Hearing none, 650, 651, and 652 are admitted. Cross-examination, Public Council?

MR. OPITZ: No. Thank you, Judge.

JUDGE PRIDGIN: Staff?

MR. THOMPSON: No. Thank you, Judge.

JUDGE PRIDGIN: KCP&L?

MR. ZOBRIST: Thank you, Judge.

CROSS-EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Mr. Gorman, you said that you were retained by MECG in this case?

A. Yes.

Q. Who are the members of MECG, who are participating in this case?

A. I do not have that list with me. I can provide it to you.

Q. Would you be willing to do that in an exhibit that we could mark?

MR. WOODSMALL: Maybe I can jump in here, Your Honor. MECG is an incorporated entity. So he has been retained by an entity. It used to be MECG had members, and we would list those members when we intervened. But that is no longer the case.

Q. (BY MR. ZOBRIST) Well, whose interest is MECG representing in this case?

MR. WOODSMALL: Large commercial and industrial customers?

MR. ZOBRIST: Judge, I am asking Mr. Gorman.

MR. WOODSMALL: Oh, I'm sorry. I've been wanting to be up there.

JUDGE PRIDGIN: Mr. Gorman, you can answer the question, if you know?

A. It's my understanding that they are stakeholders of large industrial customers that purchase electricity service from Kansas City Power &

Light.

Q. (BY MR. ZOBRIST) Can you name a particular company or entity that is a customer of KCP&L?

A. I do not have a list of the companies that are included in this intervention.

Q. Would you agree to provide that to the Commission?

A. It's my understanding that, that list does not exist.

Q. I'm sorry. I misunderstood you. I thought you said that you could provide the Commission with a list of the companies that MECG is representing in this proceeding?

A. Mr. Woodsmall explained that, that list does not exist. I had the assumption that it did exist.

Q. Ah, I see.

A. So I cannot provide something that doesn't exist.

Q. And you don't know any of the interested parties who Mr. Woodsmall, or in fact you are testifying on behalf of, in this case?

A. Well, I am testifying on behalf of MECG, which I understand to represent the interests of industrial customers that purchase electricity service from KCP&L. So MECG is the entity. And industrial customers are who MECG is advocating on behalf of.

Q. You can't tell the Commission here today the name of any of those customers; is that correct?

A. Other than MECG. That's correct.

Q. Okay. Now I understand that you are not formally presenting any recommendation with regard to capital structure and cost of debt; is that true?

A. I have not taken issue with the company's position on those two.

Q. And you would agree KCP&L's proposal, with the caveat that you do not necessarily agree with their methodology, in arriving at the long-term debt of 50.12 percent, and the common equity of 49.88 percent?

A. Are you referencing my testimony?

Q. Yes, sir. I am looking at Page 2 of your direct, Lines 18 through 21.

A. That is correct.

Q. And on Page 23 of your direct, beginning at Line 4, am I correct that you stated that the proposed common equity ratio is in line with the common equity ratio for the electric utility industry, as authorized by regulatory commissions in setting rates?

A. Correct.

Q. And when you speak of ratio, that means the ratio of common equity to long-term debt?

A. Ratio of common equity to total capital. Total capital would be composed of long-term debt and common equity.

Q. Thank you. Let's move on to return on equity. I've got a couple questions about the proxy group. As I understand it, you have used a proxy group that is identical to Mr. Hevert's, with the exception of Otter Tail Power Company; is that correct?

A. It is.

Q. And the reason that you did not include Otter Tail Power within the group is that it was not available from the sources that you used in this case?

A. Growth rate sources. Correct.

Q. And estimates were available from other sources, such as Value Line and Yahoo Finance?

A. Yahoo Finance would have been an option available to me, but I do not rely on single-analyst growth rate projections in my studies. So while Value Line does follow, Otter Tail Power, that would not have satisfied the data limitation I noted in excluded that company from my proxy group.

Q. Did you exclude, or you just didn't use the

sources where they had information available, which included Yahoo Finance and Value Line?

A. Because I could not include it, I threw the entire study of the Proxy group that was excluded from the group.

Q. Now Otter Tail Power is located in Fergus Falls, Minnesota?

A. Minnesota, yes. I will accept Fergus Falls, subject to check.

Q. So it does business here in the Midwest, correct?

A. It does.

Q. It's a small to medium-sized utility?

A. Amongst other things. Yeah. It's more of a diversified company, but it is predominantly regulated operations.

Q. And you are familiar with the landmark Bluefield Supreme Court Case, correct?

A. I am.

Q. And that states that a public utility is entitled to earn a return, equal to that generally being made at the same time and in the same general part of the country, as similar businesses attended by corresponding risks and uncertainties?

A. Right. Which the compensation should be reasonable consistent with the return an investor could earn in another investment of comparable parts.

Q. And Otter Tail is such a company that it would be appropriate to use in a proxy group for this rate case?

A. I didn't exclude it because I thought it was inappropriate. I excluded it because the data from the sources I was relying on wouldn't allow me to include it.

Q. Now in Mr. Hevert's schedule, RBH-1, Otter Tail has the highest dividend yield and the highest expected dividend yield; isn't that correct?

A. It does. Because it is one of the more diversified companies, rather than just the pure regulated company within its proxy group.

Q. And the earnings growth estimated by analysts for Otter Tail was also the average earnings growth estimates for other estimates -- pardon me. For other companies within that proxy group, correct?

A. I would have to review his scheduled again. But I believe that's correct.

Q. And Otter Tail's 6.0 percent growth rate is higher than the average growth rate estimates in your schedule MPG-5; is that correct?

A. Well, I would have to review and verify the

6 percent growth rate. But if that's accurate, then your statement is correct.

Q. Now Mr. Gorman, in your rebuttal testimony, you increased your return on equity recommendation from 9.0 percent to 9.2 percent, correct?

A. Correct.

Q. And your range, similarly, increased from direct 8.8 to 9.2, and then it increased in rebuttal to 8.9 to 9.5, correct?

A. That is correct.

Q. So the lower end went up 10 basis points. The high end went up 30 basis points?

A. Correct.

Q. And as I understand it, your direct study was done as of data that was available on October 28th, 2016?

A. Yes.

Q. And the updated study went about another 32 days to December 16, 2016, correct?

A. That's correct.

Q. So in a space of just a little more than 30 days, the upper range -- pardon me. The upper number of your range went from 9.20 to 9.50, correct?

A. That's right. As Mr. Hevert noted, there were events that went on mid-year 2016, which impacted security evaluations. And I recognized that. I wanted to update my analysis to present a more normalized review of what capital market costs are. So that was the purpose for the update, and the results of the update were in line with what I expected them to be.

Q. And some of the developments that occurred were, for example, increase in stock prices, including the Dow Industrial -- Dow Jones Industrial average breaking 20,000?

A. I would have to review the specific numbers. But yeah, the effect of it is after the Brexit event in Mid-2016, yields, particularly treasury bond yields and some corporate yields dropped, as the uncertainty that was going to have on the world economy, and effectively the economic outlook for the U.S., and again the world economy.

As the market became more comfortable following Brexit, security evaluations recovered, and interest rates went back to more of a normalized level. More in line with what they were in 2015. So essentially there was a drop in interest rates, and then a recovery in interest rates later on in 2016.

Q. Now on Page -- I'm sorry. Did I interrupt you?

A. No. I was clearing my throat.

Q. On Page 29 of your rebuttal, beginning on Line 4, you state, as shown in these studies, and I presume your updated studies, they were based on stock prices for the 13-week period ending December 16th, 2016 --

A. Yes --

Q. -- is that correct? And since that time, stock prices have increased even further, correct?

A. You know, I would have to review specifically the stock prices. But I can tell you DCF study results have not changed significantly since I did this analysis. The reason I say that is I continue to do rate of return studies for other utilities. And DCF returns right now have been fairly consistently falling above 9 percent area.

Q. When you updated your DCF results in this case, they increased, correct?

A. Right. But I am referring to more recent studies for other rate cases, that are currently going on, that I performed in January. And some analyses that are ongoing. Those studies continue to support DCF results of about 9 percent for utility companies with bond ratings comparable to KCP&L.

Q. And the updated analysis growth rates in

December forecast for future interest rates, that again as another contributing factor to your expanding your return on equity range upward by 30 basis points?

A. Well, no. The low-end of the range was really impacted by the DCF results. And that increased by about 10 basis points. And that largely was attributable to a retraction in utility stock prices. The general market went up, but utilities actually pulled back a little bit.

So we saw dividend yields goes up a little. There was also an increase in the growth rate also. But it is kind of a combination of those two factors. But at the end of it, generally, as I stated more recent DCF studies continue to support a return on equity for utility companies of about 9 percent.

Q. But your upper range, based upon all of your analysis, the cap end, the risk premium, and the DCF, your upper range is 9.5 percent, correct?

A. The upper end is 9.5 percent. That's more driven by the risk-premium studies than the DCF study. Your question related to the growth rate, which relates to the DCF study.

Q. Now your update included the Federal Reserve's rate increase of December 14th, correct?

A. It did. Again, the market was highly

anticipating an increase in the Federal funds rates, leading up to the actual day when the Federal Reserve implemented that increase. But I did include stock prices that followed that event.

Q. And as you continued your work on other cases, have you followed the recent announcements by the Fed of their rate non-decision in February, and how they view the economy?

A. Yes. Yes. The Federal Reserve is still expected to increase the Federal funds rates during 2017. However, there are some factors that may impact their outlooks for the U.S. economy. Maybe not another increase, or a series of increases might be appropriate this year.

Q. How many rate increases do you think the Fed is going to approve in 2017?

A. Well, I prefer to rely on what analysts are informing investors might happen in Federal funds rates this year. And based on the Blue Chip Financial Forecast, the Federal funds rate is projected to be up to about 1.1 percentage points by the fourth quarter of this year.

Q. And right now it is at 0.75?

A. Yes. So that would indicate either a two-notch increase. Generally, the Fed has been going up by about 25 basis points every time they increase it. So that would suggest that there is an expectation that the Fed may increase Federal funds rate twice this year.

Q. So that would put it at 1.25?

A. 1.25, but on average in the fourth quarter. During the entire quarter, it would be above 1.1.

Q. Mr. Gorman, I put in front of you Exhibit 153, which is the Federal Reserve Press Release of February 1, 2017. So just last Wednesday. I take it you've had a chance to view this online?

A. Not this specific document. I have read articles on Federal Reserve comments.

JUDGE PRIDGIN: Mr. Zobrist, I'm sorry. If I can interrupt. Did I miss 152?

MR. ZOBRIST: Yes, you did, Judge. I premarked that as another exhibit, and put my sticker on it. So I have skipped 152. Do you want me to remark this?

JUDGE PRIDGIN: Has 152 been offered and admitted?

MR. ZOBRIST: No.

JUDGE PRIDGIN: Thank you. You can continue.

MR. ZOBRIST: I actually had it marked, and was going to talk to Mr. Murray. But he corrected his testimony, and I had nothing to present to him.

JUDGE PRIDGIN: I'm sorry for the interruption. Thank you.

MR. ZOBRIST: That's alright.

Q. (BY MR. ZOBRIST) In formulating your opinions, you rely upon announcements and policy statements by the Federal Reserve Bank; is that fair to say?

A. In part I do. More specifically, I rely on what the consensus economists view as relevant about those statements of informing their outlooks for changes is interest rates. My analysis is concerned with trying to capture the information made available to investors that was used by them for investment decisions. That allows me to estimate what required return those investors use to produce the observable security valuations.

Q. And it's true that investors rely upon statements by the Federal Reserve and the Federal Reserve Board Open Markets Committee, correct?

A. It is.

Q. And last Wednesday the Federal Open Mark Committee stated that the labor market has continued to strengthen, and that economic activity has

continued to expand at a moderate pace?

A. Correct.

Q. And that the jobs gains remain solid, and the unemployment rate stayed nears its recent low; is that correct?

A. Yes.

Q. And that measures of consumer and business sentiment have improved of late?

A. Correct.

Q. And that inflation increased in recent quarters, but is still below the Committee's 2 percent longer-run objective; is that right?

A. That's critical. And that is correct.

Q. And the Open Market Committee expect, with gradual adjustments in the stance of monetary policy, that economic activity will expand at a moderate pace?

A. Yes.

Q. And that the labor market conditions will strengthen somewhat, and that inflation will rise to 2 percent over the median term, correct?

A. Yes.

MR. ZOBRIST: Judge, I offer Exhibit 153.

JUDGE PRIDGIN: Any objections? Hearing none, 153 is admitted.

Q. (BY MR. ZOBRIST) Am I correct also that

last Friday the Bureau of Labor Statistics announced that the non-farm payroll employment increased by 227,000 in January?

A. I will accept that, subject to check.

Q. And that the unemployment rate was little changed at 4.8 percent?

A. That is my understanding. Yes.

Q. Now is it fair to say that since July 2016 that treasury yields have increased by about 100 basis points?

A. From July, yes. And that's after they were reduced following the Brexit. The United Kingdom decision to leave the European Union, referred to as Brexit. So that had a significant impact on the market, and interest rates dropped following that decision. And then recovered, subsequent to that.

Q. Am I also correct that in December the Bureau of Economic Statistics, which is part of the Department of Commerce, stated that the third quarter gross domestic product rose by 3.5 percent?

A. For that quarter, yes.

Q. The third quarter of 2016?

A. Correct.

Q. We don't yet have the statistics for the fourth quarter of 2016, do we?

A. Well, we don't. But the annual movement isn't level throughout the quarters. So you can have one big quarter, followed by some smaller growth quarters. Overall, the projections for real economic growth are around 2 to 2.5 percent.

Q. So generally speaking, looking at all these trends we see higher interest rates and gross domestic product growth, which indicate that the financial community sees strong growth prospects throughout the economy today?

A. I disagree with your statement that we have high interest rates. We don't have high interest rates today.

Q. Pardon me. I meant to say, higher. Higher interest rates.

A. We don't have higher interest rates today either. The interest rates for utility bonds today are comparable to what they were doing KCP&L's last rate case. They are comparable to what they were in 2015. They are higher than they were in July of this year. But again, they were reduced in July of this year, because of the international event that caused interest rates to drop. They have recovered since then. But interest rates are not higher today than they have been over the last couple years.

Q. They are higher today than when you filed your direct testimony, Mr. Gorman; isn't that true?

A. Yes. Because most interest rates were impacted by the events in mid-2016.

Q. And based upon those developments, it is reasonable therefor to expect higher dividend yields and higher growth grates, correct?

A. Well, the higher dividend yields are reflected in my updated DCF analysis. And that resulted in about a 10 basis point increase in my recommended range. Along with the growth rates that may have been impacted also.

Q. Exactly. And those combined to increase the cost of equity, which is why your -- why the upper end of your ROE recommendation range went up 30 basis points?

A. I would be clear that is only true with respect to the estimate of the cost of equity in July of 2016. If you would have compared it to DCF results for 2014 and 2015, the DCF results would not be higher. Interests rates were about -- well, were low in 2016, and they rose by the end of 2016. So interest rates when up by the end of 2016. But those interest rates are not higher than they were in 2014 and 2015.

Q. Now let me ask you with regard to your constant growth DCF model. The recommendation of 9.0 percent return on equity in your rebuttal reflects an increase from 8.8 percent of your direct, right? Twenty basis points?

A. Can you repeat that question?

Q. Yeah. The recommendation of 9.0 percent return on equity in your rebuttal, or the discounted cash flow constant growth model, was a 20-point increase from 8.8 percent in direct?

A. That's correct.

Q. And that's a result of the increase in your growth rate from 5.41 percent to 5.52 percent in rebuttal?

A. That, along with changing dividend yield. Yes. I think I may have mentioned that to be a 10 basis point change before, and it was 20. I apologize for that.

Q. And your dividend yield was -- in your direct testimony, Schedule NPG-6, in Column 4, it was 3.39 percent, correct?

A. My dividend yield?

Q. Yes.

A. Yes.

Q. And it's now in your rebuttal schedule,

3.50 percent?

A. That's correct.

Q. I have a few questions on the alternative bond yield, plus risk premium analysis --

A. Can I comment quickly on that? I mean that's the adjusted dividend yield. So it reflects the dividend yield adjusted by the growth rate. So it's not purely attributable to the stock price and the change in the observable yield. As that column says, it is adjusted. Adjusted by the growth rate. So that's the effect of both dividend yield and growth rate changes.

Q. Thank you. Switching to the risk premium model. You commented in I believe rebuttal, on Mr. Hevert's alternative bond yield plus risk premium analysis, correct?

A. I did.

Q. And you said that the alternative bond yield plus risk premium analysis that he used was a substantial improvement over his basic risk premium analysis, right?

A. Yes. It still needs improvement, but it is much better than his non-adjusted one.

Q. But you liked it a lot better, because you said the basic one was simplistic, correct?

A. It's so simplistic, that it simply was not real.

Q. Thank you. What you did is you took Mr. Hevert's alternative bond yield plus risk premium analysis and you did your analysis, correct?

A. I did. I added another factor and adjusted the nominal yields to produce a real yield.

Q. Well, what you did is you stripped out his volatility index, correct?

A. And I removed his volatility index. Yes.

Q. And you didn't put a volatility index in yourself?

A. Because the statistical analysis had stronger and more predictable regression parameters by removing it, than it did by retaining it.

Q. Well, did you think it was inappropriate to consider volatility of any kind in the risk premium?

A. It would be inappropriate to not distinguish the difference between general market volatility for higher risk investments, relative to utility stocks, versus the volatility of utility stocks themselves. Mr. Hevert's volatility index reflects the volatility of the overall stock market.

It's generally agreed by all witnesses in this case that utility stock investments are lower risk, they are more predictable returns. So the volatility of the overall stock market is not an appropriate parameter for measuring an expected return on a lower risk and lower volatile investment like a utility stock.

Q. Did you substitute a volatility factor that in your opinion is representative of the utility industry?

A. I relied on the volatility of changes in real bond returns, as a substitute for volatility in utility securities. That was included in my analysis by adjusting the nominal utility bond yields by inflation factor to produce a real utility --

Q. So the answer to my questions is no, that you did not insert your own volatility index? You relied upon other factors?

A. No. My answer is what I just described. I may not have substituted a third parameter. But your question was whether or not there was a recognition of stock volatility. Or risk volatility at the analysis. The way I understood your question, the answer is, yes. It does reflect volatility. Because that volatility is captured by variations in the equity risk premium, relative to the changes in real bond yields.

Q. The answer to my question is yes or no. Did you substitute a volatility factor that is representative of the utility industry?

A. I did in the form of the real bond yields.

Q. Now the conclusion that you came to, and I am looking at Page 22 of your rebuttal, is that based on the 30-year treasury yields and the spreads between the A-rated utility bonds and the treasury bonds, that a return on equity of 9.76 percent was the result?

A. Yeah. It was a measure of the market's evaluation of utility securities, versus those of other securities which are generally regarded as higher risk than that of the utility industry.

Q. And then you made a similar analysis of the treasury bond yield, and the spread between B Double A utility bonds to treasuries, correct?

A. Yes.

Q. And that return on equity estimate was 9.73 percent?

A. Correct.

Q. And you concluded that the study you performed supported a return on equity of KCP&L of no higher than 9.75 percent, correct?

A. Based on Mr. Hevert's analysis. That was the result. However, my analysis indicated an appropriate return on equity would be no higher than 9.5 percent.

Q. Well, but you took the alternative bond yield plus risk premium analysis that you viewed as a substantial improvement, and put in your own numbers, and then said it would get you to a return on equity of no higher than 9.75 percent, correct?

A. I said it was a substantial improvement from the analysis Mr. Hevert performed. However, it still does not properly gauge the level of equity risk premium, based on the amount of investment risk of the utility securities. The correction I made was to simply remove an obvious factor that can explain changes in bond yields, relative to equity risk premiums.

And that's the outlook for changes in expected future inflation. If future inflation decreased by 1 percentage point, and it is going forward relative to the past, then you would expect a 1 percentage point drop in the required return on equity, along with the 1 percentage point required return in utility bond yield, holding everything else constant.

Under Mr. Hevert's analysis, a drop of 1 percentage point in bond yield due to a change in inflation alone would equate to a higher equity risk premium, in his study. That simply has no economic logic in that conclusion. Inflation is both the equity return and the bond return.

So an improvement in his study is to at a minimum recognize that changes in nominal bond yields can equate to changes in inflation outlooks, but that change in inflation outlook would also equally change on a one-for-one basis the expected return on common equity.

Q. The bottom line is, you took his model, and you ran your own figures through it, and you said it got to an ROE recommendation of no higher than 9.75 percent, correct?

A. Well, the bottom line is --

Q. No. I would just like a yes or no answer. Is it 9.75 percent, Mr. Gorman?

A. Well, that's not your question.

Q. My question is, did your analysis, and I am quoting Page 22. I just want to see if you are still -- if you are moving off of what you said. The revised alternative, BYP risk premium study supports a return on equity for KCP&L no higher than 9.75 percent. Is that your testimony?

A. That's the way I describe it in my

testimony, and is my testimony. It's not your characterization though.

Q. We can leave this topic. I just want to make sure that those two lines, you are not backing away from them. You are telling me that you are not?

A. You need to read the full description of that analysis to understand the point I am making. The point I am making is --

Q. No. No.

MR. ZOBRIST: I object, Judge. I move to strike. I am simply trying to make certain that he is not moving off of what he has said on Pages 22, Lines 12 and 13.

JUDGE PRIDGIN: That's sustained. You are trying to answer questions that aren't being asked. So I sustain that objection.

THE WITNESS: I apologize.

Q. (BY MR. ZOBRIST) Mr. Gorman, let me move on to return on equities authorized by other public service commissions. In your direct testimony on Page 5, you return to the Kansas Commission's decision that we have talked about here today, that was issued in 2015 at a rate of 9.30 percent, correct?

A. I'm sorry. What page?

Q. Page 5 of your direct testimony, and then

Table 1 at Page 7.

A. Yes.

Q. Did you make any adjustments for the fact that in Kansas the Commission permits not only an energy cost adjustment, which is like our FCA in Missouri, I mean our FAC in Missouri. But also the transmission delivery charge?

A. I did not. I am observing what the authorized return on equity was.

Q. Okay. How much did the authorization of the transmission delivery charge permit KCP&L to recover in Kansas?

A. I'm sorry. How much of the --

Q. Are you familiar with the transmission delivery charge that the Commission approved in that 2015 case?

A. Just generally. I would have to review it to comment on specifics of it.

Q. Do you recall that it permitted the company to recover $33 million a year?

A. Not as I sit here.

Q. If you would accept that as true, wouldn't that require some kind of an accommodation or an adjustment to that 9.30 percent ROE?

A. If it was a new regulatory mechanism, which improved the likelihood that they were going to recover their cost of service, then I would recommend, or I would believe it would be appropriate to adjust the authorized return on equity.

Q. So if you took out that $33 million a year, that could have brought the return on equity up to who knows, maybe 9.5 percent, correct?

A. Or no change at all.

Q. But you didn't consider that when you were analyzing the 9.3 percent, you just accepted it at face value?

A. I have already testified, yes, that is true.

Q. Now but you told this Commission that they should disregard the decision by the Wisconsin and Michigan Commissions because you think those returns on equity are too high, correct?

A. Correct.

Q. And you also told the Missouri Commission that it should ignore the return on equity granted by the Indiana Utility Regulatory Commission to the Indianapolis Power & Light, because it was too high?

A. I think there were factors underlying that decision that I though resulted in a return on equity that I thought was not typical.

Q. Now are you familiar that in Kansas there is also a property tax flow-through that permits ad valorem taxes to be flowed through either to increase rates or decrease rates that are 30-day basis?

A. Indiana does have what they call rider mechanisms. I am not familiar with all of them. But I know they do have them.

Q. Maybe I misspoke. I meant to say, Kansas. If I said, Indiana, I apologize. Let me rephrase my question. In Kansas, when you looked at the ROE of 9.3 percent, did you consider the Kansas provision that allows ad valorem tax changes to be approved within 30 days of the filing?

A. I did not look at their rider mechanisms or regulatory mechanisms. I was simply noting what the authorized return on equity was.

Q. Now in your testimony you have referred to, on a number of occasions, data and analysis conducted by regulatory research associates; is that correct?

A. Yes.

Q. Mr. Gorman, will you tell me what I have marked that as? I think Exhibit 144.

A. 155.

Q. 155?

A. Yes.

Q. Thank you.

JUDGE PRIDGIN: Did I miss 154? The press release is 153.

MR. ZOBRIST: I had marked that Bureau of Labor Statistics report, and I didn't have to put that in front of the witness. So I skipped another one.

JUDGE PRIDGIN: Thank you.

Q. (BY MR. ZOBRIST) Mr. Gorman, this is 155?

A. That's what is written.

Q. Thank you. And is this a copy of the Regulatory Research Associate's regulatory focus that was issued on January 18th, 2017?

A. Yes.

Q. Now I know we are running out of lunch hour here, so I will try to cut to the chase. If we go to Page 6, that indicates the electric average authorized ROE's from 2006 to 2016; is that correct?

A. Yes.

Q. And the first block of numbers there relate to settled versus fully-litigated cases, correct?

A. Correct.

Q. And I should have asked you this. Have you had a chance to read this report, prior to coming here today?

A. I have. Yes.

Q. Thank you. The conclusion of RRA is that there really isn't any difference between litigated -- pardon me. There is no pattern between litigated and settled cases? Sometimes the settled cases have higher ROE's, and somethings the litigated cases have higher ROE's; is that a fair statement?

A. Are you referring to a statement?

Q. Yes. On Page 2, if you go to the second paragraph. It starts out, included. Then if you go to the second sentence it states, for both electric and gas cases no pattern exists in average annual authorized ROE's, in cases that were settled, versus those that were fully litigated?

A. It does state that. But there is a difference, as noted on Page 6 of the table.

Q. Well, there are differences, but what RRA says is there is no particular pattern. Some years the litigated cases may result in a higher return on equity, and some years the litigated cases may result in a lower return on equity?

A. I presume that's what they intend. I would agree with that. But there clearly is a difference in the findings for litigated cases, in my judgment.

Q. Well, if you look at that first block on Page 6, the fully-litigated cases results in 2016 with

an ROE of 9.74 percent. And the litigated cases were 9.80 percent, right? So the litigated cases were 6 points lower?

A. Yes. I think I heard the numbers backward. The fully-litigated was 9.74. The settled cases were 9.8.

Q. That what I mean to say, if I misspoke. So the litigated cases were 6 points lower. And then if you go to the previous year, the litigated cases are 41 basis points lower, correct?

A. Correct.

Q. Then you go back to 2014, it's the reverse. The fully-litigated cases are 32 points higher. Then you go back one year to 2013, and they are 27 basis points lower. Then you go one more, it's 20 basis points higher, right?

A. Yes.

Q. Now with the regard to the middle block on general rate cases versus limited rider issues, for 2016 and 2015, the average return on equity was 9.60 percent, correct?

A. For general rate cases. Yes.

Q. And then if we look at the vertically integrated cases in the bottom block, for 2016 the average return on equity was 9.77 percent. For 2015

it was 9.75 percent?

A. That's on average for 17 decisions in 2015 and 20 decisions in 2016.

Q. And am I correct that the statistics that RRA compiles are national statistics, and they include statistics from all of the regulatory utility commissions in all the 50 states?

A. That's my understanding. Yes.

MR. ZOBRIST: Judge, I move the admission of Exhibit 155.

JUDGE PRIDGIN: Any objections? Hearing none, 155 is admitted.

Q. (BY MR. ZOBRIST) Are you familiar with the term, zone of reasonableness?

A. Yes.

Q. What does that mean?

A. It's a range. It's what is included in my testimony. It discusses the uncertainty there is in accurately measuring what the current investor required return on equity is. So you can get a pretty good estimate within a zone, and determine whether or not a point estimate within that zone is appropriate for setting rates. So generally, the zone of reasonableness outlines what the best estimate is of what the current market cost of equity is. That will fairly compensate the utility for their equity investments.

Q. Is that typically a range of -- I have heard sort of a minimum of 50 basis points, up or down from the national level, up to a range of 100 basis points, up or down from the national level?

A. It can vary over time. But yes, that is a fair characterization.

MR. ZOBRIST: Judge, nothing further. Thank you.

JUDGE PRIDGIN: Bench questions? Mr. Chairman?

QUESTIONS FROM THE BENCH

QUESTIONS BY CHAIRMAN HALL:

Q. Good afternoon.

A. Good afternoon.

Q. Do you have Mr. Hevert's surrebuttal testimony in front of you?

A. I do not have it in front of me.

CHAIRMAN HALL: Will somebody get that to him. Surrebuttal.

Q. (BY CHAIRMAN HALL) Turning to Page 4.

A. I'm there.

Q. The chart that he has at the top of the page.

A. Yes.

Q. What should I extrapolate from that, in your opinion?

A. Well, essentially, in the cross-examination, Exhibit 155, it gives annual listings of the authorized returns on equity. And this charge is made, based on that data. It shows that the authorized returns on equity for utility companies, historically, are consistent with these dots on this chart. His argument is that my 9.2 percent return on equity is lower than all but one of those actual findings by regulatory commissions.

Q. And that's accurate, correct?

A. That is accurate. Yes.

Q. So why should I not, from that chart, determine that your position is out of line with all of the decisions since January of '13?

A. Well, I think there are two considerations that I would ask you to wrestle with in determining whether or not my 9.2 percent recommendation is reasonable. One is, how does it compare to the industry authorized returns on equity, which is what this chart shows.

Those returns on equity were based on historical analyses, based on information available in each of those rate cases. It was also based on what the regulatory commission found to be an appropriate return on equity, given the information in those cases. In my judgment, the regulatory commissions generally look at the market data what the most reasonable estimate is at the current market cost of equity.

But also consider the risk that, that cost of capital may change when the rates are actually in effect. With the concern that if they award a return on equity that is too low. That could have negative implications on the utility when the rates are actually in effect.

What we have been seeing over the last three to four years is a lot of data that suggest that if certain events happen, capital market costs could increase. The biggest factor that is underlying when capital market costs will increase is this inflation outlook.

Inflation has been in check at very low levels for at least the last five years. Inflation outlooks right now still appear to be in check. Consequently, capital market costs going forward will likely remain very low. So while my return on equity appears low, based on what regulatory commissions found in previous rate cases, I think the evidence in this case suggests that there is pretty clear evidence that the market is embracing relatively low capital market costs today.

Q. You can see from this chart a trend downward. Is that accurate?

A. I can't imagine how anyone could deny that there is a downward trend in authorized returns on equity.

Q. There is a trend downward, but it is clear that your recommendation is lower than all but one decision since 2013?

A. That is true.

Q. And there is a legitimate concern for KCP&L, because investors will be comparing, or could be comparing investment with KCP&L versus alternative electric utility companies with higher return. And that could be a detriment for KCP&L?

A. KCP&L will have to compete with those other utilities for capital. That's right. And whichever utility presents the best investment opportunity is likely the utility investors will choose to put their capital into. But there is complicating issues around that also. The ROE, not only has to be fair to investors, but it has to be fair to customers as well.

To the extent the Commission awards a return on equity which is higher than needed to fairly compensate the utility and provide them an opportunity to access capital under reasonable terms and prices, which KCP&L has had that access for at least the last five years. Then the rates will increase, and that can impact the economic activity in their service territory.

That can in turn impact the utility to the extent it stifles growth and revenue. It stifles growth and sales. Which can impact not only business customers, but can flow down to the residential customers also. So I think in terms of using as much information available to get the right number.

I would encourage you to consider not only what the authorized returns on equity have been for all electric utility companies, but more specifically consider what they have been for integrated utility companies, vertically integrated utility companies under litigated cases.

And what is important about a litigated case is there is no question that the revenue requirement to the ROE are intertwined together. You give them more or less ROE, that impacts their revenue requirement.

In a settlement, there is not necessarily any connect whatsoever between the ROE and the revenue requirement. And consequently, the rates that customers pay. So that's why I believe it's important to look at only litigated cases. Because that describes what customers are willing to pay. Or are required to pay, as fair compensation by the regulatory commission.

Settlements can just be pieces of statements without a clear interconnect between how those pieces fit together. But the market evidence shows that authorized returns on equity for most integrated electric utility companies has been around 9.5 percent. And has been declining a little bit over time.

And those utilities have had access to large amounts of capital, not just KCP&L. But the industry at whole has had access to significant amounts of capital, under reasonable terms and prices. So that's clear observable market evidence that an authorized return on equity of no higher than 9.5 percent, the utility is fairly compensated because stock prices have been very rich in valuation lately.

Utility access to capital under reasonable terms and prices. And the utility industry as a whole has supported very large capital programs, in this environment. The prices that customers pay are at an ROE which are no higher than necessary to achieve those objectives, fair compensation and maintain a financial integrity utility.

Q. Have you done analysis of electric utility service prices in Missouri or nationally?

A. Yeah. We do those on a pretty regular basis.

Q. And those prices have been going down, have they not?

A. Fuel costs have been going down, so electric utility prices have been going down.

Q. Is that the main driver?

A. It is, yes. Because most utilities' infrastructure investment has been an abnormally high levels. Cyclically high levels that have caused increases in non-fuel rates. But those non-fuel rate increases have been offset by fuel rate decreases.

Q. Have you done an analysis on -- a Missouri-specific analysis or a KCP&L specific analysis of that?

A. We have. Yes.

Q. Is that in your testimony?

A. It's not in this testimony. I did file it in testimony in Kansas recently.

Q. So how do you reconcile -- I think I know the answer to this. But how do you reconcile the data that shows that electric service price index is going down, but utility rates are going up?

A. I'm sorry. Can you repeat that question?

Q. Well, we have been talking about the service price index for electric utility service. And that's been going down. And you said the main driver is fuel costs?

A. Right.

Q. So what I am trying to understand is how do you reconcile what consumers are actually paying for utility service, going down, with rates that have been going up? I am sure I am doing apples and oranges, but I am trying to take advantage of your understanding of this to help me out.

A. If you kind of split the utility rate up into the fuel rate, the non-fuel rate, the non-fuel rates are generally going up. Fuel rates have come down quite a bit the last few years. They may have decreased, but they are more stable now, based on gas prices.

The coal market could change, depending on changes in environmental regulation. But it has dropped recently. It may be stabilizing also. But the big driver of increasing electric utility rates has been the invested capital piece. Rate bases are growing significantly across the industry.

Q. Which has an effect on the prices that the rate payers pay?

A. Significant impact on prices. Yes.

Q. So how is it that CPI is going down, but all the rates are going up? There was some discussion about if the Commission were to implement the rate increase requested by the company, you'd have almost 100 percent rate increase since 2006. So I am trying to reconcile that information with what I have been reading about CPI for electricity going down.

A. Well, since 2006, that is 10 years. Over that time period, Kansas City Power & Light has undertaken significant capital investments. I don't know the exact growth in the rate base, but I do understand it to be very significant. The introduction of a new coal-fired unit.

The introduction of scrubbers. And wind generation assets. As well as a build-out in modernization in their wire infrastructure. There has been tremendous growth in their rate base over the last 10 years.

CHAIRMAN HALL: I have no further questions. Thank you.

JUDGE PRIDGIN: Commissioner Stoll?

COMMISSIONER STOLL: I have no questions. They've been answered in testimony.

JUDGE PRIDGIN: Thank you. Mr. Rupp?

COMMISSIONER RUPP: Yes.

QUESTIONS FROM THE BENCH

QUESTIONS BY COMMISSIONER RUPP:

Q. Good afternoon.

A. Good afternoon.

Q. Can you walk me through how the volatility index that Mr. Hyneman had used, how it affects the regression analysis and how oppositely it was affecting when you used the utility bond yields, and what does that regression analysis tell me about those two inputs?

A. Well, Mr. Hevert --

MR. RUPP: Mr. Hevert. I'm sorry.

A. -- performed a regression study, which he was attempting to estimate what an appropriate equity risk premium is, based on current market information. In doing that, he relied on nominal bond yields and a volatility index based on the S&P 500.

When I reviewed that analysis, I thought it was an improvement from his other risk premium study, which regressed simply nominal bond yields, relative to equity risk premiums. And the reason I thought his other analysis would be appropriate is because it could be adjusted to translate the nominal bond yields into a real bond yield.

And by doing that, you take away one important factor which would impact equally equity risk premiums and bond yields. And that's the inflation index.

Q. (BY COMMISSIONER RUPP) So maybe I misunderstood. So did you perform a regression analysis to see how that input affected whether or not it showed that there was a stronger correlation of this information to the predictability of the rates, or were you just using the word regression as a term? I thought you said earlier, and this was a while back in the beginning, that there was a statistical difference in the correlation of predictability of using the --

A. You're right. Page 21 of my rebuttal testimony.

Q. Okay.

A. I describe the difference in the regression statistics. And I explain that under my model, the regression statistics were stronger. The R-squared was 84.5 percent and in my model, it was about 68.6 percent in his model. The T-statistic was 0.0037 in my model. It was 0.0054 in his model. The T-statistic both said that the factors were statistically significant. But my R-squared number says my model predicted more accurately the change in equity risk premium, relative to the change in real bond yields.

Q. That is exactly what I was looking for.

COMMISSIONER: Thank you. That's all.

JUDGE PRIDGIN: Commissioner Coleman?

COMMISSIONER COLEMAN: No.

JUDGE PRIDGIN: Any recross based on bench questions? Public Council?

MR. OPITZ: No. Thank you, Judge.

JUDGE PRIDGIN: Staff?

MR. THOMPSON: No. Thank you, Judge.

JUDGE PRIDGIN: KCP&L?

MR. ZOBRIST: No questions.

JUDGE PRIDGIN: Redirect?

MR. WOODSMALL: Yes. Thank you, Your Honor.

REDIRECT EXAMINATION

QUESTIONS BY MR. WOODSMALL:

Q. I'm kind of working backwards. Commissioner Hall was asking you to compare KCP&L with other utilities and other states. He referenced Kansas. Do you know if KCP&L had any difficulty raising capital after Kansas authorized a 9.3 ROE?

A. No. Quite the contrary. KCP&L, along with its parent, Great Plains Energy, has announced a major acquisition of a Kansas utility. And they are raising significant amounts of both debt and equity to fund that transaction. The primary source of earnings and cash flow available to Great Plains Energy is KCP&L. And to also to a significant degree, Greater Missouri Operations.

Q. And you were asked some questions by Commissioner Hall. Compare rates over time. You were talking about fuel and non-fuel components. Do you recall those questions?

A. Yes.

Q. Would you turn to Schedule MPG-2 of your direct testimony. Maybe this is what the Chairman was asking for. Tell me when you are there.

A. I'm there.

Q. Is that a comparison of KCP&L utility rates versus other states over time?

A. It is. Yes.

Q. Okay. And granted, this is for a very, very large industrial customer, 50 megawatts. But it shows certainly KCP&L rates increasing relative to other states; is that true?

A. It does. Yeah. This is an all-in cost, which would include both fuel and non-fuel components. This weights a customer bill, divided by kilowatt hours.

Q. And that chart, or those charts, show certain states having a rate that is decreasing? For instance, Michigan; is that correct?

A. If you tracked it over time, you would be able to identify states with decreasing costs. Yes.

Q. Now going to questions from Mr. Zobrist. He started off asking you some questions about your proxy group and the inclusion and exclusion of Otter Tail. Do you recall that?

A. I do.

Q. And you excluded Otter Tail. Mr. Hevert included Otter Tail; is that correct?

A. It is.

Q. Did Mr. Hevert ever attempt to quantify any impact on ROE from his inclusion or your exclusion of Otter Tail?

A. No. He simply noted that the growth rates

-- the reason I excluded it was the growth rates were not available. And he observed that growth rates from other sources were available. I commented that I didn't believe it had a significant impact on my recommendation or his. I don't believe he took issue with that.

Q. At MPG-4 you show that your proxy group consists of 15 companies; is that correct?

A. Yes.

Q. And if you had included Otter Tail, it would have been 16 companies; is that correct?

A. Yes.

Q. When you do an analysis, for instance a DCF on your proxy group, you come up with a DCF for each individual company, and then average across the 15 companies; is that correct?

A. Well, I do a little more than that. I mean I do DCF analysis for each of the companies. I create a proxy group average. But to the extent there is an outlier number within the proxy group, then I would also compute a proxy median, and I would determine whether or not the group average or median more accurately reflects the central tendency of all the proxy group results, in forming my recommendation.

So to the extent if I would have included

Otter Tail, and that would have drove up the average. It clearly would have been an outlier within my study. Then I would have formed my recommendation based on the proxy group median, and not the average. Because the average would have been skewed by the inclusion of an outlier company.

Q. But in any case, the addition of one company to a group of 15 wouldn't have a dramatic effect on the ultimate bottom line, would it?

A. I wouldn't think so. And that certainly is not the reason I didn't include Otter Tail in my proxy.

Q. You were then asked some questions by Mr. Zobrist about -- I think he termed it the update period. Updating your analysis from October 28th in your direct, to December 16th in your rebuttal. Do you recall that?

A. I do.

Q. And he said it was about 30 days. Just for clarification, would you agree that is 49 days?

A. I do.

Q. And he talked about during that 49-day update period, expectation of future interest rate increases. Do you recall that?

A. Yes.

Q. Does an expectation of interest rate increases always come true?

A. There has been a strong expectation of an improving economy and an increase in the Federal Funds rate for the last five years. A lot of the expectations simply haven't been realized. They were in December 2015, and then again 2016. There is expectations of further economic strengthening this year, which are expected to be followed by further increasing in the Federal funds rate. But that expectation has been the general outlook for many, many years now.

Q. And even when it does come true, does the interest rate increase always have a direct correlation on ROE?

A. No. The Federal funds rate is a short-term rate. It's an overnight rate for banks lending to each other. Generally, it reflects more short-term borrowing costs. Very short-term borrowing costs. In contrast, the common equity security is a long-term investment. So it's at the other end of the investment horizon curve.

The first time the Fed had increased Federal funds rate, long-term interest rates actually dropped in response to it, because the outlook for the economy was improving, but inflation wasn't picking up much steam. So the economy was getting stronger without inflation. And that brought down long-term interest rates.

When the increase came again in December of last year, interest rates didn't move. Long-term interest rates didn't move that much, after December. They did from July of 2016. But from December of 2016, interest rates have not changed. Corporate bond interest rates have not changed considerably since that time.

Q. Then you were asked some questions by Mr. Zobrist about Mr. Hevert's alternative risk premium analysis. Do you recall those questions?

A. I do.

Q. And he latched onto the word, substantial improvement. Do you recall that phrase? Substantial improvement over his other risk premium analysis?

A. Yes. I think he was using my characterization of the study. Yes.

Q. While a substantial improvement, do you think the alternative risk premium is a reliable ROE indicator?

A. It's an improvement relative to his very simplistic study, but it still does not accurately gauge an equity risk premium based on the difference between the market's perception of the risk of an equity investment, versus the risk of a bond investment. That should be the factor which describes the equity risk premiums. Changes in interest rates are one of those factors. And it's an important factor. But it's not the only factor.

If you look at -- read the arguments that Mr. Hevert and I go through in these studies. We talk about flight to quality, where low-risk investments are priced at a premium. The equity risk premium goes up. Versus more normal conditions, where the market is not pricing such a premium in low-risk securities, which means the equity's premium comes down.

So that is an indication of how much appetite market investors have for risk. And how much additional compensation they demand to assume greater levels of risk. When investors are concerned about the integrity of the market place, they pay a premium for low-risk investments, because they are not willing to take on the uncertainty of higher risk investments.

When the market calms down, investors are more interested in higher returns and they are willing to assume greater risk to get those higher returns. Often we see equity risk premiums contract. So changes in nominal bond yields is one factor. More specifically, changes in real bond yield is a factor that helps describe what a balanced equity risk premium is in the current market place.

But it's not the only factor. And that's the deficiency in Mr. Hevert's study, is he only considers changes in interest rates. Not changes in relative investment risk characteristics.

Q. And you were asked some questions about your recitation in your directive of 9.3 ROE in Kansas, and you were asked about Kansas' recovery mechanisms. Do you recall that?

A. I do.

Q. Would you agree that those Kansas recovery mechanisms were already reflected in KCP&L's current credit rating?

A. I didn't look at the specific rate filings for that. But I presume they were. I did not verify that.

Q. The credit agencies would reflect those mechanisms when they assign a credit rating for KCP&L; is that true?

A. The credit rating agencies in the market would already know the regulatory mechanisms, and the impact those mechanisms have on the utility's ability to earn the expected earnings and cash flows from the utility.

Q. And then finally, you were asked some questions about other states. You were talking about Wisconsin and Indiana ROE's. You characterized those as, quote, not typical. Do you recall that?

A. I do. Yes.

Q. And can you tell me why those are not typical?

A. Well, we work on both of those jurisdictions. To give you an example, in Detroit Edison's most recent case, the staff analyst had a range of authorized return on equity that went from about 9.0 percent, up to about 9.5. And one outlier at about 10 percent. The Commission awarded, and the industrial group of one of my associate's had a return on equity recommendation of about 9.3.

The company witness was well into the 10's. Well above 10. The Commission awarded a 10.1 percent return on equity, while being very critical of the analysis the utility witness made. Without the utility witness, there was really no record support for anything above 9.5, so it's difficult for us to explain how the Commission arrives at those decisions, based on some of the comments they had in the record.

In Wisconsin, often the Commission will simply award a return on equity without much discussion of the ROE evidence. The effect of doing that, as in Michigan, rates stay expensive. Michigan is a legacy cost structure with very high rates. It's difficult for energy intensive companies to compete while operating in Michigan.

And we have advised the Commission, and they have not seen much weight and value in our advice. But they continue to authorize above industry average returns on equity in rate setting. The effect of that is that the credit rating of those utilities is no stronger than the industry average common equity ratio.

One reason is because they have energy intensive companies, and their rates are not that competitive. And the service area is not growing very strongly. Amongst some other factors. So it's important to understand where the return on equity is awarded, and the information the regulatory commissions consider in determining what's a balanced and fair return on equity. In my judgment, what they do in Wisconsin and Michigan is not the more balanced methodology that has historically occurred here in Missouri.

Q. And just following up on Wisconsin, the ROE's generally authorized in Wisconsin are higher than the average; is that correct?

A. Yes.

Q. And is it your understanding that Wisconsin has four or five electric utilities?

A. Yes.

Q. And they are required to file rate cases every two years or so?

A. Two years. Yes.

Q. So you see lots of Wisconsin decisions with a higher ROE, so Wisconsin has the effect of inflating an average; is that correct?

A. Yeah. If you look at only the industry average, it will be highly impacted by ROE decisions, which clearly are outside the large number of observations available for that year. It will skew up the average result.

MR. WOODSMALL: I have no further questions. Thank you, Your Honor.

JUDGE PRIDGIN: Thank you, Mr. Gorman. Thank you very much. You may step down. I believe Mr. Gorman is our final witness of the day. What I understand is we would resume at 8:30 in the morning with depreciation. And then move on to fuel adjustment clause.

MR. ZOBRIST: That's correct.

JUDGE PRIDGIN: Anything further, before we go off the record. Hearing nothing, we are in recess until 8:30 in the morning. Thank you very much. We are off the record.

(WHEREIN, the Evidentiary Hearing was concluded on February 7, 2017 at 1:10 p.m.)

I N D E X

E X H I B I T S

(All Exhibits are entered into the record except Exhibit 200, which was referred to, but not offered or admitted.)

CERTIFICATE OF REPORTER

STATE OF MISSOURI)
) ss.
COUNTY OF ST. LOUIS)

I, Matthew Behlmann, a Certified Court Reporter (MO), and a Notary Public within and for the State of Missouri, do hereby certify that I was personally present at the proceedings as set forth in the caption sheet hereof; that I then and there took down the proceedings had at said time and was thereafter transcribed by me, and is fully and accurately set forth in the proceeding pages.

Matthew Behlmann

Notary Public within and for
The State of Missouri

D

O