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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

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1 PROCEEDINGS

2

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

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

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

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

25 JUDGE PRIDGIN: Any comments or objections?

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

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

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

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

14 MR. ZOBRIST: That's right, Judge.

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

19 OPENING STATEMENT

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

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

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

12           Both Mr. Hevert and Mr. Gorman revised  
13 their projections in their rebuttal testimony. Most  
14 notably, Mr. Gorman raised his overall recommendation  
15 from a 9.0 percent to a 9.20 percent. The risk  
16 premium actually went up 30 basis points from 9.20 to  
17 9.50. And his overall discounted cash flow  
18 recommendation moved from 8.8 percent, up 20 basis  
19 points to 9.0 percent.

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

25           If you turn to Page 2, with regard to

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

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

19 There are actually changes that are  
20 happening more current, and in the very recent past,  
21 the last couple of months, but we did see it in the  
22 early part of 2016. For example, if you look at the  
23 bottom of Page 2 on the growth rates, Mr. Gorman's  
24 Stage 1 growth rate, if you look at Footnote 3, that  
25 5.41 percent was as of November 30th. Just 30 days

1 later, and again based upon updated economic  
2 information, it increased to 5.52 percent.

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

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

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

24 There is really no need to use the Great  
25 Plains Energy capital structure, given the improved

1 credit profile that we are seeing at GMO, which since  
2 2013 has really established its stand-alone ability to  
3 finance its own operations. I would saying that using  
4 KCP&L's actual capital and cost structure is  
5 consistent with at least one prior KCP&L rate case  
6 decision back in 2010, where the Commission had  
7 rejected Staff's effort to adjust KCP&L's debt, as a  
8 result of lower cost GMO debt.

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

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

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



1 2016, which is very high in equity at 54 percent, or  
2 adopting a hypothetical structure that does not exist.  
3 The proposal, I believe, is as of June 30th, with  
4 certain adjustments.

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

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

20 So again, we have adjustments made to a  
21 proposal. Whereas, what the company is proposing is  
22 what its actual capital structure is. All of these  
23 words are summarized on Page 5, where you see that the  
24 common equity has projected for KCP&L is just under 50  
25 percent. We believe that the true-up figures will

1 show it's a little below 50 percent, at 49.72 percent,  
2 with long-term debt per true-up at 50.28 percent.

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

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

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

1           They have said that there is some double  
2     counting that was done by KCP&L. We dispute that.  
3     But we say if you either use the yield to maturity  
4     formula, or the simple interest amortization formula,  
5     we are okay with either. Just be consistent. Our  
6     proposal on the year to maturity is 5.51 percent. The  
7     simple interest amortization is a little bit lower at  
8     5.59 percent. Either of those figures would be  
9     agreeable to Kansas City Power & Light.

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

14           CHAIRMAN HALL: No questions. Thank you.

15           JUDGE PRIDGIN: Mr. Zobrist, thank you.

16    Opening from Staff?

17           MR. THOMPSON: Thank you, Judge.

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

20                            OPENING STATEMENT

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

1 and the cost of capital, and the expectations of  
2 investors.

3 Mr. Gorman for MECG recommends 9.20  
4 percent. And Mr. Hevert for the company recommends  
5 9.90 percent. That is a span of 125 basis points from  
6 Staff's point recommendation to Mr. Hevert's point  
7 recommendation. And each of those basis points is  
8 worth approximately \$205,000. \$205,000. In the area  
9 of capital structure, as you just heard from Mr.  
10 Zobrist, Staff recommends the use of the consolidated  
11 capital structure of Great Plains Energy.

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

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

25 It is not common for Staff to come in with

1 a negative case. It doesn't happen very often. We  
2 were in this room not really so very many months ago,  
3 listening to the Missouri Industrial Energy Consumers,  
4 as they sought to prove an over-earnings case against  
5 Ameren Missouri. I know that many of you will recall  
6 that.

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

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

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

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

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

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

23           As Mr. Murray has testified, that's how the  
24 financial community views it. That's how the bond  
25 raters view it. There is no ring fencing. There is

1 no real separate of Kansas City Power & Light from its  
2 parent. So they are considered by Standard & Poor's,  
3 for example, as a single entity.

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

14 CHAIRMAN HALL: No questions. Thank you.

15 JUDGE PRIDGIN: Mr. Thompson, thank you.

16 MR. THOMPSON: Thank you.

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

19 OPENING STATEMENT

20 MR. OPITZ: May it please the Commission?  
21 Good morning. I intend to be very brief. First, as  
22 to the capital structure. In the company's last rate  
23 case, this Commission concluded that the appropriate  
24 capital structure is the GPE consolidated capital  
25 structure to set rates. And the Commission did so in

1 the case prior to that, ER-2012-0174.

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

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

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

23 Of the witnesses offering specific ROE  
24 recommendations, only the company's witness recommends  
25 to increase the ROE. Public Council believes that



1 this increase is excessive and should be rejected.

2 Instead, the Commission should authorize an ROE in the  
3 range of 7.9 percent to 8.75 percent, as recommended  
4 by Staff's witness.

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

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

22 CHAIRMAN HALL: No questions. Thank you.

23 JUDGE PRIDGIN: Mr. Opitz, thank you.

24 MR. OPITZ: Thank you, Judge.

25 JUDGE PRIDGIN: Opening from MECG? Mr.

1 Woodsmall, when you are ready, sir.

2 OPENING STATEMENT

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

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

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

1           They point out specific flaws in his  
2 analysis. Most particularly, they talk about his  
3 growth rates are excessive and too high. And can't  
4 lead to a reasonable ROE recommendation. So on Slide  
5 4, Mr. Gorman's analysis -- and it is important here  
6 to recognize the date as which he performed this  
7 analysis.

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

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

23           One of the things that is unique about Mr.  
24 Gorman's testimony, and I talk about this on Slide 6,  
25 is that he attempts to go in and fix the flaws in the

1 company's ROE analysis. So on Slide 6, you see a  
2 table where he went in and tried to fix the growth  
3 rates that the Commission has said are too high. And  
4 previously said are excessive.

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

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

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

24           Again, just like in the other ones, you see  
25 a significant drop in the ROE recommendation, if you

1 use reasonable assumption. So ultimately on Slide 11,  
2 he talks about, what's the bottom line? He says,  
3 corrections to Mr. Hevert's studies or use of more  
4 balanced market base information supports a return on  
5 equity for KCP&L in the range of 9.0 to 9.5. That's  
6 important.

7 He does his own analysis, and Mr. Gorman  
8 comes out at 9.2. He then takes Mr. Hevert's analysis  
9 and puts in reasonable assumptions, and comes out to  
10 9.0 to 9.5. Not a lot of difference there. On Slide  
11 12, I had some other considerations for you. Backing  
12 up, I spent most of my time talking about the problems  
13 in KCP&L's analysis, and how it is flawed. I don't  
14 intend to discuss the merits of Mr. Gorman's analysis.  
15 You are obviously very familiar with his analysis from  
16 previous cases.

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

23 First off, as Mr. Opitz said, KCP&L is the  
24 only party here today that says you should increase  
25 the ROE. No one else believes that. And let's look

1 at what the Kansas Corporation Commission did. Just  
2 last year, the KCC authorized a return of 9.3 percent  
3 for KCP&L, with a fuel adjustment clause. Well, last  
4 year you authorized a fuel adjustment clause for  
5 KCP&L.

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

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

23 So his analysis is inflated by 73 basis  
24 points. So you take it right in the middle of his  
25 range, 10.0, and then deduct 73 basis points, you are

1 at 9.25. Mr. Gorman is at 9.2 KCC is at 9.3. We seem  
2 to be converging on a singular point here.

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

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

22 He does these at a 9.0 ROE. And he shows  
23 here that on a 9.0 ROE, they meet all these metrics to  
24 maintain their current investment grade credit rating.  
25 So it ensures financial soundness. It ensures their

1 ability to attract capital. Only Mr. Gorman's  
2 analysis does this test to ensure that his  
3 recommendation is consistent with Supreme Court  
4 guidance.

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

11 CHAIRMAN HALL: I have no questions. Thank  
12 you.

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

19 MR. ZOBRIST: That's correct.

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

23 \* \* \* \* \*

24 ROBERT HEVERT,  
25 of lawful age, produced, sworn and examined, says:



1 DIRECT EXAMINATION

2 QUESTIONS BY MR. ZOBRIST:

3 Q. Good morning, Mr. Hevert.

4 A. Good morning.

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

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

9 Q. And where are you employed?

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

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

16 A. Yes, I did.

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

19 A. I have two. My apologies. These are  
20 typographical errors. The first is on my rebuttal  
21 testimony, Page 62, Line 8, there is a reference to a  
22 9.6 percent premium-based estimate. That should be  
23 9.2 percent. I apologize for that. And then in my  
24 surrebuttal on Page 5, Line 17, right after the  
25 parenthetical one there is an extraneous word, the,

1 t-h-e, which should be stricken.

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

5 A. Yes, they would.

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

8 A. Yes, it is.

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

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

19 MR. WOODSMALL: Very briefly, Your Honor.

20 CROSS-EXAMINATION

21 QUESTIONS BY MR. WOODSMALL:

22 **Q. Good morning, sir.**

23 A. Good morning.

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

1 **for your recommendations in prior cases?**

2 A. I do.

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

5 JUDGE PRIDGIN: You may.

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

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

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

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

17 MR. WOODSMALL: Okay.

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

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

1 final decisions.

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

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

15 Q. Thank you.

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

18 JUDGE PRIDGIN: 655 has been offered. Any  
19 objections?

20 MR. ZOBRIST: No objections.

21 JUDGE PRIDGIN: 655 is admitted.

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

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

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

3 JUDGE PRIDGIN: You may. Yes.

4 CROSS-EXAMINATION

5 QUESTIONS BY MR. OPITZ:

6 Q. Good morning.

7 A. Good morning.

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

10 A. I do.

11 Q. At Page 11 of your surrebuttal.

12 A. Yes. I am there.

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

16 A. Yes, it is.

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

21 A. That's correct.

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

24 A. It principally measures investor behavior.

25 And I will tell you why. All of the cases in which I

1 have been involved are based on market-based data.  
2 The same types of models, the same types of issues,  
3 the same types of market considerations that are at  
4 issue in this proceeding. All Commissions, of course,  
5 have discretion as to how they view that data. As to  
6 how they apply the models. As to the decisions that  
7 they arrive at, based on that data.

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

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

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

25 A. I'm sorry. Where are you?

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

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

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

8           MR. OPITZ:  Your Honor, may I approach?

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

12          THE WITNESS:  I appreciate that.

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

15          THE WITNESS:  Thank you.

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

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

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

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

9           A. I hope so. We will find out.

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

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

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

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



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

3 JUDGE PRIDGIN: Cross from Staff?

4 MR. THOMPSON: Thank you, Judge.

5 CROSS-EXAMINATION

6 QUESTIONS BY MR. THOMPSON:

7 Q. Good morning, Mr. Hevert.

8 A. Good morning, Mr. Thompson.

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

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

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

16 A. I am being compensated. Yes.

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

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

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

24 A. Reasonable expenses.

25 Q. Reasonable expenses. Okay. Is this the

1 first time you've testified on ROE this year?

2 A. It is not.

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

5 A. In 2017, one other time.

6 Q. One other time. Where was that?

7 A. Virginia.

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

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

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

13 A. More than 10.

14 Q. More than 20?

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

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

18 A. I was traveling quite a bit. Yes.

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

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

25 Q. And did you testify on any of those

1 occasions on behalf of a consumer advocate?

2 A. Same answer.

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

5 A. On rate of return issues?

6 Q. Yes, sir.

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

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

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

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

25 A. No.

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

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

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

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

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

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

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

24          A. That's a very good point. I think all of  
25          us tend to use the same types of models. And

1 differences that arise in our recommendations, arise  
2 from the application of the models, the assumptions we  
3 make, and how we interpret market data, both  
4 quantitative and qualitative market data.

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

8 A. That's correct.

9 **Q. So your investors wouldn't be very happy at**  
10 **8.65 percent, would they?**

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

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

20 A. I think what it means is that markets are  
21 always forward looking. And there are actually  
22 several parts to that question. I will try to answer  
23 this as succinctly as possible. But first, investors  
24 in markets are always forward looking. And if a  
25 return was authorized lower than that which was

1 requested, investors will understand that. They will  
2 look at it. They will look forward to what may be the  
3 next rate filing. That's one thing.

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

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

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

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

25 JUDGE PRIDGIN: Mr. Thompson, thank you.

1 Any bench questions? Mr. Chairman?

2 QUESTIONS FROM THE BENCH

3 QUESTIONS BY CHAIRMAN HALL:

4 Q. Good morning.

5 A. Good morning.

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

9 A. Yes, sir. I am.

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

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

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

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

25 A. I think several things likely could happen.

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

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

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

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

18 If they see a return of 8.65 percent for a  
19 company with the same risk as KCP&L, and they can go  
20 to -- I will give you the far end example. FPL, which  
21 recently was authorized a return of 10.55 percent. Of  
22 course, capital will flow from one to the other. Even  
23 if we were to look at North Carolina, and also South  
24 Carolina, which recently authorized returns of 9.9 and  
25 10.1 percent. Clearly, capital would flow from a



1 company with 8.65 to 9.9 and 10.1 and 10.55 percent.

2 **Q. Do you believe that there could be a credit**  
3 **downgrade?**

4 A. I am always reluctant to speak for the  
5 rating agencies. But having -- again, having spent  
6 part of my career raising capital and sitting across  
7 from the rating agencies, I think they would react  
8 very strongly. We don't know how they would react,  
9 because have never seen a return that low before.

10 But when you consider the fact that the  
11 regulatory environment, from Moody's perspective,  
12 represents about 50 percent of the weight that they  
13 applied in arriving at their ratings determinations, a  
14 return that low would have to put significant pressure  
15 on the rating. If only for the qualitative  
16 considerations.

17 Then you get to the quantitative  
18 considerations. The ability to generate cash flow  
19 with an 8.65 percent return. It's obviously very  
20 constrained. It would be very diluted. So I think  
21 the rating agencies would react. Yes.

22 **Q. Is it accurate that ROE's have been**  
23 **trending down for vertically integrated utilities,**  
24 **over the last 10 years?**

25 A. I think we have to parse the data a little

1 bit. If you were to look --

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

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

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

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

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

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

20 **Q. And how did the market react to that?**

21 A. We saw a couple of things. We saw the  
22 regulatory research associates, for example, react  
23 quite invidious. Quite negatively. Noting that the  
24 return was very low. The credit ratings did not  
25 change. But again, that's where we have to be sure

1 that we draw the distinction between debt and equity.  
2 It's so often hard to look at whether rating -- excuse  
3 me. Credit ratings change, and then infer from that,  
4 that there is no change in the cost of equity. But as  
5 I understand it, those were the reactions.

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

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

19 **Q. When interest rates increased in 2016?**

20 A. When interest rates hit their low, the  
21 30-year treasury yield hit its low of about 2.15  
22 percent in July of 2016.

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

25 A. Mid-2016. We have seen utilities

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

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

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

20           And the very dramatic acceleration in the  
21 increase in interest rates over the past five or six  
22 months. Let me just put that in perspective. From  
23 August through December, again, interest rates  
24 increased -- the 30-year treasury increased by about  
25 85 basis points.

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

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

13           A. You know, I had seen that from the March  
14 2015 Moody's report. I don't know that Moody's ever  
15 drew a line from one to another in that report. What  
16 Moody's did note in that report was that -- and that  
17 was in March of 2015, I believe. That's when that  
18 report came out.

19           **Q. That is correct.**

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

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

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

9           A. Yes, I did.

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

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

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

17          A. Yes, sir.

18          **Q. And that would be a break from prior  
19 Commission treatment on that issue, since at least  
20 2010; is that correct?**

21          A. That's my understanding. Yes.

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

24          A. That's a great question. To me, the issue  
25 of the -- setting the company-specific capital

1 structure by reference to the parent company, the  
2 consolidated capital structure, works. The  
3 consolidated capital structure works when it is  
4 reasonably representative of how the operating utility  
5 will finance itself. And it is consistent with  
6 industry practice.

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

10 **Q. By difference, do you mean numerically?**

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

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

23 Then I think the operating capital  
24 structure is very appropriate. It is the one, after  
25 all, that is supporting the assets that are part of

1 the rate base that are supplying service. So my view  
2 is that when the consolidated capital structure is  
3 consistent with the operating company and is  
4 consistent with industry practice, then there is  
5 really not much of a difference.

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

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

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



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

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

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

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

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

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

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

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

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

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

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

1 I think it does provide important protections for rate  
2 payers.

3 CHAIRMAN HALL: No further questions.

4 Thank you.

5 THE WITNESS: Thank you.

6 COMMISSIONER STOLL: No questions. Thank  
7 you.

8 JUDGE PRIDGIN: Mr. Kenney?

9 COMMISSIONER: Thank you.

10 QUESTIONS FROM THE BENCH

11 QUESTIONS BY COMMISSIONER KENNEY:

12 Q. Good morning.

13 A. Good morning.

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

20 A. Right.

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

23 A. No. It has generally stayed about the  
24 same. If we look over the past two years, it has  
25 generally stayed the same. We have seen a couple of

1 returns that are somewhat higher. I mentioned Florida  
2 at 10.55, South Carolina at 10.1, and North Carolina  
3 9.9. So we have seen a couple of data points higher.

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

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

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

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

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

21 A. Over four years?

22 **Q. Well, since 2013.**

23 A. Since 2013, I --

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

25 A. Yeah, it was.

1 Q. Page 4 of your surrebuttal.

2 A. Yeah. Let me look. It's probably in the  
3 range of about 70 cases. The 2015, the average was  
4 about 9.75. In 2016, 9.77. So about the same over  
5 '15 and '16.

6 Q. So it has dropped down a little bit from  
7 '13 and '14?

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

10 MR. KENNEY: Thank you, very much.

11 JUDGE PRIDGIN: Mr. Rupp.

12 EXAMINATION

13 QUESTIONS BY COMMISSIONER RUPP:

14 Q. Good morning.

15 A. Good morning.

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

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

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

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

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

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

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

25          **Q.    And the ROE the company is currently**

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

3             A.    I can't recall.

4             **Q.    Was it higher or lower?**

5             A.    It was higher.

6             **Q.    It was higher?**

7             A.    Yes.

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

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

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

23            A.    Because we are competing still with other  
24    companies. Other companies have FAC's. Other  
25    companies have rate mechanisms in place. Other

1 companies have returns that on average are between  
2 9.75 and 8.75 percent over the past few years. Always  
3 competing for capital with other companies. So it is  
4 important to keep that in mind.

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

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

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

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

25 **Q. So if the interest rates are rising, what**



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

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

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

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

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

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

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

15 A. I think -- well, just to go back to the  
16 premise. The premise is that when interest rates are  
17 low -- again, let's go back to June and July 2016.  
18 Shortly after the Brexit vote, for example, when a  
19 30-year treasury hit 2.15 percent. It was so low that  
20 people were willing to take on equity risk in order to  
21 get some yield. Something better than 2.15 percent.

22 So they would go into dividend paying  
23 stocks. Consumer staples. Utilities. They did so,  
24 and really increased the valuation. So for example,  
25 whereas utilities would normally trade at a price to

1 earnings multiple discount of say 15 percent to the  
2 market, now they are trading at a premium of 20  
3 percent to the market.

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

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

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

22 A. You would mean the ROE's are going up. As  
23 the prices start to fall; it means that people are  
24 discounting them at a higher rate. They are expecting  
25 a higher return. So as the prices start to fall, it

1 means that the return that is being required is going  
2 up. And then that would be consistent with the  
3 increase in interest rates.

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

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

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

25 On the other hand, it simply is a fact that

1 returns that are authorized represent returns that are  
2 available to investors elsewhere. So that's my  
3 understanding of why this commission would set a zone  
4 of reasonableness by reference to returns that are  
5 available in other jurisdictions. It just makes sense  
6 that if there is an opportunity to invest elsewhere at  
7 a higher return, investors will go there.

8 **Q. So someone offered in their opening**  
9 **testimony the State of Kansas Commission was granted**  
10 **at 9.3 percent, and why should we be any different**  
11 **than the neighbors that share that? Can you comment**  
12 **on why, if we are not looking at what other**  
13 **jurisdictions are doing, refute that we should be at**  
14 **9.3 percent because Kansas is?**

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

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

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

3 A. Looking at price performance relative to  
4 authorized returns?

5 Q. You know if investors can invest in  
6 Florida.

7 A. Uh-huh.

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

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

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

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

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

4           **Q.    There you go.  There you go?**

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

6           JUDGE PRIDGIN:  Thank you.  Commissioner  
7    Coleman?

8           COMMISSIONER COLEMAN:  No.

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

11          MR. WOODSMALL:  Yes.  Very quickly.

12                                RECROSS EXAMINATION

13    QUESTIONS BY MR. WOODSMALL:

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

18          A.    I do.

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

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

23           **Q.    Page 11.**

24          A.    Yes.  I see that.  Thank you.

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

1 changes, 75 percent of them were upgrades. In 2014,  
2 97 percent were upgrades. 2015, 70 percent were  
3 upgrades. Do you recall that?

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

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

13 A. Sure. But let's just be sure. I think we  
14 have all agreed that interest rates changed over that  
15 time period. There is a corresponding change in  
16 returns. Again, when we look at the more recent time  
17 period, even Mr. Gorman's data will tell you from  
18 2015, 2016, the authorized returns have remained about  
19 the same.

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

23 A. I do.

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



1 9.5; is that correct?

2 A. Yes. That's right.

3 Q. And the Kansas Commission a 9.3 ROE?

4 A. That's correct.

5 Q. Do you also understand that KCP&L has  
6 issued debt and equity over the last year; is that  
7 correct?

8 A. When you say KCP&L has issued equity, what  
9 do you mean by that?

10 Q. I'm sorry. GPE.

11 A. Yes. I'm aware of that.

12 Q. And that was done primarily to finance the  
13 Westar Acquisition?

14 A. The equity issuance?

15 Q. Yes.

16 A. Yes. I understand that.

17 Q. So they were able to attract capital for  
18 that purpose, at those ROE's?

19 A. Those were the prevailing ROE's. But I  
20 will say it one more time, markets are forward  
21 looking.

22 Q. Okay. Finally, you were asked some  
23 questions by Commission Rupp. He was talking about a  
24 comparison to Kansas. You mentioned that the flip  
25 side of the coin is a comparison to Florida. Do you

1 **recall that?**

2 A. I do.

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

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

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

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

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

13 A. As a single entity.

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

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

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

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

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

1 MR. OPITZ: Briefly, Judge.

2 RECROSS EXAMINATION

3 QUESTIONS BY MR. OPITZ:

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

7 A. I do. Yes.

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

11 A. That's right.

12 Q. But you did offer testimony in that case?

13 A. I did. Yes.

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

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

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

23 JUDGE PRIDGIN: Alright.

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

25 JUDGE PRIDGIN: Any objections?

1 MR. THOMPSON: Staff objects.

2 JUDGE PRIDGIN: On what grounds?

3 MR. THOMPSON: Relevance.

4 JUDGE PRIDGIN: Overruled.

5 MR. OPITZ: Thank you, Judge.

6 JUDGE PRIDGIN: Cross from Staff?

7 MR. THOMPSON: No questions. Thank you.

8 JUDGE PRIDGIN: Redirect?

9 MR. ZOBRIST: Just briefly, Judge.

10 REDIRECT EXAMINATION

11 QUESTIONS BY MR. ZOBRIST:

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

15 A. Yes.

16 Q. What were the ranges of your risk premium?

17 A. In my rebuttal testimony, the range of my  
18 risk premium estimate was -- I looked at it a couple  
19 different ways. But for settled-only cases, it was  
20 9.81 percent to 10.28 percent. And for fully  
21 litigated cases, it was 10.12 percent to 10.41  
22 percent.

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

1 A. Yes.

2 Q. Did you testify in that case?

3 A. I did.

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

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

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

11 A. Yes.

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

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

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

19 A. Yes. That's correct.

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

24 A. Yes. That's right.

25 Q. And those are national averages of all

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

3 A. Yes. For vertically integrated companies.

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

5 Thank you.

6 JUDGE PRIDGIN: Commissioner Rupp?

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

9 FURTHER BENCH QUESTIONS

10 QUESTIONS BY CHAIRMAN RUPP:

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

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

22 **Q. What year was that?**

23 A. 2012 time frame.

24 COMMISSIONER RUPP: Thank you. That's all.

25 JUDGE PRIDGIN: Any recross, based on those

1 bench questions? Redirect?

2 MR. ZOBRIST: No questions, Judge.

3 JUDGE PRIDGIN: Thank you. Excuse me, Mr.

4 Hevert, thank you very much.

5 THE WITNESS: Thank you.

6 JUDGE PRIDGIN: You may step down.

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

8 JUDGE PRIDGIN: Any objections? You can be  
9 excused. Thank you very much. It looks like the next  
10 witness is Mr. Bryant. We will see how long Mr.

11 Bryant's testimony goes, and try not to break in the  
12 middle of a witness. But we will see how long this  
13 goes. If need-be, we may need to take a break around  
14 10:30 or so. We'll see how long this testimony takes.  
15 Mr. Bryant, if you will come forward to be sworn,  
16 please, sir.

17 \* \* \* \* \*

18 KEVIN BRYANT,  
19 of lawful age, produced, sworn and says:

20 DIRECT EXAMINATION

21 QUESTIONS BY MR. ZOBRIST:

22 Q. Good morning.

23 A. Good morning, Mr. Zobrist.

24 Q. Please state your name.

25 A. Kevin Bryant.

1 Q. And where are you employed?

2 A. I am employed at KCP&L as a senior  
3 vice-president and chief financial officer.

4 Q. And Mr. Bryant, did you prepare, in this  
5 case, direct testimony, rebuttal testimony, and  
6 surrebuttal testimony?

7 A. I did.

8 Q. Do you have any corrections to the answers  
9 that were set forth in those three exhibits?

10 A. I do not.

11 Q. And those have been marked as Exhibits 106,  
12 107, and 108; is that correct?

13 A. That is correct.

14 Q. If I were to ask you those questions, would  
15 your answers be set forth in those three exhibits?

16 A. Yes, sir.

17 Q. Okay.

18 MR. ZOBRIST: Judge, I have no further  
19 questions. And I move the admission of Exhibits 106,  
20 107, and 108.

21 JUDGE PRIDGIN: Any objections? Hearing  
22 none, Exhibits 106, 107, and 108 are admitted into  
23 evidence.

24 MR. ZOBRIST: And I tender Mr. Bryant for  
25 cross-examination.



1 JUDGE PRIDGIN: Mr. Zobrist, thank you.

2 Cross-examination, MECG?

3 MR. WOODSMALL: No questions.

4 JUDGE PRIDGIN: Public Council?

5 MR. OPITZ: No questions, Judge.

6 JUDGE PRIDGIN: Staff?

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

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

11 CHAIRMAN HALL: I think just a few.

12 QUESTIONS FROM THE BENCH

13 QUESTIONS BY CHAIRMAN HALL:

14 Q. Good morning.

15 A. Good morning, Chairman.

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

20 A. Sure.

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

1 customers from activities such as the Westar  
2 acquisition.

3 A. Sure.

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

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

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

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

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

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

6           **Q.    Let's be specific to the Westar**  
7 **acquisition.**

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

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

20           A.    With this specific transaction, as  
21 financed?

22           **Q.    Yes.**

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

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

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

9 **Q. Has KCP&L had any difficulty attracting**  
10 **capital, either debt or equity?**

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

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

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

1 **side?**

2 A. Not that I'm aware of.

3 **Q. Is that calculation even possible?**

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

7 **Q. Yes, I am.**

8 A. I think it's possible.

9 **Q. So how would you go about doing that?**

10 **First, has that calculation been done? If you are**  
11 **aware?**

12 A. Not that I'm aware of.

13 **Q. How would you do that calculation?**

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

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

23 A. Correct.

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

1     **reduction?**

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

9             You will see that historically Great Plains  
10    has traded at a discount to its peers on a  
11    price-earnings multiple basis.  So for example, in the  
12    2015 and 2016 time frame you saw price earning  
13    multiples with the stock price as a multiple of the  
14    utility's earning per share in the 17 to 18 times  
15    range.

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

23            CHAIRMAN HALL:  No further questions.

24    Thank you.

25            THE WITNESS:  Thank you.

1 COMMISSIONER STOLL: No questions.

2 QUESTIONS FROM THE BENCH

3 QUESTIONS BY COMMISSIONER RUPP:

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

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

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

24 A. And you are talking to the difference  
25 between the utility capital structure and the holding

1 company?

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

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

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

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



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

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

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

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

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

20 A. Sure.

21 COMMISSIONER RUPP: Thank you.

22 JUDGE PRIDGIN: Commissioner Coleman, any  
23 questions?

24 COMMISSIONER COLEMAN: No.

25 JUDGE PRIDGIN: Any recross, based on bench

1 questions?

2 MR. WOODSMALL: Briefly, Your Honor.

3 RECROSS EXAMINATION

4 QUESTIONS BY MR. WOODSMALL:

5 Q. Good morning, sir.

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

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

11 A. The cost of debt increases as ROE  
12 decreases?

13 Q. Yes.

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

17 Q. Okay. And again --

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

20 Q. Sure. But there is a correlation?

21 A. Absolutely.

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

25 A. That's correct.

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

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

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

7 A. Yes, sir.

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

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

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

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

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

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

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

1     **payers?**

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

5             **Q.    Okay.**

6             MR. WOODSMALL:  No further questions.  
7    Thank you.

8             JUDGE PRIDGIN:  Thank you.  OPC?

9             MR. OPITZ:  No, Thank you, Judge.

10            JUDGE PRIDGIN:  Staff?

11            MR. THOMPSON:  Thank you, Judge.

12                                RECROSS EXAMINATION

13    QUESTIONS BY MR. THOMPSON:

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

16            A.    Yes, sir.

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

20            A.    Yes, sir.

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

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

25            **Q.    Would you be surprised if I told you that**

1 **Staff valued the capital structure issue at \$2.2**  
2 **million?**

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

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

7 A. I trust that calculation is correct.

8 **Q. Thank you.**

9 MR. THOMPSON: No further questions.

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

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

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

17 MR. ZOBRIST: Pardon me.

18 REDIRECT EXAMINATION

19 QUESTIONS BY MR. ZOBRIST:

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

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

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

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

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

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

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

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

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

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

19 A. That's correct.

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

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

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

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

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

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

15 MR. ZOBRIST: No further questions, Judge.

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

18 THE WITNESS: Thank you, sir.

19 JUDGE PRIDGIN: And this looks to be a  
20 convenient time to break. I am showing the clock at  
21 10:25. Let us take 15 minutes. We will then go on  
22 with Mr. Murray at 10:40. We are off the record.

23 (WHEREIN, a brief recess was taken.)

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

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

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

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

17 MR. STEINER: That's correct.

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

21 \* \* \* \* \*

22 DAVID MURRAY,  
23 of lawful age, produced, sworn and examined says:

24 DIRECT EXAMINATION

25 QUESTIONS BY MR. THOMPSON:



1 Q. Good morning, Mr. Murray.

2 A. Good morning.

3 Q. How are you employed?

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

7 Q. Mr. Murray, are you the same David Murray  
8 that prepared or caused to be prepared a contribution  
9 to Staff's direct revenue requirement report, I think  
10 marked as Exhibit 200, rebuttal testimony marked as  
11 Exhibit 220, and surrebuttal testimony marked as  
12 221-HC?

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

15 Q. So you did not contribute to the report?

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

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

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

23 Q. And that's your only correction?

24 A. Yes.

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

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

3 A. Yes.

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

8 A. Yes.

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

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

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

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

17 MR. OPITZ: No cross, Judge.

18 JUDGE PRIDGIN: MECG?

19 MR. WOODSMALL: No, thank you.

20 JUDGE PRIDGIN: Kansas City Power & Light.

21 MR. ZOBRIST: Thank you, Judge.

22 CROSS-EXAMINATION

23 QUESTIONS BY MR. ZOBRIST:

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

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

3 A. Yes.

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

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

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

13 A. That is correct.

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

16 A. Yes.

17 Q. But it does not endorse the current capital  
18 structure, as the end of the true-up period, December  
19 31, 2016; is that correct?

20 A. Yes.

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

1 of 2016?

2 A. Yes.

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

5 A. That is correct.

6 Q. And if the Commission were to use Great  
7 Plains Energy's capital structure, as it exists today,  
8 that would result in a common equity of approximately  
9 54 percent, correct?

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

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

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

17 Q. You think that it has?

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

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

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

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

15          A.    Yes.

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

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

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

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

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

4 A. That sounds correct.

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

7 JUDGE PRIDGIN: You may.

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

14 A. I do.

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

18 A. That is correct.

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

22 A. Yes.

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

25 A. I am.

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

6           A. Yes.

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

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

11          JUDGE PRIDGIN: Thank you.

12          MR. ZOBRIST: And the KCP&L GMO is Exhibit  
13 151.

14          JUDGE PRIDGIN: Thank you. Sorry to  
15 interrupt.

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

19          A. Yes.

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

24          A. There is.

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

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

4 A. That is correct.

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

8 A. That is correct.

9 Q. And by contrast with GMO, which is Exhibit  
10 151, at the top of Page 5 it says, competitive  
11 positions as satisfactory?

12 A. Yes.

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

15 A. I do.

16 Q. What is an anchor credit rating?

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



1 profile.

2 Q. And the anchor rating for KCP&L on Exhibit  
3 150 is A-minus. And for GMO on Exhibit 151 it is  
4 Triple B, correct?

5 A. That is correct.

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

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

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

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

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

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

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

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

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

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

5 A. That is correct.

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

10 A. That is correct.

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

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

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

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

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

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

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

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

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

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

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

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

12 A. If you could show it to me.

13 Q. Sure.

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

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

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

20 A. That is exactly correct.

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

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

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

3 A. Yes.

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

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

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

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

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

1 151?

2 A. I'm on there.

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

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

11 Q. And on the next page, the Commission  
12 declined to use that, correct? Looking at Paragraph  
13 419.

14 A. That is correct.

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

20 A. That is what it says. Correct.

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

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

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

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

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

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

15 Q. Let me just show you again excerpts from  
16 that report and order, which was issued April 12th,  
17 2011. Mr. Murray, if you look at Paragraph 360, which  
18 is on Page 125 of this excerpt, it states, in his  
19 true-up rebuttal, Mr. Murray expanded on his theory  
20 suggesting two alternative figures, based upon a  
21 hypothetical assignment of \$250 million at 2.75  
22 percent, senior notes that Great Plains Energy issued  
23 solely for the benefit of GMO in August 2010, correct?

24 A. That is an accurate reading. Yes.

25 Q. And that proposal was rejected by the

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

3 A. That is correct.

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

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

13 Q. Right.

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

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

22 A. Yes.

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



1 is that correct?

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

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

15 A. Yes.

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

20 A. That is what it says.

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

1 **rebuttal. That is acceptable to Staff; is that**  
2 **correct?**

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

5 **Q. Thank you.**

6 MR. ZOBRIST: Judge, nothing further.

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

9 QUESTIONS FROM THE BENCH

10 QUESTIONS BY CHAIRMAN HALL:

11 **Q. Good morning.**

12 A. Good morning.

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

18 A. Yes.

19 **Q. Why do you believe that it was obvious?**

20 A. There's a lot of complexity and history to  
21 Great Plains Energy, and after it acquired GMO. But  
22 GPE had to issue debt on behalf of GMO, and then  
23 through affiliate loan transactions. Some of those  
24 debt issuances were not consistent with what you would  
25 expect for a debt issuance that would have occurred at

1 the subsidiary level with a regulated utility, such as  
2 doing at least a 10-year tenor.

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

10 **Q. Let me stop you for a second.**

11 A. I'm sorry.

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

15 A. 2011 and 2012.

16 **Q. Okay. Keep going?**

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

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

1 **frame?**

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

6 **Q. Okay. So after the 2011 and 2012 time**  
7 **frame, do you continue to believe that GPE was**  
8 **financially managing two subsidiaries to achieve the**  
9 **lowest overall capital cost for GPE as a consolidated**  
10 **entity, or are you talking specifically about that**  
11 **2011 and 2012 time frame?**

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

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

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

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

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

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

25           **Q. And to be perfectly clear, there is nothing**

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

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

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

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

1 KCP&L, versus GMO.

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

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

17 And so my opinion, and I believe Staff as a  
18 whole, is that is a subsidy that you may not be able  
19 to directly measure, but it was a real additional cash  
20 flow that Kansas City Power & Light paid to try to  
21 preserve Kansas City Power & Light's credit rating.

22 And at the same time during that comprehensive energy  
23 plan, when they were providing additional cash flow,  
24 they made the acquisition of Aquila, which had some  
25 significant financial effects.

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

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

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

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



1 A. Yes.

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

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

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

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

22 A. I am just going to be quite frank. I think  
23 this is over my expertise level. I mean there are  
24 many things that would have to go into place that  
25 would require legal and structural, and even

1 governance types of requirements, to achieve this.

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

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

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

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

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

1 2013 or 2014. I think maybe just to give an  
2 indication of what they could be if they didn't put  
3 them under the family group of companies.

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

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

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

23 With Missouri American, yes. I think that  
24 is one of the clearest situations where the company is  
25 not even issuing its own debt, and hasn't done so

1 since 2006. So we recommend American Water's capital  
2 structure.

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

8 **Q. And Ameren?**

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

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

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

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

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

1 A. It would increase the revenue requirement.

2 It depends on --

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

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

14 Q. Where is that in your testimony?

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

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

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

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

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

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

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

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

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

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

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

14 A. Yes.

15 Q. I think I got it. Thank you.

16 A. Thanks.

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

20 QUESTIONS FROM THE BENCH

21 QUESTIONS BY COMMISSIONER RUPP:

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

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

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

18 And at that time, Great Plains Energy was  
19 trying to manage its capital costs to the lowest point  
20 possible to go ahead and hopefully successfully  
21 execute on its plan to restore GMO to financial  
22 stability. Clearly, that capital cost was higher than  
23 what was reasonable for Kansas City Power & Light.  
24 Kansas City Power & Light, it had only been about a  
25 year or two since they acquired GMO. So you didn't



1 have as much uncertainty, as far as the years that  
2 have gone past, as to what KCP&L could have looked  
3 like, if it wasn't associated with Great Plains  
4 Energy. Now you have about eight or nine years.

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

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

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

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

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

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

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

23           A. No. Not in general. No.

24           COMMISSIONER RUPP: Thank you.

25           JUDGE PRIDGIN: Commissioner Coleman?

1 COMMISSIONER COLEMAN: Nothing.

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

4 MR. OPITZ: No thank you.

5 JUDGE PRIDGIN: MECG?

6 MR. WOODSMALL: No questions.

7 JUDGE PRIDGIN: KCP&L?

8 RECROSS EXAMINATION

9 QUESTIONS BY MR. ZOBRIST:

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

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

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

18 A. It did.

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

21 A. That's correct.

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

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

1 definitely.

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

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

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

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

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

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

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

1 Missouri Operations Company, correct?

2 A. Yes.

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

6 A. It was.

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

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

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

25 A. That's correct.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

20 A. Early on. Not towards the end.

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

22 Thank you.

23 JUDGE PRIDGIN: Any redirect?

24 MR. THOMPSON: Thank you, Judge.

25 REDIRECT EXAMINATION

1 QUESTIONS BY MR. THOMPSON:

2 Q. Mr. Murray, do you have up there Exhibit  
3 150 that Mr. Zobrist handed you a copy of, and which  
4 was admitted?

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

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

9 A. It is.

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

13 A. Yes.

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

16 A. Yes.

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

19 A. The outlook on KCP&L reflects the outlook  
20 on parent Great Plains Energy, Incorporated. The  
21 negative outlook on GPE and its subsidiaries reflects  
22 the potential for lower ratings if GPE's financial  
23 risk profile, which will deteriorate due to the  
24 financing used in the proposed acquisition of Westar  
25 Energy does not improve after the transaction closes,



1 funds from operations to total debt, is well over 13  
2 percent after 2018.

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

7 MR. ZOBRIST: Objection. Leading and  
8 suggestive.

9 JUDGE PRIDGIN: Overruled.

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

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

24 A. Yes.

25 **Q. Thank you.**

1 MR. THOMPSON: I have no further questions.

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

8 MR. THOMPSON: I apologize, Judge.

9 JUDGE PRIDGIN: Thank you.

10 MR. THOMPSON: I'll do that.

11 JUDGE PRIDGIN: Thank you.

12 \* \* \* \* \*

13 CHARLES HYNEMAN,  
14 of lawful age, produced, sworn and says:

15 DIRECT EXAMINATION

16 QUESTIONS BY MR. OPITZ:

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

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

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

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

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

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

2 A. Yes, I am.

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

5 A. I do not.

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

9 A. Yes.

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

12 A. Yes.

13 MR. OPITZ: With that, Judge, Public  
14 Council moves to enter Exhibits 302, 303, 304-HC, and  
15 304-NP into evidence, and tenders the witness for  
16 cross-examination.

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

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

22 JUDGE PRIDGIN: MECG?

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

25 JUDGE PRIDGIN: Thank you. Kansas City

1 Power & Light?

2 MR. ZOBRIST: No questions, Judge.

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

5 QUESTIONS FROM THE BENCH

6 QUESTIONS BY CHAIRMAN HALL:

7 Q. Good morning.

8 A. Good morning.

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

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

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

1 **sort that you would contend constituted poor**  
2 **management.**

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

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

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

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

22 You continue to see KCP&L taking regulated  
23 transmission revenues. And moving that out of the  
24 case. Not giving credit to the utility. So it's more  
25 of a mindset and an attitude than I could contribute

1 any specific dollar amount in earnings to a specific  
2 action.

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

5 A. Yes. And I think over a long history. In  
6 fact, Union Electric filed witness testimony in a 2007  
7 case, and it was very praising of the Commission and  
8 the regulatory environment, which the Commission  
9 created, which allowed Ameren UE to have very good  
10 earnings during that time. And that was during the  
11 2006 time frame. And my research indicates that ROA,  
12 even in 2012, found that the Missouri regulatory  
13 environment was right in the middle of all  
14 commissions. That continues today, through 2016. So  
15 the Missouri commission is right where it needs to be,  
16 as far as regulatory utilities. It is not too  
17 excessively pro-shareholder, or pro consumer.

18 CHAIRMAN HALL: Thank you.

19 JUDGE PRIDGIN: Any questions?

20 COMMISSIONER COLEMAN: Nothing.

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

23 MR. THOMPSON: No thank you, Judge.

24 JUDGE PRIDGIN: MECG?

25 MR. WOODSMALL: Very briefly, Your Honor.

1 RE CROSS EXAMINATION

2 QUESTIONS BY MR. WOODSMALL:

3 Q. Good morning, Mr. Hyneman.

4 A. Good morning.

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

8 A. Yes.

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

11 A. In the last rate case?

12 Q. Uh-huh.

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

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

17 A. I don't remember specifically.

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

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

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

1 **recall that?**

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

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

5 A. Yes.

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

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

14 MR. WOODSMALL: No further questions.

15 Thank you.

16 JUDGE PRIDGIN: KCP&L?

17 MR. ZOBRIST: No questions, Judge.

18 JUDGE PRIDGIN: Redirect?

19 MR. OPITZ: No thank you, Judge.

20 JUDGE PRIDGIN: Thank you, Mr. Hyneman.

21 Thank you very much. You may step down. I believe

22 Mr. Gorman will be our last witness for the day.

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

25 MR. ZOBRIST: Judge, could we take just



1 five minutes so I can get reorganized?

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

4 MR. ZOBRIST: Great. Thank you.

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

7 (WHEREIN, a brief recess was taken.)

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

11 \* \* \* \* \*

12 MICHAEL GORMAN,  
13 of lawful age, produced, sworn and says:

14 DIRECT EXAMINATION

15 QUESTIONS BY MR. WOODSMALL:

16 Q. Good morning, Mr. Gorman.

17 A. Good morning.

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

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

22 Q. And who retained you for this case?

23 A. The Midwest Energy Consumers' Group.

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

1     **rebuttal testimony, and 652, surrebuttal testimony?**

2             A.    I did.

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

5             A.    It is.

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

8             A.    Yes.

9             **Q.    Do you have any corrections to make?**

10            A.    I do not.

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

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

17            MR. OPITZ:  No.  Thank you, Judge.

18            JUDGE PRIDGIN:  Staff?

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

20            JUDGE PRIDGIN:  KCP&L?

21            MR. ZOBRIST:  Thank you, Judge.

22                                CROSS-EXAMINATION

23     QUESTIONS BY MR. ZOBRIST:

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

1 A. Yes.

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

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

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

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

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

15 MR. WOODSMALL: Large commercial and  
16 industrial customers?

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

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

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

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

1 Light.

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

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

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

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

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

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

17 Q. Ah, I see.

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

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

23 A. Well, I am testifying on behalf of MEECG,  
24 which I understand to represent the interests of  
25 industrial customers that purchase electricity service

1 from KCP&L. So MECG is the entity. And industrial  
2 customers are who MECG is advocating on behalf of.

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

5 A. Other than MECG. That's correct.

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

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

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

16 A. Are you referencing my testimony?

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

19 A. That is correct.

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

25 A. Correct.

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

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

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

12          A.    It is.

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

16          A.    Growth rate sources.  Correct.

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

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

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

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

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

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

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

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

12 A. It does.

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

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

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

19 A. I am.

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

25 A. Right. Which the compensation should be

1 reasonable consistent with the return an investor  
2 could earn in another investment of comparable parts.

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

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

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

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

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

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

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

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



1 6 percent growth rate. But if that's accurate, then  
2 your statement is correct.

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

6 A. Correct.

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

10 A. That is correct.

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

13 A. Correct.

14 Q. And as I understand it, your direct study  
15 was done as of data that was available on October  
16 28th, 2016?

17 A. Yes.

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

20 A. That's correct.

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

24 A. That's right. As Mr. Hevert noted, there  
25 were events that went on mid-year 2016, which impacted

1 security evaluations. And I recognized that. I  
2 wanted to update my analysis to present a more  
3 normalized review of what capital market costs are.  
4 So that was the purpose for the update, and the  
5 results of the update were in line with what I  
6 expected them to be.

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

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

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

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

1 A. No. I was clearing my throat.

2 Q. On Page 29 of your rebuttal, beginning on  
3 Line 4, you state, as shown in these studies, and I  
4 presume your updated studies, they were based on stock  
5 prices for the 13-week period ending December 16th,  
6 2016 --

7 A. Yes --

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

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

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

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

25 Q. And the updated analysis growth rates in

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

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

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

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

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

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

25            A.     It did.  Again, the market was highly

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

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

9 A. Yes. Yes. The Federal Reserve is still  
10 expected to increase the Federal funds rates during  
11 2017. However, there are some factors that may impact  
12 their outlooks for the U.S. economy. Maybe not  
13 another increase, or a series of increases might be  
14 appropriate this year.

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

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

23 **Q. And right now it is at 0.75?**

24 A. Yes. So that would indicate either a  
25 two-notch increase. Generally, the Fed has been going

1 up by about 25 basis points every time they increase  
2 it. So that would suggest that there is an  
3 expectation that the Fed may increase Federal funds  
4 rate twice this year.

5 **Q. So that would put it at 1.25?**

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

8 **Q. Mr. Gorman, I put in front of you Exhibit**  
9 **153, which is the Federal Reserve Press Release of**  
10 **February 1, 2017. So just last Wednesday. I take it**  
11 **you've had a chance to view this online?**

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

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

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

20 JUDGE PRIDGIN: Has 152 been offered and  
21 admitted?

22 MR. ZOBRIST: No.

23 JUDGE PRIDGIN: Thank you. You can  
24 continue.

25 MR. ZOBRIST: I actually had it marked, and

1 was going to talk to Mr. Murray. But he corrected his  
2 testimony, and I had nothing to present to him.

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

5 MR. ZOBRIST: That's alright.

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

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

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

22 A. It is.

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

1 continued to expand at a moderate pace?

2 A. Correct.

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

6 A. Yes.

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

9 A. Correct.

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

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

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

17 A. Yes.

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

21 A. Yes.

22 MR. ZOBRIST: Judge, I offer Exhibit 153.

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

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



1 last Friday the Bureau of Labor Statistics announced  
2 that the non-farm payroll employment increased by  
3 227,000 in January?

4 A. I will accept that, subject to check.

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

7 A. That is my understanding. Yes.

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

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

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

21 A. For that quarter, yes.

22 Q. The third quarter of 2016?

23 A. Correct.

24 Q. We don't yet have the statistics for the  
25 fourth quarter of 2016, do we?

1           A.   Well, we don't.  But the annual movement  
2   isn't level throughout the quarters.  So you can have  
3   one big quarter, followed by some smaller growth  
4   quarters.  Overall, the projections for real economic  
5   growth are around 2 to 2.5 percent.

6           **Q.   So generally speaking, looking at all these**  
7   **trends we see higher interest rates and gross domestic**  
8   **product growth, which indicate that the financial**  
9   **community sees strong growth prospects throughout the**  
10   **economy today?**

11          A.   I disagree with your statement that we have  
12   high interest rates.  We don't have high interest  
13   rates today.

14          **Q.   Pardon me.  I meant to say, higher.  Higher**  
15   **interest rates.**

16          A.   We don't have higher interest rates today  
17   either.  The interest rates for utility bonds today  
18   are comparable to what they were doing KCP&L's last  
19   rate case.  They are comparable to what they were in  
20   2015.  They are higher than they were in July of this  
21   year.  But again, they were reduced in July of this  
22   year, because of the international event that caused  
23   interest rates to drop.  They have recovered since  
24   then.  But interest rates are not higher today than  
25   they have been over the last couple years.

1           **Q. They are higher today than when you filed**  
2 **your direct testimony, Mr. Gorman; isn't that true?**

3           A. Yes. Because most interest rates were  
4 impacted by the events in mid-2016.

5           **Q. And based upon those developments, it is**  
6 **reasonable therefor to expect higher dividend yields**  
7 **and higher growth rates, correct?**

8           A. Well, the higher dividend yields are  
9 reflected in my updated DCF analysis. And that  
10 resulted in about a 10 basis point increase in my  
11 recommended range. Along with the growth rates that  
12 may have been impacted also.

13           **Q. Exactly. And those combined to increase**  
14 **the cost of equity, which is why your -- why the upper**  
15 **end of your ROE recommendation range went up 30 basis**  
16 **points?**

17           A. I would be clear that is only true with  
18 respect to the estimate of the cost of equity in July  
19 of 2016. If you would have compared it to DCF results  
20 for 2014 and 2015, the DCF results would not be  
21 higher. Interest rates were about -- well, were low  
22 in 2016, and they rose by the end of 2016. So  
23 interest rates went up by the end of 2016. But those  
24 interest rates are not higher than they were in 2014  
25 and 2015.

1 Q. Now let me ask you with regard to your  
2 constant growth DCF model. The recommendation of 9.0  
3 percent return on equity in your rebuttal reflects an  
4 increase from 8.8 percent of your direct, right?  
5 Twenty basis points?

6 A. Can you repeat that question?

7 Q. Yeah. The recommendation of 9.0 percent  
8 return on equity in your rebuttal, or the discounted  
9 cash flow constant growth model, was a 20-point  
10 increase from 8.8 percent in direct?

11 A. That's correct.

12 Q. And that's a result of the increase in your  
13 growth rate from 5.41 percent to 5.52 percent in  
14 rebuttal?

15 A. That, along with changing dividend yield.  
16 Yes. I think I may have mentioned that to be a 10  
17 basis point change before, and it was 20. I apologize  
18 for that.

19 Q. And your dividend yield was -- in your  
20 direct testimony, Schedule NPG-6, in Column 4, it was  
21 3.39 percent, correct?

22 A. My dividend yield?

23 Q. Yes.

24 A. Yes.

25 Q. And it's now in your rebuttal schedule,

1     **3.50 percent?**

2             A.    That's correct.

3             **Q.    I have a few questions on the alternative**  
4 **bond yield, plus risk premium analysis --**

5             A.    Can I comment quickly on that?  I mean  
6 that's the adjusted dividend yield.  So it reflects  
7 the dividend yield adjusted by the growth rate.  So  
8 it's not purely attributable to the stock price and  
9 the change in the observable yield.  As that column  
10 says, it is adjusted.  Adjusted by the growth rate.  
11 So that's the effect of both dividend yield and growth  
12 rate changes.

13            **Q.    Thank you.  Switching to the risk premium**  
14 **model.  You commented in I believe rebuttal, on Mr.**  
15 **Hevert's alternative bond yield plus risk premium**  
16 **analysis, correct?**

17            A.    I did.

18            **Q.    And you said that the alternative bond**  
19 **yield plus risk premium analysis that he used was a**  
20 **substantial improvement over his basic risk premium**  
21 **analysis, right?**

22            A.    Yes.  It still needs improvement, but it is  
23 much better than his non-adjusted one.

24            **Q.    But you liked it a lot better, because you**  
25 **said the basic one was simplistic, correct?**

1           A.    It's so simplistic, that it simply was not  
2 real.

3           **Q.    Thank you.  What you did is you took Mr.**  
4 **Hevert's alternative bond yield plus risk premium**  
5 **analysis and you did your analysis, correct?**

6           A.    I did.  I added another factor and adjusted  
7 the nominal yields to produce a real yield.

8           **Q.    Well, what you did is you stripped out his**  
9 **volatility index, correct?**

10          A.    And I removed his volatility index.  Yes.

11          **Q.    And you didn't put a volatility index in**  
12 **yourself?**

13          A.    Because the statistical analysis had  
14 stronger and more predictable regression parameters by  
15 removing it, than it did by retaining it.

16          **Q.    Well, did you think it was inappropriate to**  
17 **consider volatility of any kind in the risk premium?**

18          A.    It would be inappropriate to not  
19 distinguish the difference between general market  
20 volatility for higher risk investments, relative to  
21 utility stocks, versus the volatility of utility  
22 stocks themselves.  Mr. Hevert's volatility index  
23 reflects the volatility of the overall stock market.

24                    It's generally agreed by all witnesses in  
25 this case that utility stock investments are lower

1 risk, they are more predictable returns. So the  
2 volatility of the overall stock market is not an  
3 appropriate parameter for measuring an expected return  
4 on a lower risk and lower volatile investment like a  
5 utility stock.

6 **Q. Did you substitute a volatility factor that**  
7 **in your opinion is representative of the utility**  
8 **industry?**

9 A. I relied on the volatility of changes in  
10 real bond returns, as a substitute for volatility in  
11 utility securities. That was included in my analysis  
12 by adjusting the nominal utility bond yields by  
13 inflation factor to produce a real utility --

14 **Q. So the answer to my questions is no, that**  
15 **you did not insert your own volatility index? You**  
16 **relied upon other factors?**

17 A. No. My answer is what I just described. I  
18 may not have substituted a third parameter. But your  
19 question was whether or not there was a recognition of  
20 stock volatility. Or risk volatility at the analysis.  
21 The way I understood your question, the answer is,  
22 yes. It does reflect volatility. Because that  
23 volatility is captured by variations in the equity  
24 risk premium, relative to the changes in real bond  
25 yields.

1 Q. The answer to my question is yes or no.

2 Did you substitute a volatility factor that is  
3 representative of the utility industry?

4 A. I did in the form of the real bond yields.

5 Q. Now the conclusion that you came to, and I  
6 am looking at Page 22 of your rebuttal, is that based  
7 on the 30-year treasury yields and the spreads between  
8 the A-rated utility bonds and the treasury bonds, that  
9 a return on equity of 9.76 percent was the result?

10 A. Yeah. It was a measure of the market's  
11 evaluation of utility securities, versus those of  
12 other securities which are generally regarded as  
13 higher risk than that of the utility industry.

14 Q. And then you made a similar analysis of the  
15 treasury bond yield, and the spread between B Double A  
16 utility bonds to treasuries, correct?

17 A. Yes.

18 Q. And that return on equity estimate was 9.73  
19 percent?

20 A. Correct.

21 Q. And you concluded that the study you  
22 performed supported a return on equity of KCP&L of no  
23 higher than 9.75 percent, correct?

24 A. Based on Mr. Hevert's analysis. That was  
25 the result. However, my analysis indicated an



1 appropriate return on equity would be no higher than  
2 9.5 percent.

3 **Q. Well, but you took the alternative bond**  
4 **yield plus risk premium analysis that you viewed as a**  
5 **substantial improvement, and put in your own numbers,**  
6 **and then said it would get you to a return on equity**  
7 **of no higher than 9.75 percent, correct?**

8 A. I said it was a substantial improvement  
9 from the analysis Mr. Hevert performed. However, it  
10 still does not properly gauge the level of equity risk  
11 premium, based on the amount of investment risk of the  
12 utility securities. The correction I made was to  
13 simply remove an obvious factor that can explain  
14 changes in bond yields, relative to equity risk  
15 premiums.

16 And that's the outlook for changes in  
17 expected future inflation. If future inflation  
18 decreased by 1 percentage point, and it is going  
19 forward relative to the past, then you would expect a  
20 1 percentage point drop in the required return on  
21 equity, along with the 1 percentage point required  
22 return in utility bond yield, holding everything else  
23 constant.

24 Under Mr. Hevert's analysis, a drop of 1  
25 percentage point in bond yield due to a change in

1 inflation alone would equate to a higher equity risk  
2 premium, in his study. That simply has no economic  
3 logic in that conclusion. Inflation is both the  
4 equity return and the bond return.

5 So an improvement in his study is to at a  
6 minimum recognize that changes in nominal bond yields  
7 can equate to changes in inflation outlooks, but that  
8 change in inflation outlook would also equally change  
9 on a one-for-one basis the expected return on common  
10 equity.

11 **Q. The bottom line is, you took his model, and**  
12 **you ran your own figures through it, and you said it**  
13 **got to an ROE recommendation of no higher than 9.75**  
14 **percent, correct?**

15 A. Well, the bottom line is --

16 **Q. No. I would just like a yes or no answer.**  
17 **Is it 9.75 percent, Mr. Gorman?**

18 A. Well, that's not your question.

19 **Q. My question is, did your analysis, and I am**  
20 **quoting Page 22. I just want to see if you are still**  
21 **-- if you are moving off of what you said. The**  
22 **revised alternative, BYP risk premium study supports a**  
23 **return on equity for KCP&L no higher than 9.75**  
24 **percent. Is that your testimony?**

25 A. That's the way I describe it in my

1 testimony, and is my testimony. It's not your  
2 characterization though.

3 **Q. We can leave this topic. I just want to**  
4 **make sure that those two lines, you are not backing**  
5 **away from them. You are telling me that you are not?**

6 A. You need to read the full description of  
7 that analysis to understand the point I am making.  
8 The point I am making is --

9 **Q. No. No.**

10 MR. ZOBRIST: I object, Judge. I move to  
11 strike. I am simply trying to make certain that he is  
12 not moving off of what he has said on Pages 22, Lines  
13 12 and 13.

14 JUDGE PRIDGIN: That's sustained. You are  
15 trying to answer questions that aren't being asked.  
16 So I sustain that objection.

17 THE WITNESS: I apologize.

18 **Q. (BY MR. ZOBRIST) Mr. Gorman, let me move**  
19 **on to return on equities authorized by other public**  
20 **service commissions. In your direct testimony on Page**  
21 **5, you return to the Kansas Commission's decision that**  
22 **we have talked about here today, that was issued in**  
23 **2015 at a rate of 9.30 percent, correct?**

24 A. I'm sorry. What page?

25 **Q. Page 5 of your direct testimony, and then**

1 **Table 1 at Page 7.**

2 A. Yes.

3 **Q. Did you make any adjustments for the fact**  
4 **that in Kansas the Commission permits not only an**  
5 **energy cost adjustment, which is like our FCA in**  
6 **Missouri, I mean our FAC in Missouri. But also the**  
7 **transmission delivery charge?**

8 A. I did not. I am observing what the  
9 authorized return on equity was.

10 **Q. Okay. How much did the authorization of**  
11 **the transmission delivery charge permit KCP&L to**  
12 **recover in Kansas?**

13 A. I'm sorry. How much of the --

14 **Q. Are you familiar with the transmission**  
15 **delivery charge that the Commission approved in that**  
16 **2015 case?**

17 A. Just generally. I would have to review it  
18 to comment on specifics of it.

19 **Q. Do you recall that it permitted the company**  
20 **to recover \$33 million a year?**

21 A. Not as I sit here.

22 **Q. If you would accept that as true, wouldn't**  
23 **that require some kind of an accommodation or an**  
24 **adjustment to that 9.30 percent ROE?**

25 A. If it was a new regulatory mechanism, which

1 improved the likelihood that they were going to  
2 recover their cost of service, then I would recommend,  
3 or I would believe it would be appropriate to adjust  
4 the authorized return on equity.

5 Q. So if you took out that \$33 million a year,  
6 that could have brought the return on equity up to who  
7 knows, maybe 9.5 percent, correct?

8 A. Or no change at all.

9 Q. But you didn't consider that when you were  
10 analyzing the 9.3 percent, you just accepted it at  
11 face value?

12 A. I have already testified, yes, that is  
13 true.

14 Q. Now but you told this Commission that they  
15 should disregard the decision by the Wisconsin and  
16 Michigan Commissions because you think those returns  
17 on equity are too high, correct?

18 A. Correct.

19 Q. And you also told the Missouri Commission  
20 that it should ignore the return on equity granted by  
21 the Indiana Utility Regulatory Commission to the  
22 Indianapolis Power & Light, because it was too high?

23 A. I think there were factors underlying that  
24 decision that I thought resulted in a return on equity  
25 that I thought was not typical.

1           **Q. Now are you familiar that in Kansas there**  
2 **is also a property tax flow-through that permits ad**  
3 **valorem taxes to be flowed through either to increase**  
4 **rates or decrease rates that are 30-day basis?**

5           A. Indiana does have what they call rider  
6 mechanisms. I am not familiar with all of them. But  
7 I know they do have them.

8           **Q. Maybe I misspoke. I meant to say, Kansas.**  
9 **If I said, Indiana, I apologize. Let me rephrase my**  
10 **question. In Kansas, when you looked at the ROE of**  
11 **9.3 percent, did you consider the Kansas provision**  
12 **that allows ad valorem tax changes to be approved**  
13 **within 30 days of the filing?**

14          A. I did not look at their rider mechanisms or  
15 regulatory mechanisms. I was simply noting what the  
16 authorized return on equity was.

17          **Q. Now in your testimony you have referred to,**  
18 **on a number of occasions, data and analysis conducted**  
19 **by regulatory research associates; is that correct?**

20          A. Yes.

21          **Q. Mr. Gorman, will you tell me what I have**  
22 **marked that as? I think Exhibit 144.**

23          A. 155.

24          **Q. 155?**

25          A. Yes.

1 Q. Thank you.

2 JUDGE PRIDGIN: Did I miss 154? The press  
3 release is 153.

4 MR. ZOBRIST: I had marked that Bureau of  
5 Labor Statistics report, and I didn't have to put that  
6 in front of the witness. So I skipped another one.

7 JUDGE PRIDGIN: Thank you.

8 Q. (BY MR. ZOBRIST) Mr. Gorman, this is 155?

9 A. That's what is written.

10 Q. Thank you. And is this a copy of the  
11 Regulatory Research Associate's regulatory focus that  
12 was issued on January 18th, 2017?

13 A. Yes.

14 Q. Now I know we are running out of lunch hour  
15 here, so I will try to cut to the chase. If we go to  
16 Page 6, that indicates the electric average authorized  
17 ROE's from 2006 to 2016; is that correct?

18 A. Yes.

19 Q. And the first block of numbers there relate  
20 to settled versus fully-litigated cases, correct?

21 A. Correct.

22 Q. And I should have asked you this. Have you  
23 had a chance to read this report, prior to coming here  
24 today?

25 A. I have. Yes.

1           Q.    Thank you.  The conclusion of RRA is that  
2   there really isn't any difference between litigated --  
3   pardon me.  There is no pattern between litigated and  
4   settled cases?  Sometimes the settled cases have  
5   higher ROE's, and somethings the litigated cases have  
6   higher ROE's; is that a fair statement?

7           A.    Are you referring to a statement?

8           Q.    Yes.  On Page 2, if you go to the second  
9   paragraph.  It starts out, included.  Then if you go  
10   to the second sentence it states, for both electric  
11   and gas cases no pattern exists in average annual  
12   authorized ROE's, in cases that were settled, versus  
13   those that were fully litigated?

14          A.    It does state that.  But there is a  
15   difference, as noted on Page 6 of the table.

16          Q.    Well, there are differences, but what RRA  
17   says is there is no particular pattern.  Some years  
18   the litigated cases may result in a higher return on  
19   equity, and some years the litigated cases may result  
20   in a lower return on equity?

21          A.    I presume that's what they intend.  I would  
22   agree with that.  But there clearly is a difference in  
23   the findings for litigated cases, in my judgment.

24          Q.    Well, if you look at that first block on  
25   Page 6, the fully-litigated cases results in 2016 with



1 an ROE of 9.74 percent. And the litigated cases were  
2 9.80 percent, right? So the litigated cases were 6  
3 points lower?

4 A. Yes. I think I heard the numbers backward.  
5 The fully-litigated was 9.74. The settled cases were  
6 9.8.

7 Q. That what I mean to say, if I misspoke. So  
8 the litigated cases were 6 points lower. And then if  
9 you go to the previous year, the litigated cases are  
10 41 basis points lower, correct?

11 A. Correct.

12 Q. Then you go back to 2014, it's the reverse.  
13 The fully-litigated cases are 32 points higher. Then  
14 you go back one year to 2013, and they are 27 basis  
15 points lower. Then you go one more, it's 20 basis  
16 points higher, right?

17 A. Yes.

18 Q. Now with the regard to the middle block on  
19 general rate cases versus limited rider issues, for  
20 2016 and 2015, the average return on equity was 9.60  
21 percent, correct?

22 A. For general rate cases. Yes.

23 Q. And then if we look at the vertically  
24 integrated cases in the bottom block, for 2016 the  
25 average return on equity was 9.77 percent. For 2015

1 it was 9.75 percent?

2 A. That's on average for 17 decisions in 2015  
3 and 20 decisions in 2016.

4 Q. And am I correct that the statistics that  
5 RRA compiles are national statistics, and they include  
6 statistics from all of the regulatory utility  
7 commissions in all the 50 states?

8 A. That's my understanding. Yes.

9 MR. ZOBRIST: Judge, I move the admission  
10 of Exhibit 155.

11 JUDGE PRIDGIN: Any objections? Hearing  
12 none, 155 is admitted.

13 Q. (BY MR. ZOBRIST) Are you familiar with the  
14 term, zone of reasonableness?

15 A. Yes.

16 Q. What does that mean?

17 A. It's a range. It's what is included in my  
18 testimony. It discusses the uncertainty there is in  
19 accurately measuring what the current investor  
20 required return on equity is. So you can get a pretty  
21 good estimate within a zone, and determine whether or  
22 not a point estimate within that zone is appropriate  
23 for setting rates. So generally, the zone of  
24 reasonableness outlines what the best estimate is of  
25 what the current market cost of equity is. That will

1 fairly compensate the utility for their equity  
2 investments.

3 **Q. Is that typically a range of -- I have**  
4 **heard sort of a minimum of 50 basis points, up or down**  
5 **from the national level, up to a range of 100 basis**  
6 **points, up or down from the national level?**

7 A. It can vary over time. But yes, that is a  
8 fair characterization.

9 MR. ZOBRIST: Judge, nothing further.  
10 Thank you.

11 JUDGE PRIDGIN: Bench questions? Mr.  
12 Chairman?

13 QUESTIONS FROM THE BENCH

14 QUESTIONS BY CHAIRMAN HALL:

15 **Q. Good afternoon.**

16 A. Good afternoon.

17 **Q. Do you have Mr. Hevert's surrebuttal**  
18 **testimony in front of you?**

19 A. I do not have it in front of me.

20 CHAIRMAN HALL: Will somebody get that to  
21 him. Surrebuttal.

22 **Q. (BY CHAIRMAN HALL) Turning to Page 4.**

23 A. I'm there.

24 **Q. The chart that he has at the top of the**  
25 **page.**

1 A. Yes.

2 Q. What should I extrapolate from that, in  
3 your opinion?

4 A. Well, essentially, in the  
5 cross-examination, Exhibit 155, it gives annual  
6 listings of the authorized returns on equity. And  
7 this charge is made, based on that data. It shows  
8 that the authorized returns on equity for utility  
9 companies, historically, are consistent with these  
10 dots on this chart. His argument is that my 9.2  
11 percent return on equity is lower than all but one of  
12 those actual findings by regulatory commissions.

13 Q. And that's accurate, correct?

14 A. That is accurate. Yes.

15 Q. So why should I not, from that chart,  
16 determine that your position is out of line with all  
17 of the decisions since January of '13?

18 A. Well, I think there are two considerations  
19 that I would ask you to wrestle with in determining  
20 whether or not my 9.2 percent recommendation is  
21 reasonable. One is, how does it compare to the  
22 industry authorized returns on equity, which is what  
23 this chart shows.

24 Those returns on equity were based on  
25 historical analyses, based on information available in

1 each of those rate cases. It was also based on what  
2 the regulatory commission found to be an appropriate  
3 return on equity, given the information in those  
4 cases. In my judgment, the regulatory commissions  
5 generally look at the market data what the most  
6 reasonable estimate is at the current market cost of  
7 equity.

8 But also consider the risk that, that cost  
9 of capital may change when the rates are actually in  
10 effect. With the concern that if they award a return  
11 on equity that is too low. That could have negative  
12 implications on the utility when the rates are  
13 actually in effect.

14 What we have been seeing over the last  
15 three to four years is a lot of data that suggest that  
16 if certain events happen, capital market costs could  
17 increase. The biggest factor that is underlying when  
18 capital market costs will increase is this inflation  
19 outlook.

20 Inflation has been in check at very low  
21 levels for at least the last five years. Inflation  
22 outlooks right now still appear to be in check.  
23 Consequently, capital market costs going forward will  
24 likely remain very low. So while my return on equity  
25 appears low, based on what regulatory commissions

1 found in previous rate cases, I think the evidence in  
2 this case suggests that there is pretty clear evidence  
3 that the market is embracing relatively low capital  
4 market costs today.

5 **Q. You can see from this chart a trend**  
6 **downward. Is that accurate?**

7 A. I can't imagine how anyone could deny that  
8 there is a downward trend in authorized returns on  
9 equity.

10 **Q. There is a trend downward, but it is clear**  
11 **that your recommendation is lower than all but one**  
12 **decision since 2013?**

13 A. That is true.

14 **Q. And there is a legitimate concern for**  
15 **KCP&L, because investors will be comparing, or could**  
16 **be comparing investment with KCP&L versus alternative**  
17 **electric utility companies with higher return. And**  
18 **that could be a detriment for KCP&L?**

19 A. KCP&L will have to compete with those other  
20 utilities for capital. That's right. And whichever  
21 utility presents the best investment opportunity is  
22 likely the utility investors will choose to put their  
23 capital into. But there is complicating issues around  
24 that also. The ROE, not only has to be fair to  
25 investors, but it has to be fair to customers as well.

1           To the extent the Commission awards a  
2   return on equity which is higher than needed to fairly  
3   compensate the utility and provide them an opportunity  
4   to access capital under reasonable terms and prices,  
5   which KCP&L has had that access for at least the last  
6   five years. Then the rates will increase, and that  
7   can impact the economic activity in their service  
8   territory.

9           That can in turn impact the utility to the  
10   extent it stifles growth and revenue. It stifles  
11   growth and sales. Which can impact not only business  
12   customers, but can flow down to the residential  
13   customers also. So I think in terms of using as much  
14   information available to get the right number.

15           I would encourage you to consider not only  
16   what the authorized returns on equity have been for  
17   all electric utility companies, but more specifically  
18   consider what they have been for integrated utility  
19   companies, vertically integrated utility companies  
20   under litigated cases.

21           And what is important about a litigated  
22   case is there is no question that the revenue  
23   requirement to the ROE are intertwined together. You  
24   give them more or less ROE, that impacts their revenue  
25   requirement.

1           In a settlement, there is not necessarily  
2 any connect whatsoever between the ROE and the revenue  
3 requirement. And consequently, the rates that  
4 customers pay. So that's why I believe it's important  
5 to look at only litigated cases. Because that  
6 describes what customers are willing to pay. Or are  
7 required to pay, as fair compensation by the  
8 regulatory commission.

9           Settlements can just be pieces of  
10 statements without a clear interconnect between how  
11 those pieces fit together. But the market evidence  
12 shows that authorized returns on equity for most  
13 integrated electric utility companies has been around  
14 9.5 percent. And has been declining a little bit over  
15 time.

16           And those utilities have had access to  
17 large amounts of capital, not just KCP&L. But the  
18 industry at whole has had access to significant  
19 amounts of capital, under reasonable terms and prices.  
20 So that's clear observable market evidence that an  
21 authorized return on equity of no higher than 9.5  
22 percent, the utility is fairly compensated because  
23 stock prices have been very rich in valuation lately.

24           Utility access to capital under reasonable  
25 terms and prices. And the utility industry as a whole



1 has supported very large capital programs, in this  
2 environment. The prices that customers pay are at an  
3 ROE which are no higher than necessary to achieve  
4 those objectives, fair compensation and maintain a  
5 financial integrity utility.

6 **Q. Have you done analysis of electric utility**  
7 **service prices in Missouri or nationally?**

8 A. Yeah. We do those on a pretty regular  
9 basis.

10 **Q. And those prices have been going down, have**  
11 **they not?**

12 A. Fuel costs have been going down, so  
13 electric utility prices have been going down.

14 **Q. Is that the main driver?**

15 A. It is, yes. Because most utilities'  
16 infrastructure investment has been an abnormally high  
17 levels. Cyclically high levels that have caused  
18 increases in non-fuel rates. But those non-fuel rate  
19 increases have been offset by fuel rate decreases.

20 **Q. Have you done an analysis on -- a**  
21 **Missouri-specific analysis or a KCP&L specific**  
22 **analysis of that?**

23 A. We have. Yes.

24 **Q. Is that in your testimony?**

25 A. It's not in this testimony. I did file it

1 in testimony in Kansas recently.

2 Q. So how do you reconcile -- I think I know  
3 the answer to this. But how do you reconcile the data  
4 that shows that electric service price index is going  
5 down, but utility rates are going up?

6 A. I'm sorry. Can you repeat that question?

7 Q. Well, we have been talking about the  
8 service price index for electric utility service. And  
9 that's been going down. And you said the main driver  
10 is fuel costs?

11 A. Right.

12 Q. So what I am trying to understand is how do  
13 you reconcile what consumers are actually paying for  
14 utility service, going down, with rates that have been  
15 going up? I am sure I am doing apples and oranges,  
16 but I am trying to take advantage of your  
17 understanding of this to help me out.

18 A. If you kind of split the utility rate up  
19 into the fuel rate, the non-fuel rate, the non-fuel  
20 rates are generally going up. Fuel rates have come  
21 down quite a bit the last few years. They may have  
22 decreased, but they are more stable now, based on gas  
23 prices.

24 The coal market could change, depending on  
25 changes in environmental regulation. But it has

1 dropped recently. It may be stabilizing also. But  
2 the big driver of increasing electric utility rates  
3 has been the invested capital piece. Rate bases are  
4 growing significantly across the industry.

5 **Q. Which has an effect on the prices that the**  
6 **rate payers pay?**

7 A. Significant impact on prices. Yes.

8 **Q. So how is it that CPI is going down, but**  
9 **all the rates are going up? There was some discussion**  
10 **about if the Commission were to implement the rate**  
11 **increase requested by the company, you'd have almost**  
12 **100 percent rate increase since 2006. So I am trying**  
13 **to reconcile that information with what I have been**  
14 **reading about CPI for electricity going down.**

15 A. Well, since 2006, that is 10 years. Over  
16 that time period, Kansas City Power & Light has  
17 undertaken significant capital investments. I don't  
18 know the exact growth in the rate base, but I do  
19 understand it to be very significant. The  
20 introduction of a new coal-fired unit.

21 The introduction of scrubbers. And wind  
22 generation assets. As well as a build-out in  
23 modernization in their wire infrastructure. There has  
24 been tremendous growth in their rate base over the  
25 last 10 years.

1 CHAIRMAN HALL: I have no further  
2 questions. Thank you.

3 JUDGE PRIDGIN: Commissioner Stoll?

4 COMMISSIONER STOLL: I have no questions.  
5 They've been answered in testimony.

6 JUDGE PRIDGIN: Thank you. Mr. Rupp?

7 COMMISSIONER RUPP: Yes.

8 QUESTIONS FROM THE BENCH

9 QUESTIONS BY COMMISSIONER RUPP:

10 Q. Good afternoon.

11 A. Good afternoon.

12 Q. Can you walk me through how the volatility  
13 index that Mr. Hyneman had used, how it affects the  
14 regression analysis and how oppositely it was  
15 affecting when you used the utility bond yields, and  
16 what does that regression analysis tell me about those  
17 two inputs?

18 A. Well, Mr. Hevert --

19 MR. RUPP: Mr. Hevert. I'm sorry.

20 A. -- performed a regression study, which he  
21 was attempting to estimate what an appropriate equity  
22 risk premium is, based on current market information.  
23 In doing that, he relied on nominal bond yields and a  
24 volatility index based on the S&P 500.

25 When I reviewed that analysis, I thought it

1 was an improvement from his other risk premium study,  
2 which regressed simply nominal bond yields, relative  
3 to equity risk premiums. And the reason I thought his  
4 other analysis would be appropriate is because it  
5 could be adjusted to translate the nominal bond yields  
6 into a real bond yield.

7 And by doing that, you take away one  
8 important factor which would impact equally equity  
9 risk premiums and bond yields. And that's the  
10 inflation index.

11 Q. (BY COMMISSIONER RUPP) So maybe I  
12 misunderstood. So did you perform a regression  
13 analysis to see how that input affected whether or not  
14 it showed that there was a stronger correlation of  
15 this information to the predictability of the rates,  
16 or were you just using the word regression as a term?  
17 I thought you said earlier, and this was a while back  
18 in the beginning, that there was a statistical  
19 difference in the correlation of predictability of  
20 using the --

21 A. You're right. Page 21 of my rebuttal  
22 testimony.

23 Q. Okay.

24 A. I describe the difference in the regression  
25 statistics. And I explain that under my model, the

1 regression statistics were stronger. The R-squared  
2 was 84.5 percent and in my model, it was about 68.6  
3 percent in his model. The T-statistic was 0.0037 in  
4 my model. It was 0.0054 in his model. The  
5 T-statistic both said that the factors were  
6 statistically significant. But my R-squared number  
7 says my model predicted more accurately the change in  
8 equity risk premium, relative to the change in real  
9 bond yields.

10 **Q. That is exactly what I was looking for.**

11 COMMISSIONER: Thank you. That's all.

12 JUDGE PRIDGIN: Commissioner Coleman?

13 COMMISSIONER COLEMAN: No.

14 JUDGE PRIDGIN: Any recross based on bench  
15 questions? Public Council?

16 MR. OPITZ: No. Thank you, Judge.

17 JUDGE PRIDGIN: Staff?

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

19 JUDGE PRIDGIN: KCP&L?

20 MR. ZOBRIST: No questions.

21 JUDGE PRIDGIN: Redirect?

22 MR. WOODSMALL: Yes. Thank you, Your  
23 Honor.

24 REDIRECT EXAMINATION

25 QUESTIONS BY MR. WOODSMALL:

1           **Q. I'm kind of working backwards.**  
2 **Commissioner Hall was asking you to compare KCP&L with**  
3 **other utilities and other states. He referenced**  
4 **Kansas. Do you know if KCP&L had any difficulty**  
5 **raising capital after Kansas authorized a 9.3 ROE?**

6           A. No. Quite the contrary. KCP&L, along with  
7 its parent, Great Plains Energy, has announced a major  
8 acquisition of a Kansas utility. And they are raising  
9 significant amounts of both debt and equity to fund  
10 that transaction. The primary source of earnings and  
11 cash flow available to Great Plains Energy is KCP&L.  
12 And to also to a significant degree, Greater Missouri  
13 Operations.

14           **Q. And you were asked some questions by**  
15 **Commissioner Hall. Compare rates over time. You were**  
16 **talking about fuel and non-fuel components. Do you**  
17 **recall those questions?**

18           A. Yes.

19           **Q. Would you turn to Schedule MPG-2 of your**  
20 **direct testimony. Maybe this is what the Chairman was**  
21 **asking for. Tell me when you are there.**

22           A. I'm there.

23           **Q. Is that a comparison of KCP&L utility rates**  
24 **versus other states over time?**

25           A. It is. Yes.

1 Q. Okay. And granted, this is for a very,  
2 very large industrial customer, 50 megawatts. But it  
3 shows certainly KCP&L rates increasing relative to  
4 other states; is that true?

5 A. It does. Yeah. This is an all-in cost,  
6 which would include both fuel and non-fuel components.  
7 This weights a customer bill, divided by kilowatt  
8 hours.

9 Q. And that chart, or those charts, show  
10 certain states having a rate that is decreasing? For  
11 instance, Michigan; is that correct?

12 A. If you tracked it over time, you would be  
13 able to identify states with decreasing costs. Yes.

14 Q. Now going to questions from Mr. Zobrist.  
15 He started off asking you some questions about your  
16 proxy group and the inclusion and exclusion of Otter  
17 Tail. Do you recall that?

18 A. I do.

19 Q. And you excluded Otter Tail. Mr. Hevert  
20 included Otter Tail; is that correct?

21 A. It is.

22 Q. Did Mr. Hevert ever attempt to quantify any  
23 impact on ROE from his inclusion or your exclusion of  
24 Otter Tail?

25 A. No. He simply noted that the growth rates



1 -- the reason I excluded it was the growth rates were  
2 not available. And he observed that growth rates from  
3 other sources were available. I commented that I  
4 didn't believe it had a significant impact on my  
5 recommendation or his. I don't believe he took issue  
6 with that.

7 **Q. At MPG-4 you show that your proxy group**  
8 **consists of 15 companies; is that correct?**

9 A. Yes.

10 **Q. And if you had included Otter Tail, it**  
11 **would have been 16 companies; is that correct?**

12 A. Yes.

13 **Q. When you do an analysis, for instance a DCF**  
14 **on your proxy group, you come up with a DCF for each**  
15 **individual company, and then average across the 15**  
16 **companies; is that correct?**

17 A. Well, I do a little more than that. I mean  
18 I do DCF analysis for each of the companies. I create  
19 a proxy group average. But to the extent there is an  
20 outlier number within the proxy group, then I would  
21 also compute a proxy median, and I would determine  
22 whether or not the group average or median more  
23 accurately reflects the central tendency of all the  
24 proxy group results, in forming my recommendation.

25 So to the extent if I would have included

1 Otter Tail, and that would have drove up the average.  
2 It clearly would have been an outlier within my study.  
3 Then I would have formed my recommendation based on  
4 the proxy group median, and not the average. Because  
5 the average would have been skewed by the inclusion of  
6 an outlier company.

7 **Q. But in any case, the addition of one**  
8 **company to a group of 15 wouldn't have a dramatic**  
9 **effect on the ultimate bottom line, would it?**

10 A. I wouldn't think so. And that certainly is  
11 not the reason I didn't include Otter Tail in my  
12 proxy.

13 **Q. You were then asked some questions by Mr.**  
14 **Zobrist about -- I think he termed it the update**  
15 **period. Updating your analysis from October 28th in**  
16 **your direct, to December 16th in your rebuttal. Do**  
17 **you recall that?**

18 A. I do.

19 **Q. And he said it was about 30 days. Just for**  
20 **clarification, would you agree that is 49 days?**

21 A. I do.

22 **Q. And he talked about during that 49-day**  
23 **update period, expectation of future interest rate**  
24 **increases. Do you recall that?**

25 A. Yes.

1           **Q. Does an expectation of interest rate**  
2 **increases always come true?**

3           A. There has been a strong expectation of an  
4 improving economy and an increase in the Federal Funds  
5 rate for the last five years. A lot of the  
6 expectations simply haven't been realized. They were  
7 in December 2015, and then again 2016. There is  
8 expectations of further economic strengthening this  
9 year, which are expected to be followed by further  
10 increasing in the Federal funds rate. But that  
11 expectation has been the general outlook for many,  
12 many years now.

13           **Q. And even when it does come true, does the**  
14 **interest rate increase always have a direct**  
15 **correlation on ROE?**

16           A. No. The Federal funds rate is a short-term  
17 rate. It's an overnight rate for banks lending to  
18 each other. Generally, it reflects more short-term  
19 borrowing costs. Very short-term borrowing costs. In  
20 contrast, the common equity security is a long-term  
21 investment. So it's at the other end of the  
22 investment horizon curve.

23                   The first time the Fed had increased  
24 Federal funds rate, long-term interest rates actually  
25 dropped in response to it, because the outlook for the

1 economy was improving, but inflation wasn't picking up  
2 much steam. So the economy was getting stronger  
3 without inflation. And that brought down long-term  
4 interest rates.

5 When the increase came again in December of  
6 last year, interest rates didn't move. Long-term  
7 interest rates didn't move that much, after December.  
8 They did from July of 2016. But from December of  
9 2016, interest rates have not changed. Corporate bond  
10 interest rates have not changed considerably since  
11 that time.

12 **Q. Then you were asked some questions by Mr.**  
13 **Zobrist about Mr. Hevert's alternative risk premium**  
14 **analysis. Do you recall those questions?**

15 A. I do.

16 **Q. And he latched onto the word, substantial**  
17 **improvement. Do you recall that phrase? Substantial**  
18 **improvement over his other risk premium analysis?**

19 A. Yes. I think he was using my  
20 characterization of the study. Yes.

21 **Q. While a substantial improvement, do you**  
22 **think the alternative risk premium is a reliable ROE**  
23 **indicator?**

24 A. It's an improvement relative to his very  
25 simplistic study, but it still does not accurately

1 gauge an equity risk premium based on the difference  
2 between the market's perception of the risk of an  
3 equity investment, versus the risk of a bond  
4 investment. That should be the factor which describes  
5 the equity risk premiums. Changes in interest rates  
6 are one of those factors. And it's an important  
7 factor. But it's not the only factor.

8           If you look at -- read the arguments that  
9 Mr. Hevert and I go through in these studies. We talk  
10 about flight to quality, where low-risk investments  
11 are priced at a premium. The equity risk premium goes  
12 up. Versus more normal conditions, where the market  
13 is not pricing such a premium in low-risk securities,  
14 which means the equity's premium comes down.

15           So that is an indication of how much  
16 appetite market investors have for risk. And how much  
17 additional compensation they demand to assume greater  
18 levels of risk. When investors are concerned about  
19 the integrity of the market place, they pay a premium  
20 for low-risk investments, because they are not willing  
21 to take on the uncertainty of higher risk investments.

22           When the market calms down, investors are  
23 more interested in higher returns and they are willing  
24 to assume greater risk to get those higher returns.  
25 Often we see equity risk premiums contract. So

1 changes in nominal bond yields is one factor. More  
2 specifically, changes in real bond yield is a factor  
3 that helps describe what a balanced equity risk  
4 premium is in the current market place.

5 But it's not the only factor. And that's  
6 the deficiency in Mr. Hevert's study, is he only  
7 considers changes in interest rates. Not changes in  
8 relative investment risk characteristics.

9 **Q. And you were asked some questions about**  
10 **your recitation in your directive of 9.3 ROE in**  
11 **Kansas, and you were asked about Kansas' recovery**  
12 **mechanisms. Do you recall that?**

13 A. I do.

14 **Q. Would you agree that those Kansas recovery**  
15 **mechanisms were already reflected in KCP&L's current**  
16 **credit rating?**

17 A. I didn't look at the specific rate filings  
18 for that. But I presume they were. I did not verify  
19 that.

20 **Q. The credit agencies would reflect those**  
21 **mechanisms when they assign a credit rating for KCP&L;**  
22 **is that true?**

23 A. The credit rating agencies in the market  
24 would already know the regulatory mechanisms, and the  
25 impact those mechanisms have on the utility's ability

1 to earn the expected earnings and cash flows from the  
2 utility.

3 Q. And then finally, you were asked some  
4 questions about other states. You were talking about  
5 Wisconsin and Indiana ROE's. You characterized those  
6 as, quote, not typical. Do you recall that?

7 A. I do. Yes.

8 Q. And can you tell me why those are not  
9 typical?

10 A. Well, we work on both of those  
11 jurisdictions. To give you an example, in Detroit  
12 Edison's most recent case, the staff analyst had a  
13 range of authorized return on equity that went from  
14 about 9.0 percent, up to about 9.5. And one outlier  
15 at about 10 percent. The Commission awarded, and the  
16 industrial group of one of my associate's had a return  
17 on equity recommendation of about 9.3.

18 The company witness was well into the 10's.  
19 Well above 10. The Commission awarded a 10.1 percent  
20 return on equity, while being very critical of the  
21 analysis the utility witness made. Without the  
22 utility witness, there was really no record support  
23 for anything above 9.5, so it's difficult for us to  
24 explain how the Commission arrives at those decisions,  
25 based on some of the comments they had in the record.

1           In Wisconsin, often the Commission will  
2 simply award a return on equity without much  
3 discussion of the ROE evidence. The effect of doing  
4 that, as in Michigan, rates stay expensive. Michigan  
5 is a legacy cost structure with very high rates. It's  
6 difficult for energy intensive companies to compete  
7 while operating in Michigan.

8           And we have advised the Commission, and  
9 they have not seen much weight and value in our  
10 advice. But they continue to authorize above industry  
11 average returns on equity in rate setting. The effect  
12 of that is that the credit rating of those utilities  
13 is no stronger than the industry average common equity  
14 ratio.

15           One reason is because they have energy  
16 intensive companies, and their rates are not that  
17 competitive. And the service area is not growing very  
18 strongly. Amongst some other factors. So it's  
19 important to understand where the return on equity is  
20 awarded, and the information the regulatory  
21 commissions consider in determining what's a balanced  
22 and fair return on equity. In my judgment, what they  
23 do in Wisconsin and Michigan is not the more balanced  
24 methodology that has historically occurred here in  
25 Missouri.



1 Q. And just following up on Wisconsin, the  
2 ROE's generally authorized in Wisconsin are higher  
3 than the average; is that correct?

4 A. Yes.

5 Q. And is it your understanding that Wisconsin  
6 has four or five electric utilities?

7 A. Yes.

8 Q. And they are required to file rate cases  
9 every two years or so?

10 A. Two years. Yes.

11 Q. So you see lots of Wisconsin decisions with  
12 a higher ROE, so Wisconsin has the effect of inflating  
13 an average; is that correct?

14 A. Yeah. If you look at only the industry  
15 average, it will be highly impacted by ROE decisions,  
16 which clearly are outside the large number of  
17 observations available for that year. It will skew up  
18 the average result.

19 MR. WOODSMALL: I have no further  
20 questions. Thank you, Your Honor.

21 JUDGE PRIDGIN: Thank you, Mr. Gorman.  
22 Thank you very much. You may step down. I believe  
23 Mr. Gorman is our final witness of the day. What I  
24 understand is we would resume at 8:30 in the morning  
25 with depreciation. And then move on to fuel

1 adjustment clause.

2 MR. ZOBRIST: That's correct.

3 JUDGE PRIDGIN: Anything further, before we  
4 go off the record. Hearing nothing, we are in recess  
5 until 8:30 in the morning. Thank you very much. We  
6 are off the record.

7 (WHEREIN, the Evidentiary Hearing was  
8 concluded on February 7, 2017 at 1:10 p.m.)

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3   COUNTY OF ST. LOUIS        )  
4   I, Matthew Behlmann, a Certified Court Reporter (MO),  
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7   present at the proceedings as set forth in the caption  
8   sheet hereof; that I then and there took down the  
9   proceedings had at said time and was thereafter  
10  transcribed by me, and is fully and accurately set  
11  forth in the proceeding pages.

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14   Notary Public within and for  
15   The State of Missouri

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