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In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of Its Regulatory Plan	) Case No. ER-2006-0314

RONALD D. PRIDGIN, Presiding,
REGULATORY LAW JUDGE.
CONNIE MURRAY,
ROBERT M. CLAYTON,
LINWARD "LIN" APPLING,
COMMISSIONERS.

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JUDGE PRIDGIN: All right. Good morning. We're back on. I show the time being about 8:40 a.m. Wednesday, October 5th.

And before we put the first witness on, I just want to clarify with counsel that today we would have Dr. Hadaway -- not necessarily in this order, but Dr. Hadaway, Dr. Woolridge and Mr. Schnitzer on the stand and those would be all of our witnesses for today; is that correct?

MR. ZOBRIST: I believe that's correct, Judge.

JUDGE PRIDGIN: Okay. And is there anything that counsel needs to bring to my attention before we put Mr. Hadaway on the stand?

MR. ZOBRIST: Judge, I did want to distribute to the parties some highly confidential information, which is an update of the Northbridge analysis of the range of probabilities with regard to off-system sales.

And I advised Mr. Dottheim and I think a number of other counsel that this would be available should anyone want to ask any questions of Mr. Schnitzer. I understand it's very close to his examination and it -- they may not want to ask him any questions and it may be more proper for discussion and examination at the true-up, but they are dated -- the report is dated October 25th, 2006 and I would like to distribute it at this time.

JUDGE PRIDGIN: All right. Thank you.

MR. ZOBRIST: And just one other matter, I believe that the highly confidential numbers that are contained in here, the updated numbers were distributed with work papers that Kansas City Power & Light Company revealed to the other parties I think either other the weekend or perhaps Monday or Tuesday.

JUDGE PRIDGIN: Okay. Thank you Mr. Zobrist.

MR. MILLS: Could we get this electronically as well?

MR. ZOBRIST: I don't know, but I can ask that question. I think the answer's probably yes.

That's all I have as a preliminary matter, Judge. Dr. Hadaway's free to take the stand if that's appropriate.

JUDGE PRIDGIN: All right. Thank you. Anything else from counsel before Dr. Hadaway takes the stand?

Okay. If you'll come forward to be sworn, please, sir.

(Witness sworn.)

JUDGE PRIDGIN: Thank you very much, sir. Please have a seat.

And, Mr. Zobrist, anything you need to cover before he's tendered for cross?

MR. ZOBRIST: Yes, sir.

SAMUEL C. HADAWAY testified as follows:

DIRECT EXAMINATION BY MR. ZOBRIST:

Q. Dr. Hadaway, do you have a correction or two to your Direct Testimony?

A. Yes, sir, I do.

Q. Okay. Would you please note those for the record?

A. In the Direct Testimony on page 28, at line 29 the number there should be 24 rather than 16. Then with respect to the schedules in the Direct Testimony, in Schedules SCH 1, 3, 4, 5, 6 and 7, in my office we labeled those as Great Plains Energy at the top. That should read Kansas City Power & Light.

Then with respect to the Rebuttal Testimony, Schedules 9, 12, 13 and 14 were also labeled Great Plains Energy and those should be labeled Kansas City Power & Light. Pardon me.

On Schedule 15, because of the copying of that schedule and the dark background, on most of the pages the footer does not appear. There should be an SCH-15 to indicate that that is Schedule 15. And there are 25 pages to that schedule. Those are all the corrections that I had.

Q. Thank you.

MR. ZOBRIST: I tender the witness for cross-examination, Judge.

JUDGE PRIDGIN: Mr. Zobrist, thank you.

Parties want cross? Mr. Thompson, Mr. Phillips, Mr. Mills. Any other parties?
Okay. Mr. Phillips, when you're ready, sir.
CROSS-EXAMINATION BY MR. PHILLIPS:
Q. Morning, Dr. Hadaway,
A. Good morning, Mr. Phillips.
Q. I don't think I've seen you since I saw you in Texas a number of years ago.
A. That's probably correct.
Q. Good to see you again.
A. Thank you.
Q. I represent the DOE/NNSA facility, which has a large plant in the Kansas City area and then also other affected federal executive facilities in this case. I just have a few questions for you this morning.
First of all, if you could turn back to page 28 where you made a correction in your testimony. And there you're talking about three versions of your DCF model that you made. I think your correction was at the bottom of the page. You changed that 16 company to 24; is that correct?
A. Yes, sir, that was just a typo.
Q. Okay. In the first model that you did, the growth rate that you used in that model was 4.78 percent; is that correct?
A. I -- I can check that in the schedule, but

that's very close, yes, sir.
Q. Okay. And that's the result of analysts' recommendations or --
A. It's an average of four sources of growth rates: Value Line, analyst estimates, B times R methodology called a sustainable growth rate, and long-term gross domestic product. It's just a simple average of those four.
Q. And then in your second model, you changed the growth rate, didn't you, to 6.6 percent?
A. Yes, sir.
Q. And what's that the result of? Is that GDP?
A. Yes, sir. That's the forecast of GDP growth.
Q. In your risk premium approach, did you use the Regulatory Research Associates' rate case ROE determinations in that risk premium?
A. Yes, sir.
Q. And have you reviewed the most recent RRA dated October 5 of 2006?
A. Yes, sir, I have.
Q. Is it true that in that latest release, that the average DOE granted to electric utilities during the third quarter of 2006 was 10.06 percent?
A. I may have misheard you. You mean the return on equity that was granted?
Q. Yes.

A. Yes, sir. That was the number. It was a small group of companies, but that is indeed the correct average.

Q. Was it seven companies?

A. I believe that's right.

Q. And was the highest number in there 10.54 percent?

A. If I might, I have that document.

Q. Sure. Go ahead. Take your time.

A. Well, I had that document. I will take your word for that.

Q. Okay. If you would like subject to check when you have --

A. I believe I left it in my briefcase. I'm sorry.

Q. Okay. Would you agree that the lowest number there was 9.557 percent on return on equity?

A. I believe for one of the New York distribution companies, yes, that was right.

Q. Yes. And the change that you made in your Direct Testimony from 16 companies to 24, were those your comparable companies or your companies that you looked at in developing your DCF?

A. Dr. Woolridge and I both used the same 24 company that -- the 16 was simply a typo.

Q. So you both used the same. Was Commonwealth Edison one of the comparable or similar companies that you looked at?

A. Yes, sir.

Q. And how about Public Service Company of New Mexico?

A. I don't believe they're part of the group.

Q. Okay. And have you recently testified on return on equity relating to Commonwealth Edison over in Illinois?

A. Yes. And I may have misspoken. Con Ed in New York was one of the companies. If you asked me ComEd, it was not.

Q. I meant Commonwealth Edison.

A. No. They are not a publicly traded company. They are a subsidiary, so -- so they are not part of the 24-company group.

Q. They're a subsidiary of what company?

A. The holding companies have various names, but they're part of a large holding company.

Q. Okay. We had some -- you weren't here the other day, but we tried to work through some of those companies and their new iterations.

A. Well, the name of the company is Exelon.

Q. Exelon. But you did testify in Illinois recently for Commonwealth Edison?

A. Yes, sir, in their distribution case.

Q. And has a decision been reached in that case?

A. I'm not sure if there has been a decision or not.

Q. Okay. And how about in New Mexico? Have you testified on behalf of PNM?

A. We have testimony on file there in the gas case.

Q. But that case hasn't been final yet, has it?

A. No. There's -- there's not been a hearing yet on that.

Q. And has your return on equities in both of those cases been 11 percent?

A. I think that is correct.

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

JUDGE PRIDGIN: Mr. Phillips, thank you.

Mr. Mills?

MR. MILLS: Just a few, thank you.

CROSS-EXAMINATION BY MR. MILLS:

Q. Dr. Hadaway, in your Direct Testimony at page 6, the very -- at least on my printout, the very first line, line 1, you talk about pessimistic analysts' growth forecasts. In that sentence are you referring to the analysts as pessimistic or their forecast as pessimistic?

A. I don't think we can attribute any particular psychology to the forecasts themselves, but the analysts that review electric utilities are very pessimistic about the growth rates for electric utilities. Maybe I should have said that a little differently.

Q. And how do you define the word "pessimistic"?

A. I demonstrated in my schedule that analyst forecasts for utility growth have dropped between 100 and 200 basis points over the last five years.

Q. Okay.

A. So they're much lower than they used to be.

Q. So say four or five years ago, how would you characterize analysts' forecasts?

A. Four or five years ago, in my exhibit, in 2001, analysts' growth rates were the same as the growth rate in long-term GDP. They were in the 6 to 6 1/2, 7 percent range.

Q. So back in 2001, they were accurate and now they're pessimistic?

A. They were consistent with the long-term growth in the economy. The long-term nature of the DCF model requires that.

Q. The long-term nature of the DCF model requires analysts to assume that electric utilities will grow at the same rate as GDP -- GEP?

A. No, sir. Maybe I misspoke. The long-term nature of the DCF model requires that when you look out to the very, very long term for the G-term that is in that model --

Q. Okay.

A. -- it technically goes out to infinity. Analyst growth rates, pardon me, are for three to five years. So that's what I meant by that they failed to meet the time period that is required for the DCF model.

Q. Okay. So you're not saying that it's necessarily true that the electric utility industry or any particular electric utility will grow in the long term at the same rate as GEP?

A. I think there's good evidence, and I presented the studies that I provided in my Direct Testimony, that that is the case. But the industry, as everyone in this room knows, has gone through major restructuring, even during the period of 2004 and 2005, the date most of us had to work with here. We saw very low earned rates of return for some of the companies because of restructuring charges. All these things have caused the analysts to tremendously reduce their growth rate forecast for the next three to five years.

Q. Now, were they optimistic before they turned pessimistic?

A. I don't believe they were. I think they were consistent with the long-term growth rate in the economy.

Q. All right. Let me ask you to turn to page 30 of your Direct Testimony. Can you read the part of the quote that you have there from lines 24 through 27?

A. IBES long-term growth estimates are associated with realized growth in the intermediate short-term future.

Q. The next sentence too, please.

A. Over long horizons, however, there is little forecastability in earnings and analysts' estimates tend to be overly optimistic.

Q. Okay. This is from a 2003 article on which you relied?

A. That's correct.

Q. Now, I think you mentioned -- well, strike that.

In your traditional DCF calculation, did you include dividend growth rate -- I'm sorry, dividend growth?

A. I did in the two-stage model.

Q. Okay. In your traditional DCF, did you?

A. No. Not in the first model.

Q. Okay. Had you done so, would the results of your traditional DCF result have been even lower?

A. It probably would have.

Q. Okay. Now, in conclusion and in recommending -- in making your recommendation to the

Commission, you relied primarily on the risk premium model, is that correct, rather than the DCF model?

A. No, sir, not at all. I used the risk premium model as a check of reasonableness on the DCF results. The DCF results were between 10.6 and 11.3. And the mid-point of that DCF range is approximately the 11 percent base ROE that I recommend.

Q. So your testimony today is you relied primarily on your DCF results?

A. That's my testimony in the pre-filed direct as well.

Q. And it's still your testimony today?

A. Yes, sir.

Q. Okay. Now, let's talk about your 50 basis point risk adjustment. How did you calculate that?

A. I studied risk adders that have been applied by this Commission, by the Federal Energy Regulatory Commission and to the best I could, other commissions around the country. I found that the FERC has used risk adders in the 50 basis point to 200 basis point range, that this Commission in the recent Empire District case debated a 30 to 60 basis point risk adder and determined a 30 basis point adder was appropriate.

I did not have a model because there's not a model like the DCF model or other capital asset pricing model that includes those kind of factors.

Q. And that was really my question. There wasn't a specific calculation you did where you put in things like growth rate and GDP and then ran some numbers and came up with that answer?

A. To my knowledge, there is not a model like that.

Q. So the 50 basis point adjustment is based on your judgment and your analysis of what commissions have done in terms of risk adjustments in the past?

A. I think that's a fair assessment.

Q. Okay. Now, is it theoretically possible to put together a group of comparable companies for KCPL that would eliminate the need to put together a risk adjustment -- I mean to add a risk adjustment?

A. There are about 60 companies that are considered to be major electric utilities that are covered in Value Line where you have the data to do DCF, CAP-M type analyses.

And if one were to try to find companies that had as large construction program relative to net plant as KCPL's undertaking, you would be down to a very, very small sample. Therefore, I don't think that you could simply call out those companies and say the results of this small group would be an adequate estimate of ROE.

Q. Okay. So you're saying that although it may theoretically be possible, because of the nature of the utility industry and the country and the nature of the construction projects that KCPL's embarking on, it's not possible now?

A. I don't think it would be statistically reliable.

Q. Okay. How many companies would you end up with?

A. I don't know. I haven't made that analysis. But I doubt that there are more than three or four.

Q. Okay. Now, when you looked at the other companies and the other Commission decisions in which a risk adder was put into place, did you investigate as to whether any of the companies that were affected by those adders had a regulatory plan similar to KCPL's?

A. Some of the FERC cases, particularly the Path 15 case in California where they applied a 200 basis point risk premium, that was all sort of part and parcel of a plan that was put in place to get that transmission line built. It's not the same kind of plan that you have here for KCP&L, but it is an example of the kinds that other commissions have used.

Q. In that case, wasn't the 200 basis point adder a part of the plan --

A. Yes, sir.
Q. -- rather than imposed later in addition to the plan?
A. It was -- it turned out to be part of the plan, but it was a request that the owners of the project made and that the FERC ultimately approved.
Q. In the context of the plan?
A. It -- it was a follow on. It's actually a letter agreement order that the FERC later issued. So it was not like the parties got together and negotiated this. This was a contested issue and the FERC decided that the 200 basis points were appropriate.
Q. But they decided that in the context of approving the whole plan?
A. No, sir. I don't think that's right. I think the plan was in place and then to finalize the rates that would be used following from the plan, they determined that a hypothetical capital structure and a 200 basis point adder would be appropriate.
Q. Now, you talk about some utility risks on page 24 of your Direct Testimony. Has KCPL been affected by disruption of natural gas supply from hurricanes?
A. The whole utility industry certainly has been affected by that. I understand and recognize that KCPL is well positioned with respect to coal-fire generation, some

nuclear generation so that they are not as subjected to the vagaries of gas prices as others. But the wholesale power markets across the entire country have been affected by that.

Q. And because of the way that KCPL plays in the wholesale power market, was KCPL negatively or positively affected by the effects of hurricanes?

A. I don't know.

Q. But you know they were affected?

A. Well, what I'm saying is, I know that their native load generation is largely coal and nuclear based and that they don't depend, as many companies in Texas, for example, do, that I'm most familiar with, on serving native load with gas-fired generation. Those are the companies whose customers were most affected by the effects of the hurricanes that shut down the gas supply from the Gulf Coast.

Q. Okay. Your testimony here is that the hurricanes have caused further unsettling conditions. And I'm simply trying to get from you in what way this was unsettling to KCPL particularly. Not to Texas utilities or the industry as a whole, but to KCPL.

A. What I'm saying is that the industry was affected. That's what this piece of the testimony is about. And by extension, that affects all companies. What I'm saying to you here is that I understand that KCPL has done a good job with its resource planning and, fortunately, was not as affected by these issues as other companies. But the providers of capital look at the whole industry and that's what this discussion is about, about the stock market going up and down since 2002 and so forth in that same page.

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

JUDGE PRIDGIN: Mr. Mills, thank you.

Mr. Thompson?

MR. THOMPSON: Thank you, your Honor.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Morning, Dr. Hadaway.

A. Morning, Mr. Thompson.

Q. Dr. Hadaway, are you being paid for your participation in this case?

A. I am.

Q. How much are you being paid?

A. I'd have to go back and look at the billing records.

Q. Do you know what your hourly rate is?

A. I know what my firm's hourly rate for my services is.

Q. What is that?

A. $300 an hour or $325 an hour, depending on whether the work is prior to 2006 or not.

Q. If you know, how much in total does your firm

expect to earn from your participation in this case?
A. I do not know.
Q. Now, you have a schedule attached to your Direct Testimony that lists your experience as a witness; is that correct?
A. Yes.
Q. And tell me, since you have left the Texas Commission, with respect to cost of capital issues, isn't it true that you've only testified on behalf of utilities?
A. No, that's not true.
Q. You have testified on behalf of commissions?
A. I don't remember about commissions, but when I left the Texas PUC, I had a two-year prohibition against working for any of the utilities in the state of Texas.
Q. I see.
A. And our work was for Bethlehem Steel, for Nucor Steel, for --
Q. What we could call --
A. -- subsidiary of Cargill, the industrial customers.
Q. I see. The industrial customers. Very good.
How about since that two-year prohibition ended? Have you testified for anyone other than a utility?
A. We have done work for some of the cities, not on ROE specifically, but on debt service coverage issues,

things like that. We have testified predominantly though for the investor-owned utility companies.

Q. Very good. Thank you.

On page 14 of your Direct Testimony, you set out quotes from two decisions issued by the United States Supreme Court, Bluefield Waterworks and Hope Natural Gas. Do you see those?

A. Yes.

Q. And you would agree, would you not, that those are the legal touchstones against which the rate of return or return on equity set by this Commission must be measured?

A. I took these quotes from some regulatory economics textbooks that I've routinely used. Beyond the idea that risk and return and reasonable return for the same level of risk, I don't know all of the legal implications.

Q. Okay. And perhaps that was an unfair question. But nonetheless, they're in here. And I wonder if you could read for me the quote from Bluefield that starts on line 3 of page 14 and read it up to that semicolon on line 8, if you would.

A. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments and other business undertakings which are attended by corresponding risks and uncertainties.

Q. Thank you very much. Then there's a sentence in the following quote from the Hope case that begins on line 15 and ends on line 17. I wonder if you could read that quotation, please.

A. By that standard, the return to the equity owner should be commensurate with returns on investments and other enterprises having corresponding risks.

Q. Thank you. Now, in your Direct Testimony on page 9 you testified that establishing a return on common equity is primarily a matter of informed judgment.

Do you recall that testimony?

A. Yes, sir.

Q. Does that basically reduce to, Trust me, I'm an expert?

A. I would hope not. It means to me that for the past 25 years I have participated in proceedings like this and I've reviewed the methods and the outcomes of cases like this. Based on that and the analysis that I have done and presented in this testimony, it is my informed judgment that 11 percent is the right base ROE.

Q. I understand. Now, with reference to the quotes that I had you read from the Bluefield and the Hope case, you would agree with me, would you not, that the phrase "informed judgment" did not appear in either one of those extracts, did it?

A. I don't know if it did elsewhere. It certainly does not in those quotes.

Q. Thank you. Now, you testified that you have relied primarily upon versions of the DCF model; isn't that correct?

A. Yes.

Q. That's the discounted cash flow model?

A. That's right.

Q. And that's widely used, is it not, by investors in determining what kind of return they can expect from an investment?

A. It's widely used in the regulatory process. It is probably not as widely used by the investment banking firms, for example.

Q. Okay. And you gave an example in your Direct Testimony, and I didn't mark where it was, where you showed that an investor's expectation was equal to the share price plus the expected growth and the value of the share. Do you recall that? Or the dividend yield plus the expected growth of the value?

A. Thank you. Yes. The -- the textbook definition of a return that people expect is the dividend yield plus the growth or capital gains that they expect to make.

Q. And that's pretty much what the DCF model is, isn't it?

A. That's exactly what it is.

Q. And you testified that the DCF model is the most widely used in the regulatory setting on page 16 of your direct, didn't you?

A. Yes.

Q. And that its results typically are consistent with capital market behavior. Correct?

A. Yes.

Q. So if Mr. Barnes relied on the DCF model as his primary analytical tool, well, he was just, in fact, following your guidelines, wasn't he?

A. No, he did not.

Q. He didn't rely on the DCF model?

A. He did on a very narrow version of the model. He didn't test his results with other approaches. He didn't do a number of things that are required to come up with a reasonable estimate.

Q. But he did use the DCF model, did he not?

A. He did do that.

Q. Thank you. Now, you can discarded what you refer to as the traditional constant growth DCF model, didn't you?

A. I did.
Q. Because you felt it did not meet basic checks of reasonableness; is that right?
A. That's right.
Q. Did you do an analysis using the traditional constant growth DCF model?
A. Yes. In my Schedules 5 and 5A, I present the results for both the -- I'm sorry, Schedule 5. I present the results for all three of the models, the traditional constant growth, the traditional model with GDP growth and then the two-stage version of the model.
Q. What were your results from the traditional constant growth DCF model?
A. If you want exactly, I'd be happy to look at the schedule.
Q. Please do.
A. But it was somewhere in the mid-9 percent range.
On page 1 of 5 -- I misspoke before -- Schedule 4, the constant growth number is 9.3 to 9.4 percent.
Q. And you would agree with me, would you not, that that's comparable to Staff's result of 9.32 percent to 9.42 percent?
A. They're almost exactly the same.
Q. Thank you. Tell me, did you calculate a

company-specific traditional DCF model for KCPL?
A. I looked at KCPL's rather high dividend yield and I made an informal calculation, but I didn't go through the full study. It would have been much higher than the 11 percent that I came up with.
Q. Thank you. Now, on your direct at page 6 you testify that as the DCF is traditionally applied, that near-term circumstances do not reflect longer term expectations for higher capital costs; isn't that correct?
A. Yes.
Q. You're talking there about the growth rates; is that right?
A. That's right.
Q. Okay. Now, near-term circumstances, doesn't that basically mean now?
A. It means the restructuring of the industry that has been occurring for the past several years. As I explained to counsel earlier, analysts' forecasts for growth in the electric utility industry have dropped precipitously over the past five years and that's what I'm referring to here.
Q. And those are the reasons you didn't want to use the short-term growth rates; isn't that correct?
A. I -- I don't think they're consistent with the long-term growth rate that's required in the DCF model.

That's why I went through the process, I tested it against my checks of reasonableness. It failed those tests, so I eliminated that model.

Q. Okay. But you would agree with me, wouldn't you, that the Supreme Court said in that excerpt you read from Bluefield on page 14 of your direct, that the return should be equal to that generally being made at the same time. Isn't that what the Supreme Court said? I mean, please go back and look at the excerpt if you don't --

A. No. I entirely agree with what you just read. It has nothing to do with the discounted cash flow model. It didn't even exist in 1923 or 1940 either.

Q. I understand that. But it may, would you grant, have something to do with the setting of return on equities by state regulatory commissions?

A. It is -- if you're talking about Hope and Bluefield now, it is the basis for how we do this. But the models that we use to do it evolve over time and the correct models are those that are more robust than the one that Mr. Barnes applied.

Q. I understand that. And I appreciate that. Thank you.

Now, you used a comparative DCF model, didn't you, in all three versions that you applied? You used a group of proxy companies?

A. Yes, I did.

Q. Okay. And I think you said that your proxies, and I'm basing this on your direct at pages 3 and 4, that your proxies were all electric utilities and they were selected from the Value Line investment survey; is that correct?

A. Yes.

Q. And they were all investment grade with at least a triple B bond rating. Correct?

A. From at least one of the rating agencies.

Q. Okay. That at least 70 percent of their revenues derived from regulated utility sales; is that correct?

A. Yes.

Q. That they had consistent financial records not affected by recent mergers or restructuring. Correct?

A. Correct.

Q. That they had a consistent dividend record with no dividend cuts in the past two years; is that correct?

A. Yes.

Q. And starting on Schedule 4 -- or page 1 of Schedule 4 then, you provide specific information for your list of 24 proxies. Do you see that?

A. On Schedule 4?

Q. Yes, sir.

A. Yes, I have them.

Q. Okay. So as I look at that, the first one is Alliant; is that correct?
A. Yes.
Q. Now, for Alliant, can you tell me where is Alliant located?
A. Madison, Wisconsin.
Q. In Wisconsin. And then the next one is Ameren. We know where Ameren is, don't we?
A. Yes, sir.
Q. How about AEP? Where are they located?
A. Columbus, Ohio.
Q. And CH Energy?
A. They're in Pakipsi, New York.
Q. How about Central Vermont?
A. They're in a small town of Vermont. I don't recall the name of it.
Q. That's in New England. Correct?
A. Yes.
Q. Consolidated Edison?
A. They're in Manhattan, New York.
Q. How about DTE Energy?
A. They're in Detroit.
Q. Ducane Light?
A. They're in Pittsburgh.
Q. Now, Empire District, we know where they are,

don't we?

A. I believe --

Q. How about Energy?

A. -- they're in Joplin.

Q. Joplin, Missouri. Correct?

A. That's correct.

Q. How about Energy East?

A. Energy East is the New York State electric and gas, central main power and one other company combination upstate New York in New England.

Q. Okay. And based on your other comments, would I be right in understanding that they also have natural gas operations?

A. Rochester Gas and Electric is part of that, so they certainly do.

Q. How about First Energy? Where are they located?

A. First Energy is the old CapCo Companies, Ohio Edison, Toledo Edison, Cleveland Electric, Ohio Power. It's a large group of companies that were put together, but in the Ohio, Pennsylvania area.

Q. Very good. Green Mountain Power?

A. Green Mountain is also in Vermont.

Q. How about Hawaiian Electric?

A. They're headquartered in Honolulu.

Q. And you would agree with me, wouldn't you, that Mr. Barnes also used Hawaiian Electric as one of his comparables?
A. Yes, he did.
Q. How about MGE Energy? Where are they located?
A. They're also in Madison. It's Madison Gas and Electric.
Q. Wisconsin?
A. Wisconsin.
Q. Thank you, sir. How about -- I think it's N-i Source or NiSource?
A. NiSource. They're -- the northern Indiana -- I don't know if it's Public Service Company. I don't recall the exact name, but in the Midwest.
Q. Indiana. Very good. And NSTAR?
A. NSTAR is the old Boston Edison Company.
Q. So that's Massachusettes?
A. Yes, sir.
Q. New England. Okay. How about Pinnacle West?
A. They're headquartered in Phoenix. They're the parent company of Arizona Public Service Company.
Q. Very good. And you would agree with me that Mr. Barnes also used Pinnacle West as a proxy, did he not?
A. Yes, he did.
Q. How about Progress Energy?

A. Progress Energy is a combination company of four of the Progress corporations in Carolina Power and Light, serves North Carolina, South Carolina. Progress Energy serves in Florida.

Q. Very good. So it's East Coast?

A. Yes.

Q. Southeast. Puget Energy?

A. They're headquartered in Belleville, Washington.

Q. And Mr. Barnes, you would agree, also used Puget Energy, didn't he?

A. Yes, he did.

Q. How about SCANA?

A. SCANA is South Carolina Gas and Electric, I believe. I don't remember exactly what the acronym means, but it's Carolinas.

Q. Very good. How about Southern Company?

A. Southern Company serves in the southeast. They're headquartered in Atlanta, Georgia.

Q. Very good. And you would agree Mr. Barnes also used Southern Company as a proxy?

A. Yes.

Q. How about Vectren?

A. Vectren is a new name and I'm not sure if I can recite exactly what every one of these companies does, but

Vectren is Indiana Energy and C Corp.

Q. Very good.

A. I can check that in Value Line.

Q. Thank you. How about West Star?

A. West Star is the -- the Kansas Gas and Electric and Kansas Power and Light Company.

Q. Very good. And finally Excel Energy?

A. Excel Energy is a public service of Colorado and Southwestern Public Service Company in the panhandle of Texas and another company either in the Midwest or Central Midwest portion of the country.

Q. So it's a conglomerate operating in perhaps several areas?

A. Yes.

Q. Okay. Very good. Now, do you know for -- let's take Alliant just for example. Do you know what Alliant's level of capitalization is?

A. Its market cap is $3.3 billion.

Q. Very good. How about Ducane Light?

A. Theirs is about 3 billion -- I'll check and see.

No, I'm sorry. They're smaller, 1.3 billion.

Q. Now, in the list of factors that I read to you that we went through from your direct, pages 3 and 4, when you were forming your proxy group, you did not take account, did you, of the capitalization level of each of these proxy companies?

A. Implicitly I did, but it was not one of the five criteria that I used.

Q. Okay. What about number of employees? Do you know how many employees that CH Energy has?

A. About a thousand. I don't know exactly. Maybe less than that.

Q. Maybe less?

A. Very small company.

Q. How about First Energy?

A. They're a much larger company. They have several thousand employees.

Q. In the list of factors that you relied on, was number of employees one of those factors?

A. I don't mean to cut this short, but in a sense it was, because Value Line only follows major publicly traded electric companies. And so I didn't go to those other additional issues. I used the five risk-based criteria that I described earlier in my testimony.

Q. And that's fine. That's exactly the testimony I wanted to hear.

How about number of customers? Do you know how many customers these companies have?

A. No. I know that -- that we have about 2,400 cus-- 2,400 employees, about 500,000 customers, but I don't know specifically what each one of these companies has.

Q. Right. Let me cut this short. You could look that up for each one of these companies, could you not?

A. And I have.

Q. And you have. But it's not one of the five explicitly stated criteria that you used in forming your proxy group?

A. It is not.

Q. Thank you. Now, you testified that you used a risk premium analysis based on ROEs allowed by state regulators relative to Moody's average utility debt costs in order -- as a test of reliability; is that correct?

A. That's describing structure of my risk premium test. That's part of it.

Q. Right. Okay. And you testified that you obtained a range of results from your risk premium analyses from 10.94 to 11.8; is that correct?

A. Well, the analysis that you were just asking me about was the 10.94.

Q. Oh, I see.

A. The Ibitson analysis and the Harriston-Marston analysis provide higher risk premiums.

Q. You did several risk premiums analysis?

A. I did one analysis and I reviewed the other authors' analyses.

Q. I see. Thank you. You can see I'm swimming in very deep water with this financial analysis stuff.

And you compared to ROEs allowed by other state regulators; is that correct?

A. Well, the structure of the analysis is to subtract the average utility interest rate on bonds from the average annual allowed rate of return on equity provided by state regulators, and that tells us what the risk premium for that year is.

Q. I see. Is there any kind of circularity problem using reported ROEs set by other state regulatory commissions?

A. I think that if we only used that approach, there could be. But since I'm looking at a period from 1980 up to the present and looking at essentially the informed judgment of all regulatory commissions around the country, I don't think circularity is a significant problem. I understand the argument and I understand certainly that if that were the only way we did the analysis, that it could be a problem.

Q. Are you familiar with this Commission's decision with respect to Empire District Electric Company Case ER-2004-0570?

A. Is that the case that was decided in the spring of '05?

Q. That is the case.

A. I have read their order in that, yes.

Q. And in that case, the Commission used an average ROE figure set by other state commissions as something of a benchmark, didn't it?

A. They referred to that in the order. As part of the record in that case, the company's witnesses provided DCF analyses and that sort of thing. The Commission then, it appears to me, used sort of as a check what other commissions had done.

Q. I see. Now --

A. Now, I'm -- I may be speaking a bit out of school there because I don't know exactly what was in their minds when they did it, but I know that they came up with an 11 percent ROE based on I think a 10.7 percent DCF analysis plus 30 basis points.

Q. In your expert opinion, using an average of other commission decisions in that way, is there a problem of circularity?

A. Not as a check of reasonableness. It demonstrates that other commissions, for example, through the first nine months of 2006 have given a rate of return of 10.3 percent for electric cases, many of them distribution cases. The ones that I was asked about earlier, the 9 percent ones were all distribution cases. And it gives me comfort to see how my analysis compares to what others that are making these same kinds of decisions are coming up with.

Q. Okay. Now, you propose a 50 basis point adder or upward adjustment, do you not, to reflect KCPL's high construction risk?

A. Yes.

Q. Okay. And on page 4 of your direct, you testified this approach of using a comparable reference group of utilities and adjusting for risk is consistent with the economic requirements of Hope and Bluefield. Do you recall that testimony?

A. Yes.

Q. Now, thinking back to those excerpts that I had you read from Hope and Bluefield, do you recall -- or should I say, isn't it true that there was no reference to an adjustment for risk in either of those excerpts, was there?

MR. ZOBRIST: Your Honor, I'm going to object to quizzing the expert on legal holdings of these cases. I think it's fair to quiz him on the general propositions which he relies upon as an economist, but I think conducting a legal examination of a non-lawyer is improper.

JUDGE PRIDGIN: I'm going to overrule. I mean, it's something that he's quoted in his testimony and I think counsel's asking him what that testimony says. So I'll let him answer that question.

THE WITNESS: I want to find the sentence that I want to say speaks directly to what you just asked me about.

BY MR. THOMPSON:

Q. Absolutely.

A. I found the first reference but I haven't found the second one here.

This is on page 14. If we look in the --

JUDGE PRIDGIN: I'm sorry. Do you need the question asked again, Dr. Hadaway? Because I think it was something to the effect of isn't it true.

And, Mr. Thompson, if you can ask your question again.

BY MR. THOMPSON:

Q. The question was, isn't it true that the excerpts that I had you read from the Bluefield case and the Hope case say nothing about an upward adjustment for risk?

A. I believe they do. I think we have a slight disagreement.

Q. Please explain how you think they do.

A. Okay. The sentence that I would like to point to is on line 15, page 14. And it's one that I believe -- part of what I was asked to read earlier.

By that standard, the return to the equity owner should be commensurate with the returns on investments in other enterprises of corresponding risks.

Q. Okay.

A. So to -- to reach corresponding risks, we have to make an adjustment that accounts for KCPL's current risk situation. That's what the adder does.

Q. Isn't it possible that what that sentence is referring to is the construction of the proxy group?

A. I don't think anyone can answer that question because we have no idea what the Supreme Court was thinking about when they wrote this decision in 1944.

Q. That's fair enough. But isn't it at least possible?

A. Oh, certainly it's possible. Anything is possible.

Q. Thank you. And speaking of the Supreme Court's requirements, we went through your list of proxy groups and we saw that several were not located in the Midwest; isn't that correct?

A. Predominantly they are. There are several that aren't, but it's a large group of 24 companies and --

Q. Sir, my question was, isn't it true that we saw that several were not located in the Midwest?

A. Yes.

Q. Thank you. And the Supreme Court did say, did it not, equal to that generally being made at the same time and in the same general part of the country; isn't that correct?

A. In 1923, that's what the Supreme Court said, yes, that is correct.

Q. I agree they said it in 1923, but they did say that. Right?

A. That's what they said.

Q. Thank you. Now, are you aware that Kansas City Power & Light has relied on margins from off-system sales for a significant part of its profit in recent years?

A. I -- I have seen testimony about that, but I have not studied that issue myself.

Q. I understand.

A. So --

Q. But you are aware of it?

A. Well, in very general terms I'm aware of it, but I don't know how much or whether it's significant or not significant or how significant it is.

Q. Would you be surprised if I told you that Kansas City Power & Light, through the testimony of another witness or witnesses, has proposed an ROE adjustment to reflect the risk associated with that sale margin?

A. I was able to watch on the excellent website that you have at this Commission, which in my experience is sort of unique around the country, Mr. Giles' testimony earlier and I heard that testimony. But beyond that, I have not investigated the issue.

Q. If you can have an ROE adjustment to reflect increased risk such as you have proposed with respect to construction risks and Mr. Giles has proposed with respect to off-system sales margin risks, can you also have a downward adjustment for decreased or reduced risk?

A. If it could be demonstrated that the subject company were somehow less risky than the proxy group, then yes, you could have symmetrical treatment.

Q. I'm guessing you do not agree that the regulatory plan additional amortization would, in fact, be just such an element of reduced risk to KCPL in this case?

A. I have read -- and I have read when I filed my Direct Testimony that plan and that stipulation. And for the equity shareholders, the effect -- if it affects the rate of return they would expect at all is very, very small compared to the effect for the bond holders. It is driven by Standard and Poor's credit metrics that deals strictly with the fixed income securities, the debt of the company.

Q. Very good. Now, are you familiar with the testimony of Robert Camfield that's been offered on behalf of KCP&L?

A. I have seen Mr. Camfield's testimony, but I did not investigate the area.

Q. Would you be surprised if I told you that he proposes a performance adjustment, an adder of 50 to 100 basis points, to reflect KCP&L's top level performance?

A. You would have to talk to him about your characterization of his testimony. The words may be there but in the company's requested ROE there's a 50 basis point adjustment and that was it.

Q. My question was, would you be surprised if I told you this is what he is proposing?

A. I have read his testimony, but the company is not proposing a 150 basis point adjustment.

JUDGE PRIDGIN: I think the question was would you be surprised.

THE WITNESS: I wouldn't be surprised. I've read his testimony the same as counsel has.

MR. THOMPSON: I think that's a no.

THE WITNESS: Yes, I'm sorry. No, I would not be surprised.

BY MR. THOMPSON:

Q. Thank you, sir. Can there be a similar adjustment -- and I know this is outside of your area, but could there be a similar adjustment for bad performance?

A. Yes.

Q. So if, for example, the utility had managed to, say, blow up a generating station, would that be an

instance of bad performance?
A. I would have to know the facts. If the utility was negligent and you had an investigation and the Commission determined that there was some imprudence, then imprudence typically has a connotation of bad performance. But no utility is going to intentionally or knowingly allow one of its generating stations to be blown up or to fall down or to break somehow.
Q. Are you, by any chance, familiar with an action brought before this Commission against Kansas City Power & Light by one of its industrial customers some years ago that operated in Missouri under the name GST Steel Company?
A. No.
Q. Would you be surprised if I were to tell you that GST Steel Company alleged that it suffered service of such poor quality that it faced the possibility of going out of business?
A. You're asking me these questions of would you be surprised. I don't know the facts of any of these things so I can't tell you whether I'd be surprised or not.
Q. Fair enough. I'll withdraw that question.
MR. THOMPSON: No further cross. Thank you, your Honor.
JUDGE PRIDGIN: All right, Mr. Thompson.

Thank you.

Let me see if we have any questions from the bench. Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning, Dr. Hadaway.

A. Good morning, Commissioner Murray.

Q. I have a few questions for you. Starting with page -- I'm trying to find the number. In your Direct Testimony -- the pages are numbered, aren't they?

A. Yes, ma'am. In the lower right-hand corner on mine.

Q. Okay. I had written over them. That's why I couldn't find it.

On page 30 you go into what you look at when applying the DCF model to a large reference group with investment-grade electric utilities. Correct?

A. Yes, ma'am.

Q. And on the bottom of that page and over on the next page, you list some of the things that you consider that the companies must have to be included; is that correct?

A. Yes.

Q. Are these the only criteria or the only factors that you apply in establishing the group -- the makeup of the group?

A. No. These are sort of the narrow discussions of the structure of the discounted cash flow analysis, but there are certainly many other factors that go into the other models and to the selection process.

Q. Okay. Mr. Thompson asked you a few of the things earlier. I don't recall whether he asked you if a company's location has any bearing on your choice.

A. It could have. At one time we excluded companies in the western section of the United States when the western energy crisis was actually going on. But typically we use more general risk-based criteria than just location.

Q. So would you say it's not a factor?

A. It -- it could be a factor. In this particular case, I did not exclude any companies because of their location. But most of them are through the middle part of the United States.

Q. Do you look at the company's fuel mix at all?

A. Yes. We didn't exclude any, but in some cases -- in past years when the concern about nuclear power was very high, if the subject company did not have nuclear generation, we would not use companies that did have nuclear generation.

Q. But in this case, you did not limit your choices to those who are electric only; is that correct?

A. We -- we limited them to the ones that Value

Line characterizes as major electric utilities, but they are indeed, many of them, combination gas and electric companies.

Q. Okay. And that was a little bit different question than I led into, but -- so how many of them are gas and electric?

A. I would have to -- to go back and look at them carefully. Value Line has about three different sections of utilities, The ones they characterize as major electric utilities or predominantly electric, then they have some local distribution gas companies that are a separate group and we have not included any of those. And they have some pipeline companies and some other energy providers and we have not included any of those. So these are predominantly electric companies, but some of them do have gas service territory.

Q. Okay. And do you consider at all the load factors?

A. In this case we did not, but --

Q. Do you generally?

A. -- again, I -- I have in some cases. Where a particular entity has mostly residential customers, their load factor will be low. In other cases where some companies have extremely high concentrations of industrial customers, there have been discussions that those companies sometimes are more risky and that -- it's more the concentration of the customer size than it is load factor, but it's sometimes reflected in the load factor of the companies.

Q. Mr. Barnes, Staff's witness, indicated, I believe, that he had relied on a projected three- to five-year forecast. Is that your understanding?

A. Yes. The -- the Value Line projections are for three to five years. The other surveys are usually for five years.

Q. And what did you rely on in terms of the forecast?

A. The main thing that I relied on is the long-term forecast growth in gross domestic product. In the traditional model that I ultimately eliminated after the check of reasonableness, I did review analysts' forecasts, Value Line forecasts, the Value Line sustainable growth B times R method. And with those three and GDP, I determined an average growth rate.

Q. And where are -- which schedule would that be?

A. It's Schedule 4.

Q. Which has five pages?

A. Yes, ma'am.

Q. And which page specifically?

A. The summary is on page 1. And then in the copy that I have, it appears that the other pages may have been left out. But the second page is the constant growth traditional model, the third page is the constant growth with gross domestic product as the growth rate, and the fourth page is the two-stage DCF model. The front page in the column titled Traditional Constant Growth DCF Model is the one where I use the four different growth rates.

Q. Okay. And I'm sorry, I probably should have understood your answer better, but the number of years that you're looking at?

A. In -- in the GDP growth rate, we went back to 1947 and did various weighted averages, sort of a forecasting methodology, that gave greater weight to the more recent time periods because growth rates have been slower with lower inflation and so forth. But we looked at a period from 1947 in this case up through 2004. We've now updated that through 2005. It doesn't change the results.

For the analyst estimates, the Value Line numbers are three to five years and the Sachs Analyst Survey is for five years.

Q. And what is your rationale for using the longer period?

A. If we look at Schedule SCH-5, I think this is the -- the key thing about why the analyst growth rates are difficult to use right now by themselves.

Q. I'm sorry. Schedule 5 did you say?

A. Yes, ma'am.

MR. THOMPSON: Judge, if I could, as filed, the testimony of Dr. Hadaway does not include pages 3, 4 or 5 of his Schedule 5 and so no one has seen it and it's not in the record of the case.

JUDGE PRIDGIN: I believe Mr. Thompson is saying that some -- and I'm sorry. Could you repeat that for the --

MR. THOMPSON: Pages 3, 4 and 5 of Schedule 5 to the Direct Testimony of Dr. Hadaway were not filed with his testimony in EFIS and, therefore, no one's seen them and they're not part of the record of the case as far as I'm aware.

THE WITNESS: Excuse me, counsel, it's Schedule 4.

MR. THOMPSON: Schedule 4. I'm sorry.

MR. BLANC: And I can speak to that, your Honor. It's correct that in his initial direct, only page 1 of Schedule 4 was included but the other pages were supplementally submitted.

COMMISSIONER MURRAY: They were added on April 3rd, I believe; is that correct?

MR. BLANC: Yes, Commissioner.

MR. THOMPSON: I'm sorry. I wasn't aware of that.

JUDGE PRIDGIN: Not a problem. That's quite all right.

I'm sorry. Dr. Hadaway, do you need the Commissioner to ask the question again?

THE WITNESS: Yes. On Schedule 5, we have the analyst growth rates compared for two different time periods. And there -- there is only one page to -- to Schedule 5.

BY COMMISSIONER MURRAY:

Q. Now, you have the analysts' growth rates compared to two different time periods you said; is that correct?

A. Yes, ma'am.

Q. And you're comparing Value Line earnings with Value Line BR. And I'm sorry, tell me again what BR is.

A. It's the sustainable growth method that is sometimes used along with analysts and other approaches to estimating the growth rate. The comparison --

Q. What does that mean --

A. Excuse me.

Q. -- sustainable growth method?

A. When Professor Gordon developed the discounted cash flow model back in the 1950's, he proposed that one method -- in fact, he proposed the method of calculating G in that model would be to multiply the earned rate of return times the company's earnings retention percentage.

So B is the retention percentage and R is the earned rate of return on the equity investment. Those two multiplied together tell you the growth rate that the company would be able to sustain with the reinvestment of earnings that it does.

Q. And that compares to the other -- just the Value Line earnings? How is that calculated?

A. Okay. If I may, they're -- they're kind of two separate analyses. In the first three columns, the company's names are listed. And then 2001 Value Line earnings is the earnings growth rate estimate for 2001 that Value Line made at that time. The growth rate that they projected is averaged at the bottom and it was 6.8 percent.

What I said earlier when asked questions about this was that that was entirely consistent with the 6.6 percent gross domestic product growth rate that we are using in the present case.

If we look ahead to 2005 when we prepared this schedule, Value Line's earnings growth rates had dropped by 2 1/2 percentage points from 6.8 percent down to only 4.3 percent.

My testimony is that that doesn't seem like a very appropriate long-run permanent growth rate if it fluctuates that much. And so I attempted to find other methods and I looked to see what other commissions had done. And the Federal Energy Regulatory Commission has routinely used gross domestic product growth, GDP growth, in gas pipeline cases. Some other commission staff members have used GDP growth, in New Hampshire, for example, and to a slight extent in the Utah in cases I'm familiar with.

But it's my effort to try to deal with this short-term drop in analyst growth rates. That drop has a tremendous effect since G is directly added in in the DCF model to the other people's ROE estimates. Without such a low G, the ROE estimates would have been much higher, very much like mine.

I presented the traditional method using these low estimates to show that 9.3 or 9.4 is what you get. I tested that against the risk premium numbers and those results failed to pass the test of reasonableness so I rejected them. I went back to the 6.6 percent forecast GDP growth rate, put it into the model and it produces approximately 11 percent ROE, slightly higher than that.

Q. Thank you. Now, how does this compare to the projected growth rates that Staff witness used? I believe he said he relied on S&P and you're talking about Value Line here. Are we talking about the same item?

A. I think on the growth rates we're -- we're talking about the same item. He used S&P to initially select their integrated utilities to begin his comparable group selection. But then we all used some form of analyst growth estimates like the ones that I used. I don't think there's any dispute about those numbers being in the 4 percent or so range.

Mr. Baudino found in his company a slightly higher number than that, but it depend-- and Dr. Woolridge found a slightly lower number than that. But the analyst growth rates are for the three- to five-year period and the GDP growth rate is for the very long period general growth in the economy.

Q. But GDP growth rate was not used by the other parties; is that correct?

A. That's correct.

Q. On page 10 of your Rebuttal Testimony, you talk about, on line 12 and following, Ida Corp. And you're referring to data in Mr. Barnes' Schedule 17; is that correct?

A. Yes, ma'am.

Q. And you indicate that inclusion of Ida Corp in his small sample group makes the group average fall 4.62 percent. Is that your testimony?

A. It -- it cuts the average because there are only five companies in there and they have an extremely low dividend yield. So that one item cuts the dividend yield by 24 basis points so approximately a quarter of a percent from 4.86 down to 4.62.

Q. Okay. And in the year -- your position is that that company should have been excluded for -- because it

had an undue effect on a small sample; is that correct?
A. There -- there are two things. That and the use of such a small sample simply lends itself to these kinds of problems. I said there was a reliability problem and there's a representativeness problem.
So -- so the reliability problem is sort of statistical anomaly that occurs when you have one company that is sort of unusual and you average it in with the others. It has a larger effect than it would have had in a much larger group.
Q. What was the second problem? The reliability problem and represent--
A. Representativeness. He -- he didn't have any companies that were in the midwestern portion of the country. His -- his companies -- southern companies in the southeast only and the other companies were predominantly in the west.
Q. Okay. And if you were -- if you're trying to determine what is a reasonable sample size, what criteria do you use to determine that?
A. I try to make my samples as large as I possibly can. Over the years, I have seen difficulties arise and the extreme cases have been where witnesses have been -- it has been suggested that witnesses might have selected their companies for a particular outcome.
That certainly is not suggested here. No one

has said that. We've generally agreed -- Mr. Baudino, Dr. Woolridge and I used almost the same companies. Mr. Barnes chose to use a smaller group but certainly not for any unreasonable reasons as far as selecting companies. His group is just too small, as far as I'm concerned.

But the -- the issue on sample size falls out from the criteria that I used. I use an investment grade bond rating criteria, 70 percent of revenues coming from regulated operations so that unregulated activities don't dominate the companies.

The DCF model, because it depends on the dividend yield, we have a requirement that dividends must not have been cut in the past two years. We have a requirement because prices can be affected by what's happening with mergers and acquisitions and that can cause unusual yield results, perhaps like the Ida Corp situation. So if an company is in any way involved in mergers or acquisitions, we tend to try to eliminate those.

Then we look at other things that are slightly more subjective. For example, Entergy is not here because one of its subsidiaries filed for bankruptcy protection. So unusual financial events like that can cause a company to be excluded.

But I try, as generally as I can, to keep the group as large as possible. And 24 companies is what resulted when we did this particular analysis back at the end of 2005.

Q. Okay. And none of the other parties who used a smaller sample relied upon any of those companies that you would have excluded for the reasons you just listed, did they?

A. Certainly Dr. Woolridge and I used exactly the same companies. I don't recall -- I know I looked at Mr. Baudino's sample and I didn't have any problems with it. My main problem with Mr. Barnes was his sample was too small.

Q. Size. How do you decide -- if you're looking at whether to eliminate a company from a group, other than those things that you just talked about, do you look at whether inclusion of that particular company results in a -- or affects the result to a greater degree than the other companies' individual inclusion would affect the results?

In other words, do they have to -- to have some reasonable relationship to each other in terms of how they affect the results?

A. We try very hard to avoid that. Now, that fifth criterion where we look at things like whether to include Entergy or not, we certainly did not look to see what Entergy's estimated ROE was and then eliminate it or include it because of that. I think that would be selectivity, that's not appropriate.

What we try to do is go, as I said before, from a very large group, 60 companies, all the major companies that are listed in Value Line in the electric group, we apply, as objectively as we can, and I believe we provide or we -- I don't know if they requested it or not, but we generally provide a sheet that shows exactly why various companies out of the 60 are not included. Typically we're asked in the discovery process for why a company or another one is not included. I don't recall whether we were in this case.

Q. So the necessity to eliminate a company because it skews the results -- its inclusion skews the results would pretty much disappear from the need to be considered if the group were large enough; is that right?

A. It certainly reduces the effect. I don't know if it would disappear. If something is extreme enough, than it probably should be considered even in a large group.

For example, if -- if a company is rumored to be about to enter into a merger situation, sometimes its stock may shoot up 20 or 30 percent. That will reduce its dividend yield to a very low level like Ida Corp, for example. I don't know why Ida Corp has such a low dividend yield. But those kinds of things can cause us even in the large group to go in and say, That company's not appropriate.

Q. And basically it's something that's out of the ordinary for one reason or another?

A. Right. It's not comparable to the other companies or to the subject company that you're trying to estimate ROE for.

Q. Back to your Direct Testimony for a minute. On page 26 you speak about market uncertainties and increasing utility capital costs. And from line 15 on down through the bottom of the page you talk about all utilities being affected by the industry's transition to competition; is that correct?

A. Yes, ma'am.

Q. So I think what you're saying is that even in unrestructured states like Missouri, the electric utilities are experiencing investor uncertainty which increases the need to account for more risk in their ROE; is that accurate?

A. That -- that's the general statement of it. The sort of best place probably to see that is to look at the volatility of the Dow Jones utility average that I showed a few pages earlier on page 24.

The -- through this period of restructuring and consolidation and various things that have occurred, starting at the top of page 24, the Dow Jones utility average was at the level of 310 in 2002 early, it dropped to 180, it went up to 400, it dropped back to 280. Utility stocks have simply been much more volatile through this period than historically they would have been.

Now, at the present time we're back up to a level of over 400. Whether that's going to remain, it really depends on where interest rates go, if they go on up like they're forecasted to do in 2007 after the election is over, then we -- you know, we may see continuing volatility.

Q. And how does the volatility in utility stocks compare to the volatility in all other stocks?

A. Typically utilities are about -- if you look at their beta coefficients, which measures how utilities fluctuate relative to other companies Mr. Baudino has the Value Line betas in his analysis and they're about .8. That means they're about as 80 percent as volatile. He has some other betas that says they're .6.

Depending on which source you use, utilities typically are less volatile than the overall market. The concern that some people have, even with the CAP-M results is related to this increased volatility of utility stocks over the past five years. And their betas have -- they are reported to be higher than they were earlier than that.

Q. And if you look back before 2001 -- 2001 and earlier, for example, what would the betas have come out for utilities?

A. They certainly would have been more like .6 to .7. It's not a huge difference, but there are some statistical reasons for the difference. It depends on the time period and the exact methodology that's used. So there will always be some differences based on the sources.

Q. And those increases in beta you're suggesting are being experienced by all electric utilities whether they are in restructured states or not; is that --

A. Well, it's not just caused by the restructuring, but, for example, the beta for Ameren I have here off their Value Line sheet, if I can find the right spot, is .75. And they -- and so in Value Line they -- they range more like the .75. Some of them are even like .9.

And -- and what that indicates, I think -- and certainly, you know, Ameren has got maybe some other issues, but that even companies that have not gone through restructuring may have gone through other things that -- that have contributed to this as well.

Q. Do you have a schedule that's showing these?

A. I do not. Because of -- these are in my work papers and I brought those along with me.

Q. Did you do the beta calculation for Great Plains?

A. I have the Value Line sheet for it. Its beta is .9.

Q. That's pretty high, is it not, for an electric utility?

A. Well, for the overall market the beta is 1. It's an index. That's an assumption. And for technology type stocks, the beta might be 1 1/2. For utility stocks, it's typically less than 1. And it used to be farther from 1 than it has been in more recent years.

Q. The higher the beta coefficient, the greater the risk; is that correct?

A. In the capital asset pricing model. There are concerns that people have about that model, but just in the textbook presentation, CAP-M, yes, that's correct.

Q. Did you do any beta calculations for -- I guess you didn't list them anywhere, but did you look at the beta for any of the other companies that you listed in your comparables?

A. I looked at them in the Value Line sheets. I just reviewed the sheets and that's certainly one of the things that I look at. But I generally do not apply the capital asset pricing model. I use the allowed rate of return risk premium study that's in my Schedule 5 in place of a capital asset pricing model.

Q. Okay. And how many basis points did you add for risk?

A. For the construction program risk, I added 50 basis points.

Q. And is that the only risk you considered?

A. I considered some of the risk that I was asked about earlier such as the off-system sales methodology that's used for KCPL and the effect of the stipulation, particularly after that was raised in the other people's testimony. In my

Rebuttal Testimony I responded directly to that.

But I only really focused and my analysis in my testimony only gives a comparison of KCPL's construction program relative to the construction program of the comparable companies. That's my Exhibit 1. And -- and that's where we -- we made the comparison showing that the KCPL construction program, relatively speaking, is almost twice as large as the average for the group.

Q. And you did not adjust for off-system sales?

A. I did not explicitly, no.

Q. And you did not adjust for the regulatory plan?

A. Not explicitly, no.

COMMISSIONER MURRAY: Thank you.

JUDGE PRIDGIN: Commissioner Murray, thank you very much.

Commissioner Appling?

QUESTIONS BY COMMISSIONER APPLING:

Q. Good morning, Doctor.

A. Good morning, Commissioner.

Q. You are recommending a 11 or 11.5 for KCPL?

A. I'm recommending an 11 percent base ROE for the comparable companies, plus 50 basis points for KCPL's higher construction risks. So the requested ROE is 11.5 percent.

Q. Okay. Let's go to your Direct Testimony on page 6. And I also want to go to page 11 after we talk just a little bit about page 6.

The question in the center of page 6, would you -- I'm trying to get a better understanding of how you landed on this number so that I can work with that. So take the question on line 12 on page 6. Would you just kind of generally -- not in long terms, but shortly take me through that. And then page 11, we'll go to that.

A. Okay. On page 6 what I'm referring to is kind of the overall results of the analysis. If we look at the very end of the testimony, there is a table that summarizes all the outcomes. I believe it's on page --

Q. 28?

A. Maybe you're right. The one I'm thinking of is on page 35. It's a further summary of some of that -- of the same data.

Q. I'm with you.

A. Okay. On page 35, the results of the discounted cash flow analysis are shown there on lines 8 through 11.

Q. Got you.

A. And the two versions of the model that I endorsed after checking them for reasonableness and so forth, indicate a range of 11.6 -- I'm sorry, of 10.6 to 11.3. So the 11 percent number that I ultimately recommended comes from pretty much the center of that range. So that discussion back on page 6 is in effect -- it says we've come down to a return on equity of 11 percent for the group. The basis of that statement on page 6 is this range that's ultimately presented here on page 35.

Q. Okay. Thank you. On page 11, I think it's line 5, the question, if you'd talk to me just a little bit on that.

A. This section of the testimony is sort of the textbook presentation of how risk and return are related. And as risk is higher than investors demand and expect and historically have received a higher rate of return. If we look on the next page on page 12, there's a graph that attempts to demonstrate those relationships.

Common stocks that we're talking about for the equity rate of return have a range around a center point. The center point is, as Commissioner Murray was asking me about, sort of those companies with a beta of 1. Companies that are in the technology business, Dell Computer company or others like that, have betas that are higher than 1. Utilities, because they are regulated, most of them, and have typically more conservative cash flows and more stable cash flows have betas that are less than 1.

So it's up and down that -- what's called the capital market line in that graph that we look at the risk return relationship. And that's what I'm explaining back there on page 11.

Q. Thank you. I think that's helpful.

COMMISSIONER APPLING: Thank you very much.

JUDGE PRIDGIN: Commissioner Clayton?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Sir, I apologize for coming in the middle of your testimony and I just had a few questions that popped up that I wanted to run by you.

First of all, your suggestion for the appropriate cost of equity is what? How much again?

A. 11 1/2 percent.

Q. And that's based on a benchmark of 11 percent, then you add in 50 basis points --

A. Yes.

Q. -- is that correct?

What model did you use on -- on the 11 percent number?

A. The principal model is the discounted cash flow model.

Q. And then how many additional models did you use to test that figure?

A. I did one study of my own that is presented in Schedule 5, my risk premium analysis. And I reviewed two

other risk premium studies. So in total, three.
Q. Okay. Okay. And they confirm the 11 percent figure?
A. Yes, sir. The risk premium study that I did, based on allowed returns from other commissions, provided a number of 10.94 percent, which was very consistent with the 10.6 to 11.3 that I got from the DCF model. The others are higher. I don't really rely on those others, but I demon-- I use those to demonstrate sort of the relative level of my own risk premium levels.
Q. Okay. Is this your first time testifying before a Public Service Commission?
A. No, sir, it's not.
Q. It's not? I'm surprised by that answer. How many times would you say you've testified before any US Public Service Commissions or Utility Commissions?
A. Between two and three hundred times.
Q. Two and three hundred?
A. Yes.
Q. Holy mackerel. You've been in this business a while?
A. Yes, sir.
Q. How many years you been doing this type of work?
A. Counting the time at the Texas Public Utility

Commission, since 1980. So going on 26 years.

Q. Since 1980. So you were at the Texas Commission prior to 1980?

A. That's when I came there as chief economist.

Q. That's when you went to -- when did you leave the Texas Commission?

A. 1983.

Q. 1983. Something else. Congratulations on your work.

What is the highest return on equity figure that you've ever recommended?

A. I would have to go back and look. I know that some of staff recommendations from people working under my supervision --

Q. Let's focus on -- I'll tell you what, just for clarification, while you've been in private sector acting as a consultant rather than working in a government agency.

A. I think the highest that I recall is 16 1/2 percent on behalf of Bethlehem Steel in Pennsylvania in a rate case.

Q. Okay. How about in a -- Bethlehem -- that was on behalf of the --

A. The industrial intervenors in the case, yes, sir.

Q. And how long ago was that? Was that in the

'80s?

A. Probably 1984, 1985.

Q. I'll tell you what. Why don't we restrict the time period because the times were significantly different in the '80s than they are today. In the last, say, five or ten years, what would you say your highest ROE would be? And I'm not going to hold you to a specific figure. If you struggle that, if you could give me a range.

A. Generally in the 11 to 11 1/2 percent range.

Q. And in that same time period, what would you suggest the lowest ROE would be that you've recommended while working for a utility?

A. I think 11 percent is probably the lowest.

Q. Okay. So is it fair to say that your recommendations, at least in the shared cases from the last five or ten years, the recommendation have been between 11 and 11.5 percent?

A. Last year we had a case for Pacific Corp in California where they asked for an 80 basis point adder, so that was the actual highest one was 11.8. But generally 11 percent to 11 1/4 has been the base ROE. I'm sort of at the low end of that right now and the adders have caused the numbers to be higher.

Q. Seems like an awful lot of work to go into these calculations when the spread isn't very wide. Would you agree with that statement?

A. We try to look at the data for the market at each point in time. And if you look at the Regulatory Research Associates' outcomes for the various regulatory commissions around the country, you find a spread that not very wide. It has become wider as interest rates dipped down last year and the records were made at the very bottom of that interest rate cycle.

Q. Have your recommendations over time also dipped down like the rest of the country as you just suggested?

A. Absolutely. I was, as I told you, above 16 percent back in the '80s. And as the markets have changed and even in recent years as interest rates have come down, my recommendations have declined from 11 1/4, 11.4 as a base ROE down to presently 11 percent in this case.

Q. Okay. Okay. The 50 basis points adder that you included in your final recommendation 50 basis points based on what?

A. I tried to study the risk adders that this Commission has used and that other commissions around the country have used in recent cases. The Federal Energy Regulatory Commission has been the most explicit about that and their risk adders have ranged from 50 to 200 basis points.

I also reviewed your decision in the Empire

District case and saw the debate there between 30 and 60 basis points and saw that this Commission added on 30. So that's -- there aren't any models like the DCF model or the CAP-M that we can plug in factors and come up with a risk adder, but --

Q. Okay.

A. -- based on reviewing those cases, that's what I found.

Q. And you added those 50 basis points focusing though on facts specific with KCP&L?

A. Yes, sir. In my Exhibit 1.

Q. And which facts were those? I think suggested construction of the plant, the Iatan plant; is that correct?

A. Yes, sir. In my Exhibit 1, I demonstrate the size of the KCPL construction program in the coming years relative to the size of the projected construction programs from comparable companies, demonstrated it's almost twice as big. And that's the basis -- the analysis that I did to demonstrate a risk adder should be applied.

Q. Did you take into consideration the regulatory amortization plan or the regulatory plan that KCPL has in place from a prior case?

A. Yes, sir, I did.

Q. How did you address that plan and the components of that in your risk adder? Did you reduce your risk adder? Did you increase it? Was there a zero effect?

A. There essentially ended up being a zero effect. I found from my reading of that document, the stipulation, that the effect on credit ratings, the debt bond ratings of the company are directly addressed there. The impact on shareholders is somewhat questionable about the substitution of amortization or depreciation for earnings.

So I -- I'm not sure that I see a reduction at all in the risk to shareholders from that plan. Certainly it is a constructive plan, it is a good thing for trying to get this plant built as cheaply as possible for your constituents and the company's customers, but -- but it focuses mostly on fixed income securities.

Q. So it's your testimony that the result of the workshops associated with the regulatory plan that's been approved, the workshop, the case, the Stipulation and Agreement, the order approving that Stipulation and Agreement from this Commission did absolutely nothing to reduce the amount of risk that KCP&L faces in the marketplace?

A. Well, Mr. Commissioner, please -- I didn't intend to say that at all.

Q. Okay. That's okay. I want to be clear, so feel free to elaborate.

A. Certainly with respect to maintaining the company's bond ratings and its access to capital, the plan is an excellent and a hard piece of work that all the parties did together. The details of how all of it works are things that other people here know much, much more about than I do.

But from my reading of the plan back in late 2005 when it was sent to me when we were preparing the initial Direct Testimony, there is not much in the plan that addresses the shareholders' position. Certainly if the bond rating of the company is maintained, it's better to have an investment-grade bond rating from the shareholders' perspective than it is a non-investment-grade bond rating.

But you don't have additional amortizations that directly say that an ROE of this level or that level should be adjusted to account for those things, like you do the S&P metrics for the bonds.

Q. Well, just so I'm clear -- I don't want to belabor this, just to be clear though. If the workshops leading to a case, leading to a stipulation, leading to an order where this Commission approved the Stipulation and Agreement, if all that work had not occurred, would your estimate for cost of equity still be 11.5 percent and be unchanged from what it is today?

A. If the company had lost its investment grade bond rating, then the estimate of the cost of equity, if that had been caused from the regulatory of the side of the business by the construction of this plant, then my estimate of ROE would have indeed been higher.

Q. Okay. Are there any other factors associated with the risk adder that you'd like to bring up on how you arrived at the 50 basis points or any other factors?

A. Other witnesses -- other witnesses have discussed other factors in the case, but my assignment and the work that I did, the analysis, was just related to the construction program.

Q. Okay. Okay. How many cases are you in right now, are you in the process either finishing up or just starting would you say right now?

A. Probably six.

Q. Six cases. And is this ROE at the high end or low end of the recommendation of those cases?

A. It's at the low end.

Q. It's at the low end?

A. The 11 percent base ROE is.

Q. I see. Can you tell me what states that you have ongoing work?

A. Yes. We have a case in New Mexico, a gas case, where the recommendation is 11 percent. There is a case in Louisiana where the recommendation is 11 1/8 percent, it's just an unusual situation over there, sort of a show-cause case.

Q. French common law. It's weird down in Louisiana. I understand.

A. And we have some other cases that we are preparing that amount to the other four that I just described of the six.

COMMISSIONER CLAYTON: Okay. Okay. I don't think I have any other questions. Thank you, sir.

THE WITNESS: Thank you.

JUDGE PRIDGIN: Commissioner Clayton, thank you.

I think I have just a question or two. Before I ask, let me verify with counsel, are we going to have some recross examination, I would assume and some redirect, I would assume?

Okay. Let me just ask a quick question or two and then since we've been going for a couple hours, this looks to be a good time to take a break before recross.

QUESTIONS BY JUDGE PRIDGIN:

Q. Dr. Hadaway, did I understand your testimony just a second ago to say that there's not much in that Stipulation and Agreement that would benefit shareholders?

A. Well, I may not have said it very artfully. It's not that there's not a benefit probably to the -- to the customers, the shareholders, the bondholders, to everyone. It's a constructive plan and I -- that's why I responded the way I did to the Commissioner's follow up.

But there is not an explicit adjustment to benefit the shareholders in the way there is an explicit adjustment to maintain the bond rating for the bondholders.

Q. What benefit, if any, explicit or implicit, would there be for the shareholders in that experimental regulatory plan?

A. Well, it could cut both ways, but certainly the maintenance of an investment-grade bond rating is very, very important. We have found the spreads, if you lose investment-grade bond rating on the debt side, to be three to four to five times as high as for investment-grade bonds. There is not a book to look in to see then how much higher is the return on equity, but it certainly is higher. So we've prevented that.

On the other hand, the present case provides a very strong example of how complicated plans like this can perhaps not benefit shareholders at all. If you substitute a large amount of amortization for a very low ROE, then the earnings of the company are hurt now and they're hurt as you go forward because its rate-base is smaller. So, you know, there's a two-edge sword here just a little bit.

JUDGE PRIDGIN: And I don't have any questions beyond that. Thank you very much.

This does -- before we begin recross, since this witness has been on the stand for a while, this does look to be a convenient time to break. It's 10:25 on the clock at the back of the wall, so let's resume at 10:40. Thank you very much. We're off the record.

(A recess was taken.)

JUDGE PRIDGIN: All right. We're back on the record. We just finished with Bench questions for Dr. Hadaway and we will have some recross.

And before we begin that, let me double check with counsel as far as travel schedules. I think we have two witnesses left either Dr. Woolridge and Mr. Schnitzer. Is there a preference for which one goes first?

MR. ZOBRIST: Well, I was going to put on Mr. Schnitzer right now and I think we could -- well, I can't, of course, speak for other counsel. My plan was to get him done before noon and put Dr. Woolridge on right after lunch.

MR. PHILLIPS: Due to the travel that Dr. Woolridge faces, we would like to have him on next if at all possible. And we would be willing to work through the noon hour with him if that would help. Because I think some of the Commissioners' questions that they've asked this morning of Dr. Hadaway they might like to explore with Dr. Woolridge sooner rather than later. It might be beneficial to keep the record together.

JUDGE PRIDGIN: Mr. Thompson?

MR. THOMPSON: Judge, I have medical reasons I can't work through the noon hour. You're well aware of them.

JUDGE PRIDGIN: I understand. Mr. Zobrist?

MR. ZOBRIST: I was going to say, I don't know Mr. Schnitzer's travel plans, but he is, you know, from the east coast and I know he needs to leave tonight. And I've got questions for Dr. Woolridge, but it's probably not going to be more than 20, 30 minutes at the most.

Mr. Schnitzer needs to be in Philadelphia tonight and he needs to be on a plane mid to late afternoon.

JUDGE PRIDGIN: Okay. Let's go ahead and resume with recross and if we have to have Mr. Zobrist and Mr. Phillips get together to see if there's some way we can accommodate all these folks, certainly do the best we can. Anything else before we begin recross of Dr. Hadaway?

All right. Thank you. Which counsel would like recross? Mr. Thompson, Mr. Mills. Anyone else?

Mr. Mills, when you're ready, sir.

MR. MILLS: I just have a few questions.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Dr. Hadaway, Commissioner Murray asked you some questions about betas and particularly how they relate to electric utilities that operate in restructured states. Do you recall those?

A. Yes.

Q. Would the beta of a company that operates either wholly or significantly in a restructured state be higher or lower than a company that does not operate in a restructured state?

A. I haven't seen any tests to determine that.

Q. So you don't know if there's any correlation at all?

A. I haven't seen any empirical tests. In theory, if the company's risk is lower, its beta should be lower.

Q. So is the risk higher or lower in a restructured state?

A. Well, that's the problem. There's a mixed bag of things there.

Q. Okay. How about Illinois, in particular? Would you believe that a company that operates in Illinois faces a higher or lower risk than a company that operates, say, in Missouri?

A. It depends on which portion of the company you're talking about. The distribution0only pieces of the company, according to the rating agencies at least, have less risk and they can support a higher debt ratio and those kinds of things than the integrated companies.

Q. So a company that's a distribution company in Illinois should face less risk than a company that's a vertically-integrated company in Missouri?

A. The rating agencies have said that. There's still debate about it.

Q. But the rating agencies are the ones that come up with the betas; is that correct?

A. No, no. I'm sorry. Rating agencies rate the bonds, the fixed income of the companies. And they've said that distribution-only companies can carry more debt. I have not seen a study that says distribution companies have lower or higher betas. I don't think -- it would be very difficult to do that test.

Q. Okay. Now, Commissioner Clayton asked you some questions about the regulatory plan. Were you involved in the development or the negotiation of the regulatory plan?

A. No.

Q. Did you have any input to KCPL on that?

A. No.

Q. Okay. So your only involvement was after it was executed and approved and then you looked at it in the context of this case; is that correct?

A. Yes. That's exactly right.

Q. Now, in the context of this case, have you formed an opinion as to if there was no regulatory plan for KCPL, would KCPL have been downgraded in the last year?

A. It's speculation, but there's certainly a chance they would have been.

Q. Okay. Does the cash flow that KCPL is receiving right now under current rates allow it to meet the metrics set forth in the regulatory plan?

A. I don't know.

Q. Now, the basis of your testimony and, in particular, the 50 basis point adder, is that there needs to be an explicit adjustment that recognizes the risks to shareholders because of the construction projects; is that correct?

A. Yes.

Q. And that's obvious to you, is it not?

A. I'm not sure if I know what you mean by "obvious."

Q. It was not something that you had to struggle hard to realize that there was, in your opinion, additional risks to shareholders that was not recognized in the regulatory plan; is that correct?

A. That might be a fair assessment, but the judgment that I made was based on my experience in this industry for a long time. And certainly seeing what has happened to shareholders with large construction programs over the years was an additional element beyond what you've mentioned.

Q. And I'm not talking about the level of the adder that you've proposed. I'm talking about the fact that you recognized that there was a need to go beyond what was set forth in the regulatory plan to take care of the risk to shareholders from the construction project. That was obvious to you, was it not?

A. Well, it -- I'm struggling because --

JUDGE PRIDGIN: Can you give a yes or no answer? Because I think he's asking that was obvious, was it not?

THE WITNESS: I'm not sure I know what he means by "obvious."

MR. MILLS: I'm certainly willing to give him the latitude to explain how obvious or unobvious or what it was to him. I'm not trying to restrict him.

JUDGE PRIDGIN: Thank you. I'm sorry. You can answer?

THE WTINESS: Judge, if I may very briefly, it -- "obvious" may be the right word. All the parties -- not all the parties because all of you haven't agreed, but the parties that deal with this company found the need and created a plan to deal with the bond ratings of the company to maintain an investment grade rating. I picked companies that have investment grade ratings.

So if we had the construction risk and didn't have the regulatory plan, indeed -- I was asked earlier, the required rate of return might have been higher because we couldn't use investment grade companies. So there is a need relative to just a base investment-grade company to have the adder.

I'm not saying that it was obvious to me until I analyzed the size of this company's construction program relative to others, the data I presented in Exhibit 1. So the word "obvious" is the part I'm struggling with.

BY MR. MILLS:

Q. Okay. Would the company -- at the time that it determined what its construction programs should look like, would the company have recognized that it was relatively large?

A. Sure they did.

Q. Okay. But yet at the time they negotiated the regulatory plan, they didn't put anything in there about an ROE adder to accommodate the risk to shareholders; is that correct?

A. Well, there's nothing in there like that, but I don't know what all they considered.

Q. But as far as you're concerned, in the regulatory plan itself, there's nothing that addresses the risk to shareholders -- nothing that specifically addresses the risk to shareholders and accounts for it in the way that your 50 basis point adder does?

A. Well, in my response to the Commissioner earlier, I tried to explain that it can cut both ways for shareholders. But certainly maintaining the investment grade bond rating is a good thing for customers, for the company, for shareholders and its bondholders.

Q. But even though it's a good thing, it's not sufficient because you have recommended a 50 basis point adder?

A. Having reviewed what this Commission, what the FERC and what other commissions have done under similar circumstances, it was my judgment that that was the appropriate thing that should be done.

Q. But it wasn't done in the regulatory plan?

A. Not that I know of.

Q. Okay.

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

JUDGE PRIDGIN: Mr. Mills, thank you.

Mr. Thompson?

MR. THOMPSON: Thank you, Judge.

RECROSS-EXAMINATION BY MR. THOMPSON:

Q. Dr. Hadaway, you had a fairly extensive discussion with Commissioner Murray about the defects in Mr. Barnes' analysis. Do you recall that?

A. I recall our discussion of his comparable group.

Q. Well, nonetheless, with all the problems with his comparable group, he still achieved a result that you have admitted is just about identical to the result you, yourself, achieved doing a traditional constant growth DCF model. Right?

A. First model in my Schedule 4, yes.

Q. Thank you. And you had a discussion with Commissioner Clayton about the level of your recommendations in recent years. And I believe you testified to him that they have run between 11.0 and 11.5; isn't that correct?

A. And then I remembered that I had testified in California to a higher -- an 80 basis point adder that resulted in 11.8 last year.

Q. Okay. And that's kind of what you guys would call an outlier; isn't that right?

A. Outliers usually have to be shown to be statistically different from the rest of the numbers, and I don't know that 11.8 is that much different than 11.5.

Q. So let's take your testimony then to Commissioner Clayton as being amended, if you would, in that your recent testimony has run between 11.0 and 11.8. Is that a fair statement?

A. I believe that's what I explained to him.

Q. Okay. And if you look at the chart that you very helpfully provide at the top of page 28 of your Direct Testimony, wouldn't you agree with me that for the most part, your 11.0 to 11.8 recommendations have been above and in some cases significantly above the average ROEs awarded by state regulatory utility commissions in 2004 and 2005 as you have represented those ROEs in your chart?

A. For 2004, the ROE was 10.75 percent.

Q. That was the average. Right?

A. Yes, sir.

Q. And in the first quarter, the average was 11.00. Right?

A. Yes.

Q. Which, in fact, is the low end of what you've been testifying to. Right?

A. That's right.

Q. But that's the only one of those eight quarters in which the average has reached 11, isn't it, according to your chart?

A. That is correct.

Q. And nowhere did the average go above 11 in those eight quarters; isn't that correct?

A. The averages did not. Some of the cases did.

Q. I understand that. But my question was about the averages.

A. You're correct.

MR. THOMPSON: Thank you. No further questions.

JUDGE PRIDGIN: Mr. Thompson, thank you.

Mr. Zobrist, redirect?

MR. ZOBRIST: I just had one question, Judge.

REDIRECT EXAMINATION BY MR. ZOBRIST:

Q. Dr. Hadaway, are you familiar with what the parties discussed in negotiations that led up to the Stipulation and Agreement?

A. No, sir.

MR. ZOBRIST: Nothing further, Judge.

JUDGE PRIDGIN: All right. Thank you.

There's nothing further from the Bench. All right. Dr. Hadaway -- I'm sorry, Mr. Dottheim.

COMMISSIONER CLAYTON: Someone creeping forward here.

MR. DOTTHEIM: Just one item I had visited with Mr. Zobrist about while we were on break.

Yesterday when I was cross-examining Mr. Cline on additional amortization, I had a question to him regarding a schedule and a hypothetical. I asked whether Mr. Hadaway's capital structure would change for the true-up for September 30th and I was directed to Mr. Hadaway; that is, with the hypothetical that if -- in the September 30th true-up if the company had in its case regulatory plant additional amortizations.

The company -- I believe it was on Saturday, but it's shown in EFIS as having been filed on Monday, the company made a filing of its true-up as of September 30th and built into that true-up is $12 million of additional amortization.

JUDGE PRIDGIN: Okay. You can certainly ask questions of Dr. Hadaway.

MR. DOTTHEIM: Well, I'll go into that.

And the Staff obtained this morning the work papers for the capital structure in which the true-up is based and which the update for the prior update, which is June 30th, capital structure was based and there is a change.

I visited with Mr. Zobrist, who's visited with Mr. Hadaway and Mr. Hadaway cannot explain the difference. So we're going to defer this then to the true-up when the company will provide someone who can explain the change in the capital structure from June 30th to September 30th and whether that relates in any manner to the additional amortizations of $12 million which is now in the company's September 30th update. So thank you.

JUDGE PRIDGIN: Thank you, Mr. Dottheim.

If there's nothing further for this witness -- all right, Dr. Hadaway, thank you very much, sir. Appreciate it.

THE WITNESS: Thank you, Judge.

JUDGE PRIDGIN: Now, I don't want to play travel agent. I know that Dr. Woolridge and Mr. Schnitzer both have travel plans. And, Mr. Zobrist if you and Mr. Phillips need a moment to talk, certainly.

(Off the record.)

JUDGE PRIDGIN: Do we have a preference from counsel, an agreement?

MR. ZOBRIST: Judge, I think Dr. Woolridge has more pressing travel plans so I don't have a problem going through that.

I would like at this time to offer Dr. Hadaway's testimony, which are Exhibits 33, 34 and 35.

JUDGE PRIDGIN: Okay. Any objections? Exhibits 33, 34 and 35 are admitted.

(Exhibit Nos. 33, 34 and 35 were received into evidence.)

JUDGE PRIDGIN: And if Dr. Woolridge would come forward to be sworn, please.

(Witness sworn.)

JUDGE PRIDGIN: Thank you very much, sir. Please have a seat.

And, Mr. Phillips, anything before he's tendered for cross?

MR. PHILLIPS: There are a couple of corrections we need to make. When his testimony was filed on EFIS, we discovered there was an error in his affidavit and also an error in a schedule. What we have done is bring today some bound volumes of his testimony which has those two corrected, which I'm going to ask him to identify, but we also found that in the new printed version, that for some reason there was gobblety gook inserted in some of the questions. And so we need to correct those questions first so that his answers will be more responsive to the questions as they appear now.

So I'm going to just read through those for you and ask him if, as corrected, those are the questions that he has responded to in his testimony. And then I'll ask him about the corrections of the affidavit and schedule.

J. RANDALL WOOLRIDGE testified as follows:

DIRECT EXAMINATION BY MR. PHILLIPS:

Q. Dr. Woolridge, first of all, let's go to page 49. And at page 49 there is a question at line 7. Do you see that?

A. Yes.

Q. We need to strike the letter "L" after the "Q" for question. And then the question should read, Please initially discuss the problems with his 50 basis point risk adjustment. Striking the "S" and inserting in lieu thereof a "5" and then deleting the "E" at the end of adjustment; is that correct?

A. Yes.

Q. And then at page 50 -- excuse me, the correction I gave you was page 50. I'm sorry.

Page 49 at line 20, the "Q" once again has an "L" after it which needs to be deleted. And it should read, Please review Mr. Hadaway's equity cost rate approaches, deleting the lingering "L" for some reason that wanted to stick there. So that needs to be corrected. Correct?

A. Yes.

Q. And then at page 51, line 11, the question, once again, has an "L" in there, In assessing the riskiness of Kansas City Power & Light, has Mr. Hadaway considered elements of the Stipulation and Agreement? There's an "L" after Mr., M-R, isn't there?

A. Yes.

Q. That needs to be deleted.

At page 55, the question is at line 11 and this question came out that should -- Please assess Mr. Hadaway's discussions of the slowing growth of electric utility companies. There's another "L" there and then there's some other gobblety gook for that question, isn't there?

A. Yes.

Q. But as I stated, that's how you responded in your answer was to the question, Please assess Mr. Hadaway's discussion of the slowing growth of electric utility companies; is that correct?

A. Yes.

Q. And, finally, at page 57 at line 12 it reads, Please initially assess Dr. Vernara's examination and that should be --

A. Dr. Hadaway.

Q. -- Dr. Hadaway; is that correct?

A. Yes.

Q. And the other corrections to your EFIS filing is Exhibit 7, page 2. The page was blank as filed, wasn't it?

A. Yes.

Q. And that's corrected in this copy?

A. Yes.

Q. And then finally the affidavit -- the affidavit that was filed on EFIS was incorrect and the affidavit here is correct; is that correct?

A. Yes.

Q. All right. Are there any other changes or additions --

A. No.

Q. -- to your testimony?

Your Direct Testimony has been filed and stamped as Exhibit 801, your Surrebuttal as Exhibit 802.

MR. PHILLIPS: I would offer those into evidence at this time.

BY MR. PHILLIPS:

Q. And it's my understanding, Dr. Woolridge, this is the first time you've testified before this Commission; is that correct?
A. Yes.
Q. Thank you.
MR. PHILLIPS: I would tender Dr. Woolridge for cross.
JUDGE PRIDGIN: All right. Thank you. Mr. Phillips, let me find those exhibits.
MR. PHILLIPS: Judge Pridgin, you swore him, didn't you?
JUDGE PRIDGIN: Yes.
Mr. Phillips, I'm sorry, did you offer exhibits -- I'm sorry -- 801 and 802?
MR. PHILLIPS: I did.
JUDGE PRIDGIN: All right. Thank you. Any objection?
Hearing none, Exhibits 801 and 802 are admitted.
(Exhibit Nos. 801 and 802 were received into evidence.)
JUDGE PRIDGIN: Anything further before he's tendered for cross?
Mr. Phillips, is this witness ready for cross?
MR. PHILLIPS: He is.

JUDGE PRIDGIN: All right. Thank you. Counsel wish cross?

MR. ZOBRIST: Kansas City Power & Light does.

JUDGE PRIDGIN: Staff. Any other parties?

Mr. Dottheim, when you're ready.

MR. DOTTHEIM: Yes, thank you.

CROSS-EXAMINATION BY MR. DOTTHEIM:

Q. Morning, Dr. Woolridge.

A. Morning.

Q. Dr. Woolridge, at page 52 of your Direct Testimony, Exhibit 801, lines 5 and 6 you make reference to the amortization to maintain S&P's financial ratio benchmarks. And on page -- well, in Exhibit 802, your Surrebuttal Testimony on page 4, lines 13 and 14, you make reference to the amortization to maintain S&P financial ratio benchmarks that are in the Kansas City Power & Light regulatory plan Stipulation and Agreement, do you not?

A. Yes.

Q. Kansas City Power & Light is presently triple B rated by Standard and Poor's?

A. Yes.

Q. And triple B rating is investment grade?

A. Yes.

Q. Dr. Woolridge, is it a certainty that Standard and Poor's would downgrade Kansas City Power & Light if it did not meet the triple B metrics?

A. No.

Q. Well, could you please explain that?

A. I mean, companies on an ongoing basis don't meet the metrics for the ratings they achieve. And, in fact, if you read any of the S&P documentation or those of Moody's, they'll say these are not strict guidelines. These are simply metrics they look at. And they're very insistent to indicate that these are not the strict guidelines that some people think they are.

I've been involved in several cases where commissions have set things based off of the S&P metrics. And the thing is, first of all, these metrics are broad ranges. Second of all, if you look at Moody's, their range -- their metrics tend to be much more lenient in terms of what their ranges they look at to achieve a certain bond rating.

But they are not strict guidelines. And, I mean, that's kind of my observation from looking at these things over the years. But all you have to do is read the S&P documentation on their ratios and that's the first thing they tell you, they're not strict guidelines.

MR. DOTTHEIM: Thank you, Dr. Woolridge. That's all.

JUDGE PRIDGIN: Mr. Dottheim, thank you.

Mr. Zobrist?

CROSS-EXAMINATION BY MR. ZOBRIST:

Q. Good morning, Dr. Woolridge.

A. Good morning.

Q. I'm Karl Zobrist. I represent the company in this case.

Now, am I correct that since obtaining your educational degrees, you've spent your full-time employment either teaching or consulting?

A. Yes.

Q. Okay. And has the bulk of that time been teaching at the college level?

A. I teach at the university level. Probably teach more on the executive level. I've taught in 25 different countries around the world to executive groups and that sort of thing. So it's kind of both university and executive.

Q. Okay. Have you ever worked for a regulated public utility?

A. No.

Q. Okay. Have you ever worked full-time for a for-profit institution?

A. I mean, I've worked a lot as a consultant for all the major investment banks and that sort of thing. So I guess it depends. If I have an ongoing consulting arrangement, I guess it's not full-time, but I have regular engagements.

Q. And you attached an Appendix A to your Direct Testimony; is that correct?

A. Yes.

Q. And that sets forth the proceedings in which you have testified on behalf of various clients?

A. Yes.

Q. And am I correct that on none of those occasions have you ever testified on behalf of a regulated public utility?

A. No.

Q. Okay. Now, you had a reference -- if I could ask you to turn to page 73. And this may be just a typographical error. But under Connecticut it indicated that you had offered some testimony in a KCP&L --

A. Oh, no.

Q. -- case. And I'm just wondering if that was correct, because I'm not aware Kansas City Power & Light Company does any business in Connecticut.

A. No. That was a United Illuminating case.

Q. All right. Thank you. And in these proceedings where you did testify, you were testifying on behalf of governmental offices, mainly consumer advocate offices; is that true?

A. Yes. Or staffs of utility commissions, that sort of thing, correct.

Q. Okay. And today you're here representing the US Department of Energy; is that correct?

A. Yes.

Q. Okay. And is it your position that the recommendations that you're giving to the Missouri Commission here are consistent with policies that the Secretary of Energy has espoused?

A. No, I don't know if they are. I mean, I haven't reviewed so -- reviewed those.

Q. Okay. Who is the Secretary of Energy?

A. Secretary of Energy today -- I don't -- I don't know who the Secretary of Energy is right now.

Q. His name is Samuel W. Bodman. And if I could ask you to -- well, are you aware that the policy of the Department of Energy is to encourage investment in our nation's outdated energy infrastructure?

A. I know that is one of their policies, yes.

Q. Okay. And you are familiar with the Department of Energy having supported the introduction and the passage of what became the Energy Policy Act of 2005. Correct?

A. I -- yes, I believe they have.

Q. Okay. And, in fact, are you aware that the subtitle of the electricity title within the Energy Policy Act is called the Electricity Modernization Act of 2005?

A. Yes. I'm not familiar with the act.

Q. Okay. But you are familiar that it's the policy of the United States Department of Energy to facilitate infrastructure growth that may be necessary to meet the demands of the emergency economy. Correct?

A. Yes. That sounds reasonable.

Q. Okay. And is it also the policy of the Federal Energy Regulatory Commission to encourage investment in our energy infrastructure?

A. Yes. They're the regulator.

Q. Now, in your testimony I believe on page 1 you said that you had been retained by -- if I'm pronouncing it correctly -- Keres, K-e-r-e-s, Consulting?

A. Yes.

Q. Now, who is Keres Consulting?

A. They are a group that has been retained by the Department of Energy to oversee situations, rate cases, that sort of thing.

Q. Okay. Where are they located? I'm not familiar with them.

A. I mean, I deal mostly with the folks in New Mexico.

Q. Okay. All right. So you've actually been hired by Keres Consulting, not by the Department of Energy?

A. Yes.

Q. Okay. And the Department of Energy is the one that's hired Keres Consulting; is that correct?

A. Yes.

Q. Now, on page 1 of your testimony at the bottom, pages 20 and 21, you say that you're appearing here on behalf of DOE and the National Nuclear Security Administration, and then you say, quote, and other affected federal agencies, closed quote. Do you see that, sir?

A. Yes.

Q. Who are the other affected federal agencies?

A. As far as I know, any who would obviously be a -- a customer of -- of KCPL in one capacity or another. I --

Q. Do you know who those are explicitly?

A. No.

Q. All right. All right. Now, let me direct your attention, if I might, to your testimony, I believe it is on pages 6 and 7 of your direct related to the 2003 dividend tax cut. And the 2003 dividend tax cut was part of an act that was formerly known as the Jobs and Growth Tax Relief Reconciliation Act of 2003; is that correct?

A. Yes.

Q. And as you've told the Commission, that reduced the maximum statutory tax rate on dividends from

38 percent to 15 percent?

A. That -- yes.

Q. And then there was also a reduction on the top rate of long-term capital gains from 20 percent to 15 percent --

A. Yes.

Q. -- correct?

And the purpose of that reduction was to hopefully stimulate an investment in the stock market; is that correct?

A. Well, yeah. I mean, one thing it does is effectively reduce pre-tax returns of investors.

Q. And that's supposed to have the effect of lowering the cost of capital to business, thereby stimulating more investment and job creation?

A. Yes.

Q. Okay. And is it your opinion that the tax cut has accomplished that goal?

A. I -- I haven't studied that. I really don't know. I couldn't tell you for sure.

Q. Well, isn't your testimony to the Commission that it has done that and that is a reason why the recommendation of Dr. Hadaway should not be accepted?

A. No. I mean, my -- my testimony is that -- that if you -- it has reduced the pre-tax returns of investors by some degree. And what that degree is, is -- is tough to measure. But by reducing the pre-tax required returns, it should reduce the overall cost of capital for US corporations. The -- the extent to which that is is highly debatable.

Q. If you could turn, sir, please, to page 7, lines 9 and 10. You state there, Overall, the 2003 tax law reduced the pre-tax return requirements of investors, thereby reducing corporations' cost of equity capital?

A. Yes.

Q. So are you disagreeing with that, that you really don't know whether it reduced corporations' cost of equity capital or not?

A. I said it did, I just didn't -- the extent to which I don't know.

Q. So are you familiar with studies that have said it really did not have that effect?

A. No, I'm not.

Q. Okay.

(Exhibit No. 53 was marked for identification.)

BY MR. ZOBRIST:

Q. Dr. Woolridge, let me hand you what I've marked as KCPL Exhibit 53. This is a study that was prepared by the Division of Research and Statistics and Monetary Affairs of the Federal Reserve Board. And if you go to page 3, it was prepared September 26th, 2005. And take a moment just to look at it. I don't expect you to digest the whole document, but my question is just going to be, are you familiar with this study?

A. No.

Q. Okay. So you have not read this study?

A. No.

Q. Okay. Are you familiar at all with its conclusions that it found that US large cap and small cap indices did not outperform their European counterparts nor real estate investment trust stocks over the evident window, suggesting little, if any, stock market effect from the tax change?

A. Well, first off, I'd say given the methodology they used, I'd question the results. Event study methodology, I mean, that's kind of passe in the world of finance. So I mean, just looking at it on -- in terms of what they did and reading the abstract, I would question the results. But I -- I don't know the study.

Q. Okay. And is it fair to say that there have been studies on both sides of the issue as to whether the dividend tax cut had an effect on the stock market or whether it didn't have any effect on the stock market?

A. Yeah. I mean, I haven't seen any varied comprehensive studies on it, but you know, we do know if you look at -- you know, if you look in the world of investments, you know, investors care about taxes. And you have municipal bonds, you don't pay federal taxes and the yields reflect that. So that's the notion behind the discussion I make here.

Q. This dividend tax cut would have only affected individual stockholders of publicly-traded companies. Correct?

A. Yes.

Q. So it would not have had any effect on institutional investors in Kansas City Power & Light Company or any other company?

A. Well, it's going to affect those where eventually those taxes have to be paid by an investor.

Q. Well, for an institutional investor, it doesn't pay taxes on corporate dividends. Correct?

A. Well, they say if you have distribution in a mutual fund, that sort of thing, you pay taxes.

Q. Now, on pages 66 through 77 of your Direct Testimony, you criticize Dr. Hadaway's use of the risk premium analysis. Do you recall that?

A. Yes.

Q. Okay. Now, you were here this morning when Dr. Hadaway testified. Correct?

A. Yes.

Q. And did you understand him to say that he simply used the risk premium analysis as a check of reasonableness of his DCF calculation?

A. Yeah. I don't think I read that in his testimony, but I did hear him say that. I mean, I don't think his testimony read that way, I don't think it was presented that way. I do agree that that's what he testified to this morning.

Q. Do you recall that Dr. Hadaway at pages 15 and 16 of his direct said that use of the risk premium analysis provided a useful parallel approach with the DCF model?

A. Yes. I mean, the word "parallel," I guess it depends how he's defining that.

Q. And he stated at page 35 of his testimony that his risk premium analysis should not be extrapolated directly as stand-alone estimates of the cost of equity but they do provide a reasonable long-term prospective on market -- excuse me, capital market expectations for debt and equity rates of return; is that correct?

A. Yes.

Q. Okay. Now, looking at the big picture of the recommendations that have been provided to the Commission, you're the low ball in the group; is that correct?

A. Yes.

Q. Okay. You're at 9.0 percent?

A. Yes.

Q. Staff is at 9.32 to 9.42 percent; is that correct?
A. Yes.
Q. And Public Counsel is at 9.90 percent, 90 basis points higher than your recommendation. Correct?
A. Yes.
Q. And then the company's is 11 percent plus the 50 basis points for construction; is that correct?
A. Yes.
Q. Okay. And you did not take into consideration in your specific numeric recommendation to the Commission the fact that KCPL is embarking upon this $1.3 billion construction program; is that correct?
A. Well, no. I mean, I didn't make a specific adjustment for it like Dr. Hadaway did. And, you know, I said why I didn't in my testimony. And, you know, it's -- had to do with their capitalization and the -- the Stipulation and Agreement.
Q. Okay. Now, let's talk about the Stipulation and Agreement for just a moment. Do you understand that that still is under attack in the courts by opponents of the stipulation?
A. I don't know the extent to where it is. I just looked to see who all read it and saw who all signed on.
Q. So you're not aware that the Stipulation and

Agreement and this Commission's order is being challenged legally in the Missouri Court of Appeals?

A. No.

Q. Okay. Now, are you aware that your principal in this case, the Department of Energy, did not sign the Stipulation and Agreement?

A. Yes. But -- and I -- it looked like most of the major intervenors did.

Q. Okay. So you don't consider the Department of Energy a major intervenor?

A. Well, they're one of the few that didn't. But I mean, the Staff, the Public Counsel, major industrial users, that sort of thing.

Q. Well, and the Department of Energy is the only intervenor in this case -- I exclude Public Counsel because they're part of all of our proceedings. The Department of Energy is the only intervenor that has provided an ROE witness in this case. Are you aware of that?

A. Yes.

Q. Okay. And the other intervenors -- are you aware that there are four other intervenors in this proceeding who also did not sign the Stipulation and Agreement?

A. No.

Q. Okay. And have you read the Stipulation and Agreement?

A. Yes.
Q. So you're aware that the costs that the company incurs in building Iatan 2, the wind generation and environmental retrofits, are subject to challenge if they're not viewed as prudent by even the signatories to the agreement. Right?
A. Correct.
Q. And, in fact, if the Commission finds that KCPL has failed to prudently manage its costs, continuously improve productivity and maintain service quality during the regulatory plan, that will negate the obligation of the signatory parties to support additional amortizations. Is that your understanding?
A. Yes.
Q. Did the stipulation result in Standard and Poor's or any other rating agency raising KCPL's credit rating?
A. No. But I think it's more of a downside protection than an upside.
Q. And would you agree that it's more of a downside protection for the bondholders than it would be for other interested --
A. I think it's very much downside protection for both bondholders and stockholders.
Q. More for the bondholders than stockholders?

A. Not necessarily.
Q. Okay. Now, you agreed to utilize for purposes of your discounted cash flow study the 24 companies that Dr. Hadaway proposed; is that correct?
A. Yes.
Q. So you had no quarrel at all with the companies that he chose?
A. No. It's a broad group of electric companies.
Q. And that's appropriate for this type of proceeding. Correct?
A. Well, I think a broad group can give you an indication of an appropriate equity cost rate, yes.
Q. Now, I believe in your testimony you and Dr. Hadaway had a discussion as to whether you included short-term debt in a capital structure equity ratio; is that correct?
A. Yes.
Q. Okay. And what was the point that you were making? That you did not include short-term --
A. Yes.
Q. -- debt? Okay.
A. I mean, I did -- I mean effectively it does when you look at -- I think it's Exhibit JRW-3. That's a calculation that's done by AUS Utility Reports. And they compute common equity ratios there. And at that point there

was -- they do -- they do include short-term debt in terms of total capital.

Q. In fact, that's just what I was going to say. Maybe I don't want to need to put this into evidence. It is true that when AUS Utility Reports defines common equity ratio, that that does include short-term --

A. Yes.

Q. -- debt?

A. Yes.

MR. ZOBRIST; Okay. Judge, I think that's all I have.

JUDGE PRIDGIN: Mr. Zobrist, thank you.

Any questions from the Bench? Commission Murray?

COMMISSIONER MURRAY: Not much.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning.

A. Good morning.

Q. What are the DOE facilities that would be impacted by this decision?

A. I'm not sure of all the facilities. It's the one in Kansas City that I'm aware of, but that's all I really know.

Q. And how large is that facility?

A. I don't know.

Q. All right. On page 5 of your Direct Testimony you quote from a book called Stocks for the Long Term. And it was published in the fall of -- wait a minute. I'm looking at the wrong thing here.

Okay. You're not quoting from the book. You're quoting from a study written by the author of that book, I believe --

A. Yes.

Q. -- Jeremy Siegel. And the study is called The Shrinking Equity Risk Premium from Journal of Portfolio Management in the fall of 1999; is that correct?

A. Yes.

Q. Is he talking about PE ratio there when he talks about the historical level of -- when he talks about the high level of equity prices relative to fundamentals?

A. Yes. Probably most likely price earnings ratios, price to dividend ratios. Those are the two most prominent.

Q. Are those ratios, those PE ratios, how do they compare now to how they -- to the level at which they were in 1999?

A. In 1999, the S&P 500 peaked out around 38. We look at the market value today, obviously the stock market has measured by the Dow is at an all-time high. PE ratios today are in the low 20s.

Q. So why is this study relevant today to this case?
A. It's relevant -- this is one of many studies I cite in my testimony regarding the equity risk premium. And Jeremy Siegel studied this over 100-year time frame and just noted the fact that -- that the equity risk premium has declined relative to where it was. He studies this -- in Stocks for the Long Term he studies over 100 years of stock prices and this is one of -- one of his observations.
Q. The extent to which the dividend tax cut affected the pre-tax earnings -- I should say affected the cost of capital for utilities, is it possible that that effect was zero?
A. I mean, I -- the example I say would be -- it would be like 100 basis points, but I said that's clearly the high end.
Q. Is it possible to be zero?
A. The bottom line -- it's very unlikely. All you have to do is think about municipal bonds. Investors care about taxes. Municipal bonds trade at yields to reflect the fact that you don't pay federal income tax on the interest you receive. So it -- it's -- it's extremely unlikely, in my opinion, it was zero, mainly because investors do care about taxes. They pay taxes. So if you reduce their taxes, just like municipal bonds, it's going to reduce their pre-tax

returns.

Q. Is it possible, since you can't quantify the effect, that it is a negligible effect?

A. Well, it's an effect. Now, the thing is, for example, since Mr. Hadaway -- Dr. Hadaway and myself both are -- were using -- and other witnesses are both using stock prices primarily pre-- or post this, that the prices we reflect -- the prices that we look at reflect this tax law.

But the historical perspective is that if we look at history, look prior to that, interest in div-- I mean dividends and capital gains were taxed at a higher rate. So that just if you look at from a very broad standpoint, if you believe this is, in effect, taxes affecting investors, then you would say that capital costs have declined. The extent of which is very tough to measure.

Q. So it could be from negligible up to 100 basis points?

A. It could be. I'm just saying I think it's unlikely it's negligible.

Q. You think it's unlikely it's 100?

A. I think it's unlikely it's 100 too.

COMMISSIONER MURRAY: I think that's all I have. Thank you.

JUDGE PRIDGIN: Commissioner, thank you.

Commissioner Appling?

QUESTIONS BY COMMISSIONER APPLING:

Q. Good morning, sir.

A. Good morning.

Q. Mr. Dottheim asked you a question, I think it was the first question he asked and only question I think that he asked about downgrading of KCPL. Do you remember that question?

A. Yes.

Q. And your answer was?

A. My answer was -- I mean, his question related to the -- S&P produces ratios and -- and the question was are these -- if you -- if you don't hit these ratios, are you automatically downgraded and that's not the case. That's been my observation.

But if you read S&P's documents on these, they'll say they call them -- these are not strict guidelines, these are just -- these are broad ranges that they use when they look at a bond -- a company -- where the rated company's bonds are.

Q. Have you ever seen a company that has been downgrade under that system?

A. I mean, when it -- they have a downgrade, they will include -- they'll talk about the business environment, financial performance and they may mention some of the ratios, but I -- if you read the documents that S&P puts out on their bond rating system, they talk a lot about how it's not strictly tied to the metrics themselves.

Q. Okay. But if you're wrong, you'll get paid --

A. If --

Q. -- KCPL gets downgraded?

A. If you're wrong -- you're right. If you're wrong, I mean, it's a big cost. I mean, that's why I think this provides the -- this plan provides downside protection because this is like an insurance policy. And -- and Dr. Hadaway said the worst thing that could happen to this company for the company, for the customers, for the stockholders, the bondholders, would be a downgrade. So that's why -- the -- the plan is good in that sense.

COMMISSIONER APPLING: Thank you.

JUDGE PRIDGIN: Commissioner, thank you.

I have no questions. Any recross?

RECROSS-EXAMINATION BY MR. ZOBRIST:

Q. Dr. Hadaway, if you had -- I'm sorry.

JUDGE PRIDGIN: Mr. Dottheim, any recross?

Mr. Zobrist, go ahead.

MR. ZOBRIST: Thank you.

BY MR. ZOBRIST:

Q. Dr. Woolridge, have you had any specific conversations with any representative of Standard and Poor's about Kansas City Power & Light Company?

A. No. I was on a conference call that we had which was with somebody from Standard and Poor's, but I don't know if I asked any of the questions.

Q. When were you -- when did that conference call occur?

A. A couple months ago.

Q. All right. Is it fair to say that the company's in a better position to describe its relationship with Standard and Poor's and their beliefs as to the future of the company than you are right now?

A. Oh, most certainly.

MR. ZOBRIST: Thank you, Judge.

JUDGE PRIDGIN: Mr. Zobrist, thank you.

Any redirect?

MR. PHILLIPS: Yes, your Honor.

REDIRECT EXAMINATION BY MR. PHILLIPS:

Q. Would it make any difference to your return on equity or your overall return who the Secretary of Energy is at the moment?

A. No.

Q. Would it also make any difference in your return on equity or your overall return as to how large the DOE facility is in Kansas City?

A. No.

Q. Have you done anything differently in your study relating to a recommended or ROE in this case due to your work relationship here than with any other case that you've been in or any other client that you've served?

A. No.

Q. And you're not here today as a policy witness for the US Department of Energy, are you?

A. No.

MR. PHILLIPS: Thank you. That's all I have.

JUDGE PRIDGIN: All right. Thank you. All right, Dr. Woolridge, thank you very much, sir. You may step down.

And do we need to -- to accommodate Mr. Schnitzer's travel plans, do we need to go ahead and forge on?

MR. ZOBRIST: We certainly can, Judge. If you would like to take a break, I think he can, but I would -- I've been told there's not much cross so maybe we can get him done a little after 12:00, but --

JUDGE PRIDGIN: If there's not a whole lot of cross-examination. Okay. Very good.

MR. ZOBRIST: Judge, I was going to move to admit what I'd marked as Exhibit 53.

MR. PHILLIPS: No objection.

MR. MILLS: Hang on. I do.

JUDGE PRIDGIN: Mr. Mills?

MR. MILLS: Number 53, if you recall, was the paper that the witness said he'd never seen before and that based on his brief reading of the abstract, he contested the very foundation of its approach.

I don't think there's any foundation that has been laid for that. The only foundation we have is that that based on his roughly 30 seconds to 60 seconds review of the abstract, he disagrees with the whole approach taken in the paper. So I don't think we have any foundation as to its accuracy or its credibility. In fact, I think the only evidence we have is it's neither accurate nor credible, so I object to its admission.

MR. ZOBRIST: Judge, the report is a report that was issued by the staff of the Federal Reserve Board. It is publicly available. Dr. Woolridge did acknowledge that there are studies out there. He did not dispute the authenticity of the report and that's why it's being offered. And certainly he is free to disagree with that and that's a matter of record, but I believe that as a government report, it is essentially self-authenticating and he did not dispute that.

MR. MILLS: Authenticity, accuracy, availability, even relevance, none of those have anything to do with foundation. It can be available, it can be authentic, it can be even relevant but if you can't lay a foundation for it with a witness, then it's not admissible. And there was absolutely no foundation laid whatsoever for this exhibit.

JUDGE PRIDGIN: Mr. Zobrist?

MR. ZOBRIST: I think foundation has been laid. It clearly is a document that has been published by the Federal Reserve Board and you don't need to, under the liberal rules of evidence, particularly in administrative agency files, to have to bring in someone from Washington, DC from the Federal Reserve Board to say, A-ha, this is a report.

I might point out that I think it's page 2 of the exhibit itself contains the website of which it can be found and that in itself is evidence that it is an authentic exhibit.

JUDGE PRIDGIN: I'll overrule. Fifty-three is admitted.

(Exhibit No. 53 was received into evidence.)

JUDGE PRIDGIN: And Mr. Schnitzer's on the stand; is that correct?

MR. ZOBRIST: That's correct, your Honor.

(Witness sworn.)

JUDGE PRIDGIN: Thank you, very much, sir. Mr. Zobrist, anything we need to take up?

MICHAEL M. SCHNITZER testified as follows:

DIRECT EXAMINATION MR. ZOBRIST:

Q. Mr. Schnitzer, are there any corrections to your testimony in this case?

A. There are not.

MR. ZOBRIST: I tender the witness for cross-examination.

JUDGE PRIDGIN: Parties who wish cross. Mr. Mills. Any others, Mr. Dottheim?

Okay. Mr. Mills, when you're ready, sir.

MR. MILLS: I'm still shuffling away my ROE stuff and trying to get to this.

CROSS-EXAMINATION BY MR. MILLS:

Q. Mr. Schnitzer, I'm going to start out with just some sort of general questions. And I'm going to start out by referring to, just as an example, Schedule MMS-8 to your Rebuttal Testimony. It's an attachment to your Rebuttal Testimony MMS-8.

A. And I apologize. I'm not certain I have that here in my book.

Q. I think perhaps for my question really all you have to know is that it's this bell curve.

A. Yes, sir.

Q. And it's a highly confidential exhibit. I'm not going to ask you about any numbers on it. I'm basically going to talk to you about the shape of the curve and that sort of thing.

A. Yes.

Q. Now, help me understand your role in this case. Did you go to KCPL and say, I've created this bell curve that illustrates the probabilistic distribution of off-system sales margins for the upcoming year and you ought to include in your rate case this point right here on that curve?

A. No, sir.

Q. Okay. Basically what you did is you created the bell curve, showed it to KCPL and it was their policy decision what point on the curve to include in their rate case; is that correct?

A. Roughly, yes. My assignment was to quantify the risk inherent in the range of off-system margins and to provide that quantitative risk assessment to them. The choice of what to propose in this case for rate treatment was theirs.

Q. Okay. Now, help me understand exactly what Schedule MMS-8, and I think there's a couple of other schedules that look roughly similar to that, show. What is the Y-axis on that kind of a curve? The Y-axis being the vertical one.

A. Yes. The Y-axis in these probability distribution curves is the probability of a particular point on the curve. So points that are closer to the horizontal access, you know, are -- are lower probability and points on the curve that are more distant from the X-axis, higher on

Y-axis, are more likely or more probable.
Q. And on the X-axis, the horizontal axis, what is shown there?
A. What is shown there is the level of off-system margins under the assumptions of a particular scenario in millions of dollars for the year 2007. And -- and I should also note with reference to your previous question, the -- the area under the curve, if you will, is -- sums to 100 percent.
Q. Okay.
A. So all the probabilities sum up to one, if you will, on the curve.
Q. And I think I can refer to these two numbers without revealing any highly confidential information, but if you start at zero dollars for off-system sales margins, there's essentially zero probability that that will happen?
A. There's a very low probability of that.
Q. And as you get up into the really big numbers to the right of the scale, you get to -- and I don't know exactly where, but at some point you get to a statistically almost zero point that that could be achieved?
A. Yes. An extremely unlikely event.
Q. Okay. And as you look at sort of the middle part of the curve where it bumps up into sort of a rounded peak, the numbers at or around the top of that peak are the ones that KCPL, from your analysis, is most likely to achieve?

A. Well, as individual cases, they are -- they are the most likely cases to -- to occur. That's not the same as saying that something in that range is very likely going to happen. There's still a substantial probability cumulatively that something outside that narrow kind of range that you described could, in fact, occur.

Q. Right. But if you had to pick a point, the point that is most likely to occur compared to any other point on the graph is the one at the very, very top?

A. Yes. And if that was your only criteria, yes, that would be the most likely.

Q. Okay. And if you were to pick a range of points, a range on the X-axis, so if you were to pick a range of off-system sales margins, the way you cover the most probabilities, the way you cover the most area under the curve, is to pick the points that are at and closest to the peak of that curve; is that correct?

A. Well, un-- under the following qualification, and let me describe it. If what you're saying is for a given increment on the X-axis, 50 million or 100 million, 20 million for a given increment where would I put that increment to cover the largest possible probability?

Q. Exactly.

A. The answer to that question is sure it's right -- right around the middle. But that sort of, again, it's not the same as saying it makes it less unlikely that -- that you're going to experience events outside that increment.

Q. Right. And depending on the increment, you could get, for example, 50 percent of the area under the curve or you could get 90 percent if you draw it wider or you could get just a single 1 percent if you draw it very narrowly?

A. That's exactly right. That's exactly right.

Q. Okay. Now, in terms of probability distribution, what does the 25th percentile mean?

A. The 25th percentile means that there's a 25 percent likelihood that the off-system margin will be lower than that number.

Q. And, conversely, a 75 percent likelihood that it will be larger?

A. That is correct.

Q. So if you were to talk about the area underneath the curve, if you were to draw a line straight down from the 25th percentile mark, the area that is larger than the 25th percentile would be three times as large as the area that's less than the 25th percentile?

A. Yes. The number of events on one side would be three times as many as the number on the other, that is correct.

Q. Now, if you were to do the same exercise at the 50/50 point, at that point the area of the curve to the left of that line and the area of the curve to the right of that line would be identical in size?

A. Yes. The number of scenarios falling on either side would be the same, that's right.

Q. Okay. Now, are you familiar with, in your review for this case, the Stipulation and Agreement that we have been calling in this case the regulatory plan?

A. I have a high level of familiarity with it, yes.

Q. A high level of familiarity. Were you involved in the negotiations or the discussions that came up with that plan?

A. I was not.

Q. Okay. So when were you and/or your firm engaged by KCPL?

A. I think in the fall of 2005. I don't recollect the precise date.

Q. And your specific role at that point was for involvement in this particular rate case; is that correct?

A. Well -- well, the first thing that we were asked to do was quantify the level of the wholesale risk -- the wholesale margin of risk that existed, the off-system margin of risk that existed with the possibility that that might be something the company would want to deal with or include in the rate case. But the first assignment, to my recollection, was to have our opinion how broad that range really was.

Q. Okay. And so your contract with KCPL didn't say that you're going to provide testimony in the rate case, it was that you were going to start out with this probability analysis and see where it went?

A. That's my recollection, yes.

Q. Okay. Now, are you familiar that the regulatory plan has the statement -- and this is reflected probably a dozen or more times in the record in this case and in the transcript in this case and in several people's testimony -- that KCPL agrees that off-system energy and capacity sales revenue and related costs will continue to be treated above the line for rate-making purposes. KCPL will not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the rate-making process. Are you familiar with that statement?

A. I'm aware that that statement is in the -- is in the plan.

Q. Okay. Is the testimony you provided in this case consistent with that statement?

A. I couldn't tell you that. That's -- that's not my role in this case.

Q. Okay. Have you read the Direct Testimony of the other KCPL witnesses in this case?

A. Would you care to be more specific?

Q. Have you read all of the testimony of all the KCPL witnesses?

A. I have not.

Q. Have you read the testimony of Mr. Giles?

A. I have.

Q. Okay. Have you been involved in utility regulation throughout your entire career?

A. Yes.

Q. Okay. Are you familiar with the term "above the line for rate-making purposes"?

A. Generally, yes.

Q. And how would you define that?

A. Well, my -- my layman's understanding would be something that would be included in some manner in the rate setting process.

Q. Okay. Now, if a value for KCPL's off-system sales margins for rate-making purpose -- rate-making purposes is set at the 25th percentile, if your analysis is accurate, wouldn't this result in 75 percent of the estimated outcomes result in revenues not being reflected above the line for rate-making purposes?

A. I'm sorry. Are -- I'm trying to figure out which -- what the purpose -- what the term of your hypothetical is and whether it includes what I understand to be what Mr. Giles discussed with the Commission on Monday.

Q. It doesn't have anything to do with what Mr. Giles talked to the Commission about on Monday. Excluding that sort of from-the-stand offer to do something different is the basis of my question.

A. Okay. Now with that understanding, if you would repeat the question.

Q. Okay. With that understanding, if the Commission were to set the level of off-system sales margins for rate-making purposes in this case at the 25th percentile, if your analysis is accurate, wouldn't 75 percent of the outcomes result in off-system sales margins not being recorded above the line for rate-making purposes?

A. I don't know that I could necessarily draw that conclusion.

Q. Okay. Well, let me back up a little bit then. Do you believe that your analysis is accurate?

A. Yes.

Q. Okay. And I'm just going to throw out some made-up numbers so as to not get into any confidential information. If your analysis set the 25th percentile at $10 million for off-system sales margins, that means that according to your analysis, that there is -- in all of the probable outcomes, there are 25 percent of those outcomes KCPL would achieve $10 million or less in off-system sales margins; is that correct?

A. Yes, it is.

Q. And in 75 percent of those outcomes KCPL would achieve $10 million or more; is that correct?

A. Correct.

Q. Okay. So if the Commission were to include only $10 million in the calculation of off-system sales margins for rate-making purposes, in this hypothetical would not 75 percent of the outcomes result in KCPL achieving revenues in excess of $10 million even though only $10 million was included in revenues for rate-making purposes?

A. That statement is true, but it doesn't translate to the conclusion that, therefore, there was revenue that was not treated above the line.

MR. MILLS: Okay. I have no further questions. Thank you.

JUDGE PRIDGIN: Mr. Mills, thank you.

Further cross?

MR. DOTTHEIM: Mr. Mills has asked my questions.

JUDGE PRIDGIN: All right. Thank you.

Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning.

A. Good morning.

Q. Does any party in this proceeding provide any analysis that disputes your probability analysis?

A. Well, not -- not directly, Commissioner, although I believe Mr. Traxler's Surrebuttal Testimony provides a different view of risk and volatility, although I don't believe he specifically points to flaws or errors in my analysis, but he draws some different conclusions about the volatility of off-system margins with which I disagree.

Q. And I believe Mr. Dittmer and Mr. Brubaker also disagree?

A. Well, I believe they -- my memory is that they disagreed in two respects. One with the company's proposal to use the 25th percentile as opposed to another number, and I think a couple of them -- I think this is -- it's in my Rebuttal Testimony I think where I summarize my -- my understanding of what they -- what they said.

Mr. Smith supports the median value, the 50th percentile, Mr. Brubaker also the same, or alternately, a historic test year. So I think that the two differences of opinion are some people might say why don't we use a historic test year as opposed to a forward-looking forecast; and, then, secondly, there are people that suggest that the 50th percentile or some other number other than the 25th is appropriate.

But that's -- that's not -- that's not -- that's not a disagreement with me as -- as I think we established earlier. That's the company's proposal rather than mine. So I don't understand that either of those gentlemen directly disagree with the analysis that I performed.

Q. So the only disagreement with your analysis is by Mr. Traxler. Is that your understanding?

A. That's my understanding, yes.

Q. And Mr. Traxler did not provide an alternative methodology for determining probable risk?

A. He asserts that it's small.

Q. But does he provide an analysis to show that? I don't recall from his testimony.

A. Well, your Honor, I think he might say that he would. I disagree, you know. He -- he pointed to a historical trend in the off-system -- realized actual off-system margins from 2001 to 2005 if memory serves and -- which were steadily increasing and pointed to that as evidence of what's the risk, they keep going up and they -- they've leveled off so why does that mean they're risky.

He also points to a forecast that the company has made for a couple years in the future, 2006 and 2007, if memory serves, and those two forecasts made at the same time were roughly for the same amount. And he cites that as evidence that if the forecasts for 2006 and '7 are the same, then this can't be very risky. And -- and in my Surrebuttal Testimony I point out why I find none of those arguments particularly compelling.

Q. And what is the methodology that you used called?

A. A shorthand would be a probabilistic analysis, but at -- at the heart of it, Commissioner, it recognizes that in this region that electricity prices can be -- have close relation to natural gas prices. And I think if we've learned anything in the last several years, we've learned that natural gas prices are extremely volatile and they translate to electricity prices that are extremely volatile.

And so in a circumstance such as this, a single-point forecast is not particularly helpful if you're worried about the risk of cash flows being insufficient, for instance. And that a broader distribution of what might happen within reasonable competence intervals might be more helpful. And I think it's in that spirit that my testimony is offered to give you a sense of how broad the range of outcomes might actually be and not to focus on any particular point estimate.

Q. And that would be the point of doing a probabilistic analysis; is that correct?

A. That is correct.

Q. So the disagreement with you and your position in your testimony would be not necessarily that your probabilistic methodology is incorrect or that you achieved inaccurate results, but that a probabilistic analysis shouldn't have even been done here? Is that --

A. I think there are -- as I appreciate, your Honor -- or Commissioner, I think there are two disagreements. The first is that under rate-making practice, historic test year is what ought to be used, not a forward-looking forecast.

And I think my pos-- I don't -- I don't have a legal position obviously on what's permissible here in Missouri, but -- but my policy position would be to the extent that it is permissible, that it's better to use a forward-looking forecast in this kind of area because the past is not -- not -- often not a very good predictor of the future. So that's disagreement number one, does it have to be a historic test period or can it be a forward-looking approach.

Assuming the answer to that is that it can be a forward-looking approach, then we get to the second disagreement, which is once you have this probabilistic distribution for purposes of setting the base rates, what point on the curve does one pick? Does one pick the middle of the curve, the 50th percent curve which means that for all the points that lie to the left of that, half of the points, that the company will realize lower cash flow and lower earnings than were intended.

Or does one pick a point further to the left in recognition of the fact that with this construction program, you don't want to fall short? I mean, I think the previous -- I just overheard some testimony here sitting in the back of the room about how bad it is to get in a circumstance where you get a downgrade for everybody involved.

And so that's really, I think, is the policy question that -- that the Commission has is in the circumstance such as this where the risks of insufficient earnings and cash flow and access to capital markets can be very serious with a construction program, where do you want to pick that point.

Q. And the picking of the point was not your job; is that correct?

A. That is correct.

COMMISSIONER MURRAY: Okay. Thank you.

JUDGE PRIDGIN: All right, Commissioner. Thank you.

QUESTIONS BY JUDGE PRIDGIN:

Q. I think just a quick question or two. Could you explain why, if at all, your distribution of possibilities is a normal distribution?

A. It actually looks more like a log normal distribution, although we don't constrain it to be that. But the -- the simple reason for that -- or perhaps the not so simple reason for that is that these volatilities are typically expressed as percent variances. And they're cumulative.

You know, if next year, you don't know, it could be 10 percent higher or 10 percent lower and then you find out and the next year based on wherever you are, you can be 10 percent lower or 10 percent higher. You're constrained by zero on the downside. And so the range to the left of the 50 percent point is always going to be a little narrower than the range to the right of the 50th percent point.

And that gives the curve the shape of a log normal kind of a normal distribution as opposed to a pure normal distribution where both sides are equal width. So that's perhaps not a short answer, but that's an attempt anyway, your Honor.

Q. I don't have your schedules handy. Do they contain like your standard deviation? Do they give us some sort of road map to follow?

A. The various percentiles are marked on some of those schedules and so you can translate, you know, one and two standard deviations to whatever percentile, you know, you would wish.

JUDGE PRIDGIN: Thank you very much. That's all I have.

Any recross? Redirect?

MR. ZOBRIST: Could I ask the court reporter to retrieve Exhibit 50, which was the illustration of recent Henry hub of forward-price movements that I think discussed with the prior witness and I'd like to ask Mr. Schnitzer to examine that document.

REDIRECT EXAMINATION BY MR. ZOBRIST:

Q. Mr. Schnitzer, I'm handing you what has been previously marked as Exhibit 50. Can you identify that document, please?

A. Yes. I believe it's part of the work papers to my Surrebuttal Testimony.

Q. Okay. And what does it depict?

MR. WOODSMALL: Your Honor, I'd object at this point. I don't believe there was any cross related to Exhibit 50 so this is clearly outside any cross-examination.

MR. MILLS: And I'll have to second that. I'm the one that did the bulk of the cross and I went nowhere near anything like this. Exhibit 50 was offered before and it was rejected and I specifically didn't get anywhere near it. There should be no room for redirect on this topic at all.

JUDGE PRIDGIN: Mr. Zobrist.

MR. ZOBRIST: Your Honor, I believe that Commissioner Murray's questions elicited testimony about the natural gas prices and their relationship to electricity prices, so I believe this does respond to Commissioner questions and I would like to have an opportunity to authenticate it.

JUDGE PRIDGIN: To the extent that Bench questions went into it, I'll let you proceed.

MR. MILLS: Well, if I could address that question, I think the question from the Bench was why is this a probabilistic analysis. And the answer went into natural gas prices, but that was certainly not prompted by the question.

I mean, simply because the witness wanted to talk about it and the attorney wants to redirect about it doesn't mean that the questions open up this area. And that's my objection is that we never got into this area that -- in terms of the questions, so it's beyond the scope of either cross-examination or questions from the Bench.

JUDGE PRIDGIN: Mr. Zobrist.

MR. ZOBRIST: Judge, no one moved to strike Mr. Schnitzer's testimony and I believe it's his -- his testimony was relevant and responsive to Commissioner Murray's question.

JUDGE PRIDGIN: I'll overrule. And please be brief on it since it's not even in evidence.

MR. ZOBRIST: Well, that's -- I'm trying to get it into evidence.

MR. MILLS: That's why we're arguing about it.

JUDGE PRIDGIN: I understand.

BY MR. ZOBRIST:

Q. Would you please identify Exhibit 50?

A. Yes. Excuse me. In -- in my Surrebuttal Testimony, I provided a graph or a figure which described how much the forward natural gas prices for delivery in calendar year 2007 had moved around basically in the third quarter of this year between June and September.

And so this -- this work paper lists for every date -- every day of the third quarter what the traded forward prices were for monthly deliveries in 2007 and shows how -- how much volatility there was in the 2007 forward prices for natural gas during the third quarter of 2006.

Q. And was the information contained in that exhibit utilized in your probabilistic analysis?

A. It -- the -- the -- the June -- excuse me. The June 30th numbers would have been what was in the June 30th update and the September 29th numbers -- September 30th numbers would have been what was used in the September -- end of September update.

MR. ZOBRIST: Your Honor, I offer Exhibit 50.

MR. WOODSMALL: Objection, your Honor.

JUDGE PRIDGIN: Mr. Woodsmall.

MR. WOODSMALL: A continuing objection as stated by Mr. Lewis and myself -- Mr. Mills and myself, clearly beyond the bonds of any cross-examination. I don't think it's appropriate to be bringing this in on redirect when no one had an opportunity to prepare for it, to cross-examine on it.

If -- as he said, it was done during surrebuttal. If they wanted to put this into the record, they clearly could have attached it to his Surrebuttal Testimony. It's untimely, it's sandbagging, it is inappropriate at this point in time to offer this exhibit.

MR. MILLS: And to top all that off, it's only, at best, tangentally related to the topics on which this witness was either cross-examined about or asked questions on the Bench about, and I say at best.

JUDGE PRIDGIN: Mr. Zobrist.

MR. ZOBRIST: Judge, there's no sandbagging. It's been marked and been sitting in the court reporter and I presume Mr. Woodsmall and Mr. Mills and other counsel's briefcases for several days. It was tendered prior to the hearing commencing. There's no sandbagging. And I believe it is relevant and probative of the issues that have been

discussed here for the past couple days.
JUDGE PRIDGIN: Objection sustained.
MR. ZOBRIST: Nothing further, your Honor.
JUDGE PRIDGIN: Okay. If there's nothing further, thank you very much for your testimony, sir.
THE WITNESS: Thank you.
JUDGE PRIDGIN: Do I understand that is the final witness for the day?
MR. ZOBRIST: On behalf of the company, that's true.
JUDGE PRIDGIN: Are there any other witnesses available?
MR. MILLS: I don't think we have any more witnesses, but --
JUDGE PRIDGIN: I didn't think so.
MR. MILLS: -- if you want to recall some of mine, I've got a couple available.
JUDGE PRIDGIN: No, thank you.
MR. ZOBRIST: Well, for today. Right?
JUDGE PRIDGIN: For today. Do I understand we will have -- is it Mr. Camfield will be -- is our only witness scheduled for tomorrow?
MR. ZOBRIST: I believe that's correct, Judge.
JUDGE PRIDGIN: And he's not reasonably available to move his schedule, I take it?

MR. ZOBRIST: He's not in the state. I'm not sure he's in the country. I think he's in Canada at the present time.

Judge, forgive me for interrupting, but I would like to offer Mr. Schnitzer's Direct, Rebuttal and Surrebuttal Testimonies as Exhibit 30 through 32.

JUDGE PRIDGIN: I show 30, 31 and 32 are all NP and HC and they have been offered. Any objections?

Seeing none, 30, 31 and 32 are admitted.

(Exhibit Nos. 30, 31 and 32 were received into evidence.)

JUDGE PRIDGIN: And with regards to Mr. Camfield's travel plans, if he's going to be the only witness, it makes sense to me to bump back the start time tomorrow to allow Commissioners time for agenda in the morning and then allow them to be on the Bench in the afternoon unless that's going to really interfere with his travel plans.

MR. ZOBRIST: That's fine.

JUDGE PRIDGIN: If I'm not hearing any outcry, I would like to start tomorrow afternoon at one o'clock for Mr. Camfield. And then Friday we'll probably resume at 8:30 for the weatherization and other customer program witnesses.

MR. WOODSMALL: Did we ever resolve whether Mr. Cross is going to come in or where does that stand?

JUDGE PRIDGIN: Mr. Zobrist.

MR. ZOBRIST: Well, I believe that everyone who was at least present in the hearing room yesterday waived cross-examination of him, so I'm sorry if --

MR. WOODSMALL: No. I just wanted to make sure.

MR. DOTTHEIM: I think there's been something further on that. I think he's going to be made available by phone.

MR. ZOBRIST: All right. I was not aware of that.

MR. WOODSMALL: I don't have any cross. I was just wondering for my records.

MR. DOTTHEIM: Ultimately, I think the Staff had some cross for him by phone is the latest that I believe is the situation with that.

MR. ZOBRIST: He's Mr. Steiner's witness so I apologize.

MR. DOTTHEIM: I think Mr. Thompson is being in contact with Mr. Steiner on that. I'll verify that.

JUDGE PRIDGIN: And I'll let parties certainly clear up if we need to cross-examine Mr. Cross on the telephone. I understand he's still convalescing from an accident, which we certainly want to be sensitive to that.

Is there anything further from counsel before we adjourn for the day?

Okay. Hearing nothing further, we will adjourn for the day. We will resume tomorrow afternoon at one o'clock and Mr. Camfield will be on the stand. Thank you very much. We're off the record.

WHEREUPON, the hearing was adjourned until October 26, 2006 at 1:00 p.m.

KCP&L'S EVIDENCE

SAMUEL C. HADAWAY

US DOE/NNSA'S EVIDENCE

J. RANDALL WOOLRIDGE

KCP&L'S EVIDENCE

EXHIBITS INDEX