Exhibit No.:
Issue: Rate of Return
Witness: Zephania Marevangepo
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: ER-2014-0370
Date Testimony Prepared: May 7, 2015

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION

UTILITY SERVICES – FINANCIAL ANALYSIS

REBUTTAL TESTIMONY

OF

ZEPHANIA MAREVANGEPO

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2014-0370

Jefferson City, Missouri
May 2015

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REBUTTAL TESTIMONY

OF

ZEPHANIA MAREVANGEPO

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2014-0370

Q. Please state your name.

A. My name is Zephania Marevangepo.

Q. Are you the same Zephania Marevangepo who prepared the Rate of Return ("ROR") Section of the Staff's Cost of Service Report ("Staff Report")?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. To respond to the direct testimonies of Robert B. Hevert and Darrin Ives. Mr. Hevert sponsored ROR testimony on behalf of Kansas City Power & Light Company ("KCPL") and Mr. Ives sponsored regulatory policy testimony on behalf of KCPL.

Q. Do you have any corrections to the ROR section of the Staff Report?

A. Yes, on page 52, line 12, Staff inadvertently indicated a cost of equity ("COE") range of 7.18% to 7.96%. Consistent with the supporting schedules that were filed with the Staff Report, the COE range should be 7.21% to 7.99% instead. As a result, KCPL's implied COE reduction reported in the subsequent line (line 13 on page 52) would adjust to 85-102 basis points from 88-105 basis points.

Q. Does this correction change Staff's recommended allowed Return on Equity ("ROE")?

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

Q. Do you have any additional corrections?

A. No.

<u>EXECUTIVE SUMMARY</u>

Staff's Rate of Return Testimony:

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

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

Mr. Hevert's Rate of Return Testimony:

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

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[1] Staff Report, ER-2014-0370, page 32 – lines 18 through 29.
[2] Staff Report, ER-2014-0370, page 51 - **vi. Update of Multi-Stage DCF Analysis on the Proxy Group from the 2012 Rate Cases.**
[3] Staff Report, ER-2014-0370, page 51 - **vii. Backdating of Multi-Stage DCF Analysis on the Current Proxy Group Cases.**

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

Mr. Ives' Regulatory Policy Testimony:

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

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

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

UPDATES TO STAFF'S TESTIMONY

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

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

The current forward P/E multiples (17.15x on average) for the same proxy group that Staff used in its "2012 KCPL cost of equity study" reflect higher valuation levels when compares to the average forward P/E multiples of 14.12x in 2012.[5]

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

[4] SNL data based on EEI regulated electric utilities.
[5] Based on SNL data.

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

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

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

A. Yes. Staff backdated the data for the comparable companies included in Mr. Hevert's 2014 multi-stage COE study, which were also included in Mr. Hevert's 2012 multi-stage COE study in the Ameren Missouri rate case, Case No. ER-2012-0166.[6] Not surprisingly, the analysis produced an implied COE decline of approximately 45 to 62 basis points. In other words, a reduction based on backdating Mr. Hevert's analysis supports lowering KCPL's allowed ROE to a range of 9.10% to 9.25%.

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

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

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

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

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

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

A. No.

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

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

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

A. 10.50%.

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

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

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

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

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

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

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

[7] Based on Bonds Online data.

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

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

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

continued on next page

Table 1.

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

Table 1 note: **forward P/Es show an increasing trend from 2012 to current*

Note : All ratios are as published by SNL

Table 2.

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

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

Note : All ratios are as published by SNL

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

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

A. Mr. Hevert's 10.30% ROE recommendation is higher than Staff's 9.25% and Mr. Gorman's 9.10% by 105 basis points and 120 basis points respectively.[8] Mr. Hevert's 10.30% ROE recommendation is also 63 basis points higher than the average ROE authorized for electric utilities (9.67%) in the first quarter of 2015.[9] The RRA average authorized ROE for electric utilities in the first quarter of 2012 was approximately 10.30% and 10.10% for the 2012 calendar year *(excluding the Virginia surcharge/ rider generation cases from the data).*

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

A. Yes.

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

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

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

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

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

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

Multi-stage DCF: Mr. Hevert's multi-stage DCF method assumes a perpetual nominal[10] GDP growth rate of 5.65%, which he conveniently based on a historical (1929-2013) real GDP growth rate input of 3.27% and a forward inflation rate input of 2.31%. In his direct testimony, Mr. Hevert delicately expressed ignorance of the existence of publicly available long-term forward real GDP projection values. Thus, Mr. Hevert justified the use of historical data *for the real rate portion* of his inflated projected nominal GDP growth rate.[11] To set the record straight, analyst projections for long-term real GDP rate data exist and are publicly available.[12] The consensus long-term nominal GDP projection, based on projected real GDP and inflation, is approximately 4.32%; and not greater than 5% by any means. Even Mr. Gorman's multi-stage perpetual growth rate of 4.60% acknowledges that the U.S. projected nominal GDP is not greater than 5%.

[10] Nominal Rate – Real Rate plus Inflation.
[11] ER-2014-0370, Robert Hevert Direct Testimony, filed on October 30, 2014, page 24 –lines 10 through 12.
[12] J.P. Morgan Asset Management and Federal Reserve.

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

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

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

[13] ER-2014-0370, Robert Hevert Direct Testimony, filed on October 30, 2014, page 18 –lines 3 through 19 and page 19 –lines 1 through 4.
[14] Mr. Hevert relied on his constant DCF method and the same assumptions that Staff denounced earlier to compute his inflated market returns.

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

STAFF'S RESPONSE TO MR. IVES' DIRECT TESTIMONY

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

A. While Staff acknowledges the fact that KCPL does not have the various alternative regulatory mechanisms, which Mr. Ives highlighted on pages 3 and 11 of his direct testimony, Staff believes Mr. Ives did not provide the complete story regarding KCPL's inability to earn its allowed ROEs, such as the fact that KCPL was allowed to receive $183.4 million of cash flow above traditional ratemaking during the period of its Alternative Regulatory Plan, in exchange for considerations, such as not seeking a fuel adjustment clause until no earlier than June 1, 2015.[16] Staff witnesses that are more familiar with the details of this plan and other reasons for KCPL's under earnings will elaborate on these issues.

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

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

[15] ER-2014-0370, Darrin Ives Regulatory Policy direct testimony, page 4, Table – Earned ROE vs. Authorized ROE.
[16] Staff's Cost of Service Report filed in Case No. ER-2014-0370, page 173

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

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

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

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

<u>Wolfe Research report</u>[18]

> **Guidance and EPS growth target send confident message**
>
> Last year's results and management's outlook are the manifestation of a turnaround story that began in late 2012, when current management took over after years of disappointing results.

[17] Data request no. 0367.1, Bank of America Merrill Lynch.
[18] Wolfe Research, Great Plains Energy, Love it when a turnaround plan comes together, February 27, 2014.

> **Lag persists but potential to narrow; regulatory/legislative efforts key**
>
> In recent years, GXP has historically under-earned its allowed ROE by well over 150bp primarily due to the structural regulatory lag in MO. In 2013, GXP reduced the lag to 50bp, helped by rate relief. With its large La Cygne coal retrofit project and rising transmission costs and property taxes, the lag is expected to widen. However, there is visibility to EPS uplift in 2016 with new rates. Meanwhile, there is potential upside to our 2014-15E, as GXP is seeking regulatory and legislative measures to mitigate lag.

J.P. Morgan report[19]

> **Investment Thesis**
>
> Great Plains' earnings growth rate has the potential to accelerate in the 2016-2017 timeframe should the company be able to control cost inflation, implement favorable lag-reducing mechanisms and successfully execute a major rate case in 2015.
>
> **Valuation**
>
> Our $26 December 2014 price target is based on a 15.0x P/E multiple on 2016 EPS, which is a discount to the pure regulated peer group average P/E multiple, adjusted for interest rate risk. The discount is a result of mild commodity exposure, integrated utility operating risk and limited jurisdictional and geographic diversity.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

> **Moody's cited a constructive regulatory environment that continues to provide adequate cost recovery as one of their rationales for the upgrade.**
>
> Standard & Poor's Rating Services ("S&P") also raised the credit ratings of Great Plains Energy, KCP&L and GMO by one notch **due to continuation of the regulated utility business model with supportive cost recovery**.

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

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

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

SUMMARY AND CONCLUSIONS

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

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

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

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

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service	))))	Case No. ER-2014-0370

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

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

Zephania Marevangepo

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

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

D Suzie Mankin
Notary Public