

*Exhibit No.:*  
*Issue:* Rate of Return  
*Witness:* Zephania Marevangepo  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Surrebuttal Testimony  
*Case No.:* ER-2014-0370  
*Date Testimony Prepared:* June 5, 2015

**MISSOURI PUBLIC SERVICE COMMISSION**

**REGULATORY REVIEW DIVISION**

**UTILITY SERVICES – FINANCIAL ANALYSIS**

**SURREBUTTAL TESTIMONY**

**OF**

**ZEPHANIA MAREVANGEPO**

**KANSAS CITY POWER & LIGHT COMPANY**

**CASE NO. ER-2014-0370**

Jefferson City, Missouri  
June 2015

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**ZEPHANIA MAREVANGEPO**  
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**SURREBUTTAL 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”) and rebuttal testimony?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. To respond to the rebuttal testimony of Robert B. Hevert. Mr. Hevert sponsored ROR testimony on behalf of Kansas City Power & Light Company (“KCPL”).

**EXECUTIVE SUMMARY**

***Staff’s Rate of Return Testimony:***

Q. Would you please summarize Staff’s surrebuttal testimony?

A. Yes. Staff recommends that Mr. Hevert’s 10.30% return on common equity (“ROE”) recommendation, sponsored through his direct and rebuttal testimony, be dismissed due to his flawed application of the cost of equity (“COE”) models and his misinterpretation of the existing equity market conditions.

Despite the Commission’s recent 9.53% authorized ROE for Ameren Missouri (Case No. ER-2014-0258); and evidence presented by Staff and other ROR witnesses in this case

1 that justifies a reduction in KCPL's last allowed ROE of 9.70%, Mr. Hevert maintains his  
2 position that a 10.30% allowed ROE is fair and reasonable for KCPL in this case.

3 Q. Would you please summarize Mr. Hevert's view of Staff's 9.25% authorized  
4 ROE recommendation which is based on the "relative decline" in COE since 2012?

5 A. Yes. Mr. Hevert suggests that while the results of Staff's COE analyses  
6 support the position that the electric utility industry's COE is in the range of 6.00% to 8.00%,  
7 Staff abandoned this estimate and opted to make its recommendation based on the "relative  
8 change" (as measured by the multi-stage DCF analyses) in COE since 2012.<sup>1</sup>

9 Q. Does Staff agree with Mr. Hevert's characterization of Staff's testimony?

10 A. Not entirely. While Staff certainly does believe the COE for electric utilities is  
11 below allowed ROEs, this was not the primary reason Staff chose to recommend an allowed  
12 ROE higher than the COE. Staff believes it can more effectively serve the Commission in its  
13 deliberation of the evidence by discussing Staff's analytical results of the existing low capital  
14 cost environment for regulated utilities as compared to the 2012 cost of capital environment.  
15 Staff will provide, later in this testimony, additional evidence filed in KCPL's concurrent  
16 Kansas rate case that supports both Staff's analytical results and final recommendation.

17 Q. Would you please provide a summary of pending recommendations filed in  
18 Missouri and Kansas regarding a fair and reasonable authorized ROE for KCPL?

19 A. Yes. Please see the table below:  
20  
21

22 *continued on next page*

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<sup>1</sup> Robert Hevert rebuttal testimony, page 15, lines 9 through 19.

1

<b>KCPL'S PENDING AUTHORIZED ROE RECOMMENDATIONS IN THE MISSOURI AND KANSAS JURISDICTIONS</b>		
<b>WITNESS</b>	<b>ORGANIZATION REPRESENTED, CASE &amp; JURISDICTION</b>	<b>ROE RECOMMENDATION</b>
J. Randall Woolridge, PHD	Citizens' Utility Ratepayer Board ("CURB") <b>2015</b> <b>KCPL RATE CASE (15-KCPE-116-RTS)</b> <b>KANSAS JURISDICTION</b>	<b>8.55%</b>
Maureen L. Reno, PHD	United States Department of Energy and the Federal Executive Agencies <b>2015</b> <b>KCPL RATE CASE (ER-2014-0370)</b> <b>MISSOURI JURISDICTION</b>	<b>9.00%</b>
Michael P. Gorman	Missouri Industrial Energy Consumers and Midwest Energy Consumers' Group <b>2015</b> <b>KCPL RATE CASE (ER-2014-0370)</b> <b>MISSOURI JURISDICTION</b>	<b>9.10%</b>
Adam H. Gatewood	Kansas Corporation Commission Staff <b>2015</b> <b>KCPL RATE CASE (15-KCPE-116-RTS)</b> <b>KANSAS JURISDICTION</b>	<b>9.25%</b>
Zephania Marevangepo	Missouri Public Service Commission Staff <b>2015</b> <b>KCPL RATE CASE (ER-2014-0370)</b> <b>MISSOURI JURISDICTION</b>	<b>9.25%</b>
Robert Hevert	KCPL - ROR Witness <b>2015</b> <b>KCPL RATE CASE (ER-2014-0370)</b> <b>MISSOURI JURISDICTION</b>	<b>10.30%</b>
<b>Note: Information presented in this table was extracted from and/ or is based on witnesses' direct and/ or rebuttal testimony.</b>		
	<b>KANSAS STATE - KCPL'S PENDING RATE CASE (15-KCPE-116-RTS).</b>	

2

1 Q. What ROE's were authorized for KCPL in Missouri's and Kansas' most recent  
2 rate cases?

3 A. The Missouri Commission authorized a 9.7% ROE for KCPL in Case No.  
4 ER-2012-0174 based on its January 9, 2013 Order.<sup>2</sup> The Commission also authorized a 9.8%  
5 ROE for Ameren Missouri (Case No.ER-2012-0166) in the December 12, 2012 Order.<sup>3</sup>

6 The Kansas Commission authorized a 9.5% ROE for KCPL in its 2012 rate case in  
7 Kansas, in Docket No. 12-KCPE-764-RTS—Kansas Order dated December 13, 2012.<sup>4</sup>

8 ***Mr. Hevert's Rate of Return Testimony:***

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

10 A. Yes. Mr. Hevert's direct testimony ROE recommendation was 10.30% based  
11 on an estimated COE range of 10.20% - 10.60%. Mr. Hevert updated his COE study for  
12 purposes of preparing his rebuttal testimony and estimated a revised COE range of 10.00% -  
13 10.60%. Even though the low end of his range declined by 20 basis points, Mr. Hevert did  
14 not make any changes to his 10.30% recommendation.

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

16 ***Recap of Staff's Rebuttal Testimony Position and Updates:***

17 Q. Does Mr. Hevert's rebuttal testimony reflect or acknowledge the  
18 Commission's recent 9.53% authorized ROE decision in Ameren Missouri's rate case?

19 A. No. Despite the evidence supporting a lower COE environment, and the  
20 Commission's recent 9.53% authorized ROE for Ameren Missouri, Mr. Hevert still believes  
21 the Commission should authorize a 10.30% ROE for KCPL. Mr. Hevert does not explain

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<sup>2</sup> Commission Order in KCPL Case No. ER-2012-0174, page 1 and 24.

<sup>3</sup> Commission Order in Ameren Missouri Case No. ER-2012-0166, page 73.

<sup>4</sup> Kansas Commission Docket No. 12-KCPE-764-RTS, page 11.

1 why the Commission should authorize an ROE that is 77 basis points higher than Ameren  
2 Missouri's authorized ROE for KCPL.

3 Even after considering the market conditions, including the recent P/E contraction  
4 since January 2015, what is still notable is that the current forward P/E multiples for Edison  
5 Electric Institute's ("EEI") regulated electric utilities of 17.5x is still higher than it was in  
6 2012 (approximately 16.3x on average).<sup>5</sup> The current forward P/E multiples (18.0x on  
7 average) for the same proxy group that Staff used in its "2012 KCPL cost of equity study"  
8 reflect higher valuation levels when compared to the average forward P/E multiples of 15.4x  
9 in 2012.<sup>6</sup> The current forward P/E multiples (16.8x on average) for Staff's current proxy  
10 group reflect higher valuation levels when compared to the average (15.6x) in 2012.

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

12 A. No.

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

15 A. Yes. He sponsored ROR testimony in Ameren Missouri's rate case in 2012.

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

17 A. 10.50%.

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

20 A. Yes. Mr. Hevert's 10.30% recommendation in this case and 10.40%  
21 recommendation in Ameren Missouri 2014 rate case implies that Mr. Hevert accepts that  
22 there has been a relative decline in electric utilities' COE since 2012.

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<sup>5</sup> SNL data based on EEI regulated electric utilities.

<sup>6</sup> Based on SNL data.

1 Q. Was Mr. Hevert's ROE recommendation adopted by the Commission in  
2 Ameren Missouri's 2012 rate case?

3 A. No.

4 ***Staff's Surrebuttal Position:***

5 Q. Would you please cite the specific sections/ issues of Mr. Hevert's rebuttal to  
6 which you wish to respond?

7 A. Yes.

8 1. Mr. Hevert, on page 2 of his rebuttal testimony, claimed that the quickly  
9 increasing interest rates and rapidly decreasing utility stock prices suggests increasing capital  
10 costs. On page 9 of his rebuttal testimony, Mr. Hevert quantified the increase in 30-year  
11 treasury yields and decrease in utility equity valuations, among other factors, in order to  
12 support his claim that capital costs have increased since January 2015. While Staff disputes  
13 the use of phrases "quickly increasing" and "rapidly decreasing", Staff notes Mr. Hevert is  
14 using a very short-time frame for the context of his discussion. While the events that  
15 transpired between January and April 2015 should not go unnoticed, it is paramount to  
16 recognize that the context of most relevance to making a determination of a fair and  
17 reasonable allowed ROE in this case is a comparison of capital markets in early 2012 to the  
18 capital markets now. In that order, current utility equity valuation levels are higher than the  
19 2012 benchmarks (lower cost of equity) and current utility debt costs are lower. Such an  
20 objective and logical interpretation of the current capital markets supports a lower allowed  
21 ROE and total capital costs when compared to 2012 market conditions.

22 Unfortunately, Mr. Hevert is attempting to confuse the record by devoting more  
23 attention to "rapidly increasing" 30-year treasury rates over the last couple of months rather



1 than focusing on the more relevant insight that can be drawn from both KCPL-specific and  
2 general electric utility industry capital costs.

3           2. Mr. Hevert, on page 5 and 15 of his rebuttal testimony, claimed that  
4 (a) Staff's ROE recommendation is not based on its fundamental analysis of the Company's  
5 current COE and (b) Staff chose to sponsor a "relative change" testimony in light of the fact  
6 that the Commission would be skeptical of its multi-stage DCF analytical results of 7% - 8%  
7 (not 6%-8% as noted in Mr. Hevert's testimony). Staff notes that this assertion is misplaced.  
8 Staff will refer to an equally relevant piece of testimony that was based on an approach and/or  
9 analysis similar to what Staff applied in this case.

10           Q. How do you wish to respond to Mr. Hevert's suggestion that increasing  
11 interest rates and decreasing utility stock prices amount to increasing capital costs  
12 for utilities?

13           A. Mr. Hevert's emphasis on the relative change in US Treasury rates between  
14 January 30 and April 30, 2015 is misplaced.

15           Mr. Hevert indicated on page 9 of his direct testimony that 30-year treasury yield  
16 increased by 50 basis points since January 2015 but neglects to mention that the corporate  
17 yields increased by only 18 basis points within that period. Moreover, the 2015 average of the  
18 corporate utility bond yield (3.90%) is 86 basis points below the 2012 average (4.76%). As  
19 Staff also noted earlier on page three of this testimony, the utility equity valuation levels are  
20 still higher than 2012 levels thereby supporting COE levels lower than 2012 levels.

21           Consequently, Staff acknowledges Mr. Hevert's assertion that capital costs have  
22 increased since January 2015. However, such an assertion is of no substance for as long as it  
23 relates the increase to a period other than when the Commission previously set KCPL's

1 allowed ROE. Staff's analysis above clearly shows that the current (1) utility COE, (2) utility  
2 debt cost and (3) total utility capital costs are still below those experienced in 2012 despite the  
3 mild increase during the short period Mr. Hevert attempts to magnify.

4 Q. How do you wish to respond to Mr. Hevert's claim that Staff's ROE  
5 recommendation is not based on the fundamental analysis of KCPL's current COE?

6 A. Mr. Hevert acknowledges on pages 3 and 9 of his rebuttal testimony that  
7 ratemaking is an inexact science; and that COE depends on returns available to comparable  
8 investments. Consequently, many ROR witnesses estimate the COE based on a fundamental  
9 analysis of a group of comparable companies and not just the subject company under review.

10 While Staff's multi-stage DCF analysis implied a COE decline as high as  
11 approximately 100 basis points, Staff conservatively recommended an approximate 25 -75  
12 basis points reduction to the 9.70% authorized ROE that was ordered in KCPL's last rate case  
13 (ER-2012-0175). As it stands, Staff did not abandon its multi-stage DCF results as  
14 Mr. Hevert suggests on page 15, lines 10 through 15, of his rebuttal testimony. Staff in fact  
15 used the multi-stage DCF results as the basis for quantifying the relative decline in  
16 KCPL's COE since 2012, which supports Staff's recommendation to lower KCPL's allowed  
17 ROE to 9.25%.

18 Q. Would you please cite other relevant jurisdiction(s) in which ROR witnesses  
19 filed testimony indicating KCPL's COE is below 9%?

20 A. Yes. KCPL recently filed a rate case in Kansas to recover costs associated  
21 with the environmental upgrades to its LaCygne plant. (Docket No. 15-KCPE-116-RTS  
22 filed January 2, 2015). In that case, Kansas Corporation Commission's ("KCC") ROR  
23 witness (Adam H. Gatewood) and Citizens' Utility Ratepayer Board ("CURB") ROR witness

1 (Dr. J. Randall Woolridge), filed direct testimony on May 11, 2015, and recommended the  
2 KCC authorize a 9.25%<sup>7</sup> and 8.55%<sup>8</sup> ROE for KCPL's Kansas operations.

3 Mr. Gatewood recommends an authorized ROE of 9.25% based on a 25 basis points  
4 reduction from KCPL-Kansas' last authorized ROE of 9.50% in 2012. Even though the  
5 midpoint of Mr. Gatewood's actual COE analyses results is approximately 8.50%, he chose to  
6 recommend a higher allowed ROE to recognize that allowed ROEs have generally been above  
7 9%.<sup>9</sup> Dr. Woolridge's 8.55% authorized ROE recommendation is specifically based on the  
8 high end of his COE estimates, which were based on growth rates Dr. Woolridge does not  
9 typically believe investors view as sustainable. Dr. Woolridge performed a DCF analysis  
10 using his proxy group and Mr. Hevert's proxy group, which is the same proxy group  
11 Mr. Hevert used in this case, and arrived at COE rates of 8.40% and 8.55%, respectively.  
12 Dr. Woolridge's CAPM analysis, using the same proxy groups as noted earlier, produced a  
13 COE of 8.10% for both proxy groups.<sup>10</sup>

14 Q. Did any of the ROR witnesses in KCPL's Kansas case use the "relative  
15 change" approach to recommend a fair authorized ROE?

16 A. Yes. Mr. Gatewood's COE methods imply that KCPL's COE is below 9.00%.  
17 However, Mr. Gatewood recommended an allowed ROE of 9.25% based on the premise that  
18 COE for utilities, including KCPL, has declined since 2012. In support of his testimony,  
19 Mr. Gatewood presented a table in his direct testimony showing a 20 – 30 basis points decline  
20 in yield on Moody's Baa Utility Bonds and a 40 basis points decline in yield on KCPL's  
21 bonds. Mr. Gatewood proposed that KCPL's authorized ROE of 9.50% in 2012 be adjusted

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<sup>7</sup> Adam H. Gatewood direct testimony - Docket No. 15-KCPE-116-RTS, pages 4 and 5.

<sup>8</sup> J. Randall Woolridge direct testimony – Docket No. 15-KCPE-116-RTS, page 53.

<sup>9</sup> Adam H. Gatewood direct testimony - Docket No. 15-KCPE-116-RTS, page 5.

<sup>10</sup> J. Randall Woolridge direct testimony – Docket No. 15-KCPE-116-RTS, page 53.

1 down by 25 basis points to account for all of the financial data that supports a material  
2 decline in the COE since 2012.<sup>11</sup>

3 **SUMMARY AND CONCLUSIONS**

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

5 A. Staff's recommendation to reduce KCPL's recent authorized ROE (9.70%) to  
6 9.25% is based on Staff's conservative estimate of an approximate 25 – 75 basis points  
7 decline in the COE since 2012. The approach that Staff used in this case to arrive at its  
8 recommended allowed ROE is rational and logical. In fact, the KCC Staff's ROR witness  
9 used a similar approach in KCPL's pending rate case in Kansas. Mr. Gatewood recommended  
10 a 9.25% allowed ROE for KCPL-Kansas based on a range of 9.00% - 9.50%.

11 Also, Staff does not believe KCPL's allowed ROE should be significantly different  
12 from what the Commission recently authorized in Ameren Missouri's rate case.

13 Q. Does this conclude your surrebuttal testimony?

14 A. Yes, it does.

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<sup>11</sup>Adam H. Gatewood direct testimony, Before the State Corporation Commission Of The State Of Kansas, Docket No. 15-KCPE-116-RTS, Page 5 – Summary of Staff's Cost of Equity Estimates.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

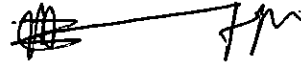
In the Matter of Kansas City Power & Light )  
Company's Request for Authority to )  
Implement a General Rate Increase for Electric )  
Service )

Case No. ER-2014-0370

**AFFIDAVIT**

COMES NOW Zephania Marevangepo and on his oath declares that he is of sound mind and lawful age; that he contributed to the attached Surrebuttal Testimony; and that the same is true and correct according to his best knowledge and belief.

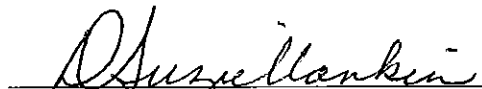
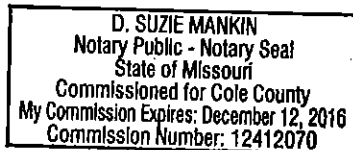
Further the Affiant sayeth not.



Zephania Marevangepo

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 4<sup>th</sup> day of June, 2015.



Notary Public