

Exhibit No.:
Issue: Capital Structure, Cost of Debt
Witness: Kevin E. Bryant
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: KCP&L Greater Missouri Operations Company
Case No.: ER-2016-0156
Date Testimony Prepared: August 15, 2016

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2016-0156

REBUTTAL TESTIMONY

OF

KEVIN E. BRYANT

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

**Kansas City, Missouri
August 2016**

REBUTTAL TESTIMONY

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KEVIN E. BRYANT

Case No. ER-2016-0156

1 **Q: Are you the same Kevin E. Bryant who pre-filed Direct Testimony in this matter on**
2 **behalf of KCP&L Greater Missouri Operations Company (“GMO” or the**
3 **“Company”)?**

4 **A: Yes.**

5 **Q: What is the purpose of your rebuttal testimony?**

6 **A: I will respond to the Revenue Requirement Cost of Service Report (the “Revenue**
7 **Requirement Report”)** submitted in this proceeding by the Missouri Public Service
8 **Commission (“Commission”) Utility Services Division Staff (“Staff”)** as it relates to the
9 **recommended capital structure and cost of debt for the Company. I also respond to the**
10 **direct testimony of Mr. Michael P. Gorman on behalf of the Office of the Public Counsel**
11 **(“OPC”), as his direct testimony relates to the recommended capital structure for the**
12 **Company.**

13 **CAPITAL STRUCTURE AND COST OF DEBT**

14 **Q: On page 28 of its Revenue Requirement Report, Staff recommended using Great**
15 **Plains Energy Incorporated’s (“GPE”) consolidated capital structure and GPE’s**
16 **consolidated cost of debt and preferred stock because this was consistent with the**
17 **last Kansas City Power & Light Company (“KCP&L”) and GMO rate cases. Did**
18 **Staff offer any additional rationale for use of GPE’s consolidated capital structure**
19 **in this case?**

1 A: No. And, while I have respect for Staff's view on this issue, I believe defaulting to use of
2 GPE's consolidated capital structure simply because it was used in GMO's most recent
3 rate case is not warranted.

4 **Q: Why should the Commission now use the GMO-specific capital structure and cost of**
5 **debt instead of GPE's consolidated capital structure for calculating the weighted**
6 **average cost of capital?**

7 A: As explained in my direct testimony, the preferred long-term approach to calculating
8 revenue requirements for a utility is to base those revenue requirements on the costs that
9 are specific to that utility. Using a capital structure and cost of capital that is different
10 than the actual capital structure and cost of capital specific to that utility will result in
11 earnings for that utility being somewhat higher or lower than intended for the return on
12 equity that was granted. If GMO's revenue requirement is not based on GMO's actual
13 capital structure and GMO's actual cost of debt reflected in interest expense on GMO's
14 income statement, then the return on equity reflected in GMO's financial statements will
15 be different than the authorized return on equity.

16 **Q: Staff's recommendation to use a consolidated capital structure and cost of debt**
17 **implies that GMO and KCP&L have the same cost of capital. Is that true?**

18 A: No. GMO has its own cost of debt that is based on debt GMO issued directly to
19 investors, debt issued by GPE on GMO's behalf with the proceeds loaned to GMO at
20 cost, and legacy Aquila debt still outstanding on GMO's balance sheet. Only 9% of
21 GMO's outstanding long-term debt is represented by the legacy Aquila debt, all of which
22 was issued prior to 2000 and prior to the onset of Aquila's credit problems. GMO's debt
23 cost for the individual debt issuances are based on the market price at the time it was

1 issued given the terms associated with each debt issuance. Both GMO and KCP&L long-
2 term debt has an average time to final maturity of approximately 10 years.

3 **Q: What is GMO's current cost of debt compared to GPE?**

4 A: GMO's 5.09% cost of debt is 32 basis points lower than the GPE consolidated cost of
5 debt recommended by Staff for purposes of setting GMO's revenue requirement. GMO's
6 cost of capital should not include the cost of debt issued by KCP&L that is unrelated to
7 GMO. Absent special circumstances, the Company's rates should be set on the basis of
8 its actual capital structure and cost of debt, consistent with the rate-making construct used
9 with all of the other electric utilities throughout the state.

10 **Q: GMO's equity ratio is higher than the GPE consolidated equity ratio and the
11 KCP&L equity ratio. Is there a reason for this difference?**

12 A: Yes. As described in my direct testimony, the credit quality of the two utilities is
13 different and justifies a higher equity ratio for GMO. S&P assigns GMO a "Strong"
14 business risk profile based on its "satisfactory" competitive position, whereas KCP&L is
15 assigned an "Excellent" business risk profile based on its "strong" competitive position.
16 S&P bases the competitive position rating for utilities on the regulatory environment in
17 the jurisdictions where the utility operates. GMO is regulated in Missouri, and KCP&L
18 is regulated in both Missouri and Kansas. Because of the difference in business risk
19 profiles, GMO cannot support as much debt as KCP&L, thus justifying a higher equity
20 ratio. Even with its higher equity ratio, Moody's credit rating for GMO at Baa2 remains
21 one notch lower than KCP&L (Baa1), in part due to the lower market position rating
22 Moody's assigns to GMO. These credit quality differences support a higher equity ratio
23 for GMO, and the mere fact that GMO's equity ratio is higher than that of either GPE or

1 KCP&L is not a reasonable basis to use GPE's consolidated capital structure to establish
2 GMO's revenue requirement.

3 **Q: Please provide a brief summary of Mr. Gorman's recommendation as it relates to**
4 **the Company's capital structure.**

5 A: Mr. Gorman suggests (on page 21 of his direct testimony) that a capital structure
6 consisting of 54.83 percent equity and 45.17 percent debt is unreasonable for GMO.
7 Rather, on pages 28-30 of this direct testimony, he proposes an equity ratio of 51.40
8 percent and a debt ratio of 48.60 percent, based on GMO's actual capital structure,
9 adjusted to deduct approximately \$169 million of goodwill on its balance sheet.

10 **Q: Do you agree with Mr. Gorman's goodwill adjustment?**

11 A: While my rationale for supporting a goodwill adjustment is different than the one offered
12 by Mr. Gorman, I can indeed agree with an adjustment to GMO's actual capital structure
13 to deduct approximately \$169 million of goodwill. When GMO was acquired in 2008,
14 Securities and Exchange Commission ("SEC") reporting requirements for registrants
15 required the goodwill from the transaction to be recorded on the acquired company's
16 balance sheet (in this instance, GMO) pursuant to SEC Staff Accounting Bulletin
17 ("SAB") Topic 5. J. The Company followed these requirements based on the expectation
18 that GMO could become an SEC registrant in the future. In November 2014, Financial
19 Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 805
20 Business Combinations was updated by Accounting Standards Update (ASU) No. 2014-
21 17 to provide an option to record goodwill on an acquired company's balance sheet.
22 Once the option is elected, it cannot be reversed. In November 2014, the SEC
23 subsequently removed its requirement to record goodwill on the balance sheet of an

1 acquired company pursuant to SAB No. 115. As a result, I can concur with a goodwill
2 adjustment of approximately \$169 million since such goodwill would not have been
3 recorded on GMO's balance sheet had the acquisition occurred today based on current
4 accounting standards. As recommended by Mr. Gorman, an adjustment to GMO's actual
5 capital structure to deduct the goodwill balance from GMO's common equity balance
6 would be reasonable.

7 **Q: Mr. Gorman stated that GMO can adjust its common equity balance by paying**
8 **dividends and issuing more debt to modify its actual capital structure to what the**
9 **Commission finds to be a reasonable mix of debt and equity capital. How do you**
10 **respond?**

11 A: I described in my direct testimony the steps GMO has taken to manage its capital
12 structure, however there are limitations that could prevent GMO from immediately
13 achieving a prescribed mix of debt and equity capital. GMO's ability to reduce its equity
14 ratio by paying more dividends is limited by GMO's retained earnings balance.
15 Modifying the capital structure by issuing additional long-term debt only makes sense if
16 there is a good use for the proceeds from the issuance. The addition of more debt could
17 also impact GMO's credit profile especially in combination with a lower equity ratio that
18 could decrease operating cash flows. I do, however, agree with Mr. Gorman that
19 continued management of GMO's common equity balance is important and believe that
20 GMO has made significant strides in reducing its equity ratio, given the constraints
21 described above, and I believe that GMO's current debt level is appropriate given its
22 credit profile and cash flow. In support of this view, in his direct testimony at page 61,
23 Mr. Hevert calculated the average capital structure for each of his proxy group companies

1 over the last eight quarters which resulted in a mean equity ratio of 52.7% and supports
2 an equity ratio in the 50-55% range as both appropriate and consistent with precedents
3 across the country. And as Mr. Gorman points out in his testimony, the Commission
4 approved a capital structure in GMO's 2012 rate case that included a common equity
5 ratio of approximately 52.3%. As a result, GMO will continue to manage its current
6 equity ratio through dividend policy if it can do so without negatively impacting GMO's
7 credit ratings. GMO's actual capital structure calculated either with or without the
8 adjustment for goodwill (about 51.42% and 54.83%, respectively) represents a reasonable
9 mix of debt and equity, so it is not necessary or advisable for the Commission to deviate
10 from long-standing rate making precedent and prescribe a capital structure different than
11 GMO's actual capital structure.

12 **Q: Will you please summarize the positions you've taken in your rebuttal testimony?**

13 A: Yes. GMO's actual capital structure, adjusted for goodwill as explained earlier in this
14 testimony, should be used to set the Company's revenue requirement. Using balances for
15 debt, equity and goodwill on the Company's books as of July 31, 2016, GMO's revenue
16 requirement and rates should be set using a capital structure consisting of 51.4178%
17 common equity and 48.5822% long-term debt. The cost rate for GMO's long-term debt
18 is 5.09% and this should be used to set revenue requirement in this case.

19 **Q: In light of the return on equity recommendations of Staff and OPC, have you**
20 **changed your return on equity recommendation to the Commission?**

21 A: No. I continue to recommend a return on equity of 9.9% which is within the range
22 supported by GMO witness Robert Hevert.

1 Q: **Does that conclude your testimony?**

2 A: Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of KCP&L Greater Missouri Operations)
Company's Request for Authority to Implement)
A General Rate Increase for Electric Service) Case No. ER-2016-0156

AFFIDAVIT OF KEVIN E. BRYANT


STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Kevin E. Bryant, being first duly sworn on his oath, states:

1. My name is Kevin E. Bryant. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Senior Vice President of Finance & Strategy and Chief Financial Officer.

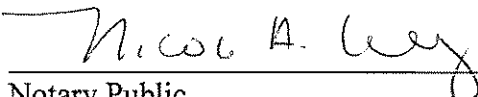
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of KCP&L Greater Missouri Operations Company consisting of seven (7) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.



Kevin E. Bryant

Subscribed and sworn before me this 15th day of August, 2016.



Notary Public

My commission expires: Feb. 4, 2019

