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**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 ) Case No. ER-2014-0370  
A General Rate Increase for Electric Service )

**SURREBUTTAL TESTIMONY**

**OF**

**MAUREEN L. RENO**

**ON BEHALF OF**

**THE UNITED STATES DEPARTMENT OF ENERGY**

**AND THE FEDERAL EXECUTIVE AGENCIES**

**JUNE 5, 2015**

U.S. DOE Exhibit No. 701  
Date 6-15-15 Reporter AT  
File No. ER. 2014. 0370

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Maureen L. Reno. I am employed as an independent consultant. My  
3 business address is 19 Hope Hill Road, Derry, New Hampshire 03038.

4 Q. ARE YOU THE SAME MAUREEN RENO WHO HAS PREVIOUSLY  
5 FILED TESTIMONY IN THIS PROCEEDING?

6 A. Yes. On April 2, 2015, I submitted direct testimony on a fair rate of return for Kansas  
7 City Power & Light (“KCP&L” or “Company”). I submitted that testimony on behalf  
8 of the U.S. Department of Energy (“DOE”) representing the Federal Executive  
9 Agencies (“FEA”), which is comprised of all federal facilities served by KCP&L. In  
10 that testimony, I recommended a return on equity (“ROE”) of 9.0 percent.

11 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

12 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of  
13 Company witness Robert B. Hevert.

14 Q. BASED ON YOUR REVIEW OF MR. HEVERT’S REBUTTAL  
15 TESTIMONY, ARE YOU REVISING IN ANY WAY YOUR  
16 RECOMMENDED 9.0 PERCENT ROE?

17 A. No, I am not. Mr. Hevert’s rebuttal testimony criticisms of my analysis and  
18 recommendations are without merit, and I continue to believe that my range of  
19 reasonableness of 8.2 percent to 9.6 percent and my midpoint estimate of 9.0 percent  
20 ROE recommendation are both reasonable and supported by the evidence.  
21 Incorporating Mr. Hevert’s updated data in the Capital Asset Pricing Model  
22 (“CAPM”) calculation does not change the upper bound of my range of  
23 reasonableness of 9.6 percent.

1 Q. BASED ON YOUR REVIEW OF MR. HEVERT’S REBUTTAL  
2 TESTIMONY, ARE YOU REVISING YOUR 6.62 PERCENT OVERALL  
3 RATE OF RETURN?

4 A. Yes. As a result of information presented by Mr. Hevert in his rebuttal testimony  
5 regarding the Company’s short-term debt and long-term debt costs, my  
6 recommendation on the overall rate of return increases from 6.62 percent to 7.02  
7 percent.

8 **I. WEIGHT OF MODEL RESULTS IN MY RECOMMENDATION**

9 Q. PLEASE EXPLAIN MR. HEVERT’S CRITICISM OF THE USE OF YOUR  
10 MIDPOINT RESULT AS THE BASIS FOR YOUR RECOMMENDATION.

11 A. My recommendation is based on the median or midpoint of my ROE estimates. Mr.  
12 Hevert claims that because seven of my nine estimates are based on Discounted Cash  
13 Flow (“DCF”) analyses, my midpoint approach gives considerable weight to DCF-  
14 based approaches in arriving at my ROE recommendation.

15 Q. HOW DO YOU RESPOND TO THIS CRITICISM?

16 A. As I discuss later in this surrebuttal testimony, Mr. Hevert’s aversion to the DCF is  
17 unsound. The DCF is a common method used by public utility commissions  
18 including the Missouri Public Service Commission (“Commission”). In an effort to  
19 capture investor-perceived risk, there are many forms of the DCF. As I have  
20 explained in my direct testimony, the various DCF models I rely upon incorporate  
21 information likely viewed by investors.

1           It is important to consider measures of growth in DCF analyses other than  
2 earnings per share (“EPS”). I examine growth in dividends, book value, and  
3 sustainable growth as part of my DCF analyses in addition to projected EPS, thereby  
4 producing seven different DCF analyses, three with the Single-Stage DCF and four  
5 with the Three-Stage DCF models. I incorporated results from all seven of these  
6 DCF analyses along with two CAPM analyses when developing my recommended  
7 ROE range.

8           I chose to use the median result as a basis of my recommendation because it is  
9 unaffected by potential outlying ROE estimates resulting from any of my ROE  
10 analyses.

11 Q.           IF YOU WERE TO GIVE EQUAL WEIGHT TO YOUR DCF AND CAPM  
12 ANALYSES, WOULD YOUR RECOMMENDATION CHANGE?

13 A.           No. Even if, for illustrative purposes, I were to give a 50 percent weight to the DCF-  
14 based results and a 50 percent weight to the CAPM-based results, my ROE  
15 recommendation would not change. As demonstrated in the following table, after  
16 calculating the average of all my DCF-based results to derive 8.68 percent and taking  
17 the average of the two CAPM results of 9.43 percent, the average between the two  
18 values would still equal about 9.0 percent.

<b>Estimated Return on Equity Summary Table</b>		<b>Average</b>
<b>Methodology</b>	<b>ROE (%)</b>	<b>ROE (%)</b>
Single-Stage DCF (EPS Growth)	9.00	
Single-Stage DCF (DPS, EPS and BVPS)	8.31	
Single-Stage DCF (Sustainable Growth)	8.20	
Three-Stage DCF (EPS, 4.8% GDP Growth)	8.62	
Three-Stage DCF (DPS, EPS, BVPS, 4.8% GDP Growth)	8.45	
Three-Stage DCF (EPS, 5.5% GDP Growth)	9.18	
Three-Stage DCF (DPS, EPS, BVPS, 5.5% GDP Growth)	9.01	<b>8.68</b>
Capital Asset Pricing Model (Current Risk-Free Rate)	9.26	
Capital Asset Pricing Model (Forecast Risk-Free Rate)	9.59	<b>9.43</b>
Average	8.85	<b>9.05</b>
Median (using all results above)	9.00	
Minimum	8.20	
Maximum	9.59	

1 **II. DISCOUNTED CASH FLOW-BASED MODELS**

2 Q. PLEASE SUMMARIZE MR. HEVERT’S CRITIQUE OF DCF MODELS.

3 A. Mr. Hevert’s principal critique of the DCF-based models is that they depend on recent  
4 stock prices as a principal input, and (in the case of the Constant Growth model)  
5 assume that Price/Earnings (“P/E”) ratios will remain constant in perpetuity. He  
6 continues by stating that “A significant analytical issue is that utility sector P/E ratios  
7 recently have been well above their historical levels, and appear unsustainable  
8 relative [to] other benchmarks, such as the overall market P/E ratio.” *See Hevert*  
9 *Rebuttal Testimony, p. 50, lines 9-11.* He further develops his critique that the  
10 industry’s current valuation levels may not persist and that analysts expect a decline  
11 in the P/E ratio in the near future. In short, Mr. Hevert believes that DCF-based  
12 methods are unreliable because of the unsustainable nature of the industry’s P/E  
13 ratios.

1 Q. DO YOU AGREE WITH MR. HEVERT'S ASSERTION THAT ROE  
2 ESTIMATES RESULTING FROM DCF-BASED METHODS ARE  
3 UNRELIABLE DUE TO THE NATURE OF THE INDUSTRY'S P/E  
4 RATIOS?

5 A. No, I do not agree. Although Mr. Hevert does not agree with the results of the DCF  
6 due to the historically low cost of capital that the results reflect, the DCF has been  
7 widely used by regulatory agencies to identify reasonable ROEs for decades,  
8 regardless of whether the cost of capital is low or high.<sup>1</sup> In fact, the Commission has  
9 expressed preference for the DCF by stating that the Risk Premium and CAPM are  
10 useful only as a check on the results from DCF analysis.<sup>2</sup> Moreover, Mr. Hevert also  
11 relies on DCF-based models; he just excludes the majority of these results in his  
12 recommendation to the Commission.

13 Mr. Hevert states that *Value Line* analysts anticipate a decline in the P/E ratio  
14 for the majority of companies in Mr. Hevert's proxy group. He also claims that the  
15 value of electric utility stocks is unsustainable, based on stock value data from  
16 January 30 through April 30, 2015. *See Hevert Rebuttal Testimony, p. 50, lines 15-*  
17 *17.*

18 Current stock price trends show a correction in the market from the high  
19 prices from 2013 and 2014 when electricity stocks saw significant gains from  
20 investors seeking attractive dividend yields in a low interest rate environment. In  
21 2015, however, the price of almost every electric utility issue has declined, as Mr.

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<sup>1</sup> The DCF model is the most commonly used model for estimating the cost of common equity for public utilities. *See The Cost of Capital – A Practitioner's Guide* by David C. Parcell, prepared for the Society of Utility and Regulatory Financial Analysts (2010 edition), page 124.

<sup>2</sup> In the Company's last rate case's *Report and Order* dated January 9, 2013, Case No. ER-2012-0174, findings of fact 11, at 17.

1 Hevert highlights in his rebuttal testimony. According to *Value Line*, however, "...it  
2 would not have been surprising to see a reversion to the mean after two years of  
3 significant outperformance."<sup>3</sup> I believe these market trends show a correction in the  
4 market as investors move towards higher-risk equities.

5 To put things into perspective, one must look at the relative strength of  
6 electric utility stocks. *Value Line* compares the relative strength of the price of  
7 electric utility stocks over time with the price of the Value Line Composite Index of  
8 approximately 1,700 stocks. When the relative strength line is rising (falling), it  
9 means that the stocks in an industry are stronger (weaker) than the broader market.  
10 According to *Value Line*, the electric utility industry's relative strength has remained  
11 within a range of 60 to about 80 since 2009.

12 Investors view utility stocks as a safe harbor. They are aware that  
13 traditionally structured utilities are treated as regulated monopolies with a franchised  
14 distribution area and are afforded a reasonable opportunity to recover prudently  
15 incurred costs. In fact, page 7 of the parent company's Securities and Exchange  
16 Commission ("SEC") Form 10-k Report states that "Missouri and Kansas continue on  
17 the fully integrated retail utility model. As a result, [the] electric utility does not  
18 compete with others to supply and deliver electricity in its franchised service  
19 territory, although other sources of energy can provide alternatives to retail electric  
20 utility customers."

21 Therefore, as investors evaluate the opportunity cost of utility stocks, they  
22 consider utility industry risks relative to their investment portfolio. As their  
23 perception of risk associated with other equities and bonds changes, their valuation,

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<sup>3</sup> *Value Line Industry Reports: Electric Utilities (Central)*, March 20, 2015.

1 as measured here in the P/E ratio, for utility stocks will change as well. As discussed  
2 above and addressed in the aforementioned *Value Line* report, this measure of  
3 earnings fluctuates over time, as it does for most industries, but it remains within a  
4 consistent range. These changes in stock valuations do not negate the use of DCF-  
5 based models as Mr. Hevert suggests. As I will discuss later, applying other types of  
6 growth rates in addition to earnings growth in the DCF model leads to more accurate  
7 ROE estimates.

8 Q. WHAT OTHER COMPONENTS OF YOUR DCF MODELS DOES MR.  
9 HEVERT BELIEVE ARE PROBLEMATIC?

10 A. Mr. Hevert believes that my reliance on earnings, dividends, and book value are  
11 problematic because earnings enable dividend and book value growth. He avers that  
12 numerous published articles support his reliance of analysts' earnings growth  
13 projections in the DCF model. He also states that, "Given that investors tend to value  
14 common equity on the basis of P/E ratios, Cost of Equity is a function of the expected  
15 growth in earnings, not dividends or book value." *See Hevert Rebuttal Testimony, p.*  
16 *52, lines 14-16.*

17 Q. DO YOU BELIEVE THAT INVESTORS WOULD RELY ON SOME  
18 INFORMATION AND CHOOSE TO IGNORE OTHER INFORMATION  
19 WHEN ESTIMATING THEIR COST OF CAPITAL OR THE  
20 OPPORTUNITY COST OF THEIR INVESTMENT?

21 A. No. Before purchasing, selling, or even choosing to hold a stock of a company,  
22 investors consider all available information regarding the future cash flows of that  
23 investment, which include the value of the asset and dividends to be received.



1           Therefore, at a minimum, investors consider other pertinent financial information in  
2           addition to expected earnings growth, such as expected dividend growth and book  
3           value growth.

4   Q.           HOW DOES MR. HEVERT INCORPORATE GROWTH IN EARNINGS  
5           INTO HIS DCF ESTIMATES?

6   A.           He makes use of three types of forecasts that all reflect projected earnings: growth in  
7           earnings per share, the P/E ratio, and the Price/Earnings to Growth (“PEG”) ratio.  
8           Earnings growth, the P/E ratio, and the PEG ratio are all related. The P/E ratio is  
9           simply the stock price divided by earnings, and the PEG ratio is the forward-looking  
10          P/E ratio divided by earnings growth.

11   Q.          IS MR. HEVERT’S RELIANCE ON THESE MEASURES OF GROWTH A  
12          PROBLEM?

13   A.           Yes. Mr. Hevert’s supposed alternative measures to earnings growth are merely  
14          derivatives of earnings. His reliance on one measure assumes that investors rely  
15          exclusively on a single measure of company growth when making investment  
16          decisions. As I stated previously, earnings forecasts are only one of many such  
17          statistics available to investors.

18   Q.          IS THE FINANCE LITERATURE UNIFIED IN CLAIMING THAT  
19          INVESTORS RELY SOLELY ON PROJECTED EARNINGS GROWTH IN  
20          MAKING INVESTMENT DECISIONS, AS MR. HEVERT PURPORTS?

21   A.           No. Although Mr. Hevert claims that there are a number of published articles that  
22          support the use of analysts’ earnings growth projections in the DCF model and he  
23          quotes findings from studies from 1986 and 1992, more recent studies have shown

1 that analysts' forecasts are too optimistic. For instance, a 2010 study by McKinsey &  
2 Company, titled "Equity Analysts: Still Too Bullish," concludes that "after almost a  
3 decade of stricter regulation, analysts' earnings forecasts continue to be excessively  
4 optimistic."<sup>4</sup> I believe that the significance of this study is that investors are hesitant  
5 to rely exclusively on analysts' earnings growth forecasts in making investment  
6 decisions.

7 Furthermore, a recent warning from the SEC titled "Investor Alert: Analyzing  
8 Analyst Recommendations" provides further caution to investors.<sup>5</sup> This statement,  
9 issued in 2010, recommends that when deciding whether to buy, hold, or sell a stock,  
10 investors should also do their own research by reading the prospectus and periodic  
11 reports filed with the SEC. The statement also warns investors of the potential  
12 conflicts of interest that analysts face, and calls into question the exclusive reliance on  
13 analysts' forecasts.

14 Q. MR. HEVERT ALSO CONDUCTS HIS OWN STATISTICAL ANALYSIS  
15 TO TEST WHETHER INVESTORS USE EARNINGS, DIVIDENDS,  
16 BOOK VALUE, OR SUSTAINABLE GROWTH RATES WHEN  
17 VALUING ELECTRIC UTILITY STOCKS. DO YOU AGREE WITH HIS  
18 ANALYSIS?

19 A. No, I do not. Although Mr. Hevert appears to conduct a robust statistical analysis  
20 testing the relationship between the P/E ratios of the universe of *Value Line* electric  
21 utility companies and the projected EPS, dividends per share, book value per share,

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<sup>4</sup> Goedhart, Marc H., Rishi Raj and Abhishek Saxena, *Equity Analysts: Still too Bullish*, McKinsey on Finance: Perspective on Corporate Finance and Strategy, Number 35, Spring 2010, pp. 14-17.

<sup>5</sup> See U.S. Securities and Exchange Commission's *Investor Alert: Analyzing Analyst Recommendations* [www.sec.gov/investor/pubs/analysts.htm](http://www.sec.gov/investor/pubs/analysts.htm)

1 and sustainable growth rates reported by *Value Line*, I believe he does not provide  
2 sufficient evidence to discount the use of my alternative measures of company  
3 growth. His analysis merely proves the strong relationship between P/E ratios and  
4 EPS, as I discuss above. That is, since the P/E ratio is calculated by dividing the  
5 stock price by earnings growth, testing that relationship will yield strong results.

6 Furthermore, the practice of employing alternatives to earnings growth  
7 projections in DCF-based approaches is widely used by public utility commissions.  
8 In the Company's last rate case, for example, the Commission ruled in favor of using  
9 multiple sources of published projections in addition to earnings growth.<sup>6</sup>

### 10 **III. CAPITAL ASSET PRICING MODEL**

11 Q. PLEASE SUMMARIZE YOUR CAPM ANALYSIS AND RESULTS.

12 A. In my CAPM analyses, I first calculate an equity risk premium by subtracting the  
13 market risk-free rate from the historical *Duff & Phelps* Large Stock Arithmetic  
14 Average Return and then multiply it by my proxy group average Beta coefficient  
15 reported by *Value Line*. I then add the risk-free rate to my sample specific equity risk  
16 premium. My two CAPM estimates differ in that the first is based on a 30-day  
17 average of the current yield on the 30-year Treasury bond, and the second relies on  
18 the *Blue Chip Economic Indicators* ("*Blue Chip*") projected yield on the 10-year  
19 Treasury bond.

20 Q. WHAT CONCERNS DOES MR. HEVERT HAVE ABOUT THE MARKET  
21 RISK PREMIUM COMPONENT OF YOUR CAPM ANALYSES?

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<sup>6</sup> See *Report and Order* dated January 9, 2013, Case No. ER-2012-0174 at 19.

1 A. Mr. Hevert avers that I should have used data from the more recent edition of the *Duff*  
2 & *Phelps 2015 Valuation Handbook – Guide to Cost of Capital*, which contains data  
3 as of 2014, to derive the market risk premium. The most recent issue that Mr. Hevert  
4 recommends was not available when I conducted my analysis. If I were to conduct  
5 the same analysis today, I would use the 2015 edition, increasing the market total  
6 return by only 3 basis points, from 11.63 percent to 11.66 percent, which would  
7 produce a negligible change in my CAPM results.<sup>7</sup>

8 Q. WHAT OTHER CONCERNS DOES MR. HEVERT HAVE REGARDING  
9 YOUR MARKET RISK PREMIUM?

10 A. Mr. Hevert is concerned whether historical estimates reasonably reflect investors'  
11 expectations and states that the forward-looking analyses contained in his direct  
12 testimony are more appropriate for that purpose.

13 Q. ARE YOU CONVINCED THAT MR. HEVERT'S FORWARD-LOOKING  
14 ANALYSIS IS A MORE APPROPRIATE ESTIMATE OF INVESTORS'  
15 EXPECTATIONS?

16 A. No. I am wary to adopt his forward-looking method to derive the market risk  
17 premium. Mr. Hevert's market return estimates of 13.7 percent (using Bloomberg  
18 data) and 13.4 percent (using *Value Line* data) are inflated because he relies on  
19 earnings growth projections when applying the DCF to calculate the overall market  
20 return.

21 Missouri Industrial Energy Consumers ("MIEC") and Midwest Energy  
22 Consumers' Group ("MECG") witness Michael P. Gorman also compares Mr.

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<sup>7</sup> If I were to update my CAPM analyses using the more recent edition of the *Duff & Phelps 2015 Valuation Handbook – Guide to Cost of Capital* to derive the market risk premium, my CAPM analysis using the current risk-free rate would increase by 2 basis points to 9.28 percent.

1 Hevert's estimated required market returns to Morningstar estimates of actual capital  
2 appreciation for the Standard & Poors ("S&P") 500 over the period 1926 through  
3 2013 to have been 5.8 percent to 7.7 percent. Mr. Gorman then provides the example  
4 of using the highest historical arithmetic average growth rate of 7.7 percent, and  
5 expected dividend yields of 1.9 percent and 1.8 percent as estimated by Mr. Hevert, to  
6 derive forward-looking market DCF return estimates of 9.6 percent and 9.5 percent.<sup>8</sup>

7 It is also important to note that Mr. Hevert applies the Constant Growth DCF  
8 model when calculating his *ex-ante* market required return—the same DCF approach  
9 to which he dedicates a large portion of his testimony criticizing. Since he relies  
10 solely on earnings growth projections in this application of the DCF, however, his  
11 analysis yields the unrealistic results described above. *See Hevert Direct Testimony,*  
12 *p. 27, line 13, through p. 28, line 3.*

13 Q. DOES MR. HEVERT HAVE ANY OTHER CONCERNS REGARDING  
14 YOUR CAPM ANALYSES?

15 A. Yes. He disagrees with my use of the yield on 10-year Treasury securities as the  
16 measure of the risk-free rate because, in his words, "The maturity of the risk-free  
17 security should approximate the life, or duration, of the underlying investment." *See*  
18 *Rebuttal Testimony of Robert B. Hevert at p. 61, lines 19-20.* Mr. Hevert continues  
19 by quoting the finance literature that states that the time horizon of the risk-free  
20 security should match the time horizon of the equity risk premium. Mr. Hevert then  
21 concludes, "Since the 30-year Treasury bond is the longest duration risk-free security,  
22 it most closely matches the horizon of equity and, therefore, is the appropriate  
23 security for the CAPM." *See Hevert Rebuttal Testimony, p. 62, lines 13-15.*

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<sup>8</sup> See analysis provided by Mr. Gorman in his rebuttal testimony, page 18, lines 9 through 16.

1 Q. WHAT EFFECT WOULD UTILIZING THE FORECASTED 30-YEAR  
2 TREASURY BOND RATE HAVE ON YOUR ROE RESULTS?

3 A. The effect on my ROE estimate would be negligible. If I were to update my CAPM  
4 analyses using the most recent *Blue Chip Financial Forecasts* projection of the 30-  
5 year Treasury bond rate of 3.7 percent, my CAPM result using the forecast risk-free  
6 rate would decrease by 3 basis points to 9.56 percent.<sup>9</sup>

7 Q. DO THESE ADJUSTMENTS CHANGE YOUR UPPER BOUND OF 9.6  
8 PERCENT IN YOUR ROE RANGE OF REASONABLENESS?

9 A. No.

#### 10 **IV. CAPITAL STRUCTURE AND COST OF DEBT**

11 Q. WHAT POSITION DOES MR. HEVERT TAKE ON CAPITAL  
12 STRUCTURE IN HIS REBUTTAL TESTIMONY?

13 A. At page 63 of his rebuttal testimony, Mr. Hevert states that I should apply Great  
14 Palins Energy Incorporated (“GPE”)’s consolidated capital structure because this is  
15 consistent with industry practice. He states that the Commission, in its *Report and*  
16 *Order* issued January 9, 2013, Case No. ER-2012-0174, at pages 24-26, approved a  
17 capital structure reflecting the parent’s actual capital structure. The Commission  
18 likewise accepted the consolidated GPE capital structure for KCP&L Greater  
19 Missouri Operations Company in Case No. ER-2012-0175.

20 Q. DO YOU AGREE WITH MR. HEVERT’S ASSESSMENT OF INDUSTRY  
21 PRACTICE?

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<sup>9</sup> MIEC and MECG witness Gorman also applies a 3.7 percent consensus 30-year Treasury bond forecast to his CAPM estimate provided from the March edition. *See Gorman Direct Testimony, p. 34, lines 16-17, and footnote 26.*

1 A. No. Applying the capital structure of the parent company is akin to applying a  
2 hypothetical capital structure, which is typically the practice when the company's  
3 capital structure is weighted heavily on either low-cost debt or higher-cost equity and  
4 regulatory authorities are concerned that customers will pay the burden of the cost of  
5 an imbalanced capital structure.

6 Q. WHAT OTHER CONCERNS DOES MR. HEVERT HAVE WITH YOUR  
7 CAPITAL STRUCTURE?

8 A. He also believes that I should have excluded short-term debt from my capital  
9 structure to remain consistent with the Federal Energy Regulatory Commission's  
10 ("FERC's") Order No. 561 formula for calculating the Allowance for Funds Used  
11 During Construction ("AFUDC"). He states that since short-term debt is first used to  
12 fund Construction Work In Progress ("CWIP"), the same short-term debt amount  
13 cannot also be included in the regulatory capital structure without double-counting  
14 that debt.

15 Q. DO YOU AGREE WITH MR. HEVERT'S CONCLUSION THAT  
16 INCLUDING SHORT-TERM DEBT IN THE CAPITAL STRUCTURE IS  
17 DOUBLE-COUNTING THE COST OF DEBT?

18 A. No, I do not. If his rationale were to hold, then the Company would have to also  
19 exclude the portion of long-term debt also used to fund CWIP since the amount of  
20 CWIP is over three times the amount of short-term debt balances.<sup>10</sup> Furthermore, the  
21 practice of excluding short-term debt from the capital structure assumes that the

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<sup>10</sup> From November 2013 to November 2014, the CWIP balance exceeded the commercial paper balance: the 13-month average CWIP balance was approximately \$692 million, while the 13-month average short-term commercial paper balance was approximately \$184 million. *See Hevert Rebuttal Testimony*, p. 64, line 21, through p. 65, line 2.

1 Company is refinancing long-term debt to pay off short-term debt balances and is  
2 using short-term debt as a temporary substitute for long-term debt. Although the  
3 Commission has allowed the Company to exclude short-term debt from the capital  
4 structure, it needs to be aware that the Company maintains a constant and significant  
5 short-term debt balance. *See Reno Testimony, p. 11, lines 1-3.*

6 Since short-term debt is used to fund the operations and investments of the  
7 firm, credit-rating analysts incorporate such interest-bearing debt in their ratings. For  
8 example, S&P considers ratios, such as Funds from Operations/Total Debt and Total  
9 Debt/Capitalization when rating a company. These ratings, in turn, are used by  
10 investors to gauge the risks associated with valuing a utility's assets. Finally,  
11 excluding short-term debt from the capital structure makes the capital structure more  
12 equity-rich, which is more expensive, thereby shifting the cost to ratepayers.

13 Q. DOES MR. HEVERT AGREE WITH YOUR SHORT-TERM AND LONG-  
14 TERM DEBT RATES?

15 A. No, he does not. Mr. Hevert states that based on the Company's current bond rating,  
16 it may borrow under its revolving credit facility at LIBOR plus 125 basis points.  
17 KCP&L also has a commercial paper program that enables it to borrow for short  
18 periods at lower interest rates. Mr. Hevert also avers that the undrawn cost of the  
19 revolving credit facility must be included with the cost of the commercial paper to  
20 calculate the Company's total short-term borrowing cost and provides an adjusted  
21 short-term cost of 0.99 percent.

22 Q. DO YOU AGREE WITH MR. HEVERT'S ADJUSTMENTS TO YOUR  
23 SHORT-TERM DEBT COSTS?



1 A. After reviewing Mr. Hevert's rebuttal testimony, supporting workpapers, and  
2 responses to information requests, I agree with his adjustments to my short-term debt  
3 cost, increasing my proposed rate from 0.26 percent to 0.99 percent.

4 Q. MR. HEVERT ALSO MAKES AN ADJUSTMENT TO YOUR PROPOSED  
5 LONG-TERM DEBT RATE. DO YOU AGREE WITH HIS CHANGES?

6 A. Yes. Mr. Hevert claims that I incorrectly calculated the cost of long-term debt when I  
7 divided actual interest paid of \$112,100,000 by the debt balance of \$2,298,500,000  
8 for the result of 4.88 percent. He also states that this interest paid amount is net of  
9 capitalized interest and that I should have used interest expense that includes  
10 amortized expense. After reviewing his rebuttal testimony and supporting  
11 documentation, I believe that his adjustments correctly calculate KCP&L's long-term  
12 debt cost, increasing my proposed cost of long-term debt from 4.88 percent to 5.70  
13 percent.

14 Q. HOW DO THESE ADJUSTMENTS CHANGE YOUR RECOMMENDED  
15 OVERALL RATE OF RETURN?

16 A. The adjustments to both my short-term debt rate and my long-term debt rate increase  
17 my overall rate of return recommendation from 6.62 percent to 7.05 percent:

<b>Adjusted Weighted Average Cost of Capital for KCP&amp;L</b>				
	<b>December 31, 2014 Balance</b>	<b>Weight</b>	<b>Pre-Tax Cost of Capital</b>	<b>Actual Weighted Cost</b>
<b>Long-Term Debt<sup>1</sup></b>	\$2,298,500,000	47.89%	5.70%	2.73%
<b>Short-Term Debt<sup>2</sup></b>	\$225,750,000	4.70%	0.99%	0.05%
<b>Common Equity</b>	\$2,275,000,000	47.40%	9.00%	4.27%
<b>Total Capitalization</b>	\$4,799,250,000	100.00%		7.05%

*Source: Company's SEC 2014 Form 10-k Report*

*1. Cost of long-term debt as provided by company witness Hevert. See Hevert Rebuttal Testimony page 66, line 12.*

*2. Average short-term debt year-end balances for 2013 and 2014 as reported in the Company's SEC 2014 Form 10-k Report on page 84. The Cost of short-term debt provided by company witness Hevert. See Hevert Rebuttal Testimony, page 65, line 13.*

1 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

2 A. Yes, it does.

