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In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service) File No. ER-2012-0174

In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement a General Rate Increase for Electric Service) File No. ER-2012-0175

DANIEL R.E. JORDAN, Presiding,
SENIOR REGULATORY LAW JUDGE.

KEVIN D. GUNN, Chairman,
ROBERT KENNEY,
STEPHEN STOLL,
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Service Commission.

(WHEREUPON, the hearing began at 8:33 a.m.)

JUDGE JORDAN: We're on the record. Good morning, everyone. Commission is calling the actions in Files No. ER-2012-0174 and ER-2012-0175. These are the general rate actions of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company.

I'm Daniel Jordan. I'm the Regulatory Law Judge assigned to these actions. We will begin by silencing cell phones and other devices. You don't have to turn them off, but make sure they don't ring and go off and distract people during these proceedings.

And then we will take entries of appearance, and I'm just going to start at the first center and move on back. Start with Staff counsel.

MR. THOMPSON: Kevin Thompson, Jeff Keevil, Nathan Williams and Sarah Kliethermes for the Staff of the Missouri Public Service Commission.

JUDGE JORDAN: Thank you.

MR. MILLS: On behalf of the Office of the Public Counsel, Lewis Mills and Christina Baker. Thank you.

MR. LUMLEY: Carl Lumley appearing for Dogwood Energy.

MR. ZOBRIST: On behalf of the companies, Karl Zobrist, Charles Hatfield, Roger W. Steiner.

CAPTAIN MILLER: On behalf of the Federal Executive Agencies, Captain Sam Miller. If I could, I'd also like to make an entry for Mr. Perry Arthur Bruder.

JUDGE JORDAN: Thank you. I think that leaves only you.

MR. CONRAD: Okay. Thank you, Judge. Stu Conrad on behalf of Praxair in the 0174 case and MEUA in the 0175 GMO case.

JUDGE JORDAN: Thank you. I think that's everyone. Any preliminary matters that we wish to address before we begin, before we resume taking testimony? I think there's an adjustment to the order of the witnesses; is that correct?

MR. ZOBRIST: That is correct, Judge. The company asked to present Kevin Bryant, who is the vice president and controller of Great Plains Energy and Kansas City Power & Light first, and then we'll proceed with our return on equity witness, Dr. Sam Hadaway, after Ed Blunk, who is the first witness on the Crossroads issues. And Mr. Hatfield is going to handle that segment of the case.

JUDGE JORDAN: Right. So we will be starting with Mr. Blunk as planned, but then we'll go to witness Bryant before witness Hadaway; is that correct?

MR. ZOBRIST: That's correct.

JUDGE JORDAN: Very good. With that, then, we will resume the taking of testimony and hear our next witness. Good morning. Please raise your right hand.

(Witness sworn.)

JUDGE JORDAN: Please be seated.

WILLIAM EDWARD BLUNK testified as follows:

DIRECT EXAMINATION BY MR. HATFIELD:

Q. Good morning. Could you state your name for the record, please.

A. My name is William Edward Blunk.

Q. Mr. Blunk, are you the same William Edward Blunk who filed direct, supplemental direct, rebuttal and surrebuttal in the KCPL case 0174?

A. Yes.

Q. And are you also the same William Edward Blunk who filed direct, rebuttal and surrebuttal in the GMO case 0175?

A. Yes.

Q. Do you have any corrections or additions to any of that testimony?

A. No.

Q. If we were to ask you all of the same questions that are recorded in your direct testimony, would your answers be the same today?

A. Yes.

MR. HATFIELD: Judge, we would move the admission of KCPL Exhibits 3, 4, 5 and 6 and GMO Exhibits 102, 103 and 104.

JUDGE JORDAN: I'm not hearing any objections, so those documents will be entered into the record.

(KCPL EXHIBIT NOS. 3, 4, 5 AND 6 AND GMO EXHIBIT NOS. 102, 103 AND 104 WERE MARKED AND RECEIVED INTO EVIDENCE.)

MR. HATFIELD: Tender the witness for cross.

JUDGE JORDAN: Running down the list of the sequence of cross-examination, I think the first on our list for this witness will be Dogwood.

There may be an issue with our sound right now. I'll just ask you to hang on for a second. And while we're at a pause, I thought I saw Mr. Bruder come in the room.

MR. BRUDER: Yes.

JUDGE JORDAN: Mr. Bruder, we'll be calling your client directly just from that phone when his time comes.

MR. BRUDER: He has asked me to ask, do you have any answer of when that will be? He wants to make sure he's ready.

JUDGE JORDAN: I think the parties have a better sense of how this will go than I do, but we can discuss that during a break. We'll be taking a break after Mr. Blunk's examination, so we can discuss it then.

In fact, since I'm not getting any feedback from my technical people, so to speak, on this sound issue, why don't we take a brief break while we sort that out, and we'll be in recess for ten minutes.

(A BREAK WAS TAKEN.)

JUDGE JORDAN: We're on the record, and a few announcements. First, my technical people tell us that we have fixed our sound issue. Now, as far as other technical issues, I'm told that if there is a drop in water pressure on this floor also in this building, that the Jefferson Building right down the street has water.

And finally there's an announcement as to the schedule of issues for today.

MS. KLIETHERMES: Yes, Judge. GMO rate case expense which was on the revised schedule we provided yesterday afternoon I believe is no longer anticipated to be an issue.

JUDGE JORDAN: Thank you. Anything else before we begin cross-examination? Not seeing anything, counsel, you may proceed.

MR. LUMLEY: Thank you. For the record,

Carl Lumley for Dogwood Energy.

CROSS-EXAMINATION BY MR. LUMLEY:

Q. Mr. Blunk, you're the supply planning manager; is that correct?

A. Yes.

Q. Since 2009?

A. Yes.

Q. And your duties include, according to your testimony, development and implementation of fuel and power sales and purchase strategies?

A. Yes.

Q. In your testimony, one topic you addressed is natural gas service to the Crossroads generation plant?

A. Yes.

Q. And that's a 300 megawatt combustion turbine generation plant in Clarksdale, Mississippi?

A. Yes.

Q. GMO obtains power from that plant in the summer months at time of peak demand, correct?

A. We can obtain power from it any time of year, but that's the primary use, yes.

Q. So it's classified as a peaker?

A. Yes.

Q. Isn't it correct that it's never been used by GMO to date to serve load in winter?

A. As far as I know, that's true.
Q. And even during the summer months, it would never be running even as much as half the time; is that correct?
A. That's true.
Q. It's fueled by natural gas, right?
A. Yes.
Q. Obtained over the pipeline owned by Texas Gas Transmission?
A. Yes.
Q. And do you have your testimony available to you?
A. Yes, I do.
Q. If you'd look at your direct testimony, page 29.
MR. KEEVIL: Which case?
MR. LUMLEY: In the 175 case.
BY MR. LUMLEY:
Q. All my questions will be about your testimony in the 175 case, and I'm looking at the HC version. I assume the pages are the same.
A. Yes.
Q. Okay. And about the middle of the page you testify to an HC number that, according to the question, GMO pays as a reservation or demand charges for natural

gas service to Crossroads in Mississippi?
A. Yes.
Q. And I don't intend to get into the number. What are the reservation charges for that you refer to there?
A. That is providing us firm transportation into Crossroads.
Q. Firm natural gas transportation?
A. Yes.
Q. And what period of time during the year is that firm transportation in place?
A. We primarily use that during the summer. We pay firm fees --
Q. If I could show you a document that might refresh your recollection.
MR. LUMLEY: May I approach the witness?
JUDGE JORDAN: You may.
BY MR. LUMLEY:
Q. Looking at the document I handed you, does it refresh your recollection that your company has a firm contract in place with Texas Gas Transmission for the period from 2009 to 2022?
A. We have two firm transportation arrangements at Crossroads.
Q. Is one for the summer and one for the

winter period?
A. That's what I'm looking to find. I just don't remember off the top of my head. Sorry. I was anticipating South Harper questions. We have one firm piece for Crossroads that runs from November to March, and then another that runs from May through September.
Q. And the reservation charge figure that you cite in your testimony includes both contracts?
A. Yes.
Q. On an annual basis?
A. Yes.
Q. What are the demand charges for?
A. The demand charges? They -- what do you mean, what they're for?
Q. What part of the service do they cover?
A. They cover providing firm transportation to the plant. They have different purposes. One of them is really to provide that firm transportation, and that Texas Gas one you showed me is primarily to help pay for some facilities.
Q. So the reservation and the demand charges both relate to the firm contract?
A. The two different contracts.
Q. Okay. Could you explain that a little further, how those terms relate to the two contracts?

A. We have a contract with Texas Gas, which is what you referred to and handed me a document for, and that covers one time period, and we have another contract with ProLiance Energy which covers a different time period.

Q. What was the name again?

A. ProLiance Energy.

Q. Okay. So you have firm arrangements in the winter season, November to March with --

A. With Texas Gas.

Q. -- with Texas Gas, and you have firm arrangements with ProLiance for March to September?

A. From May to September.

Q. May through September?

A. Yes.

Q. And do the reservation and demand charges relate to both contracts or --

A. It's the sum of the two. The number that I've got in my testimony is essentially the sum of the two.

Q. And the ProLiance would be the demand charges?

A. Yes. Yes.

Q. Do you also have interruptible arrangements with Texas Gas for the summer?

A. Not as a contract. If we needed it from Texas Gas, we can just call on it.

Q. Do you have arrangements in place to facilitate you being able to call on that on short notice?

A. Yes. We work through ProLiance who provides our firm transport. They manage our gas transportation and purchase into Crossroads.

Q. Okay. So it's a firm arrangement but it's available on demand?

A. Yes.

Q. Given the nature of Crossroads as a summer peak generation source, why does the company need firm arrangements for the winter period?

A. Well, I described, I guess in a DR, that sometimes when dealing with pipelines you have to buy firm transport. At times you don't need it. It's not because it's the customers' need. It's because that's what the pipeline needs in order to be compensated for providing their service. And in our case, the arrangement was that we would pay Texas Gas for this reservation charge through the winter months as compensation for the construction of some facilities.

Q. Facilities serving the Crossroads plant?

A. Yes.

Q. On page 27 of your direct testimony, you

indicate that the Southern Star Pipeline has two zones.
Do you recall that?
A. Yes.
Q. And you indicate that your testimony regarding the estimated cost of firm transportation relative to Southern Star relates to the market zone; is that correct?
A. Which page was that, 27?
Q. 27.
A. Yes.
Q. And the market zone essentially relates to the last leg that's actually connecting to the generation facility?
A. That is true.
Q. Does Texas Gas Transmission also have two zones?
A. Texas Gas has multiple zones.
Q. Do your firm arrangements with Texas Gas apply to the market side, the last leg, or is it broader than that?
A. They're broader than that. The zone or tier that we're in is the SL.
Q. So how many zones does that cover?
A. They operate a little differently than how we see it with Southern Star. With Southern Star, you add

them together. In Texas we're on the SL zone, and it represents the whole transport. So we don't have to add pieces together.

Q. So that's what I was getting to. The number you've supplied is a complete charge from production to market for the transport?

A. That I'm not sure of.

Q. At page 26 of your direct, you refer to release capacity?

A. Yes.

Q. And that's pipeline transportation capacity that's made available by somebody else that has firm rights but doesn't need it at the time, is that a fair way of summarizing it?

A. Yes.

Q. And as an example, GMO's Greenwood plant has been using capacity released by MGE this summer over the Southern Star Pipeline, is that --

A. Yes.

Q. In your surrebuttal testimony at page 2, you testify that firm transportation can be required to meet SPP requirements?

A. Yes.

Q. And you're talking about their requirements concerning system capacity?

A. Yes.

Q. And those requirements include the flexibility to have short-term four-month arrangements in place for peak needs, correct?

A. If that's when you're going to account the capacity, yes.

Q. And release capacity can be obtained on a firm basis for the period of time, correct?

A. Release capacity can be called back. You can get released capacity if it's available. So I guess what is your question?

Q. Is it one option that it can be released on a firm basis so you know for the few months that you've signed up for it, it's yours and can't be called back?

A. You can put that contract, yes.

Q. In your direct testimony again at page 27, you're testifying about an estimate you obtained from Southern Star of pipeline capacity expansion costs; is that correct?

A. Yes.

Q. And this is relating to your discussion about putting facilities, a hypothetical of putting facilities in place for 300 megawatts of generation at the South Harper site?

A. Yes.

Q. When you talk about expansion, are you talking about expansion of the compression facilities?

A. Well, it can include a variety of things but -- and Southern Star is the one that looked at that, but I would sooner include the compression and any other facilities they need to expand.

Q. Was it your understanding that would include actually new right of way and new pipeline or just expanding the capacity of existing pipeline?

A. As far -- we're not that specific. They just gave us a dollar amount.

Q. And in your testimony, you're talking essentially about an estimate of what it would cost today to achieve that expansion?

A. Yes.

Q. Are you aware that in your company's testimony in this case it asserts that the appropriate time for deciding to put the Crossroads plant into the fleet was in the 2007-2008 time frame?

A. Yes.

Q. You're aware that Staff asserts likewise that the time was the 2004-2005 time frame?

A. Yes.

Q. Did you get estimates of the expansion costs for either of those time periods?

A. No. Actually, these numbers are from our prior case, the 2010 case.

Q. Okay. So I wasn't trying to trick you with my question. So to clarify your prior answer, it's not really the cost today but the cost of roughly in 2010?

A. Yes.

Q. Do you know whether Southern Star had firm transportation that was available for service to South Harper in 2008?

A. It's my understanding they did not.

Q. What about in 2004 or 2005?

A. I do not know.

Q. Are there other pipelines that could have served a plant equivalent to Crossroads at the South Harper location at such prior times besides Southern Star?

A. The South Harper location?

Q. Uh-huh.

A. South Harper is served by either Southern Star or Panhandle Eastern.

Q. Do you know if Panhandle Eastern had available firm transportation in 2008?

A. No, they did not. And I guess as I'm putting your questions together, when South Harper was constructed, it is my understanding that Aquila when they put together the deal with Panhandle for this back haul capacity, they did that because there was no forward haul capacity available on either Southern Star or Panhandle, and this is what was available.

Q. What time period was that? You're saying when the plant was built?

A. When the plant was built.

Q. Is that roughly 2002, or was it even before that?

A. South Harper was 2005.

Q. 2005. Are you familiar with the Dogwood generation plant in Pleasant Hill?

A. Not very much, no.

Q. I mean, you know it exits, you know what I mean?

A. I know it exists.

Q. And it uses natural gas as well?

A. Yes.

Q. It's about 20 miles away from South Harper, give or take, Pleasant Hill and Peculiar --

A. Yes.

Q. -- does that sound fair?

Are you aware that Southern Star expanded capacity in 2009 to serve the Dogwood plant?

A. No.

Q. Do you recall reviewing Mr. Jansen's

testimony in the prior rate case on that point?
A. I do not remember.
Q. Going back to your -- are you sure the plant was built in 2005 or was that when it went into bankruptcy?
A. For South Harper?
Q. Yeah. No. I'm sorry. You were talking about -- I confused myself. The 2005 date you gave was South Harper?
A. That's my understanding.
Q. My apologies. I misunderstood your answer. Are you aware of any Southern Star expansion in western Missouri from 2005 to 2009?
A. No.
Q. In your surrebuttal at page 6, you indicate one aspect of your testimony is that opportunities for cost sharing and economies of scale with regard to expansion would be speculative; is that right?
A. Yes.
Q. But if others were actually obtaining expansion at the time, then the opportunities actually existed, correct, it wouldn't be speculation?
A. Yes.
Q. Surrebuttal, page 5, in the first full question and answer, just for clarity, when you in your

testimony refer to SSCGP, you're referring to Southern Star; is that right?
A. Yes, Southern Star Central Gas Pipeline.
Q. And when you refer to PEPL, is that Panhandle?
A. Yes, Panhandle Eastern Pipeline.
Q. And you indicate in your testimony that Southern Star does not offer seasonal firm transportation, correct?
A. Correct.
Q. But it does offer seasonal release capacity on a firm basis, doesn't it?
A. Actually, the release capacity is owned by the people who have the firm, and then they post it up to Southern Star, yes.
Q. And Southern Star manages that?
A. Yes.
Q. And so through that arrangement, seasonal release capacity can be available on a firm basis?
A. It can be. An issue with it is that volume that you need.
Q. And that's something that the Greenwood plant bought this summer?
A. Greenwood can rely on release capacity because Greenwood has oil backup.

Q. But you agree, they did buy it?
A. They did buy it.
Q. And you indicate that Pandhandle does have seasonal firm service, correct?
A. Yes.
Q. In your direct at page 28, line 6, you refer to an 80 percent chance of back haul capacity on Panhandle; is that correct?
A. Yes.
Q. And the 80 percent figure you're citing there is your estimate in terms of today, correct, present day?
A. That's my assessment of what it would be, yes.
Q. And what -- how did you come up with that 80 percent figure? What's it based on?
A. It's based on, one, it's not a certainty, but we think it's a high likelihood. So four out of five is representative of that.
Q. So it's not based on a mathematical analysis, it's --
A. No.
Q. Okay. You're indicating just a high likelihood?
A. Yes.

Q. At pages 28 to 29 you're comparing the cost of gas shipped on Panhandle to gas shipped at Crossroads, correct?
A. Yes.
Q. Do you compare gas shipped on Southern Star?
A. Well, what we were looking at here is gas we were sure we could get to the plant. Southern Star, we have no assurance we can get that gas to the plant.
Q. So you didn't make that comparison?
A. I did not make that comparison.
Q. And you didn't apply an 80 percent weighting factor to combined Panhandle and Southern Star gas prices, correct?
A. Correct, because the 80 percent that I was talking about there was whether or not we could get the back haul capacity on Panhandle versus having to expand the pipeline.
Q. In your rebuttal at pages 2 to 3, you have some discussion about gas transportation to plants in Illinois, correct?
A. Yes.
Q. Do you understand now that Staff has not taken the position that GMO should have built a plant in Illinois?

A. That is correct. I don't think Staff took that position.

MR. LUMLEY: That's all my questions. Thank you.

JUDGE JORDAN: The next person on my list for cross-examination will be Consumers Council of Missouri and AARP.

MR. COFFMAN: No questions, your Honor.

JUDGE JORDAN: U.S. Department of Energy?

MR. BRUDER: No questions, sir.

JUDGE JORDAN: And any other Federal Executive Agencies?

CAPTAIN MILLER: No questions, your Honor.

JUDGE JORDAN: Anything from the GMO industrials?

MR. CONRAD: No questions, your Honor.

JUDGE JORDAN: Or Praxair or Ag Processing? Or the KCPL industrials. I don't know if I recited them already. Office of the Public Counsel?

MR. MILLS: I have no questions either.

JUDGE JORDAN: Questions from Staff?

MR. THOMPSON: No questions. Thank you, Judge.

JUDGE JORDAN: Questions from the Bench? Commissioner Kenney, any questions? Not hearing any.

Commissioner Stoll?

COMMISSIONER STOLL: I have no questions, your Honor. I don't think -- he may be on mute, which means he should be able to hear us. In any event, I have no questions. Will there be any recross?

MR. HATFIELD: Just a little bit, your Honor.

JUDGE JORDAN: Redirect. I'm sorry.

MR. HATFIELD: I know what you meant.

REDIRECT EXAMINATION BY MR. HATFIELD:

Q. Mr. Blunk, I just have a few quick questions. In my experience at the PSC, sometimes we skip the basics. So I'm going to ask you real quickly about this Crossroads plant. As I understand it, based on the cross that you just had with Mr. Lumley, the Crossroads plant generates electricity, correct?

A. Yes.

Q. And that electricity is transported up here from Mississippi to the GMO service territory in Missouri, correct?

A. Yes.

Q. And in order to generate that electricity, what fuel is it that the Crossroads factory plant needs?

A. Crossroads is natural gas.

Q. All right. So your testimony when you were talking to Mr. Lumley just now has to do with the cost of getting fuel into that plant in Mississippi in order to generate electricity that is then transmitted up here to Missouri?

A. True.

Q. All right. And Mr. Lumley asked you about the number on page 29 of your testimony, and that number, as I understand it, is what it costs to bring the natural gas to the Crossroads facility down there in Mississippi?

A. That is true.

Q. All right. And I'll just ask it this way: After going through the cross with Mr. Lumley, does your testimony about what that cost is change in any way?

A. That is the cost of it. It's worth noting that it's significantly less down in Crossroads, Mississippi because it's located essentially in the heart of the gas field of the country.

Q. You're getting ahead of me. Slow down. All right. Did you happen to prepare a demonstrative exhibit to kind of explain the transportation of gas?

A. I did. I did.

MR. HATFIELD: Judge, I'm just using this as a demonstrative. I've marked it as Exhibit 144, which I think is the next one on the GMO list.

(GMO EXHIBIT NO. 144 WAS MARKED FOR

IDENTIFICATION.)

BY MR. HATFIELD:

Q. What does Exhibit 144 show us, Mr. Lumley?

A. This is a map of the United States, and what you see on it, the lines, the blue lines represent the interstate natural gas pipelines throughout the country, and the red lines represent the intrastate natural gas pipelines.

Q. So does this map give us any indication as to why it costs so little in order to bring natural gas to the Crossroads facility in Mississippi?

A. Yes. If you'll look down where Crossroads is, which is down -- it's in Mississippi, close to Louisiana, if you look close to the Gulf of Mexico, you can see there's a large cluster of blue. That's the main thing you really get out of this map at this scale. It's a deep cluster of blue there, because that's where all the pipelines are. That's the primary source of natural gas in this country.

And since Crossroads is located in the heart of all that gas production and all its gas pipelines, you have -- well, you have more flexibility in getting gas to it. You have more options. In fact, Texas Gas is, shall we say, a bit more gas-fired generation friendly than the other pipelines we deal with.

Q. Then Mr. Lumley asked you a little bit about getting gas to South Harper. Let's come back to that in just a minute. But does this map tell us anything about the difficulty in bringing gas into, let's say, Missouri?

A. Yes, because if you notice, if you look at where Missouri's at, there are very few pipelines crossing Missouri. Just making contrast, there are just a few lines that cross through Missouri as opposed to the cluster of blue you see down in the southern part of the country.

Q. And is that one of the reasons that, as you discussed with Mr. Lumley, your testimony is it's more expensive to bring natural gas to a location in Missouri than it is to bring it to a location in Mississippi?

A. Yes.

Q. So without getting into the specific numbers, do GMO ratepayers save money on gas transportation costs by having the plant located in Mississippi?

A. Yes. They save -- they save a lot of money.

Q. And so -- now, let me just finish up a little bit on the cross from Mr. Lumley. He asked you about the Southern Star testimony and South Harper, and maybe I'll just ask you this way: What was the point of your testimony about South Harper in your prefiled testimony?

A. The point of my testimony regarding South Harper and for that matter Goose Creek/Racoon Creek was just pointing out that to operate a plant you have to get gas transported into it, and you have to have -- Mr. Crawford speaks to having to be able to pay to get the electricity out.

You have to have the transmission side. You're balancing those two. It has to be the sum of the two, and you can trade and have low gas transportation and high transmission or you can pay to have low electric transmission and high gas transportation, but it's the sum of the two that matter. You've got to pay both of them.

Q. So just to bring that to conclusion, so when an electric generating plant that's fueled by natural gas is located in Mississippi, the natural gas costs are low, but the transmission costs up to Missouri might be high?

A. The gas transportation costs are going to be low in Mississippi, but the electric transportation costs will be high.

Q. Conversely, if the plant were located, same plant were located in Missouri, the gas transportation costs would be very high, but the transmission costs would be very low?

A. That's true.

Q. All right. Now, sticking with this map, you talked about the Southern Star line and the other line, and you talked about back haul and -- I wrote down the other term somewhere -- two ways to get gas.

A. Back haul and forward haul.

Q. Can you just explain to the Commission what you meant when you talk about back haul and forward haul?

A. Can I use the ELMO?

Q. You know what? It might be easier if you just turn around and point at the screen right behind you, if that's all right with you, Judge.

JUDGE JORDAN: It's fine by me.

THE WITNESS: South Harper's basically right about here, and for what we're calling for forward haul, we'd basically be getting gas from here in the Oklahoma area and it could come up to Kansas City. That's forward haul. Gas generally speaking moves from west to east and south to north, except for what's going out to here (indicating). So when we're talking forward haul, we're talking going from west to east.

What we're having to do for South Harper is that we're having to get gas originated down here, bring it up to Illinois and bring it backwards. And in reality the gas doesn't really move backwards on Pandhandle's pipeline. It's just since they have a customer further upstream, we can displace that gas and take their gas off in Kansas City.

BY MR. HATFIELD:

Q. Why don't you get back to the microphone because I forgot about that aspect.

So when you talk about back haul and forward haul, you're calculating the cost of bringing gas to a hypothetical Missouri plant in two different ways?

A. Yes.

Q. So based on the calculations you've done in your testimony, does it save the ratepayers money on transportation costs to use the Crossroads facility in Mississippi?

A. Yes.

Q. And is that savings sufficient to justify the transmission costs?

A. Yes. You save more off the -- you save more off the natural gas transportation than what the electric transmission is going to cost.

Q. And is that why the company is requesting that transmission costs be included in rate base in this case?

A. Yes.

Q. Last question. I should have asked you this earlier. Mr. Lumley asked you about why you purchase firm transportation in the winter months.

A. Yes.

Q. And you said you do that because there's some demand from the pipeline, as I understand it.

A. Yes.

Q. I just want to make sure I got that. So it's sort of like how I have to pay for my cable TV even when I'm on vacation?

A. That is true.

MR. HATFIELD: No further questions, Judge.

JUDGE JORDAN: Then this witness may stand down. My understanding is this has been cross-examination on all issues on which this witness has testified.

And so before we begin testimony from other witnesses, I'm going to give you an update on the water situation. I think I mentioned that water is available, whatever else happens here, in the Jefferson Building down the street, and also water is available on the first and second floors of this building. I'm informed that the source of the problem is a pump or pumps of Missouri American Water Company that have failed, and whether what they have now will continue is uncertain.

I think we have a recess scheduled for right now, and when we come back, we'll resume testimony of witnesses. Mr. Bryant will be our first. And since the rest of our witnesses, unlike this, will be testifying on specific topics, we'll begin each topic with a mini opening statement from the parties. Thank you. We'll take ten minutes.

(A BREAK WAS TAKEN.)

JUDGE JORDAN: We're back on the record. And before we resume taking the testimony of witnesses, Mr. Bruder, you had something you wanted to mention about the timing of our phone call today.

MR. BRUDER: We've agreed that Mr. Kahal will be cross-examined telephonically at two o'clock today eastern time, one o'clock today central time here. I have informed him of that, and he indicates that he will be ready.

JUDGE JORDAN: Very good. So that's one o'clock our time?

MR. BRUDER: Correct.

JUDGE JORDAN: Thank you. The Commission will now take up the issue of rate of return, including return on equity issues. We'll begin this portion of the hearing with small confined opening statements, and the first on my list of opening statements is Kansas City

Power & Light Company and KCP&L Greater Missouri Operations Company.

MR. ZOBRIST: May it please the Court? Karl Zobrist on behalf of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company.

I'd like to summarize a variety of issues that we're going to be dealing with over the next few hours today. They deal with the capital structure of the company, certain adjustments to cost of debt that Staff has proposed, and then the return on equity issue.

With regard to capital structure, I'm putting in front of the Commission a demonstrative evidence that indicates the consolidated cost of debt that Staff proposes as part of the capital structure of the company. Overall, KCP&L and GMO propose using the actual capital structure of Great Plains Energy as of August 31st, 2012. That will be trued up when we come back here in early November. And Staff generally agrees, Mr. Murray's the witness for Staff, generally agrees with that proposition.

Mr. Gorman, who is the expert witness on behalf of the industrials, initially endorsed setting it as of March 31st. In surrebuttal he raised certain issues with regard to the redemption of the equity units that the Commission dealt with in the last case and raised certain questions with regard to the increase in the equity of Great Plains Energy.

And Mr. Bryant on behalf of the companies, he's vice president and treasurer of the company, will be responding to several of the issues that Mr. Gorman has raised.

The change in the equity component arose not only because of the retirement of the equity units that Mr. Gorman acknowledges but also a shifting of certain long-term debt that was retired to short-term, and that's why it doesn't appear in the capital structure.

Mr. Kahal on behalf of the Department of Energy generally agrees with the capital -- using the actual capital structure. He has some issues with regard to other comprehensive income, which we call OCI. Mr. Bryant addressed that in his rebuttal and will be available for questioning on that. He points out that the Commission in its last four cases has approved the adjustments, whether negative or positive, that the company had requested.

The cost of debt will be an issue in the case because of the adjustments proposed by Staff. No other witness proposes explicit adjustments to issuances of debt in this case. Mr. Murray proposes three adjustments to the senior notes. As you can see, the top number there is the actual -- what the company proposes to be the actual cost of debt, which is 6.425. We actually have three numbers from Staff. They have one number in the report, they had a second number in Mr. Murray's rebuttal, and then in surrebuttal Mr. Murray had yet another series of adjustments that he made.

Our position is that the adjustments are arbitrary and not reasonable. They are not based upon any standard benchmarking or metrics that require an adjustment. We do not believe that any adjustments should be made to any of these issuances or to their terms and conditions which reflect the markets when they were sold and the prudent actions by the company.

I'd like to go through just one of those adjustments so you can understand some of the issues that we're dealing with. The first adjustment that Staff proposes is regard to GPE's senior notes that were issued in August of 2010, $250 million worth at an interest rate of 2.75 percent.

The purpose of that refinancing was to extinguish certain high-cost debt that was on the books, and also to fund for GMO -- this GPE debt was issued on behalf of KCP&L Greater Missouri Operations Company -- to pay for certain capital expenditures related to Iatan 1 and 2.

Mr. Murray thinks that the issue should have been -- the debt should have been issued by GMO and not GPE at a higher credit rating. And what we have pointed out through the testimony of Mr. Bryant is that this ignores the fact, first of all, that GMO does not have three years of interrupted audited financial statements, which is a minimum required for either a public or a private offering.

In any event, a GPE holding company guarantee would have been required, probably making the interest rate exactly what was assigned even if GMO had done it itself. So it would have been a 2.75 percent interest rate. It also ignores the fact that if GMO had actually issued this debt as a new issuer, it would have been assessed a new issue concession fee, which would have bumped up the interest rate.

And then finally Mr. Bryant points out that Mr. Murray has ignored the fact that GMO actually has a split credit rating between Moody's and S&P. As I recall, the S&P rating is slightly -- is one notch higher than the Moody's, and that probably would have again required, had GMO been able to do it alone, which we don't think it would have been able to, a higher interest rate.

And finally I might mention, with regard to this particular issue, this was in the case in the

Commission's Report and Order issued last year in GMO's 2010 rate case. Staff did not make any proposed adjustments to that, and it came into the capital structure of the company at the interest rate that it bore.

For Chairman Gunn and Commissioner Kenney and Commissioner Jarrett, you're going to see a lot of your old friends from the last rate case: Dr. Hadaway on behalf of the company, Mr. Gorman on behalf of Public Counsel this time -- formerly he represented or provided testimony on some of the industrials -- and of course Mr. Murray on behalf of the Staff.

But this year we have a new issue. We have some issues related to the discounted cash flow proxy group. In the past cases, Mr. Gorman had accepted Dr. Hadaway's proxy group and Mr. Murray had had his own. Initially here both Mr. Kahal and Mr. Gorman accepted Dr. Hadaway's proxy group, but then because proxy groups are formulated on the basis of criteria, and Dr. Hadaway here will talk about his four criteria, when it came time for rebuttal, there were four companies in his initial group of 22 companies that did not pass the criteria and they were eliminated.

And as the exhibit shows up here, Ameren, Clico, Edison International and Vectren were dropped by

Dr. Hadaway in rebuttal, and the reasons for those are described in the testimony. Ameren has been undergoing certain issues with regard to its generation in Illinois and some other issues. Clico's stock has been bouncing around, and they are the subject of merger speculations. Edison International has had some issues with regard to its existing coal plants. And Vectren now has, as I recall, more than -- or pardon me -- less than 70 percent of its revenue from regulated operations, so they were dropped off.

And Dr. Hadaway's dropping of these four companies and adding three others who met his criteria has been criticized by Mr. Kahal and by Mr. Gorman.

Now, one of the criticisms of Dr. Hadaway is that he removed two of the lower yielding or lower performing companies and should have somehow balanced that by throwing a couple of the top performing companies off. The point of this exhibit is to show that there were other two low performing companies in the proxy group who were not eliminated because they still met the criteria.

IDACORP, which is Idaho Power, and Xcel, which is Northern States Power Company, a utility out in Colorado, they were also low-performing companies when analyzed in terms of growth rates. Dr. Hadaway did not remove them. They stayed in there. So our argument is that the proxy group as modified by Dr. Hadaway in rebuttal is reasonable and appropriate and should be accepted by the Commission.

COMMISSIONER GUNN: Karl, can I ask you a quick question there?

MR. ZOBRIST: Yes, sir.

COMMISSIONER GUNN: So those remained in. They were not added back in as new criteria. There were, say, four what would be considered low earning, and you took two out, but these were not -- these were not added back in to the proxy group to compensate for that removal?

MR. ZOBRIST: I'm not sure you had it exactly right, so let me repeat it. Dr. Hadaway found that four companies did not meet the criteria, regardless of whether they were low or high.

CHAIRMAN GUNN: Right. But what I'm saying is these are what you would consider low-earning or low-performing?

MR. ZOBRIST: Right. IDACORP and Xcel, when you look at --

CHAIRMAN GUNN: Right. Those were low performing or whatever you want to call it?

MR. ZOBRIST: Right. Low growth rates.

COMMISSIONER GUNN: Low growth rates. But there were two other ones in there that were removed that were considered to be low growth rates, right?

MR. ZOBRIST: Right.

COMMISSIONER GUNN: So at one point there were four companies that were considered -- that had low growth rates. Just a clarification question. So these two were not added back in to compensate for the removal of the two, they were already -- they were already in?

MR. ZOBRIST: Right. Right. In other words, what I'm trying to say is, in response to the criticism of Mr. Gorman, I believe, and Mr. Kahal, I believe it's just those two witnesses, what I'm saying is that Dr. Hadaway just didn't eliminate the low performers. If you look at the growth rates, Vectren is pretty high, and Ameren, you know, is relatively high, but they had issues that took them out of the criteria. Clico and Edison were the two low-performing ones that were eliminated.

Our point is that there were other low performers that were not eliminated, not added back in, were not eliminated, IDACORP and Xcel, because they met the criteria, you know, having more than 70 percent or at least 70 percent from regulated operations, not being the subject of merger speculations, having not cut the dividend and having financial statements that have not been affected by merger or restructuring.

COMMISSIONER GUNN: Thank you. I appreciate it.

MR. ZOBRIST: Okay. Now, the other issue or the next issue that we have deals with growth rates, and I'm not going to go through a comparison of the growth rates because you'll have to go through each of the models of the DCF from the constant growth to the long-term to the multistage.

But the overall theme that the company would like you to recognize is that only Dr. Hadaway understands and makes adjustments for the very unusual economy that we are in right now. Since the recession began in late 2008 and 2009, the Federal Reserve Board has taken intervention into his -- intervened into the economy with three rounds of quantitative easing. It has launched an Operation Twist.

These were designed to maintain and -- actually not maintain but to lower interest rates and to stimulate the economy. The general consensus, I think, is that the economy is slowly on the way back, but we have artificially low interest rates by virtue of the Federal Reserve Board's action, and that needs to be considered in how you review and how you decide return on equity in this case. Dr. Hadaway is the only person who actually takes that into consideration.

Now, Mr. Murray has come back in response to some of the criticisms in your last Report and Order of his methodology and said, well, I want to talk about growth rates. He's got about a 10 or 12 term paper (sic), if you want to call it that, on some of the other companies and some of the other private analyst and investment banker analysis that he thinks is relevant to this case. We don't think it is because it's not part of a transparent process, it's not part of a public utility process where you relate to standard models like the discounted cash flow model and the risk premium model.

But what he has done is taken some old data from 1968 to 1999 and looked at ten companies at that time. I'd like to just go through that if I could for a few minutes.

Now, this is not Mr. Murray's proxy group for DCF. That's ten other companies, and I might again contrast that Mr. Murray tends to look at far smaller numbers of companies versus the other witnesses in the case. But in the Staff growth rate analysis, he took data that was compiled from 1968 to 1999. So the most recent data is already 12 to 14 years old.

And these are the companies that he chose. You know, one company doesn't even exist anywhere, St. Joseph Light & Power. The other is Empire District, which is a very small company. And what he did is look at the growth rates of these companies and then he averaged them. In other words, he gave Empire and St. Joseph Light & Power equal weighting to much larger companies such as Detroit Edison, Wisconsin Electric and Northern States Power.

In the results of his analysis, which appear again in the Staff Report, show that the earnings per share of these ten companies was all in the 3s, either the low 3s or high 3s. They don't even break 4 percent. At the same time, he admits that the U.S. gross domestic product growth rate is 8.1 percent. This is the Staff Report at page 45. Mr. Murray does not explain why given the historic GDP growth rate of over 8 percent, why it is relevant to take data that averages off in the mid 3s as far as a growth rate.

And again, Dr. Hadaway takes the long view, the real world view of what the economy is going into, and that is why we believe that his recommendations are more reasonable and appropriate.

The ranges of ROE in this case, Dr. Hadaway has a range of 9.8 to 10.3 and recommends 10.3 given the unusual economic circumstances we have with the intervention of the Federal Government into the private economy and lowering interest rates. Mr. Kahal is at

9.5 percent. Mr. Gorman is at 9.4 percent. Staff is at a range of 8.0 to 9.0 and does recommend 9 percent.

This Commission has always reviewed the returns on equity that have been issued by other commissions. I think the phrase that has come out in recent Reports and Orders is that it will not blindly or slavishly look at the other ROEs.

But this is a summary of returns on equity during 2012 from the Midwestern states that are located in the exhibit to Dr. Hadaway's GMO surrebuttal, and they show that the average ROE for all Midwestern states from February of this year through July is 10.15 percent. There is one outlier, if you want to call it that, the Northern States Power Company decision from the South Dakota Public Utility Commission of 9.25 percent.

If you throw out the outlier, which experts sometimes do, it shows that the ROE -- ROEs issued by Midwestern state commissions this year to date have been 10.28 percent, which is only two basis points from Dr. Hadaway's recommendation of 10.3 percent, which we believe is reasonable and appropriate and should be adopted by the Commission.

Thank you.

JUDGE JORDAN: Before I take our next opening statement, I have something to pass along in terms of bad news and good news. First, the bad news is that the first floor is losing water pressure. But in the nature of kind of good news, the Jefferson Building still has water pressure. The other good news is that elevator No. 2 has returned to service.

Now, the next opening statement is from Staff.

MR. THOMPSON: May it please the Commission?

As in the recently concluded Ameren Missouri rate case, the largest single dollar issue in this case is cost of capital. Staff's position is worth $29.1 million in the KCP&L case and $20.5 million in the GMO case.

As you know, the purpose of rate of return is to provide a profit or a return on investment to the utility's owners. Rate of return is equal to the utility's weighted average cost of capital, which is calculated by multiplying each component of the capital structure by its cost and then summing the results.

While the proportion in cost of most components of the capital structure are a matter of record, the cost of common equity must be determined through expert analysis. Staff's expert financial analyst, David Murray, has determined the cost of common equity for Great Plains Energy by applying well-respected and widely used methodologies to data derived from a carefully assembled group of comparable companies. That's that proxy group you've been hearing about.

Staff applied that estimated cost of common equity to Great Plains Energy's consolidated capital structure as of August 31, 2012 to calculate a fair rate of return. Mr. Murray used GPE's consolidated cost of debt with certain adjustments that we'll talk about later.

The evidence will show that the national average of awarded ROEs for the first half of 2012 is 10.36 percent. The average for the first three months of the year was 10.84 percent, and the average for the second quarter was 9.92 percent. These figures have not changed since you heard them from me in the Ameren Missouri case not very long ago.

Mr. Murray will testify that Great Plains Energy's cost of common equity falls within the range of 8.0 to 9.0, midpoint 8.5, resulting in an overall rate of return of 7.13 percent to 7.65 percent, midpoint 7.39 percent. Based upon a consideration of all relevant factors, Mr. Murray will testify that he recommends that the Commission authorize a return on common equity for both KCP&L and GMO of 9.0 percent.

Public Counsel's witness Michael Gorman

will recommend a return on common equity of 9.4 percent, the midpoint of his recommended range of 9.3 to 9.5. Matthew Kahal testifying for the United States Department of Energy will recommend 9.5 percent. And as you have just heard, the company's expert witness, Dr. Samuel Hadaway, will testify that the appropriate figure is 10.3 percent, the top of his range of 9.8 to 10.3.

Once again you are confronted with expert testimony ranging from 8.0 to 10.3, 203 basis points. Each of these witnesses is a duly credentialed expert financial analyst. Each of them has applied variations of the same analytical methods to a group of proxy companies to produce their recommendations. Those methods are the discounted cash flow model, the capital asset pricing model and the risk premium model.

The analytical methods these experts use are mathematical models. That is to say they are equations. We all know that the result that any equation produces depends entirely on the numbers plugged into it. Depends on the inputs. So the difference in the results and recommendations reached by these experts are entirely explained by their different inputs.

I urge you to pay particular attention to the growth rates used by each expert. Dr. Hardesty would have you believe that investors rely on a perpetual

5.7 percent GDP growth rate applied in this case to a mature industry with a flat load growth expectation.

Again, I will urge you to turn to the zone of reasonableness analysis as used by the United States Supreme Court in preference to that previously used by this Commission. It embodies the requirement stated in the court's Hope and Bluefield decisions which are the guiding legal precedence for rate of return analysis. It ensures at least a constitutionally adequate return to the company's owners.

A reasonable return is one that is not confiscatory. A return that is not confiscatory is the required constitutional minimum. The court has called this point the lowest reasonable rate. That is the lowest rate that is not confiscatory. To paraphrase the Supreme Court, courts are without authority to set aside as too low any reasonable rate adopted by the commission which is consistent with constitutional requirements.

The Supreme Court has said that there is a zone of reasonableness in which the Commission is free to set a rate that is higher than a confiscatory rate. The Commission may, as the frequently quoted language has it, make pragmatic adjustments which may be called for by particular circumstances. That means the Commission may set rates to achieve relevant regulatory purposes.

As I explained to you in the Ameren case, this is a two-step analysis. The first step is to identify the cost of common equity. That's an objective value. It is the actual cost of common equity for the proxy companies because, of course, we're not analyzing the company that's under the microscope here, KCPL and GMO. We are instead analyzing comparable or proxy companies. What is their actual cost of common equity? This is the point referred to by the court as the lowest reasonable rate.

Staff suggests you will find the lowest reasonable rate in the cost of equity reported to you by Staff's expert witness David Murray in the range of 8 percent to 9 percent.

The second step is to set the return on equity. It is Staff's position that the cost of common equity and the return on equity are not necessarily the same thing. The cost of equity is an objective fact. Expert -- an expert analyst may deduce it based upon the various equations and data sets used.

The return on equity, on the other hand, is a value set and determined by the Commission in order to achieve relevant and appropriate regulatory purposes. Based on the results of his investigation into the cost of common equity of these Great Plains Energy operated companies, Mr. Murray will recommend that you authorize a return on equity of 9 percent for both of these companies.

A second issue in the cost of capital area, and you heard Mr. Zobrist refer to it, is the cost of debt. This has to do with GMO. As you know, the company we fondly refer to as GMO today was formerly an independent regulated electric utility called Aquila.

I recall an opening statement by Mr. Conrad some cases ago in which he referred to KCP&L as the golden child and Aquila as Chucky. That should bring home to you the fact that Aquila was a troubled company, and now it is, in fact, a -- no longer exists except as a subsidiary of Great Plains Energy.

Aquila, when it was independent, did not operate solely in Missouri but operated in a number of other states and also in foreign countries. In particular, Aquila had an unregulated merchant energy operation that failed, and this resulted in the accumulation of a great deal of toxic debt.

This Commission consistently acted to protect Missouri ratepayers from the negative effects of Aquila's toxic debt, and that is the reason for the adjustments that Mr. Murray has proposed in this case for the cost of GMO's debt.

Staff has proposed downward adjustments to three specific GPE debt issuances. Why? Because the cost of those issuances was higher than it would have been but for the lingering effects of Aquila's toxic debt load. Once again Staff asks this Commission to act to shield ratepayers from the poor judgment and imprudent behavior of Aquila's management which still lingers in the cost of debt.

Thank you. And I should indicate my demonstrative exhibit there shows the ROE recommendations of these four different experts. It's not really to scale. The red figure is the point ROE recommendation of each expert. Thank you very much.

JUDGE JORDAN: I have another announcement as regard to the matters we've been periodically updating. I'm now informed that water service will return today but it will be a few hours.

Corollary to that is an announcement that may be of even more interest. That is that the building's chillers which provide us with air conditioning will also have to be shut down during that time. That can make things uncomfortable and distracting.

My suggestion, and the parties may certainly discuss this when we eventually go on break, is that we proceed for as long as we can with comfort. Water is available next door. That's not the most convenient, but that is what we have. And if the air temperature and humidity get to be so uncomfortable as to make it difficult to proceed, I suggest we recess then. We do have some open days. We have an open day at the end. We also have a day that has opened up, that being Thursday, if we need to resume. So discuss that as you need to during recess.

MR. CONRAD: Would the Bench be willing to define comfort?

JUDGE JORDAN: Comfort is a subjective measure, and it has to do with -- I would gauge it according to the ability of people to function. Me, I just want you to know, I'm here for you.

MR. THOMPSON: Thank you, Judge.

JUDGE JORDAN: Anything else before we --

MR. CONRAD: Thank you for sharing.

JUDGE JORDAN: Anything else before we proceed to our next opening statement?

All right. Then let's have the mini opening statement from the Office of the Public Counsel.

MS. BAKER: Thank you. Good morning. May it please the Commission?

Just as a point of aside, Staff's statement of Public Counsel's range is incorrect, and so I will go through that myself.

The Commission's charge is to set just and reasonable rates. Part of that determination is to set affordable rates that are not detrimental to the utility. A reasonable ROE is one that is not detrimental to the utility. The U.S. Supreme Court has determined that a reasonable return on equity is, one, adequate to attract capital at reasonable terms, thereby enabling the utility to provide safe and reliable electric service; that is, two, sufficient to ensure the utility's financial integrity; and three, is commensurate with returns on investments in enterprises having corresponding risks.

Customers have gone directly to the Commission with their concerns regarding affordable rates in this economy. Public Counsel asks that once the Commission sets a reasonable range for return on equity, that the Commission implement the low end of that reasonable range to promote affordability for KCP&L and KCP&L GMO customers.

For example, Public Counsel is sponsoring testimony which shows that a reasonable range for ROE is anywhere between 9.1 and 9.5 percent. Public Counsel asks that if the Commission accepts Public Counsel's range as a reasonable ROE range, that it implement the ROE of 9.1 percent.

Similarly, Staff is sponsoring testimony showing a reasonable range for ROE anywhere between 8.00 percent and 9.00 percent. If the Commission accepts Staff's range as a reasonable range, Public Counsel asks that it implement the ROE at the low end of that reasonable range or 8.00 percent.

The evidence is clear that times have changed significantly. The capital markets today are much lower than in KCP&L -- excuse me -- KCP&L GMO's last rate cases. Bond yields have also declined. With this reality in mind, the awarded ROEs throughout the country have also declined.

In order to protect the consumer, the Commission should use a hypothetical capital structure of 50 percent debt, 50 percent equity in this case rather than the company's projected actual capital structure at the end of August 2012.

The evidence will show that the company has no justification for its proposal to increase common equity ratio from 45.51 percent to 52.475 percent. Common equity of the capital structure has increased from approximately 50 to 50 -- 50 percent to 52.5 percent in this case.

However, when comparing long-term debt issuance to long-term debt retirement, the company retired more debt than was issued, so the amount of long-term outstanding debt is increased. The company's decision to issue less debt than the amount of maturing debt increased the common equity ratio at detriment to the customer.

Additionally, the company's decision to use common equity to largely finance outstanding debt capital is a large detriment to the customer. The evidence will show that the company could have utilized market interest rates of GPE but instead chose to refinance outstanding debt utilizing a debt issue rate that's much higher. By utilizing the market interest rates, the company could have cut the interest rate for the cost of capital for this outstanding debt by more than half, benefiting the customer substantially.

Therefore, Public Counsel asks that the Commission reject the company's proposal and utilize a hypothetical capital structure of 50 percent debt and 50 percent equity in this case. Thank you.

JUDGE JORDAN: Thank you, counselor. Next on my list for mini opening statements is Praxair and Ag Processing.

MR. CONRAD: Your Honor, by your leave, we will pass. Thank you.

JUDGE JORDAN: Next up would be AARP and the Consumer Council of Missouri.

MR. COFFMAN: May it please the Commission?

I just have a couple of comments to add to what I thought was the fine opening of Mr. Thompson, and I would ask that you adopt the Staff's range of appropriate return on equities, from their very thorough and supportable testimony, agree that your mission is to find the lowest supportable return on equity under the law.

And that balancing the interests between the utility shareholders and its customers demands that you, once adopting the appropriate range, then look outside to economic conditions and the real economic environment that surrounds the customers who actually have to pay the return that would be allowed by this utility.

Mr. Zobrist on behalf of the utility stated that the Federal Reserve's intervention since the recession in 2008 has been keeping interest rates low, and I think the word he used was artificially low. Well, for consumers, this is the very real economy that they've been living in. It has not been a temporary intervention by the Fed. It's been very long-lasting, and the returns that are expected in this very real economy here in Missouri is sobering.

I would ask that you give sufficient weight to the testimony of customers at the low public hearings and to the economic conditions evidence that is in the testimony of your Staff. You'll find this economic conditions summarized in the Staff Report starting on about page 25. And from the transcript records of the local public hearings, you will hear customers talk about very few and minimal salary increases since 2008, historic unemployment levels, very low increases, if at all, the cost of living to Social Security benefits, very, very low earnings on most retirement investments during this time since 2008, and I believe the historical period reviewed by all of the witnesses on this issue.

Long-term gross domestic product growth rate is expected to be in the 4 to 5 percent range. The total return on the Standard & Poor's 500 last year was about 2.11 percent. And these are the economic conditions that I think justify going to a lower end of whatever range you find is reasonable for affordability and to make the balance of interests more reasonable and fair.

The evidence of these experts here support or show a capital market currently that is lower than 10 percent and which is actually trending downward, expecting authorized return on equities from utility commissions to be trending down. And again, I ask that you recognize the real economy that we're in and the large increase the customers already had to pay since 2008 in this particular case. Thank you.

JUDGE JORDAN: Any opening on these issues from United States Air Force?

CAPTAIN MILLER: I will waive my opening statement.

JUDGE JORDAN: From the United States Department of Energy?

MR. BRUDER: If I may, briefly. What we have before us -- if it please this honorable Commission and Judge Jordan, what we have before us is an outlier of a presentation by this company, and that needs to be, I believe, at the forefront of any examination of return on equity that's made here.

Now, DOE's witness, FEA's witness, the Air Force's witness Matthew Kahal went through the normal DCF, CPM and other permutations and he came up with a range of 8.8 to 9.8. He went a little higher than the midpoint, 9.5. Mr. Murray says 9 percent, Mr. Gorman 9.4. That gives an average, a rough average of about 9.3. The company is at 10.3, and the contrast is dramatic, just dramatic.

Moreover, the company is not only asking 10.3, it's asking that its permitted return on equity increase by this .3 by a very, very significant amount in an atmosphere in which we all know that concomitant rates are low, much lower and dropping. All of the vectors show down and the company is saying up. How does the company get to up when everything is going down? How does it take the traditional or seemingly traditional methodologies that all of these experts have used and get to such a dramatically different recommendation?

Well, first Dr. Hadaway chose back in February, not too very long ago, 22 companies. I emphasis this is not a choice that all of the rate of return people made in sync. These 22 companies are Dr. Hadaway's choice and his alone. The other experts all merely accepted them.

Now, back in September -- and from February to September is, from two to nine is only seven months. In September Dr. Hadaway brought to us seven changes, seven changes among those 22 companies. Better than 30 percent he wants suddenly to change. Now, what he's saying in effect is that there have been changes in the circumstances of all of those companies that are such that some should be thrown out and some should be -- and some should be newly brought in.

But the truth is that all of the companies thrown out, all brought in have such an effect upon the numbers that the numbers are driven upward, and this being the case, that goes somewhat to the credibility of that exercise.

Now, by way of answering the suggestions that these changes ought not to have been made or maybe not so many of them, the company says, well, he put in some stuff that's self-serving, but we had other stuff that was self-serving that he didn't put in. There are other changes that he also could have made and he didn't make those. And it really must, must be emphasized is a very, very -- a minimal sort of argument. No matter how far we go in one direction, we could always have gone further. And the suggestion that this is credible because they didn't go even further, I say ought to obtain -- be given only minimal weight.

Secondly, Dr. Hadaway would have the Commission adopt a growth rate of 5.7 percent. Where does that number come from? It doesn't come from anybody's forecast. It is some kind of average of 60 years of growth. We're talking about going back to 1952 and talking about growth rate in 1952 and the years that follow it, the go-go years after the second world war that some of us lived through when we know how phenomenal the growth was when this was a society that was turning into what is called the affluent society.

Those growth rates are not going to hold in the future. Nobody thinks that. I emphasis that this 5.7 percent growth rate that drives this 10.3 percent request for equity, that 5.7 percent growth rate is not anybody's forecast of growth. It's nothing but a long-term 60-year average of historical growth. It's as if I had an 18-year-old and I said, this 18-year-old has grown by so much this year, and I expect him or her to continue to grow in the future at that rate.

Third, Dr. Hadaway has introduced something called a terminal growth DCF model. Now, the thing about the terminal growth in terms of where we are here today is that Dr. Hadaway didn't use it in his earlier work in this case. None of the other experts used it. We'll find out today in cross-examination whether Dr. Hadaway has ever used it before here or anywhere else. What we do know is that it's self-serving in terms of what its effect is upon what he considers a credible result is substantial.

Now, what Mr. Kahal and I think others have demonstrated and will demonstrate is that if you remove these outlying additions and changes, if you remove the changes in the seven companies, if you take a more sensible growth rate than 5.7 percent, if you drop the terminal growth DCF model, you'll get right back in the range where the other three rate of return witnesses are.

Now, by way of trying to -- or rather further trying to justify where they are on this, what the company has said is, we know that interest rates are low and getting even lower, and yet they want a return on equity that's high and they say should be even higher. And they say, well, that's all right because interest rates and returns on equity do not move in lockstep. Now, there what they've done is set the straw man up and knocked it down. No one has ever said that interest rates and stock prices move in lockstep. Only a statistician could make that happen, not an economist who's looking at the real world.

But what they would have you believe is that not only do they not move in lockstep, but that they move in opposite directions, that although interest rates are low, low and getting lower, return on equity should be high and getting higher. It doesn't pass the very simple test of basic financial logic. So there I think we have a problem.

Finally, Dr. Hadaway has testified that his is the best, that his is the most persuasive and the most property return on equity recommendation because he is the only one who has taken into account usual present economic conditions. Well, Dr. Kahal -- I'm sorry. Mr. Kahal has testified and I think anybody would testify that if you do the DCF properly, it takes into account whatever conditions prevail. That's what it's supposed to do.

And I want to emphasize that there's no testimony in this record that I'm aware of that suggests that the DCF, the CAPM and the others do not do this. The suggestion is we use them in normal times, and because we use them in normal times they don't work in not normal times, but that is assertion, and as far as I know there's nothing in the record to buttress that. So it's fair to assume that the DCF and CAPM as applied by the three other witnesses are valid.

Moreover, if you look at the difference between the 9.3 that the three come up with and the 10.3 that the company would like, you'll see that although the difference in the number is dramatic, you can't find anything in Dr. Hadaway's presentation that does specifically tailor itself to these conditions. All he says is these conditions are such that it ought to be higher than it otherwise would be. There's nothing support specific than that that I can find.

For these reasons, I urge that the Commission adopt Mr. Kahal's 9.5 or something close to it, but mostly what I do urge is that it give very, very sharp and clear attention to the company's presentation and note the flaws and note its self-serving character and act accordingly. Thank you very much.

JUDGE JORDAN: I think that's everyone that's on my list for opening statements. Before we proceed to take our first witness, I need to give you an update as to the water situation again. I have two updates, and one is that the Jefferson City schools will be closing today due to the water situation. If school started at 8, it will be dismissed at 11:30, which is just a little less than an hour from now. If it started at 9 o'clock, it will dismiss at 12:30. That's the first note.

Second is a message from our water division, and this comes from Jim Merciel. I'm going to read this to you. I just heard that the water outage is not just here, it is all over town. He called Kevin and Gilbert at the company. They had a leak in the high service pump room. Those are the pumps that send treated water into town, and they had to shut down so the repair can be made. This means there is no water coming out of the treatment plant. They're hoping to have the repair made within a couple of hours, but there is also a chance of not having proper parts on hand.

Meanwhile, they have their emergency connections in Water Districts 1 and 2 open which will keep some customers in water but not adequate for the whole service area. There will also be a boil advisory and maybe a boil order. Gilbert is contacting DNR about that at present.

So that's where we are with water. We

won't have it for a while. When we do, we may not be able to use it for human consumption. May not be potable. Anything else before we begin to call witnesses?

MR. CONRAD: Do we need to talk about an AAO?

JUDGE JORDAN: An accounting authority order? I don't know if we can really consolidate that with this case. I'll assign Mr. Conrad to put together a stipulation of the parties.

MR. CONRAD: That's fine. Thank you.

JUDGE JORDAN: Then with that, we will proceed to hear from our first witness.

MR. ZOBRIST: Thank you. The company calls Kevin Bryant to the stand.

JUDGE JORDAN: One further update. The cafeteria that is in this building will be closing today at 11 o'clock because of the water issue. That's at 11. Please raise your right hand.

(Witness sworn.)

KEVIN E. BRYANT testified as follows:

DIRECT EXAMINATION BY MR. ZOBRIST:

Q. Please be seated. Please state your name.

A. Kevin E. Bryant.

Q. And where are you employed?

A. Kansas City Power & Light.

Q. And what is your position there?

A. Vice president of investor relations and treasurer.

Q. Mr. Bryant, did you prepare rebuttal and surrebuttal testimonies in both the 0174 and 0175 proceedings relating to Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company?

A. I did.

Q. Do you have any corrections to either of those pieces of testimony?

A. I do not.

Q. And for the record, Mr. Bryant's rebuttal and surrebuttal testimonies in the KCP&L case have been marked as Exhibit 10. There's both an HC and an NP version. And his surrebuttal is Exhibit 11. And in the GMO case it is Exhibit GMO 106, both HC and NP, and GMO Exhibit 107.

Mr. Bryant, are the questions and answers that you gave in there questions and answers that you prepared?

A. Yes.

Q. And if I were to ask you those questions, would your answers be the same as set forth in those exhibits that I just named?

A. They would.

Q. And did you deliver those answers to those questions under oath?

A. Yes.

MR. ZOBRIST: Judge, I offer Exhibits KCPL 10 and 11 and GMO Exhibits 106 and 107 into evidence at this time and offer the -- or tender the witness for cross-examination.

MR. CONRAD: No objection.

JUDGE JORDAN: I'm not hearing objections, so I will enter those documents into the record.

(KCPL EXHIBIT NOS. 10 AND 11 AND KCP&L GMO EXHIBIT NOS. 106 AND 107 WERE MARKED AND RECEIVED INTO EVIDENCE.)

JUDGE JORDAN: First cross-examination is from AARP and Consumer Council of Missouri.

MR. COFFMAN: I have no questions.

JUDGE JORDAN: Cross-examination from the United States Department of Energy?

MR. BRUDER: No questions, sir.

JUDGE JORDAN: And from the associated Federal Executive Agencies?

CAPTAIN MILLER: No questions.

JUDGE JORDAN: Anything from the GMO industrials?

MR. CONRAD: No, sir, no questions.

JUDGE JORDAN: Or Praxair or Ag Processing?

MR. CONRAD: Same.

JUDGE JORDAN: Anything from the Kansas City -- from KCPL industrials? I think none of those are in your group. From the Office of Public Counsel?

MS. BAKER: Yes.

CROSS-EXAMINATION BY MS. BAKER:

Q. Good morning, Mr. Bryant.

A. Good morning.

Q. If a company issues less debt than the amount of maturing debt, doesn't that increase the common equity ratio?

A. Not necessarily.

Q. Explain what you mean.

A. You may have debt that matures, and you can replace that with long-term debt, but it also can be replaced with short-term debt. So to the extent it's replaced with short-term debt, the overall outstanding debt level would remain the same.

Q. In the opening statement, counsel for Kansas City Power & Light made the statement that some of the testimony by Mr. Gorman was incorrect because it did not take into account that some of the long-term debt was changed into short-term debt. Is that your understanding of your counsel's statement?

A. Yes.
Q. Can you explain what that statement means?
A. I think what counsel was getting at was the equity ratio in our current case has increased due to the conversion of the equity units in June of this year to about 50 or so percent, with the equity ratio filed in the case is 52.5 percent.
The proceeds from that equity issuance this year was used to pay down a portion of high-cost GMO notes, 500 million or so of notes, which caused the increase in the equity ratio. The balance of that financing is currently in short-term debt and not a part of the long-term cap structure.
Q. But shouldn't a -- shouldn't that short-term debt be reflected in the capital structure?
A. My understanding is that that's not the way it's currently treated.
Q. When will the short-term debt be converted into long-term debt?
A. The short-term debt -- in the current market it makes sense to issue long-term debt when you get to at least a size of 250 million or so, so the issuance is index eligible. In the current market, issuances of in excess of 300 million get favorable pricing.
So it would make sense to issue long-term

debt when you have an outstanding amount north of 250 to 300 million of short-term debt, which if you look at our financing plan is our plan. We have a maturing GPE debt issuance next year of $250 million, and our plan is to combine that with the remaining short-term debt for a longer term issuance to get better pricing in the market.

Q. So what is the total amount of short-term debt that you have at the moment?

A. Currently outstanding, I don't have that number available.

MS. BAKER: May I approach?

JUDGE JORDAN: You may.

BY MS. BAKER:

Q. I'm going to give you a copy of a data response to refresh your memory on that regard.

A. Okay.

JUDGE JORDAN: And for future reference, permission won't be necessary to approach either witnesses or the bench.

MS. BAKER: Thank you.

MR. ZOBRIST: Counsel, do you have an extra copy of that by any chance?

MS. BAKER: I do not. I will show it to you as soon as he's done.

MR. ZOBRIST: Thank you.

BY MS. BAKER:

Q. Does that refresh your memory on that?

A. It does.

Q. Can you answer the question of how much short-term debt?

A. There was 344 million as of August 12th of 2012.

Q. Get that back from you and show it to your counsel.

Since it's over 300 million, are you intending to refinance before November of this year?

A. We are evaluating financing alternatives as we speak. We are evaluating an issuance this fall. That 300 million goes through August. Obviously in the summer utilities have their peak, peak of receipts, and so we would expect that to come down as we get receipts from summer collectibles. But we are evaluating a fall financing issuance as well as a first quarter of next year financing, a long-term financing.

Q. The long-term debt that you refinanced with short-term debt, was the long-term debt something that was used to finance investments that were put into rate base?

A. I'm not sure specifically. The long-term debt that matured was a $500 million note that Aquila had prior to the acquisition that KCPL had of GMO. So I'm not sure exactly what that would have financed.

Q. But utility debt is usually used to finance utility assets, correct?

A. That's fair.

MS. BAKER: No more questions. Thank you.

JUDGE JORDAN: Questions from Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Mr. Bryant, good morning.

A. Good morning.

Q. In the course of your duties, do you happen to have occasion to become familiar with the credit ratings of Great Plains Energy?

A. I do.

Q. How about of Kansas City Power & Light Company?

A. I do.

Q. And the company referred to as GMO?

A. I do.

Q. Okay. I wonder if you could tell me, what is Great Plains -- or excuse me.

With respect to Great Plains Energy, who is it rated by?

A. Standard & Poor's and Moody's.

Q. Is the same true of Kansas City Power &

Light?
A. Yes.
Q. And GMO?
A. Yes.
Q. I wonder if you happen to know what the current credit rating by Standard & Poor's is of Great Plains Energy?
A. For Great Plains Energy, the senior unsecured credit rating is BBB- for S&P and Baa3 at Moody's for Great Plains Energy.
Q. And how about for Kansas City Power & Light Company?
A. It's BBB at KCP&L and Baa3 -- I'm sorry. The question was for KCP&L?
Q. Yes.
A. Baa2 at Moody's.
Q. Okay. And finally for GMO?
A. It's BBB at S&P, and Baa3 at Moody's, senior unsecured.
Q. So looking at the Moody's ratings, you indicated that at KCP&L it's Baa2, whereas at GPE and GMO it's Baa3. Did I get that correct?
A. You did, absolutely.
Q. Now, is Baa2 a higher rating or lower rating than a Baa3?

A. It would denote a higher credit rating, so a higher credit profile.

Q. And with respect S&P, I think I heard that at KCP&L and GMO both it's BBB?

A. Correct.

Q. And at GPE it's BBB-?

A. It's triple -- at GPE, correct, BBB-.

Q. Okay. And is BBB- a higher or a lower rating than BBB?

A. It would be lower than BBB flat, which is what KCP&L is rated, but investment grade.

Q. So at least with respect to Moody's, GMO is rated lower than KCP&L; isn't that correct?

A. That's correct.

Q. And is that -- that is a result of the Aquila debt; is that not true?

A. No. That's a result of the fact that GMO does not have standalone financial statements that Moody's is able to assess and evaluate, and at the same time GPE guarantees all outstanding GMO debt, which causes the rating agencies of Moody's to default to the GPE credit rating for GMO.

Q. I see. Do you expect GMO's credit metrics to improve now that the high-cost Aquila debt has been retired?

A. We do. I do.
Q. If you know, did customers have any control over Aquila's decision to structure the corporation as it did?
A. Which corporation?
Q. Aquila.
A. I don't know.
Q. You do not know?
A. I didn't work for Aquila.
Q. Do you know if customers had any control over the investment and business line decisions made by Aquila's management?
A. I don't know, but I suspect not.
Q. If you know, did customers have any control over Great Plains Energy's decision to acquire Aquila?
A. No.
Q. And if you know, did customers have any input or control over Great Plains Energy's decision to assume Aquila's remaining debt as part of that acquisition?
A. Not other than the approval process for the merger that KCPL entered into.
Q. And, in fact, that was an acquisition, not a merger; isn't that true?
A. That's correct, my understanding.

Q. As far as you know, Kansas City Power & Light Company and GMO are still distinct corporate entities?

A. Yes.

Q. If you know, why did GPE issue equity units in 2009?

A. To preserve the company's credit rating during the build cycle for, amongst other things, Iatan 2 during a challenging market.

Q. Was there a danger at that time, had those equity units not been issued, of a downgrade?

A. Yes.

Q. Is it true that at that time S&P was concerned about the ratio of FFO to debt?

A. I believe that's correct.

Q. And isn't it true that there was an indication that if it remained below 13 percent, that GPE would have been downgraded to junk?

A. I believe that's the case.

Q. Now, were the equity units more expensive than a traditional issuance?

A. Traditional in what sense?

Q. A traditional issuance of debt, for example?

A. The equity units would have been more expensive than debt.

Q. Okay.

A. But I think the appropriate comparison was -- was to an equity issuance, because given the credit concerns at the time, KCPL and Great Plains Energy needed equity credit from both Moody's and S&P to maintain credit stability. So instead of issuing equity, which would have been at around 10 percent rate as is being discussed today, the cost of the equity units was below that cost.

MR. THOMPSON: Okay. Thank you. No further questions.

JUDGE JORDAN: Questions from the Bench?

CHAIRMAN GUNN: I don't have any questions.

COMMISSIONER KENNEY: I don't have any questions. Thanks, Mr. Bryant.

THE WITNESS: Thank you, sir.

JUDGE JORDAN: Then we have no recross. Redirect?

MR. ZOBRIST: Just a couple of questions, Judge.

REDIRECT EXAMINATION BY MR. ZOBRIST:

Q. Mr. Bryant, if you recall, with regard to that $500 million aquila debt that Public Counsel was asking you about that was refinanced, do you recall the interest rate on that Aquila debt issuance?

A. It was 11.875 percent prior to maturity.

Q. And when it was refinanced, if you recall, what was the new interest rate?

A. Well, for the remarketed GMO notes, it was 5.292 percent was the coupon rate.

Q. Just so the record is clear, Mr. Thompson asked you about FFO. What does that stand for?

A. It's funds from operations. Represents the cash flow of a company.

Q. Now, he asked you about the credit ratings that were issued to the three companies, Great Plains Energy, the holding company, KCPL and GMO. Are the credit reports issued by Moody's attached to your testimony?

A. They are.

Q. At the time that Kansas City Power & Light Company had its, I believe it was its senior unsecured rating reduced, was there any mention of the Aquila merger acquisition in that report?

A. No, not specifically that I recall.

Q. And what about with regard to either Great Plains Energy or GMO, was there any discussion that the merger, which we lawyers refer to as a merger but it was the acquisition of Aquila by GPE, was there any discussion that the downgrade was caused by or related to the acquisition of Aquila by Great Plains Energy?

A. No, not specifically.

MR. ZOBRIST: That's all I have, Judge.

JUDGE JORDAN: Then this witness may step down.

MR. ZOBRIST: May he be excused, your Honor?

MR. ZOBRIST: As far as I know there's no subpoena for him.

MR. ZOBRIST: Great. Thank you.

THE WITNESS: Thank you.

JUDGE JORDAN: We have a choice at this point as to whether to take a break now or proceed through until a lunch break. Do the parties have any consensus on that?

MR. ZOBRIST: The company is ready to go, Judge.

JUDGE JORDAN: I'm not hearing an objection to that, so let's continue.

MR. ZOBRIST: Company calls Dr. Samuel Hadaway to the stand.

(KCP&L EXHIBIT NOS. 19, 20 and 21 AND GMO EXHIBIT NOS. 114, 115 and 116 WERE MARKED FOR IDENTIFICATION.)

(Witness sworn.)

SAMUEL HADAWAY testified as follows:

DIRECT EXAMINATION BY MR. LUMLEY:
Q. Please be seated. State your name for the record, please.
A. Samuel C. Hadaway.
Q. Dr. Hadaway, where are you employed?
A. I'm employed by Financo, Incorporated.
Q. And did you prepare in this case direct, rebuttal and surrebuttal in both the 0174, the Kansas City Power & Light general rate case, and in 0175, the KCP&L Greater Missouri Operations Company rate case?
A. Yes, I did.
Q. And they have been marked, Judge, for the record as KCPL 19, 20 and 21 in the KCPL case, 19 in both highly and NP versions, and in the GMO case as GMO Exhibit 114, 115 and 116. For Exhibit 114 there's both an HC and an NP version.
Dr. Hadaway, did you prepare the questions and answers in those exhibits?
A. Yes, I did.
Q. If I were to ask you those questions, would your answers be the same today?
A. Yes, they would.
Q. Do you have any corrections to any of those exhibits?
A. Yes. I may need help with the exhibit

numbers, but in my rebuttal testimony, I believe the pages and line numbers are the same in both dockets.

Q. And that would be KCPL 20 and GMO 115.

A. Okay. Yes. Thank you. On page 20 of that rebuttal testimony, at line 17, a number appears that says 9.95 percent. That number should be 9.85 percent.

The second correction that I have is in the surrebuttal.

MR. BRUDER: Excuse me. Could we just hear that again? I'm sorry. I missed that.

JUDGE JORDAN: Please repeat your answer.

THE WITNESS: Yes. In the rebuttal testimony, on page 20, at line 17, the number 9.95 appears, and that should be 9.85.

MR. BRUDER: Thank you.

THE WITNESS: And in the surrebuttal testimony, which would be KCPL Exhibit 21 and GMO Exhibit 116, on page 3, at line 21, the date 2012 should be 2011. Those are the corrections that I have.

BY MR. ZOBRIST:

Q. I think there might be one more. Let me just check. Dr. Hadaway, if you'd look at your surrebuttal, page 4, Table 1. There's a reference there to 10.09, and I believe you advised me that should be -- the average number should be 10.05.

A. I'm sorry. I'm not on the right exhibit.
Q. In either of the surrebuttals. I'm sorry. It's the GMO surrebuttal, GMO 116.
A. I'm sorry to say that I actually don't have that piece of testimony here in front of me.
Q. It's Table 1, page 4. It's just the average of the numbers there.
A. Is it perhaps on page 7?
Q. Yes. Line 23, page 7, Table 1. Sorry.
A. Okay. I'm with you now. I'm sorry for the confusion. I let these two last pages that were added to the GMO testimony a week later when this data became available, and I forgot to bring them.
Q. And is the average of those three figures in the 2012 column which are 10.30, 9.95 and 9.90, is that average actually 10.05 rather than 10.09?
A. If you average those three numbers, yes, it is, but the number as stated there is actually correct.
Q. Okay.
A. For all the cases. There were different numbers of cases in the different quarters is the reason for that.
Q. Well, I think I muddled the record with those corrections and explanations. Well, one more question. The answers that you gave were given under oath

at the time; is that correct?
A. Yes.
Q. And any other corrections or additions to your testimony?
A. No, I don't believe so.
MR. ZOBRIST: All right. Thank you. Judge, I offer GMO Exhibits 114, 115, 116 and KCPL Exhibits 19, 20 and 21 at this time and tender the witness for cross-examination.
JUDGE JORDAN: I'm not hearing any objections. I'm not hearing any objections, so I will admit those documents into the record.
(KCPL EXHIBIT NOS. 19, 20 AND 21 AND GMO EXHIBIT NOS. 114, 115 AND 116 WERE MARKED AND RECEIVED INTO EVIDENCE.)
JUDGE JORDAN: Cross-examination from AARP and Consumers Council of Missouri?
MR. COFFMAN: No, your Honor.
JUDGE JORDAN: Cross-examination from United States Department of Energy and associated Federal Executive Agencies?
MR. BRUDER: Yes.
CROSS-EXAMINATION BY MR. BRUDER:
Q. Good morning, Dr. Hadaway.
A. Good morning, Mr. Bruder.

JUDGE JORDAN: Let's make sure the microphones are on and that they're also close enough to pick up.

MR. BRUDER: Okay. How'm I doing? Can I be heard?

JUDGE JORDAN: That's better.

MR. BRUDER: Okay. Great.

BY MR. BRUDER:

Q. I'm looking at your rebuttal, Schedule 10, page 1.

A. I'm sorry, Mr. Bruder. I have a very thick notebook, and I'm taking just a second to get to the right place.

Q. Please take your time because I have a lot of things to reference, and I'm in the same situation.

A. Yes, I have that exhibit.

Q. Okay. That is a restatement of Mr. Kahal's DCF study and shows a list of 22 companies. Now, you yourself selected those 22 companies for that group; is that correct?

A. I did.

Q. Okay. Did any of the other return on equity witnesses in this -- who have testified in this proceeding have any role in the selection of those companies?

A. I'm not sure if I understand what you're asking, but no. I mean, I didn't talk to them about it or anything like that.

Q. Now, from that same schedule, you have deleted in your later testimonies three of those companies; is that correct?

A. That's right.

Q. Is it true that two of the three companies that you deleted had the two lowest growth rates of the 22?

A. Yes, they appear to have.

Q. Just to be clear, which two were those and what were the growth rates?

A. Ameren had a negative 2.7 percent growth rate, and Edison International had a positive 2.06 percent growth rate.

Q. And we find those, that's going to be -- that's going to be on Schedule 10, page 102, and which of the columns is that?

A. That's in column 1.

Q. Okay. Thank you. Now I'll ask you to go to your rebuttal testimony, please, at page 28.

A. I have that.

Q. Now, in regard to the companies which you deleted, you chose them and you placed them in testimony

in February of this year, and you deleted them in early September when you filed your rebuttal; is that correct?
A. Yes, and there was very good reason why.
Q. With regard to the company that is called Ameren, you say at that page that it faces unusual circumstances because it has problems with its merchant generation activities. Do you see that?
A. Yes.
Q. Can you tell me what those problems are in more detail, sir?
A. They are the problems that led to the analyst growth rate being a negative number, the minus 2.7 or whatever it was we talked about just a minute ago. Most rate of return witnesses, and I believe that's happened with our witnesses in this very case, will exclude companies like that because that's not a sustainable long-term growth rate. It's simply if the company has a negative rate, it can't be sustained. The company would disappear after a period of time.
Q. Let me repeat the question. You assert there that this company faces unusual circumstances because it has problem with its merchant generation activities. I ask you now, what are those problems with its merchant generation activities?
A. My statement there comes from the ValueLine

sheet, and it's probably one sentence, but from what I know about other companies and their merchant generation business, it has to do with low gas prices and low wholesale power prices.

Q. So with regard to Ameren, you don't know what problems that specific company has, do you?

A. I do. I know that ValueLine said that they were having serious earnings problems, which reflects the 2.7 percent negative growth rate that is not sustainable, and sir, that's why I eliminated that company.

Q. I'm going to ask the question once more. You have asserted that this company has problems with its merchant generation plants. Can you tell us what specific problems this specific company has with its specific merchant plants?

A. I cannot. I can tell you that ValueLine said that and I use that in my testimony.

Q. Now, you've told us that you don't know what those specific problems are. Sir, do you know whether those problems developed between February of this year when you put that company into your 22 company group and September of this year when you took it out of that group?

A. They did in the sense that they became noticeable to the analysts that project growth rates.

They did not have a negative growth rate based on 2010 data which were available at the end of 2011 when we filed the direct testimony. Going forward to September, we had all of 2011, we had a good part of even 2012, and the analysts' opinions changed dramatically for that company. And because of that, I and other witnesses that had previously used that company have eliminated it.

Q. When exactly did you say that those problems became -- became part of the analysts' opinions that were available to you?

A. It would have been through the summer when the new ValueLine sheets that were used in the September testimony came in.

Q. It is your testimony that that was not in anything that was available to you as of February when you made the initial filing?

A. No, it was not.

Q. You say on that page also that the services are projecting negative near term earnings growth for Ameren. What are they projecting for longer term growth rates for Ameren, if you know, sir?

A. Analysts do not project beyond five years typically. So the 2.7 negative growth rate is what's out there in the press now.

Q. And for what period of time is that?

A. Five years.

Q. Now, we have another company which you removed. I'm going to ask you to pronounce it. It's C-l-e-c-o.

A. It's typically pronounced Clico, I believe.

Q. You say that there's strong evidence that its stock price is inflated by merger speculation. Could you describe that merger speculation in any further detail, sir?

A. Simply that ValueLine, a service that we all use to get our data, said that in its more recent edition, and it explained in its review of Clico that its price had gone up because of that merger speculation.

Q. But you yourself don't have any independent information about what that merger speculation is, how it affected the price or what's likely to happen with it in the future, you've taken that one statement and you have nothing further on the subject; is that right?

A. I haven't investigated it further.

Q. Now, does that and that alone constitute what you refer to as the strong evidence that the stock is inflated by merger speculation?

A. That and the confirmation that its dividend yield became much lower than the other companies. It's clear that that is what's going on, and ValueLine simply

confirmed that in its review of the company.
Q. Well, dividend yield goes down when stock price goes up, but the fact that stock price goes up doesn't mean that it went up because of merger speculation, does it?
A. I think investors would believe that that was the reason if ValueLine said that was so.
Q. I'm going to ask you the question again. You can speculate about what investors would believe, but it is not necessarily so, is it, sir?
A. You can disagree with ValueLine if you want to as you sit there. I do not disagree with them. I've reviewed Clico's price, and I believe that there is evidence in the price itself that something unusual is happening. ValueLine attributes that to merger speculation.
MR. BRUDER: Your Honor, I'm going to ask that the witness answer the specific question.
THE WITNESS: I've already said I didn't do any further analysis.
JUDGE JORDAN: Is that answer satisfactory? Is that answer satisfactory to counsel? He said he hasn't done any further analysis. Is that answer satisfactory?
MR. BRUDER: Having said that he hadn't done any further analysis, he asserted again that the

reason why the stock price has risen is the merger speculation. If he's saying that that is what he surmises and he knows nothing further about it, I'm satisfied.

THE WITNESS: I'm not surmising at all, sir. I'm simply reporting what ValueLine says and what appears to me as a person that works with this kind of situation is going on. That's it. No further analysis.

JUDGE JORDAN: The question was lengthy. If you'd like to repeat it.

MR. BRUDER: No. I think I understood.

THE WITNESS: Thank you.

JUDGE JORDAN: Very good.

BY MR. BRUDER:

Q. And this strong evidence that you speak of, sir, when and how did you become aware of it?

A. As I said a couple of times, it's in the more recent ValueLine editions. That's how I became aware of it.

Q. Your testimony is that it was not in the ValueLine editions that were available to you up to February of this year?

A. That's correct.

Q. Now, with regard to Edison International, you say that it has erratic earning prospects due to certain nonrecurring charges. That's line 8 and 9.

A. Yes.
Q. Can you describe those nonrecurring charges, sir?
A. Again, I have not investigated Edison International in detail on my own. I simply responded here in my testimony with what the ValueLine publication says about the problems that Edison International is having. So that's the extent of my analysis and the basis for that statement.
Q. You don't know either the character or the amounts of those nonrecurring charges, sir?
A. I believe that those charges may have been stated in the ValueLine sheet, but as I sit here, I don't know off the top of my head.
Q. I'm going to look now at your Schedule 12, page 1.
A. I have that.
Q. That, as I understand it, is an update of four versions of a DCF study; is that correct?
A. That's right.
Q. Now, I want to look at what you refer to as the terminal value model, which we find I believe in the far right-hand column; is that right?
A. Yes, that's right.
Q. And did you present calculations based on

that model in your direct testimony that you filed in February, sir?

A. No, I did not.

Q. But you did do so in the rebuttal testimony in September; is that right?

A. Yes.

Q. Now, can you tell us why you chose to add this in September initially?

A. Yes, sir, I can. On page 30 of my rebuttal testimony, I explain that whole situation. But in the fourth version of the DCF model, I applied terminal value approach. In this model investors receive the dividend projected by ValueLine the first four years and are assumed to sell their stock at the prevailing price at the end of the fourth year. The estimated required return is the investors' internal rate of return from the dividends and selling price over the four years. I explain how the rest of it works.

I ask them below that, why did you do this? And I said, this model provides balance during this period where, as Mr. Murray noted in his testimony, utility PE ratios are higher than they've pretty much ever been.

This model is not a model that I recommend on an ongoing basis, as I say here in this testimony, but it was used to balance the extremely low dividend yields in the other models. And it's stated there in about two or three pages beginning on page 30 of my rebuttal.

Q. Then your decision to include this in your second round of testimony was driven by, what did you say, the extremely low what?

A. Dividend yields.

Q. Is it your testimony that dividend yields were significantly lower in September when you filed the second round than they were in February when you filed the first round?

A. No. It's my testimony that the government had announced an additional quantitative easing program. It was clear that they were going to continue to eliminate any other alternative for fixed income investors in terms of yields. ValueLine and others had said that investors were turning to utility stocks and other dividend paying stocks as their only alternative, that the abnormally low interest rate environment was creating that.

In my testimony both in direct and rebuttal I explained that this was an artificially low dividend yield created by the government's artificially low interest rate environment.

Q. I'm sorry. What was the effect upon stockholders of that that you just referred to and I think briefly described?

A. I'm sorry. I don't understand what you're asking.

Q. You said that it was having an effect upon stockholders or potential purchasers of stock. What effect was that? Was it compelling them to be inclined to purchase the stocks of regulated public utilities?

A. I didn't say anything about stockholders. I said that dividend yields were artificially low because interest rates were artificially low due to government policy, that fixed income investors such as bond investors had no other reasonable alternatives.

Q. So you're saying that this phenomenon that you described was compelling bond investors to be more inclined, debt investors to be more inclined to purchase a debt of regulated utilities like KCPL?

A. No, I didn't say that at all.

Q. Okay. What did you say?

A. I said that there were no other fixed income investments available for them, and as ValueLine and other investment advisory services have explained on overrule occasions, that has caused utility stock prices to be pushed up to the highest PE ratios that we've seen, I don't know it's ever but in many, many years, and that it's created abnormally low dividend yields in those stocks.

Q. You just said that something has caused utility stock prices to be pushed up; is that right?

A. I did.

Q. Okay. What is it, please, to clarify, that you testify as caused the utility stock prices to be pushed up?

A. Because they are the next best alternative for the bond investors, just like any other savers. None of us can get a decent rate of return on our savings accounts. Retirement funds that typically try to invest in fixed income securities such as bonds can't get a decent rate of return on quality bonds. Therefore, they have moved out of that arena into dividend paying stocks.

Q. So you have testified then that this phenomenon has compelled people who are normally bond investors that cannot get decent returns on bonds to purchase utility stocks, and that has driven up the price of utility stocks; is that correct?

A. Yes. We agree on that.

Q. And are those the circumstances that impelled you to use this terminal DCF model where you hadn't used it before?

A. Well, as I explained, as I said before, beginning on page 30 of my rebuttal testimony, yes, that is one of the reasons.

Q. What are the other reasons?

A. That if you look at the traditional DCF model, just the yield plus growth model, and if the yield is pushed down just as interest rates have been pushed down by government activities, then that model will give you understated results. Therefore, other models that take the other side of the picture, the PE ratio being high, the price of the stock being high, and put that into a simple terminal value model, which is used in finance textbooks right along with the others, that that balances the low numbers that are coming out of the other models.

Q. You said that the high PE ratios and the high stock prices require something to balance them, and what -- by way of balancing them, you introduce this particular variation in the DCF model?

A. Yes.

Q. Sir, have you ever presented this DCF model in any testimony you gave before this Commission?

A. Not before this Commission, I don't believe so.

Q. Can you tell us, have you appeared before any other commission in testimony in this sort in return on equity?

A. We have been using it routinely since the summer, and at other times when utility stock prices have been very high, we have used various versions of this. This particular model is simply a shortened-up version of what is often called a multistage model, and sometimes it's called an internal rate of return model, but it appears in many people's testimony, typically with the terminal value pushed far out into the future, but it's the same kind of thing except here you don't have any GDP growth rates, you don't have any analyst growth rates other than ValueLine's earnings projections and the price that would exist if today's PE ratio is applied to that fourth year earnings number.

Q. You said, I believe, we have used it routinely since the summer. By we do you mean you and your staff?

A. Yes, in my company we have.

Q. Can you tell me where you've used this?

A. Yes. We have it file in a Baltimore Gas & Electric case in Maryland. We have it on file, we used it in the Kansas version of this company's case in Topeka. We have used it in a recent case in Louisiana, where Mr. Kahal is also the witness for the state there. So at least those five cases. I provided a data request response that listed where we had used it, but I don't have that data response right before me might right now, but at least those five cases.

Q. All of them since this summer?
A. Yes. That's what the question asked me, since the first of the year.
Q. Do you know whether any other ROE expert has presented the same or similar model, sir?
A. I need to think about this carefully because I just said that many witnesses use this kind of model with the terminal value. It's just that the value is typically out farther. So we have these issues of growth rates. I believe Mr. Gorman has used this kind of a model. I know that Mr. Murray has.
Q. That's with a longer -- that's going further out?
A. Yes, going much farther out with terminal value.
Q. More than, let me say, this is a four-year and then terminal stock prices?
A. That's right.
Q. Has anybody that you know of presented such a model with the four years out and then the terminal stock price?
A. Certainly not in this case, and I don't know if others have in other cases recently or not.
Q. But --
A. At other times, yes, they have. At times

different witnesses try different kinds of models, and because a simple sort of a textbook explanation of how short-term present value works in a classroom, this kind of model is used to explain what investors might be looking.

Q. Again, in this terminal value model you used four years of dividend growth. Can you explain why you limit it to the four years?

A. That's what ValueLine does.

Q. I'm sorry. I haven't understood. You're saying that ValueLine applies this and it uses a model which is limited to the four years and then the terminal value of the stock?

A. No. I may have misunderstood your question. I thought you asked me why I used four years. ValueLine produces four years of dividend forecast and four years of earnings forecast.

Q. So you're saying you use it because that's -- because that's the limitation of the available data?

A. That's right.

Q. Now, I want to look at Schedule 12, page 5, column 35 if we could.

A. I have that.

Q. That is the so-called terminal stock price;

is that right?
A. Yes.
Q. Can you explain what that is conceptually, please?
A. Yes. If investors buy the stock today and hold it until the fourth year, and if today's PE ratio continues to prevail, and if ValueLine's earnings forecasts are correct, if earnings have become what ValueLine forecasted them to be in the fourth year and multiply that times the PE ratio and that's how you get that price.
Q. So that price would be valid if those PE ratios hold for the fourth year and if the ValueLine earnings predictions are correct?
A. That's exactly right.
Q. And those things do have to fall into line in order for those to be correct; is that right?
A. Yes.
Q. Now, the prices themselves are numbers that you calculated yourself; is that correct? Those are not from the ValueLine or any other source, are they?
A. As I said, they're the ValueLine fourth year multiplied by today's PE ratio, and I did do that calculation.
Q. By today's PE ratio?

A. Yes.

Q. Neither ValueLine or any other authority has suggested that those will actually be the prices at that time, have they, sir?

A. ValueLine has a set of prices that they project. They don't say exactly how they get it. So I don't know.

Q. Are you saying that those prices that you have reflected there may be the same or similar to the ones that ValueLine projects?

A. No, I'm not saying that.

Q. So again, then, what authority, what evidence do we have that those projected prices four years out actually reflect what the prices of those shares will be four years out?

A. It reflects a version of the DCF model that assumes that investors today are paying 16 times earnings, and if the investor continues to pay that and if ValueLine's earnings projections are correct, that that's what the price will be.

Q. But you've also testified that we are in turbulent times and things are going to vacillate. So is it a little bit less than logical to assume that the PE ratio that holds today will continue in effect for your years coming?

A. Well, only if you assume investors are rational and that they expect to lose money on their current investments. I don't think that's implied anywhere here.

Q. I've missed the connection between my question and whether investors are rational.

A. Okay. I've tried to explain that the government's influence on interest rates has pushed down dividend yields because it's brought traditional investors into the utility markets that have a different set of risk return outlooks. They're used to investing in fixed income securities. So they've pushed the prices up where PE ratios are about 16 times earnings.

Now, those investors may have a different set of values, they may have a different view of things. That's what I'm saying. That causes the traditional yield plus growth DCF model to produce understated ROE estimates.

To balance those understated ROE estimates, I've made perhaps what you seem to be saying is an unreasonably high assumption about PE ratios in the future. I'm saying they're just going to stay the same. And if that happens, then you would get a higher rate of return than the traditional models are saying. So the two balance each other. That's all.

Q. If interest rates rise dramatically over those four years, sir, what will happen to those PE ratios?
A. I don't know. I would expect they will go down.
Q. And if that happens, then the model or at least the portion of the model that reflects those stock prices would not be met, would it?
A. And at the same time --
Q. Could you please answer the question?
A. Yes, absolutely. And at the same time, the DCF model uses yield plus growth based on those higher interest rates would produce higher ROE estimates. So the balance would be there. One might come down, but the other would definitely go up.
Q. Could I get a yes or no on my --
A. I said yes.
Q. Now, Schedule 12, page 4.
A. Okay. I have it.
Q. That shows an assumed growth rate of 5.75 percent; is that correct?
A. Yes.
Q. And the derivation of that 5.7 percent is shown at Schedule 11; is that correct?
A. Yes, that's right.

Q. At Schedule 12, page 1, third column, tell me when you have that in front of you.

A. Okay.

Q. That's a two-stage growth model, and it produces an average return of 9.9 percent; is that correct?

A. That's right.

Q. What role has that 5.7 percent assumed growth rate got in your derivation of that 9.9 return, sir?

A. It's the growth rate after year five of the model.

Q. Would you characterize that 5.7 percent growth rate as having a key role in the derivation of the 9.9 percent return?

A. Well, the growth rate accounts for the growth side of the DCF model, so yes, in all DCF models the growth rate is very important.

Q. Two of your four DCF models are based on that 5.7 percent growth rate; is that correct?

A. Yes.

Q. If we reduce that 5.7 percent rate to 4.7 percent and make no other changes, can you give us a ballpark estimate of what the resultant return would be, that is, where it's 9.9 percent now, what approximately it would be if we went from the 5.7 percent rate to a 4.7 percent rate?

A. Well, I can tell you exactly in column 2, the model just uses 5.7 percent as the growth rate. It would go down by exactly the same amount as your reduction in the growth rate. So it would be, in that column, instead of being 10 to 10.1, it would be 9 to 9.1.

In the multistage model, the impact is a little bit less. It wouldn't quite be 100 basis points, but it would be very substantial, maybe 80 basis points.

Q. Coming back again to this 5.7 percent growth rate from Schedule 11, to your knowledge, does any authority forecast that 5.7 percent will actually be in the future of the growth rate for this nation?

A. Yes. The Morningstar Ibbotson valuation book uses a number. It may even be higher than that. Sometimes it's as much as 6. Sometimes it's 5 and a half. It depends on the so-called TIPS inflation rate that they use.

Q. Well, it certainly depends on the inflation rate, but can you cite us to anywhere where they actually say that they think that long-term growth for America is going to be 5.7 percent?

A. Yes, in their most recent valuation yearbook.

Q. I'm sorry. Just to tie it up, just please state the citation.
A. I don't know the exact citation, but it's Morningstar, Ibbotson & Associates Annual Valuation Yearbook.
Q. And can you tell us in what context it would make a prediction like that?
A. Yes. Trying to determine the appropriate discount rate in the DCF model.
Q. And for what period of time would they be forecasting a 5.7 percent growth rate?
A. It's the perpetual growth rate in the DCF model.
Q. I want to look now at Schedule 11. I'm looking at the second column figures, which is labeled percent change, and at the bottom there we see that the average percent change over the past ten years is 4 percent; is that right?
A. Yes. For the most recent ten years, that's right.
Q. And for the most recent 20 years, 4.7 percent?
A. That's right.
Q. And for 30 years, 5.4 percent?
A. Yes.

Q. So we have to go all the way to a 40-year average to get over this 5 percent, 5.7 percent number that you now project, is that --

A. That's right. 40-year average is 6.7 percent.

Q. Other than the Morningstar adoption of such a rate in the circumstances that you've described, can you tell us any reason to credit 5.7 percent as the annual growth rate given that it is greater than the 10-year average, the 20-year average and the 30-year average?

A. Absolutely. As I explained in my testimony, that ten-year average is influenced by the worst economic circumstances that we've had since the Great Depression. It has negative growth rate, it has a zero growth rate and other very low growth rates because of very low inflation that has occurred.

That same ten-year average is included in the 20-year average and also in the 30-year average and in the 40-year average. And then what I do at the end is to average the averages, if you will, and that's how I get to the 5.7 percent. So that ten-year very low number is included in every one of those averages and so, in effect, given six times as much weight, for example, as the 60-year average.

The economy has slowed down, as we all

know, since 2008, and the inflation rate has been very low even to some extent before that. So my forecast is simply trying to say what is the long-term reasonable expectation that would fit with the DCF model's permanent growth rate.

Q. Okay. This is something that has come up earlier. You said you gave six times as much weight to the ten-year average, is that right, because it was the closest?

A. That's right.

Q. Now, during which if any of those periods would you say that inflation was quite high, sir?

A. Probably when inflation is much above 3 percent it's considered to be high, and certainly when it's above 4 percent it's considered to be, maybe not extremely high because it has been higher than that. But something above 3 percent is high. Something below 3 percent is low.

Q. Let me ask, we see a number of ten-year periods. Are there one or more of those periods when inflation would have been unusually high?

A. You would have to look at the fourth column, the second time that says percentage change, and what I'm saying is I don't have the year by year ten-year averages of the inflation rate set out there separately, except when you get down to -- you can see the 40-year average was 3.8 percent. That had some years when inflation was extremely high. And so the 8/10 of a percent above 3 that you have there I think represents usually high inflation during portions of that 40-year period. But I don't have the ten-year periods broken out, I think, as your question asked. That's all I'm saying.

Q. So we can't tell from your testimony what effect inflation had on those numbers, those averages that we see before us?

A. Well, I provided the averages right beside the growth rates, and the average inflation rate plus the average real growth rate result in the nominal growth rate. So yes, you can look at those and see what effect they had, but I don't have any ten-year periods set out separately is all I'm saying.

Q. Let's go back again to that ten-year average which you gave six times as much weight as the 60-year average. Did you say that average is unusually low because of certain circumstances that have held during that period?

A. That's right.

Q. Are there any of those other averages that you think are unusually high due to unusual circumstances during those periods?

A. If you could pick out the period during the

1970s, that's when inflation was unusually high.
Q. And that's what period?
A. The 1970s.
Q. No. I understand that, but you're not saying surely that it began the first day of 1970 and went to the last day of 1979 and stopped. What would you say the period is?
A. Based on my earlier statement that 3 percent is kind of the average, if you look at that second percentage change column, the fourth column numbers, you see that after 1967 the rate became 4.6 percent, in '68 5.2, 5.0, 4.7. So that period leading into the 1970s is characterized as a period of high inflation in the United States.
Q. And that would have driven up those average numbers for that period; is that right? I believe you said that. I'm not sure. I just want to tie it up.
A. I'm sorry. For which period are you asking?
Q. For the period during which there was high inflation, that would inflate the growth rate, would it not?
A. Yes.
Q. I want to look now on Schedule 12, page 2.
A. Okay. I have that.

Q. That includes three companies that you added in your September rebuttal testimony; is that correct?
A. Yes.
Q. Looking at column 8, is it true that all three of those companies you added have higher returns on equity than the average which is shown for that entire column?
A. They do.
Q. So the addition of those companies pushed up the return on equity than otherwise would the average return on equity; is that not right?
A. That's true.
Q. Can you tell us what that average would have been had you not added those companies?
A. No, not as I sit here.
Q. Can you give us a ballpark?
A. I haven't made that calculation. You'd have to take them out of the average and see what it is.
Q. I'm going to look at your rebuttal now, page 29. You added CMS, and here I'm going to ask you now to pronounce the name of the second company.
A. Integrys, I believe.
Q. And UNS. Now, you said you added Integrys because its regulated revenue percentage is now above

70 percent. Why did that impel you to add the company to this list, sir?

A. I'm sorry?

Q. Why did that fact that I've mentioned about the company impel you to add it to the list?

A. Well, I have stated criteria that I use. One is the investment grade bond rating. The second one is that to be included in the group the company must have 70 percent. Based on 2010 data that were available back when preparing the original testimony, that company was below 70 percent. With its 2011 financials that were reported, it was above 70. So it came into the group, if you will.

Q. On the basis of that one criteria and nothing else?

A. That's right.

Q. Can you tell us what caused that company's regulated revenue percentage to become greater than the 70 percent?

A. No.

Q. You added CMS and UNS, I believe it is, because their financial conditions have normalized and that their equity ratios are now above 30 percent. Is it your testimony that they weren't in 2010 and that's the reason why you didn't have them in the initial round of companies?

A. Yes.

Q. And that, too, was one of the criteria, I assume?

A. Having stable financial reporting is, and when a company's equity ratio is below 30 percent, that's an indication that there are problems.

Q. Do you have any indication other than that one figure that these companies had problems before?

A. We try to use a large group of companies, and you keep asking me if I know this or that specific. We rely on ValueLine to see what the data are, and then we look into their 10Ks for such things as the percentage of regulated revenues, and we look at actually AUS and utility reports for their capital structures. And to the extent that a company has 30 percent or less equity in its capital structure, we would find that to be an unusually low equity ratio, and we would not include a company that's having those kind of problems in our comparable group for the investment grade utilities.

Q. Is it your testimony that you would have included them in the original group had they met that criteria?

A. Yes.

Q. I'm going to look at your rebuttal

testimony now, page 24.
A. I'm there.
Q. Beginning on line 12 you say, when the government's stimulus efforts cease, there is little doubt that interest rates will rise quickly. Can you explain why that is so, sir?
A. Because the government's stated reason for its economic stimulus, Quantitated Easing 3 is the latest one it's called, is to push down interest rates. So when that stimulus ceases, that pushing down will cease and interest rates will go up.
Q. Well, you said not just that they will go up, but they will raise quickly. Will they necessarily rise quickly?
A. That's my opinion.
Q. What is that opinion based on?
A. What I just told you, that the government's efforts to push down interest rates with QE3 now have been successful. Back during the summer interest rates reached their lowest ever, the 30-year Treasury Bond, and when it was questionable about what the Fed was going to do, interest rates actually moved up about 30 basis points in about a month, 10 percent change in the interest rate, which was a pretty quick move. I'm sure it cost some bond traders a lot of money.

Q. You said when the government stimulus efforts cease. In fact, the stimulus efforts may not cease as much as they may abate a little bit at a time over time; is that not right?
A. I don't know. That might be your opinion, but I don't know.
Q. I'm not asking an opinion. I'm asking if that's a possibility.
A. It's certainly a possibility.
Q. And if that possibility came to fruition, then interest rates wouldn't rise quickly, would they?
A. It's my opinion that if the government weren't printing $40 billion a month and buying long-term bonds with it, that interest rates would rise quickly. Now, you may have a different opinion than that, and that's fine, but that's my opinion.
Q. Again, I'm going to repeat the question. You've spoken of a situation in which stimulus efforts cease. Now, it's possible that they may not cease all at one time, it's possible that they may cease by degrees, and if they do cease by degrees, do you agree that it's less likely that interest rates will rise quickly?
A. Under your hypothetical, yes, I agree.
Q. Thank you. Now, here again at page 24, this is line 5, you refer to a circumstances, a set of

circumstances which you reference as the current capital market anomalies. Now, those capital market anomalies that you reference do include unusually low interest rates we quite understand. Are there other capital market anomalies? Is it the PE ratios you chose?

A. No. In that sentence that you read the first part of, I'm talking about Mr. Kahal's acknowledging these things, and down at the bottom of the page he says, for the past three years short-term treasury rates have been close to zero. These extraordinarily low rates are the result of an intentional policy of the Federal Reserve Board governors, the Fed, to promote economic activity. The Fed has also sought to exert downward pressure on long-term interest rates through its policy of Quantitative Easing. That's what I'm talking about.

Q. So it's the low interest rates that you're talking about and only the low interest rates when you're talking about the current capital market anomalies; is that right?

A. I don't agree with that. You're adding to what Mr. Kahal said, and all I'm saying there is this is what he said.

Q. You go on to assert, do you not, that Mr. Kahal should have taken into account these current capital market anomalies? Do you not assert that, sir?

A. I do.

Q. What are the current capital market anomalies that he should have taken into account?

A. The government's continuing influence by printing money, doing Quantitative Easing 3, the effect on interest rates that that has had, the effect that abnormally low, artificially influenced interest rates have on fixed income investors, as I explained earlier, and how that effect flows through the DCF model to produce an abnormally low, artificially low, incorrect estimate of ROE.

Mr. Kahal simply has mechanically plugged the numbers in. Even though he describes these governmental policies and situations that exist, he's made no adjustment whatsoever for that, and that's my criticism in my rebuttal testimony here of his analysis.

Q. Moving to page 25 of that testimony, this is line 10 and following, you say the 10 percent ROE that was set in the last case was well below ROEs allowed for other similarly situated utilities at that time.

A. I'm sorry, Mr. Bruder, I'm not with you. Where are you?

Q. That's quite all right. Page 25, beginning at line 10. Please take your time.

A. Okay. I'm with you now.

Q. Okay. This 10 percent ROE that KCPL was allowed in the last case and is presently allowed, you say it was well below ROEs allowed for other similarly situated utilities at that time. Can you tell us which utilities?

A. All the ones included in the Regulatory Research Associates report for 2010 year in which that case was decided, the average rate of return for integrated utilities was 10.38 percent.

Q. And all of those were granted at the same time as this?

A. I didn't say that. I said the average for the year.

Q. The year of 2010?

A. Correct.

Q. And a goodly portion of those ROEs would have been granted in 2010, in the years before 2010; is that not correct?

A. No. The ones that averaged 10.38 percent were granted during 2010.

Q. And for the record, let me just have the citation for that, please. You mentioned something.

A. It's Regulatory Research Associates, and I believe I have a table that has 2010 in it. It will take me just a moment to find that for you. It's on page 5,

Table 2 of my rebuttal testimony. In the fourth quarter of 2010 when this Commission made the decision to give the company 10 percent as they had done in Kansas, the average was 10.32 percent. For the whole year it was 10.38 percent. That's the basis for my testimony that you asked me about.

Q. So it's your testimony that these utilities which make up the averages that we see on page 5 of this testimony in Table 2 are similarly situated with KCP&L?

A. Yes.

Q. How have you determined that, sir?

A. I've looked at the case decisions and determined which ones are vertically integrated, which ones are delivery only companies, and now there are a group in Virginia that are power plant only rider cases, as they're called. And I've looked at the numbers excluding those rider cases so that you don't have inflated numbers here. These are strictly for companies like KCP&L that are vertically integrated utilities.

Q. But there are lots of things that distinguish utilities from one another even though -- let me start again.

It's quite possible that there are two utilities that are properly described as vertically integrated but they might be very different in other ways, mightn't they?

A. Certainly.

Q. What ways might they be different, sir?

A. I don't know. It's your idea that they might be different. These are all the companies that are reported to have had major rate cases during 2010. So that's why we use an average. There might be some of them that are larger. There might be some that are smaller. There might be some that are a different part of the country. These are all the companies.

The 10 percent that was allowed for KCP&L in Kansas and in Missouri in 2010 was well below the national average for similarly situated companies.

Q. Well, again, the fact that two utilities are vertically integrated doesn't demonstrate that they are similarly situated, does it, sir?

A. If we're looking at all the companies, that's why we use large groups of comparable companies, using the average for all the companies as RRA does is an attempt to gauge what investors expect for similarly situated companies. What investors would have expected in 2010 was something in the mid 10.35, 10.38 range.

Q. Some of those were set two years or more ago if they were in 2010, correct?

A. At the time of the decision to set

10 percent for this company, they were set in the same year.

Q. I'll take that as a yes.

A. 2010 is two years before now, yes.

Q. I'm looking at your rebuttal now, page 25. You say that Mr. Kahal's recommendation is too low because he routinely applies the model without adjustments or explicit consideration of current abnormal market conditions.

Can you tell us what adjustments, what specific adjustment or what explicit consideration you believe Mr. Kahal should have adopted?

A. He could have gone with the top of his own range. He could have looked at dividend yields for a longer period of time. He could have looked at any number of ways that one might say the model's currently plugging in current data or not giving us reliable estimates of ROE. He didn't do any of that. He simply put the numbers in the model, he said here they are, here's the range, I'm going to be generous and go up slightly above the middle of the range. That's all he did.

Q. So when you say he should have given it his explicit consideration, you mean he should have adjusted it in one way or another; is that right?

A. He could have.

Q. Okay. And let's do it again, please. If you could give as broad a range as you could for the record of what you think appropriate adjustments in that regard would have been.

A. If Mr. Kahal had gone back to the time period between the beginning of Quantitative Easing 2 and the end of his dividend yield period in, I believe it was June of 2012, and simply used the dividend yields that existed before that, it would have increased his rate of return to about 10 percent.

In a Louisiana case where we have been confronted with him, he's at a bit lower number for a gas distribution company, but we demonstrated that his number instead of being in the 9s should have been about 10 if he had simply adjusted and used higher dividend yields. I've already said that he could have gone to the top end of his range. He would have been at 9.8 then, but not at 9.5.

So the models are difficult to interpret now. I've said that over and over again. It's simply that it should not be as mechanical application of we've got you this time because things turned out helpful for our cause. Witnesses need to look at a broader range of things than Mr. Kahal did.

Q. I'm looking at your rebuttal now, page 29. Now, this begins with line 20, and I want to emphasize that we've certainly talked about this before. It's possible you've given this answer completely. I just want to tie it up. On line 20 you speak of your screening criteria. So if you could state for the record what exactly those screening criteria are.

A. The main one is an investment grade bond rating. The second one, which we apply just directly again from the AUS Utility Report and also looking at the 10Ks for the companies, is the 70 percent of required revenues. If they have more nonregulated revenues than 30 percent, then we don't include them in the group.

The further criteria are not quite as easy. There's not a place to look and see what constitutes unusual financial circumstances. But in the DCF model, recent dividend cuts clearly make that model difficult to apply. Things like equity ratios that are far below the industry norm in the mid 50 percent equity ratio range, such as below 30 percent cause us to eliminate companies.

So you can -- you can go down the line of what constitutes unusual financial circumstances, but that's the term that we use.

Q. To your best recollection, Dr. Hadaway, have you ever had a situation in which you changed your testimony as you have here by making seven changes in an initial group of comparable entities?

A. Every year, sir, yes. Every time a new set of financials comes out, a new year comes around, we revise the group. This is not a BBB group that we created for this case. It's the same one that we're using in the Louisiana cases because Entergy is rated BBB. It's the same one we'll use in every other BBB case we do this year.

All this business about our having eliminated some companies, as Mr. Zobrist's exhibit showed, two of the companies we eliminated had high rates of return, not low, and to accuse us of eliminating ones that have low and perhaps doing self-serving things is simply incorrect. That's not the way we do business.

Q. I'm going to ask the question again. Have you ever seen circumstances in which you introduced a comparable group of about 22 companies and changed as many as seven of them in your testimony over this period of time?

A. I'll have to go back and check, but we do the same thing every year. And my answer to you would be that, as I sit here, I believe we have done that many, many times, and we would do it again next year. If the criteria are not met, they're not in the group. If the criteria are met, they are. That's all we did. We didn't do any self-serving activity. We didn't pick any lowball companies and kick them out. There were other lower companies that we left in there because they met the criteria.

The whole supposition that we somehow went in and selectively did this and did self-serving things is offensive to me, sir, because that's not the way I do rate of return testimony, and this Commission knows it.

MR. BRUDER: Nothing further. Thank you.

JUDGE JORDAN: Any cross-examination from the United States Air Force or other Federal Executive Agencies?

CAPTAIN MILLER: No, your Honor.

JUDGE JORDAN: Any cross-examination from the GMO industrials, Praxair or Ag Processing?

MR. CONRAD: No, sir.

JUDGE JORDAN: Cross-examination from the Office of Public Counsel?

MS. BAKER: I have quite a bit, and given that we're going for Mr. Kahal at one o'clock --

JUDGE JORDAN: Well, at one o'clock we will open a phone line for him.

MS. BAKER: Are we going to go through lunch?

MR. THOMPSON: Staff suggests we take a lunch break now, Judge.

JUDGE JORDAN: I think this would be a good time.

MR. ZOBRIST: Judge, let me address Public Counsel's comment. I don't think we ought to interrupt Dr. Hadaway's cross-examination by taking Mr. Kahal. I would suggest that if he can join us at one o'clock, which is what I think you suggested, and he can stay on the line and hear the testimony. Then when Dr. Hadaway's done, then we go to Mr. Kahal.

JUDGE JORDAN: We could do that. The one o'clock time refers to when we will call Mr. Kahal on the telephone, not call him to the stand. So that's what we'll do. We can maintain the entire order of witnesses until we get to Mr. Kahal at the last. The parties can decide that, if they want to depart from the order of witnesses as set forth here.

MR. BRUDER: May I make a statement?

JUDGE JORDAN: Please do, and make sure you speak into the microphone.

MR. BRUDER: I want to speak directly to you, Dr. Hadaway, and tell you, it was at no point my intention to accuse or offend. This is my job. I need to elicit this. If I offended you or -- if I offended you, apparently I did, I do apologize. I apologize sincerely on the record.

THE WITNESS: Thank you. We're friends.

JUDGE JORDAN: All right. We were talking about lunch break.

MR. THOMPSON: We were.

JUDGE JORDAN: An hour. I can be here to open the phone line.

MR. THOMPSON: Thank you, Judge.

JUDGE JORDAN: One hour from now. Do bear in mind that restaurants nearby will probably not be open due to the lack of water, and when we do get water, we probably can't drink it.

(A BREAK WAS TAKEN.)

JUDGE JORDAN: We are back on the record. During the break it was requested that due to the air conditioning situation, which is related to the water situation, that the comfort of persons participating in this evidentiary hearing would be enhanced if they were allowed to remove their jackets. Anyone may certainly doff their blazer. It will not be deemed a sign of disrespect to this tribunal or anyone else.

I believe there were no other preliminary matters; is that correct? And that being the case, we will resume our cross-examination with the Office of the Public Counsel.

MS. BAKER: Thank you.

CROSS-EXAMINATION BY MS. BAKER:

Q. Good afternoon, Dr. Hadaway.

A. Good afternoon, Ms. Baker.

Q. You would agree that the goal for the Commission is to set rates that are just and reasonable, correct?

A. Yes.

Q. And you would agree that part of determining a reasonable return or return -- a reasonable rate is to make rates as affordable as possible without causing a detriment to the utility?

A. I don't know. That's kind of beyond where I would go.

Q. In your testimony, you state that you calculated a reasonable range for return on equity for Kansas City Power & Light and Kansas City Power & Light GMO to be anywhere between 9.8 percent and 10.3 percent; is that correct?

A. Yes. That was in my rebuttal update.

Q. And based on that reasonable range, your recommendation to the Commission is 10.3 percent?

A. The company and I discussed that, and the company decided that the best policy given the state of the models was to go to the top end of the range. Then my testimony is that I support their doing that.

Q. And in the original filing of this case, your recommendation was 10.4 percent; is that correct?

A. Yes.

Q. I assume that you agree that a reasonable return on equity for Kansas City Power & Light and GMO is one that is adequate to meet -- adequate to attract capital at reasonable terms, thereby enabling Kansas City Power & Light and GMO to provide safe and reliable electric service that's sufficient to ensure the utility financially -- financial integrity and is commensurate with returns on investment in enterprises having corresponding risks?

A. Yes.

Q. So a return on equity that meets those requirements would be reasonable and not detrimental to Kansas City Power & Light and Kansas City Power & Light GMO?

A. Yes. Sort of by definition I think that's what the Hope and Bluefield standards are telling us.

MS. BAKER: I have an exhibit.

(OPC EXHIBIT NO. 313 WAS MARKED FOR IDENTIFICATION.)

THE WITNESS: Could I have a moment with counsel, please?

JUDGE JORDAN: I'm not hearing an

objection, so we can go off the record for a while we locate that exhibit.

(AN OFF-THE-RECORD DISCUSSION WAS HELD.)

BY MS. BAKER:

Q. Dr. Hadaway, you've been provided a copy of the Regulatory Focus Report for the Regulatory Research Associates, correct?

A. Yes, that's right.

Q. And within the first paragraph, about four, five lines from the bottom, starting with the words excluding these Virginia, could you read from there forward in the first paragraph?

A. Excluding these Virginia surcharge slash generation cases from the data, the averaged authorized electric ROE was 9.97 percent for the first nine months of 2012.

Q. Okay. You can stop there. Going back on the third page of that, there's a table that is at the top that states Electric Utility Summary Table. Do you see that?

A. Yes.

Q. And near the bottom of that table you see 2012 year to date and above it first quarter, second quarter and third quarter?

A. Yes, I see that.

Q. And then there is a column for ROE near the middle?

A. Yes.

Q. Could you read the numbers for the 2012 first quarter, second quarter and third quarter ROEs?

A. Yes, I'll be glad to, with the caveat that these include T&D companies, wires only companies, and that I have an exhibit that breaks this out between vertically integrated and wires only companies. So we have a little better evidence, I think. But I'll be glad to read those.

The first quarter was 10.84. Was high because it included five cases in Virginia that were like 11.4 percent. The second quarter was 9.92, and the third quarter was 9.78.

Q. And from my understanding of the table that you referenced that you had, you do not have the data for the third quarter?

A. I do in the GMO case, yes. It came out literally between surrebuttal in the KCPL case 174 and the 175 surrebuttal. So it's Schedule 14 in my GMO testimony, my surrebuttal.

Q. All right. And you mentioned for that 10.84 in the first quarter that that included the Virginia cases that were talked about whenever I had you read from the first page?

A. Right. These summary numbers back here on page 3 include all the cases, the power plant only rider cases that have adders in them that most of us exclude, which I have from my table, and also, though, the T&D wires only cases that -- particularly the cases in northeast have had much lower ROEs. So I've broken that out in my Schedule SCH-14 attached to GMO surrebuttal.

Q. And looking at the data for the ROEs for the first quarter, second quarter and third quarter, you'll agree with me that the numbers have been going down, correct?

A. They have dropped a little bit, but nothing like what these numbers make it appear to be. The 10.84 --

Q. Looking at the numbers on here, I'm asking you to look --

A. I agree with you, but the 10.84 is not a representative number is what I'm saying.

MS. BAKER: And then I ask that Exhibit 313 be admitted.

MR. ZOBRIST: No objection.

JUDGE JORDAN: I will admit that document into evidence.

(OPC EXHIBIT NO. 313 WAS RECEIVED INTO

EVIDENCE.)

BY MS. BAKER:

Q. In your testimony you utilized the DCF analysis in order to support a market-based return on equity recommendation; isn't that correct?

A. Yes.

Q. And you also utilized the DCF analysis in your testimony in the previous KCP&L rate case, ER-2010-0355, didn't you?

A. Yes.

MS. BAKER: I have another exhibit, and this one will be 314.

(OPC EXHIBIT NO. 314 WAS MARKED FOR IDENTIFICATION.)

BY MS. BAKER:

Q. Would you agree that this exhibit is a comparison of your direct and rebuttal DCF summary analysis in both the current KCP&L case and the previous KCP&L case?

A. It is a comparison. In the previous case I know on rebuttal we recommended 10.75, and it says 10.8 here. So I don't know if they're rounded the same. But yes, it's a comparison generally of the two cases.

Q. Could you read across beginning at line 1 and read the type of DCF analysis and then your direct and

rebuttal ranges for the last case and the current case?
A. Okay. Beginning with the first block in line 1, the what we call the analyst growth constant growth DCF was 10.5 to 10.7 in direct. In rebuttal it was 10.2 to 10.4.
Q. And keep on going into the current case.
A. Into the current case. Okay. In the current case, the analyst growth rate constant growth DCF, the one on line 1, was 10 percent both mean and median, so 10 percent without a range. And on rebuttal that dropped 20 basis points to 9.8 percent.
Q. Can you keep reading along that line into the decline from the last case for the direct and rebuttal, the range there?
A. Okay. Yes. It shows that the change in the mean, which is the first number in the direct, in the prior case was 10 and a half, and that it's now 10, and so there's a minus 0.5. In other words, that first model went down 50 basis points. And then based on the median, it went from 10.7 to 10, and so the difference is 70 basis points. 0.7 percent is shown there.
Q. And the same for the rebuttal?
A. Then for rebuttal in the prior case, the mean was 10.2, and it's now 9.8, and so that difference is minus 4/10 of 1 percent. And for the median, it's 10.4 in

the prior case and 9.8 in this case, so the difference is 6/10 of 1 percent.
Q. And for your second DCF analysis, the long-term constant growth?
A. The direct testimony in the prior case was at 11 percent, and in the present case it's 10.2, so it's minus 8/10. The median was minus 6/10. And then going over to rebuttal, the mean difference is minus 6/10, and the median difference is minus 8/10.
And then for the multistage model, the mean difference in direct was 8/10 of a percent, and the median was 7/10 of a percent. In rebuttal it was 5/10 or half of 1 percent, and in the median was minus 6/10 of 1 percent.
Q. So looking at the rebuttal evidence in both of these cases, you would agree that it supports a finding that the capital market costs have decreased between 40 and 80 basis points?
A. It really doesn't, Ms. Baker. Just calculating the numbers, what you've just said is true, but that's my whole point, that the models mechanically now are producing substandard or unreliably low ROEs if you just put the numbers in like you're talking about here. So while I agree that the calculations you've had me do are correct, I do not agree that these indicate that the cost of equity has dropped as much as this indicates.

Q. But it does -- these numbers do indicate a decrease between 40 and 80?

A. Mechanically.

Q. Hard numbers.

A. Mechanically they do, but with respect to the economic conditions, I don't think that that's an accurate reflection of the drop in ROE.

MS. BAKER: And I have one last exhibit. This one will be, I believe, 315.

(OPC EXHIBIT NO. 315 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MS. BAKER:

Q. And this particular exhibit is a comparison of your direct and rebuttal Baa rated utility bond yields in both the current case and the previous KCPL case, do you agree?

A. They look correct, yes.

Q. And for this, could you start at line 1 and read across for the direct, rebuttal in the last case and the current case?

A. The Baa interest rate on direct was 6.22 percent. When we got to rebuttal in October of 2010, it was 5.57, or a drop of 1.1 percent. And then in the current case -- I may not have said that right. I got ahead of myself. The drop -- that's not correct. In the current case, the direct, the Baa interest rate was 5.08, and it dropped to the lowest level that there's been at 4.91 in July.

Q. And go ahead and go through the declines.

A. Then where I got ahead of myself is in the far right-hand two columns, you're subtracting column 1 from column 3, and that's the difference, this 1.1 percent. When we were doing direct, interest rates had dropped by 110 basis points between the two cases. When we were doing rebuttal, they had dropped by about 7/10 of 1 percent, the last number on the right.

Q. Let's go ahead and go through the line on projected.

A. We use projected interest rate at 6.57 in direct, and in rebuttal we used a projected interest rate that was actually lower than the then current rate, but we used 5.25 percent. Then in this case, we started with 5.34, and we increased that by 3/100 of a percent, three basis points, to 5.37 in rebuttal.

Q. And the declines?

A. The decline in the direct is 120 basis points, and the decline in the -- there's not a decline in the rebuttal. It's actually an increase of ten basis points.

Q. So would you agree that the numbers that are reflected on this document, that the bond -- the Baa bond yields used for your direct case in this case decreased by over 110 to 120 basis points for both the current observable and the projected bond yields, in the direct?

A. For the direct, yes. The actual is decreased by 110, and the projected is decreased or had decreased by 120.

Q. And then looking at your rebuttal case, the declines are in the range of 70 basis points to a slight increase; is that correct?

A. Yes, that's right.

Q. So basically this evidence demonstrates that the current observable bond yields are now over 100 basis points lower in this case than they were in the last case; isn't that correct?

A. Yes, and there's a very good reason for that.

MS. BAKER: No further questions, and I would ask that 314 and 315 be admitted.

MR. ZOBRIST: No objection.

JUDGE JORDAN: Those documents are entered into evidence.

(OPC EXHIBIT NOS. 314 AND 315 WERE RECEIVED INTO EVIDENCE.)

JUDGE JORDAN: Cross-examination from Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good afternoon, Dr. Hadaway.
A. Good afternoon. How are you, Mr. Thompson?
Q. I'm fine. Thank you.
You're familiar with the qualifications of Mr. Murray, are you not?
A. I'm sure I read them.
Q. And the qualifications of Mr. Gorman?
A. Yes.
Q. And in your opinion, is Mr. Murray an expert in financial analysis?
A. I think that's got to be a legal question. I don't have an opinion about that.
Q. Let me ask you this. In your opinion, are you an expert in financial analysis?
A. Yes, I am.
Q. Okay. And you're not an attorney, are you?
A. No.
Q. Okay. So as an expert financial analyst, do you not have an opinion as to the expertise of the financial analysis work product produced by Mr. Murray in this case?

A. I disagree with it.
Q. I understand you disagree with it, but do you dis-- do you doubt his expertise?
A. Yes.
Q. Okay. How about Mr. Gorman?
A. No.
Q. Okay. What about Mr. Kahal, are you familiar with him?
A. I have never met him, as far as I know, face to face, but yes, I've seen his work, and he's certainly experienced and has been accepted by a lot of commissions as expert.
Q. Okay. Now, let's talk about your range in your rebuttal or your surrebuttal. Excuse me. Well, where was it you came with your new range? Was that rebuttal?
A. Yes, in the rebuttal.
Q. Pardon me. It's been a long day. And your range, I believe, was 9.8 to 10.3?
A. Yes.
Q. And would you agree that if the Commission selected any figure within that range, that that would be a just and reasonable return on equity?
A. No.
Q. It would not be? So --

A. I would not agree that it would be.

Q. So, for example, let's say they took 9.8, low end of your range. Are you with me?

A. Yes.

Q. Okay. And you don't believe that that would be an appropriate selection?

A. I think it would be too low because it's the low end of a range that's already pushed down by financial market conditions that are influenced by government policy.

Q. Okay. So when you offer that range to the Commission, 9.8 to 10.3, what use are they to make of that range?

A. Probably the comparison that Ms. Baker just did. We used the same models. We have added a PE ratio model that I was asked so much about this morning to balance the others. But we always produce the same models, we use the same approaches, and if you want to compare them from one case to the other, you can, just as she did.

But my caveat is that now with the government's monetary policy and literally from the time that we were talking about a few minutes ago in October of 2010, that's when Quantitative Easing 2 started. It went on until they ran out of money and they did Operation

Twist, and they extended Operation Twist through -- from June through the end of this year, and now they've started Quantitative Easing 3.

So what I'm saying is that all these factors have to be explicitly considered. Going to the bottom of the range would not be a correct thing to do in that environment.

Q. So is it your testimony that only the top of your range would be an adequate figure?

A. I'm saying that I think that is the most appropriate figure that the models are producing now.

Q. Okay. Now you indicated earlier that you rely on ValueLine; isn't that correct?

A. Yes.

Q. I'm looking now at your rebuttal testimony in either case, and on page 3, line 6 to 12, you quote ValueLine, do you not?

A. Yes.

Q. Okay. And you quote ValueLine to state, many electric utility stocks are priced within their 2015 to 2017 target price ranges. Did I read that correctly?

A. Well, they start out with however, and it's because they're saying that these stocks have low dividend yields. However, they're already priced at the target price that they're thinking will be around in 2015 to

2017.

Q. Okay. Now, with respect to your terminal value DCF, your market price or terminal value assumes additional price appreciation; isn't that correct?

A. To the extent that earnings grow, yes.

Q. Okay. So your terminal price assumptions are higher than the ValueLine range?

A. I was asked about that this morning. I don't have those sheets here. I know that some of them were in the upper part of their range because they're concerned that PE ratios won't remain this high. But I just haven't made that comparison to say that my number is consistently at the top or it's probably in the middle for some and it may be above the range for some, but I just haven't made that comparison.

Q. Okay. I'm going to show you a document and ask you if you recognize that.

A. Yes. It's the ValueLine sheet for Great Plains Energy for September 21st.

Q. Commonly what's referred to as a tariff sheet?

A. Some may call it that. I don't know.

Q. Okay. Now, in your Schedule 12, and I'm looking now at your rebuttal, page 5 of 6.

A. All right. I have it.

Q. Now, do you see the earnings per share figure on the tariff sheet that I handed you?
A. Yes.
Q. And would you agree with me that that figure is 1.75?
A. That's right.
Q. Okay. And is that the same as is shown on your Schedule 12, page 5?
A. Yes, it is.
Q. Okay. And you would agree with me that that's in column 29 at row 8?
A. Yes.
Q. Okay. Now, if you multiply the average annual PE value, do you see that, on the ValueLine sheet?
A. There are two or three different PE ratios.
Q. I'm sorry. I'm talking about the average annual PE ratio in the last column.
A. Oh, in the last column. Okay.
Q. Yeah.
A. There's one at the top. I'm sorry. I was looking at the wrong one. Yes, I see that. It's 12.
Q. It's 12. Okay. If you multiply that times 1.75, what do you get?
A. 21.
Q. And if you look on the ValueLine tariff

sheet at the target price range, do you see that in the upper right-hand corner?

A. Yes.

Q. And that result 21, that is within the target price range, is it not?

A. Looks like it's probably the middle of it.

Q. But what about the price that you use of 29.78?

A. It's based on a higher --

Q. Or 29.75. Excuse me.

A. Yes. It's based on higher priced earnings ratio, the one that currently exists, not ValueLine's projected annual average PE ratio. See, that's ValueLine's point in that quote that you gave me earlier that utility stocks are possibly overpriced but certainly fully priced.

MR. THOMPSON: I have no further questions. Thank you.

JUDGE JORDAN: Questions from the Bench. Commissioner Kenney?

COMMISSIONER KENNEY: You did say me?

JUDGE JORDAN: Yes. I didn't have my microphone on. Sorry about that. Any questions from the Bench, Commissioner?

COMMISSIONER KENNEY: I do.

QUESTIONS BY COMMISSIONER KENNEY:

Q. Dr. Hadaway, how are you?

A. Just fine, Commissioner Kenney. How are you?

Q. I'm doing well. Thanks. Can you hear me okay?

A. Yes, just fine.

Q. I have just a few questions. Were you deposed in this case?

A. No, sir, I was not.

Q. All right. I just want to ask a few questions about your resume. Appendix A of your direct testimony consists of 11 pages. Is that the only CV or resume that would have been attached to any testimony in this case?

A. Yes, sir, I think that's right.

Q. And does that reflect all of the testimony that you've filed in various proceedings?

A. It covers a period of almost 30 years, unless we've left some out, yes, sir. That's what's intended.

Q. It's impressive and it's lengthy. And I went through it, and you've testified in other cases other than public utility regulatory cases, I noted. I want to ask a question just in case I missed it, but is there any case in which you have testified on behalf of a public counsel or a consumer advocate?

A. We have testified for the industrial customers in some of the early cases. We've testified for some of the cities and some, I guess you would call them consumer groups, but things -- there's one case early on back in the 1980s that I remember doing in south Texas for the Valley Industrial Council. I think that was a group of commercial customers of the utility. So early on I did that, and for three years prior to that I was the chief economist at the Texas Public Utility Commission and was the sort of chief staff financial witness.

So there's probably a period of about five or six years early in my career where my testimony was either for the commission or for cities or for one group or another. I don't remember an Office of Public Utility Counsel assignment per se.

Q. So the time that you worked at the Texas PUC, that testimony is delineated separately, right, testimony on behalf of the Texas PUC staff?

A. Yes.

Q. There was no other time where you offered testimony on behalf of the Texas PUC outside of your time when you were employed there, correct?

A. Not on behalf of staff, no, sir, I did not.

Q. Okay. And then other than this time in the early '80s, is there any other testimony, say, in the late '80s or early '90s forward in which you would have offered any testimony on behalf of an office of public counsel or other consumer organization?
A. I don't believe so.
Q. Okay. So is it safe to say, then, that for the last at least 25 years, your testimony has been exclusively on behalf of utilities?
A. I'm not sure about the years, but yes, sir, approximately so.
Q. Okay. And let me ask you, what is your -- do you charge an hourly rate?
A. Yes.
Q. Is that how you bill for your services?
A. Yes, I do.
Q. And what's your hourly rate?
A. My firm receives $450 an hour.
Q. And is that the same for preparing a report as it is for appearing at a hearing?
A. Yes.
Q. All right. I couldn't hear too well when Mr. Thompson was asking you about the qualifications of Mr. Gorman and Mr. Murray. Now, I think I heard you with respect to Mr. Gorman, you said you did consider him to be

an expert?

A. Yes, sir, I did.

Q. And is that because -- well, Mr. Gorman is a chartered financial analyst?

A. My thinking on it in response to the question was that he has been qualified as an expert around the country before numerous public utility commissions and similar bodies.

Q. So is that the -- that's the basis of your opinion is that he's testified in other forum outside of this one?

A. Well, yes, and my experience that in some places if there's any question about it, a witness will be challenged as to whether he or she is an expert, and I know that Mr. Gorman has been accepted, as Mr. Kahal and I have been.

Q. And what was your response with respect to Mr. Murray?

A. I questioned Mr. Murray's judgment with respect to regulatory rate of return.

Q. Is that because you disagree with his opinion or because you find some flaw in his qualification and education and expertise?

A. Certainly not in his education, but simply the fact that he is so far off base with respect to most

every other regulatory economist that I see in my work. I don't believe his opinions are well founded with respect to the cost of equity capital for utilities.
Q. Now, is that because of the methodology he employs or the outcome he achieves?
A. It's mostly because of the very, very low growth rates that he insists on using in his discounted cash flow model.
Q. What about the other methodologies he employs, do you find fault with those?
A. I don't think under present market conditions that the capital asset pricing model can be used well, and I don't think that his approach to risk premium calculations were anything other than sort of a routine to try to say that mine were wrong. So, yes, I disagree with him in all the analyses that he's provided and the results that his models produce.
Q. So if I heard you correctly, I think you said the CAPM methodology you don't think is appropriate in this environment?
A. In the present interest rate environment, if you play it straight with that model, you get numbers between 6 and 8 percent. I believe that that is well below the cost of equity, and so do most other commissioners. Mr. Kahal in this case specifically said

that he didn't give any weight to that model. In most places I'm testifying these days that's exactly the results that you find.

Q. So that's a flaw that you find in the model itself, not the person employing it necessarily?

A. Well, there's an element of judgment about which model should be used, but yes, it's a flaw in the model particularly with respect to the risk free rate because the Treasury bond rate that's used there has been artificially depressed by the government's Quantitative Easing programs, Operation Twist and so on. So it doesn't give an accurate reflection of the cost of equity.

Q. So that's a -- like I said, that's a flaw in the methodology itself, not in the person employing it?

A. It's not a flaw in the person, but the judgment to use that model is what comes into play.

Q. Okay. You said you disagree with Mr. Murray mostly because of the low growth rates he employs. The GDP growth rates, right?

A. He actually goes lower than that. He seems to think that about 2 percent is really the right number that should be used. He did mention sort of as a top end of a growth range some numbers in the mid 4s, and I do disagree with those numbers as being accurate reflection of the long-term growth rate.

Q. You disagree that those are an accurate reflection?

A. I think they are not. They are done by government agencies that back in the 1970s forecasted permanent inflation of 6.3 percent, for example EIA, one of the ones he refers to. Now they're forecasting permanent inflation of 2 percent. They were wrong then and I think they're wrong now.

Something between those numbers is a more realistic reflection of what long-term inflation in our country is going to be, and it's not 1.9 or 2 percent as much as some of us wish that it might be. It was not 6.3 percent for the 20 years following 1979 when EIA forecasted and put in their report to Congress that that's what they expected it essentially to be on a permanent basis.

Government agencies go with the flow like anybody else, but they've been incorrect before and I think they're extremes now, and I disagree with Mr. Murray's use of those numbers and especially his further use of other numbers to try to average those down, average the CBO and the EIA numbers down to even a lower number than the one's they're reporting.

Q. What is your estimation of long-term growth again?

A. 5.7 percent on the GDP model. It's a bit lower than that with the analyst growth rates I used in one of my other models.

COMMISSIONER KENNEY: Okay. I don't have any other questions. Thanks, Dr. Hadaway.

THE WITNESS: Thank you, Mr. Commissioner.

JUDGE JORDAN: Commissioner Stoll.

COMMISSIONER STOLL: I have no questions, your Honor. Thank you for your testimony, and he did answer questions I had. Thank you.

JUDGE JORDAN: Recross from AARP or Consumers Council of Missouri?

MR. COFFMAN: No, your Honor.

JUDGE JORDAN: Recross from the United States Department of Energy.

MR. BRUDER: No, your Honor.

JUDGE JORDAN: Any from the Air Force or Federal Executive Agencies?

CAPTAIN MILLER: No, your Honor.

JUDGE JORDAN: Any recross from the Office of Public Counsel?

MS. BAKER: No, thank you.

JUDGE JORDAN: Any recross from Staff?

MR. THOMPSON: No, thank you.

JUDGE JORDAN: Any redirect?

MR. ZOBRIST: Just a few questions, Judge.
REDIRECT EXAMINATION BY MR. ZOBRIST:
Q. Dr. Hadaway, when Mr. Bruder was asking you about the ValueLine reports that you used in coming to your proxy groups and the reason why you deleted four companies and added three companies, do experts reasonably and frequently rely upon the analysts' opinion at ValueLine to produce the proxy group that you did here?
A. Yes. Every witness in this case does, and it's my experience that they do all around the country.
Q. Now, when Mr. Bruder was asking you about the terminal value model, you spoke about a utility price to earnings ratios, that they were higher than ever. When you say higher than ever, what is our point of comparison?
A. The typical PE ratio for utility companies will range between 10 and 14, and the one that I was asked about for Great Plains that's used in our model is 17. Now, that partly has to do with earnings dip. Sometimes prices don't change as much. But 17 is a very, very high price to earnings ratio.
ValueLine and others are saying that these factors of dividend seeking investors pushing prices up probably are overpricing utilities. I was asked earlier if interest rates go up, then those dividend yields are going to go up, prices are going to go down. Well, so

will the results from the DCF model. That's the point I've been trying to make, that if the yield plus growth method is going to accept prices that are high and cause very, very low dividend yields, then another way to look at is if those same investors should continue to behave in that same manner, then they would be saying that 10.3 percent is what they expect to earn based on the PE ratios they're currently paying.

Now, I don't endorse that model as an ongoing way to do rate of return. It's a very volatile model. It changes almost from month to month. I put it in to balance the others, not to tell the Commission it's the only way to do it. I even say that, I believe, on page 31 of my rebuttal testimony.

Q. Now, with regard to the 5.7 long-term growth rate that you use and that Mr. Bruder and Commissioner Kenney asked you about, you stated that you used the most recent ten-year period, I think you said something like six times, you weighted it six times. Would you explain exactly how you weighted the more recent inflationary figures versus the older ones?

A. Yes. In the 60-year period, for example, the longest period, obviously that last ten years, the earliest ten years is only in that one number, and then it goes away when you get to the most recent 50, next to the most -- next to the oldest goes away and so forth.

But that ten-year period that now is from 2002 to 2011 is every one of those averages, it's in there six times. Then, for example, in the government's programs that they use to seasonally adjust data, they use averages of averages. So this is a kind of forecasting method that I had done some academic work on a long time ago. That's why I use this method.

And you average the 60 year with the 50 with the 40 and the 30 and the 20 and the 10, that latest ten years that has virtually zero growth down around 2 percent is in there six times. Whereas, the ones that have, yes, back in the '70s and early '80s and so forth we did have higher inflation, but they're only in there once, or twice. Depends on just exactly which time period, like I was asked about.

The point is the long-term average growth rate in GDP in this country if you just go back 60 years is 6.6 percent, and my forecast based on this weighted average methodology is 5.7. I don't know if that's exactly the right number or not.

I was asked about other authorities, Ibbotson's data is widely used in valuation proceedings all over the country. The idea that these -- that the CBO and EIA, yes, they're government agencies, and blue chip economist surveys just repeat those same government forecasts, and they're all out there. Social Security as well. They've got very, very low inflation rates in them now because that's what we're experiencing, and that's what the Fed's trying to do now.

But once all this printing of money takes effect and the economy finally does get traction, that's going to change very quickly, and when it does, it's kind of like we've got this trimodal view of the world. We're either going to continue to have this muddling along that's not being fixed by monetary policy, pushing on the string, they can't help it.

We're going to have the economy, which I think is the mid version, begin to gain more and more traction. We're going to see pressure for more borrowing from the private sector. The government then maybe will back away from its policies, and we'll see the private markets then reestablish rates, but they're definitely going to be higher.

The third one, more on the fringe hopefully, is that we would have hyperinflation because of the tremendous government deficits that we're running. There are people who are worried to death that if energy prices should actually gain traction in the midst of a upswing in the world economy in the next two or three years, that we may have hyperinflation because of the serious monetary policy events that are going on now.

So hopefully it's the midpoint. That's what we all think's going to happen, and that just simply means that we shouldn't base things on the very, very bottom of the cycle. Interest rates have actually increased since July a little bit, and forecasts are that they're going to gradually continue to increase a little bit. The treasury forward curve says that interest rates will increase about 40 basis points over the next three years. But that curve if things start to happen could change very, very quickly.

And that's not S&P's forecast. That's not anybody else's forecast. That's what traders are saying in the pricing of futures contracts right now. So instead of being 2.8 percent, 2.9 or 3 percent, the view is that the treasury bond will be at 3.4 to 3.5 percent, but that's maybe two, three years from now. That's the best data that I know.

Q. Let me ask you to turn your attention to OPC Exhibit 315 that Ms. Baker showed you. Do you have that before you?

A. I'm not sure which one that is.

Q. It's the one on the Baa rated utility bonds.

A. Yes, I have that.

Q. Now, you were asked about the decline in dividends from your direct case to your rebuttal case, and you advised Ms. Baker that they had declined and then popped up a little bit, and you indicated that there was a good reason for this. What was that reason?

A. We were talking about the Baa interest rate. The reason that that forecast has gone up is because the very bottom, sort of, of the situation seemed to have occurred in July, and the trend now is that interest rates are not really expected -- I know there was discussion this morning about how everything's expected to trend down, down, down. It's not. It's like we maybe are at the bottom. We felt that before. So it could drop more, but interest rates really can't go to zero, I don't think, for long-term securities.

So it's like it will gradually turn up, and that's what you're beginning to see here, not a further decline in these things.

Q. And just for the record, because we've had a lot of questions about government intervention, would you define what Quantitative Easing is and what Operation Twice is?

A. Yes. Quantitative Easing is right now -- Quantitative Easing 3 is that the Federal Reserve system is having $40 billion a month printed, put into bank reserves and spent to buy mortgage-backed securities. That's why home mortgage rates for 30 years right now are under three and a quarter percent, and that also is why treasury bond rates got pushed down some more after they kind of went back to that.

But they're literally creating money. They say printing. They're not. They don't really print it anymore. They give it to banks to buy -- they don't give it to them. They buy their treasury securities from the banks so that they have extra reserves, which then they can lend or they can buy other kind of securities with it.

Operation Twist is a different way. When money started to run out for Quantitative Easing 2, the Feds said, we still think we need tools to keep interest rates, long-term interest rates low. So they started doing shorter term -- selling shorter term securities and using those funds to buy back longer term treasury bonds. So it was a twist in the maturity structure is what they're talking about, but that pushed long-term interest rates down, kept pressure on.

Q. And then just finally, Commissioner Kenney asked you about Appendix A, which is your curriculum vitae. Are there additional proceedings that you have testified in since that was filed with the Missouri

Commission in February?

A. I know that we filed a case in Maryland for Baltimore Gas & Electric. We filed testimony in the case in Louisiana for Entergy. I know we've filed a bunch of rebuttal testimony, but we don't list the cases separately for rebuttal. Those would probably be the two additional entries that would go on there.

MR. ZOBRIST: Thank you. No further questions, Judge.

JUDGE JORDAN: Then you may stand down.

THE WITNESS: Thank you, your Honor.

JUDGE JORDAN: Next witness.

(Witness sworn.)

DAVID MURRAY testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.

A. My name is David Murray.

Q. Could you spell your last name, please, for the reporter?

A. M-u-r-r-a-y.

Q. And how are you employed, Mr. Murray?

A. I'm employed as the utility regulatory manager with the Financial Analysis Unit.

Q. Is that at the Missouri Public Service Commission?

A. Yes, it is.

Q. Okay. And are you the same David Murray that prepared or caused to be prepared certain items of testimony in this matter, and by this matter I mean Case ER-2012-0174 relating to Kansas City Power & Light and Case ER-2012-0175 relating to KCPL Greater Missouri Operations Company?

A. Yes, I am.

Q. Okay. And if I was to ask you the same questions today, would your answers be the same?

A. Yes, they would.

Q. And I should ask you, do you have any corrections to your testimony?

A. No, I do not.

Q. And as far as you know, is the testimony contained in those items of testimony true and correct to the best of your knowledge and belief?

A. Yes, it is.

Q. Okay. And they are -- let's see. Case ER-2012-0174 you contributed, did you not, to the Staff cost of service revenue requirement report?

A. Yes.

Q. Okay. And that's been marked as Staff Exhibits 200 and 201HC. And then you also prepared rebuttal testimony that's been marked as Exhibit 227 and

228HC, correct?
A. Yes.
Q. And surrebuttal testimony marked as Exhibit 250 and 251HC, correct?
A. Yes.
Q. And in the ER-2012-0175 case, again you contributed to the Staff revenue requirement cost of service report, correct?
A. Yes.
Q. Marked as Exhibits 258 and 259HC. And you also prepared rebuttal testimony marked as 283 and 284HC?
A. Yes.
Q. And finally surrebuttal testimony marked as 3006 and 30007HC, correct?
A. Yes.
MR. THOMPSON: At this time, Judge, I would offer and move the admission of Exhibits 227, 228, 250, 251, 283, 284, 3006 and 3007.
JUDGE JORDAN: Hearing no objections --
MR. ZOBRIST: Judge, I just don't know how we're handling the Staff Report.
MR. THOMPSON: Well, if I could, typically what we do is we wait until everyone that has contributed to it has testified or have a chance to be crossed and then we offer it.

MR. ZOBRIST: And I have no objection to Mr. Murray's rebuttal and surrebuttal in the two cases.

JUDGE JORDAN: Then I will enter these exhibits into the record.

(STAFF EXHIBIT NOS. 227, 228, 250, 251, 283, 284, 3006 and 3007 WERE RECEIVED INTO EVIDENCE.)

MR. THOMPSON: I tender Mr. Murray for cross-examination. Thank you, Judge.

JUDGE JORDAN: Any cross-examination from AARP or Consumers Council of Missouri?

MR. COFFMAN: Yes, I have a couple. Thank you.

CROSS-EXAMINATION BY MR. COFFMAN:

Q. Good afternoon, Mr. Murray.

A. Good afternoon.

Q. Let me ask you, the methodology that you used in developing your discounted cash flow methodology, this is a methodology that's been adopted by the Missouri Commission in past cases; is that not correct?

A. Yes. I mean, they've adopted various versions. It's been kind of a blend, I believe, in recent Report and Orders, not necessarily a constant growth or multistage but some type of DCF methodology, that's correct.

Q. In almost every past case the Commission has used some variation of that methodology that you employ, correct?

A. Some Report and Orders have been a little bit confusing. I don't want to say that they relied specifically on one DCF version, but it's -- it's been -- sometimes it's been tough to tell exactly which one they're relying on.

Q. Would it be fair to say that they have almost always used the DCF as part of their support of a return on equity decision?

A. I'd say most recently the multistage DCF seems to be getting quite of bit of weight with electric utility cases.

Q. And is it common for the Missouri Commission to use the capital asset pricing model to further substantiate the reasonableness of its return on equity decisions?

A. Only to test reasonableness. There's been quite a wide variety of results in the capital asset pricing model, and Staff has recognized that in its recommendation.

Q. In developing your recommended range of 8.0 percent to 9.0 percent in this case, did you take into account general economic conditions apart from the data that was in your models?

A. Well, it's implicit in the models. Obviously with the stock prices as has been discussed extensively today, electric utility stock prices have increased, and that's because the cost of equity to utility companies has decreased. There's quite a bit of value placed on utility earnings because they're bond substitutes. They're a very close alternative to bond investments and they're seeking out yields.

So, yeah, that's implicit in DCF methodologies, and to the extent that you use reasonable growth rates for purposes of future potential growth, of course that's going to be implicit in the cost of equity estimation.

Q. And when you say that the general economic conditions in the country were taken into account, do you mean that the general economic conditions as they -- those conditions impact the utility or -- or were the general economic conditions that impact customers also part of your model?

MR. ZOBRIST: Judge, I'm going to object to this line of questioning. This is clearly friendly cross-examination. Mr. Coffman made it very clear in his opening statement that he endorses Staff's model. It really sounds like Mr. Murray's getting to file direct testimony once again. I object on the basis that it's friendly cross.

MR. THOMPSON: I'm not aware of any prohibition against friendly cross, Judge.

MR. COFFMAN: It's not a recognized objection that I'm aware of. I might add that I'm not necessarily getting the answers that I hoped to get from this witness.

MR. THOMPSON: Less than friendly cross.

MR. COFFMAN: I am simply trying to clarify for the record the nature of this witness' recommendations and what -- what actual evidence was the basis of which analysis.

JUDGE JORDAN: I'll overrule. The objection is overruled.

THE WITNESS: As a rate of return witness, I'm evaluating the cost of equity, and while I'm very sympathetic to the hardships of customers, we are cost of capital witnesses and that means you're evaluating the cost of capital to the company.

Now, if the economic conditions of low growth and low interest rates results in a lower ability to incur lower cost of capital to the utility company, then yes, that's reflected. But did I make an adjustment because the unemployment rate is 9 percent or 8 percent or what have you? No, I did not.

BY MR. COFFMAN:
Q. As far as you understand the methodology, would you -- would you say that such concerns as affordability for consumers is a factor that the Commission can take into consideration when choosing where within your range would be the most just and reasonable result in this -- on this issue? Would that be the place to consider that information?
A. Once again, as a cost of capital witness, you're evaluating the risk to the -- to the company. You know, if the Commission had a policy of wanting to provide incentive, incentivize returns, then I think that you may want to consider affordability. But I think I'm fairly close in estimating what the cost of capital is, and so, once again, I don't think you're going to find anything in my testimony about the current hardship of customers.
Q. So to be clear, if the Commission wants to take into account the impact on consumers, they are going to have to -- that that has not already been taken into account by you, that would be an additional adjustment that they would need to make to your range or someone other witness' range?
A. If it's within the cost of equity, I understand that might be their prerogative.
Q. You haven't already discounted your results

by taking into account the impact of rate increases on consumers?

A. Actually, I recommend the high end of my cost of equity estimate, which would be counter to what you are suggesting.

Q. And why did you choose the high end of your range?

A. Well, because I firmly believe the cost of equity, regardless of discussions earlier, that the cost of equity is quite low at this point in time. I believe that -- I believe that I have provided a tremendous amount of third party corroborating evidence support that is not produced by me that is not within the regulatory ratemaking world that proves that capital market specialists and investment experts that advise on stock investments do utilize a low cost of capital, utilize a low cost of equity, and that's the reason why I believe it's important report that to the Commission that the cost of equity is low.

Now, if the allowed ROE is chosen to be higher than what the cost of equity is, then, you know, that's -- because other states are doing it, then I understand. I sympathize with the Commission looking at those factors.

Q. If the Commission does not accept your specific recommendation to go to the high end of your range but rather chose the low end of your range, would the 8 percent of that is the low end of your range still produce a just and reasonable return on equity?

A. Yes.

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

JUDGE JORDAN: Any cross-examination from the Department of Energy?

MR. BRUDER: None, your Honor. Thank you.

JUDGE JORDAN: From the Air Force ore related --

CAPTAIN MILLER: No, your Honor.

JUDGE JORDAN: -- Federal Executive Agencies? Anything from the Office of Public Counsel?

MS. BAKER: Yes.

CROSS-EXAMINATION BY MS. BAKER:

Q. Good afternoon, Mr. Murray.

A. Good afternoon.

Q. Would you agree that fluctuations in the economy are a normal part of the business arena?

A. Yes.

Q. And you've determined that a reasonable return on equity for Kansas City Power & Light, Kansas City Power & Light GMO is between 8.00 percent and

9.00 percent, correct?

A. Yes.

Q. And this determination is based on your expert analysis of market driven data using traditional analytical tools?

A. Yes.

Q. I assume that you agree that the Supreme Court has stated that a reasonable return on equity is one that is, one, adequate to attract capital at reasonable terms, thereby enabling the utility to provide safe and reliable electric service, that is, two, sufficient to ensure the utility's financial integrity, and three, is commensurate with returns on investments in enterprises having corresponding risks?

A. Yes.

Q. Therefore, in your opinion, at a return on equity range of anywhere between 8.00 percent and 9.00 percent, Kansas City Power & Light, Kansas City Power & Light GMO is adequately able to attract capital at reasonable terms, enabling it to provide safe and reliable electric service?

A. Yes.

Q. And anywhere within this range Kansas City Power & Light, Kansas City Power & Light GMO's financial integrity is ensured?

A. Yes.
Q. And given your research, a return on equity anywhere between 8.00 percent and 9.00 percent is commensurate with returns of similar enterprises like the utility?
A. I'll go back to the Ameren Missouri case. I believe I qualified my response to this that 8 to 9 percent is my estimate of the cost of equity. The earned return of electric utility companies may be above or below the cost of equity. So when you refer to comparable returns, say, for instance, a utility company's earning a 10 percent return on equity, then I don't necessarily mean that -- believe that means that that should be the benchmark for what is a fair return. A fair return is based on the cost of equity, and if other companies have -- take Southern Company for an example. They typically get very high allowed ROEs and high earned ROEs. As a result, they tend to have a lower cost of equity. So the cost of equity of Southern Company would be the fair benchmark to review.
Q. You would agree that what the Commission is being asked today is to approve a return on equity that is an allowable amount for the company to achieve, not what they will be guaranteed to achieve?
A. An allowable amount based on what I believe

to be an estimate of the cost of capital.

Q. During the local public hearings, you're aware that there's been a lot of customer concern over the affordability of rates, correct?

A. Generally, I understand that to be the case.

Q. And you would agree that the goal of the Commission is to set rates that are just and reasonable?

A. Yes.

Q. And would you agree that part of determining a reasonable rate is to make sure that rates are as affordable as possible without causing a detriment to the utility?

A. Yes.

Q. Are you aware that Staff has produced reconciliations of the positions for various issues in these cases, including return on equity?

A. I believe so.

MS. BAKER: I have two exhibits. These will be 316 and 317.

(OPC EXHIBIT NOS. 316 AND 317 WERE MARKED FOR IDENTIFICATION.)

BY MS. BAKER:

Q. What I've handed you is the reconciliations for each of the cases, 316 being the reconciliation of

October 12th, 2012 for Kansas City Power & Light. 317 is the reconciliation for Kansas City Power & Light GMO also filed by Staff on October 12th, 2012.

And you're aware that your position was taken into account whenever Staff produced this document, correct?

A. Yes.

Q. And to the best of your belief, the numbers on this for your issue are accurate?

A. Yes.

Q. If you look at page 1, line 6 for the Kansas City Power & Light exhibit, 316, and then also on page -- that same page, page 1, line 6, do you see where it says return on equity issue KCPL 10.4, Staff 9.00?

A. Yes.

Q. And that is your recommendation, the 9.00 percent, correct?

A. Yes.

Q. According to page 1, line 1 of 316, the reconciliation is based on a Kansas City Power & Light revenue requirement as of 8/31/12 projected update. It gives a number of 112,547,915?

A. Yes.

Q. Okay. And so that would be at this time, at the time that this reconciliation was made, that would be the revenue requirement of Kansas City Power & Light at that time?

A. By the company, correct.

Q. And then according to line 6, the Staff 9.00 percent ROE would reduce the revenue requirement by 24,393,607 also in the 8/31/12 projected?

A. Yes.

Q. And you would agree with me that's approximately 22 percent?

A. That sounds about correct.

Q. So 22 percent of the revenue requirement is on this one issue alone, correct?

A. Yes.

Q. And looking to the exhibit for -- the exhibit that's No. 317 for Kansas City Power & Light GMO, also looking at line 1, under the 8/31/12 update, this is for their L&P section; is that correct?

A. Yes.

Q. And its revenue requirement is 21,536,362?

A. As requested by the company, yes.

Q. And again, looking on line 6, Staff's position of 9.00 percent would reduce that revenue requirement by 283,962?

A. Did you say ROE? I believe that's incorrect.

Q. Am I on the wrong one? I'm sorry. 5,436,278?
A. Yes.
Q. And again, that's about 25 percent?
A. Yes.
Q. Moving to the fifth page, it's numbered 4 or 4 and then the numbering kind of stops, so it's the fifth actual page. This is for the -- for the MPS section for GMO, correct?
A. Yes.
Q. And for this, line 1, the revenue requirement 64,313,510?
A. As represent by the company, yes.
Q. Okay. And then line 6, Staff's position, 9.00 percent for ROE would reduce that by 16,592,966?
A. Yes.
Q. And again, that's somewhere around 25, 26 percent?
A. That's correct.
Q. So with these two documents together, would you agree that the total savings to the customer based on your position of a 9.00 percent would be 24 million plus 5 million plus 16 million, somewhere around $46 million?
A. I'll take your word for that. I didn't add those numbers up. I have no reason to dispute that.

Q. And this is at the higher end of Staff's range, the 9.00 percent?
A. Yes.
Q. Which is fairly close to Public Counsel's lower end of their range of 9.1 percent?
A. Yes.
Q. And moving to the lower end of Staff's range at 8.00 percent, you would agree that the savings to the customers would be significantly more than $46 million?
A. Yes.
MS. BAKER: No further questions, and I move for the admission of 316 and 317.
MR. ZOBRIST: No objection.
JUDGE JORDAN: Those exhibits are entered into the record.
(OPC EXHIBIT NOS. 316 AND 317 WERE RECEIVED INTO EVIDENCE.)
JUDGE JORDAN: Cross-examination from the companies?
CROSS-EXAMINATION BY MR. ZOBRIST:
Q. Mr. Murray, let me start with some capital structure questions, if I might, please. In the Staff Report, You stated that GPE typically had a common equity ratio of close to 50 percent; does that sound correct?

A. Yes.

Q. And I believe that the Staff Report at page 33 you say, consequently, there's no reason at this time to dispute a ratemaking capital structure that has 52.42 percent equity ratio; is that correct?

A. Yes.

Q. And am I correct that Staff's position is that it is going to look at the numbers as of August 31st, 2012 in the true-up portion of the proceedings?

A. I believe I already provided that in surrebuttal testimony.

Q. All right. Thank you. And you have recommended to the Commission that a consolidated capital structure is appropriate for both of these companies, correct?

A. Yes.

Q. Based on the capital structure of Great Plains Energy, Incorporated, the holding company?

A. Yes.

Q. And am I correct that in the capital structure analysis that you prepared, short-term debt is not considered?

A. Yes. I evaluated the balances of short-term debt, but I did not include them.

Q. Now, in your Staff Report, you talked about what you believe was the effect of Aquila's practices that have transcended the acquisition by Great Plains Energy and continued to affect Aquila, which is known today as KCP&L Greater Missouri Operations Company, correct?

A. Yes.

Q. And in your surrebuttal at 29, you viewed GMO as having -- or you were saying despite Aquila or GMO's high quality regulated utility assets prior to the acquisition, ratepayers were only being protected by Aquila's decision to provide BBB protection as far as how rates were being formulated without regard to the actual lower rates and higher interest costs that Aquila was incurring at the time? That is page 29 of your surrebuttal.

A. I apologize. I'm going to have to ask you to repeat the question.

Q. The question was that you were stating that GMO, formerly Aquila, had high quality regulated utility assets, but prior to the acquisition by Great Plains Energy, Aquila's ratepayers were being protected by Aquila management's decision to pretend as it were that there was a BBB debt rating on Aquila's debt when in actuality it was a higher debt rating -- pardon me -- a lower debt rating and higher interest rates?

A. I think along with the scrutiny of the parties that were involved in rate cases to ensure that we were on the same page or whether or not we disagreed with some of the adjustments or we thought the adjustments should be higher, then I believe that that was the effort of all the parties was to attempt to ensure that the financial effects of Aquila's financial condition due to its failed nonregulated investments was not passed through to ratepayers.

Q. And would you agree that for the company that was not a sustainable proposition that it was actually agreeing to have rates set as if it bonds were at BBB rating when they really weren't?

A. It wasn't sustainable to the extent that they wanted to keep all their assets. They had to sell assets to -- there's much more to it than just saying that's the only thing that kept them from being sustainable. There were many things that were going on with Aquila, not just that high interest cost debt.

Q. But that and these other reasons that you've alluded to is what led to the acquisition of Aquila's Missouri electric assets by Great Plains Energy?

A. I can't -- I'm not sure what led to the acquisition of Great Plains Energy acquiring Aquila.

Q. All right. But it's fair to say that Aquila was not succeeding as a business proposition prior

to the acquisition, correct?
A. I believe they were divesting their assets, and whether or not they would have been able to come out of the lower investment grade credit rating situation they were in we'll never know.
Q. At any rate, Aquila's management made a decision to have its remaining Missouri electric assets acquired by Great Plains Energy; is that correct?
A. That is correct.
Q. And the Commission approved that acquisition in July of 2008?
A. That is correct.
Q. And since July 2008, we have had a number of economic events, significant economic events such as the recession, the intervention of the Federal Reserve Bank, the monetary policy, the TARP program, the Troubled Asset Relief Program, I think it's called, that have happened since the Commission approved the acquisition of Aquila by Great Plains Energy, correct?
A. Yes.
Q. Let me turn to the three debt adjustments that you proposed in this case, Mr. Murray. If I could summarize it, you proposed adjustments for three GPE debt issues that were issued for the benefit of GMO; is that correct?

A. On behalf of GMO, that would be my preferred term.

Q. And the first one was the August 2010 $250 million three-year unsecured debt at 2.75 percent, correct?

A. Yes.

Q. And that's where you support an adjustment from the 2.75 percent interest rate down to the 2 percent interest rate, 2.00?

A. In direct testimony, that's correct.

Q. And then the second issue is the GPE unsecured debt that was issued May of 2011 for $350 million, ten-year term at an interest rate of 4.85 percent, correct?

A. Yes.

Q. And in the Staff Report, there was an adjustment that you proposed of reducing that to 4.70 percent, and then in surrebuttal you made a further recommendation that it be reduced to 4.0 to 4.25 percent; is that correct?

A. Yes, based on discovery of internal GPE documentation.

Q. And then the final issue that you propose an adjustment for is the May 2012 $284.5 million ten-year unsecured debt which was related to the redemption of the equity units, correct?

A. Yes. It was an underlying -- it was a remarketing of the debt that underlie the equity units.

Q. What I'd like to do is talk about those first two, which are just straight up senior notes, and talk about those two, and then I'd like to talk about the issuance that came out of the equity units. All right?

A. Okay.

Q. Now, on the first one, you have proposed a downward adjustment of 75 basis points citing the BBB utility debt yield for August of 2010; is that correct? And just again, point of reference, this is the GMO -- I'm sorry -- GPE $250 million senior note, three-year term issued in August 10 at 2.75 percent. You propose an adjustment of 75 basis points?

A. Yes.

Q. Now, you testified in the 2010 rate case of GMO, correct?

A. Yes.

Q. And in that case you wanted a portion of that debt reassigned to Kansas City Power & Light Company, correct?

A. I believe my position was for it to be consolidated. That's when I started to push for the consolidated cost of debt methodology.

Q. And in that case, the Commission did not accept either a consolidated formula and it did not accept your reassignment proposal; is that correct?

A. Once again, I don't believe that I made a specific recommendation of a reassignment. I believe my recommendation was a consolidated, and they did reject the consolidated approach in that case.

Q. And is it correct that you did not propose an adjustment of that interest rate from 2.75 percent to a lower figure in the last rate case?

A. That's not correct. I recommended an adjustment to 2 percent in the true-up rebuttal testimony.

Q. And that was also not accepted by the Commission, correct?

A. That is correct.

Q. Okay. Now, in this case, you're recommending a 75 basis point reduction from 2.75 to 2.0, correct?

A. As I just indicated, as this case has gone along, I've done some discovery and found some internal documentation from Great Plains Energy that instead of relying on outside independent third-party information, I just relied specifically on cost of debt differentials I discovered through board of director meeting materials and also some indicative pricing schedules that were provided in response to some DRs when the companies were determining what they thought the price of these debt issues would be. And so that was a reason for the changes as you showed in your -- in your overhead earlier is I found that information that was directly from the company's internal documentation.

So the final recommendation is in my surrebuttal testimony, and I can refer you to that to make sure that we're very clear as to what the final adjustment recommendation is.

Q. Well, your proposal here is to adjust it based on your personal opinion, not anything based upon what GPE encountered in the marketplace when it floated this debt in August of 2010; is that true?

A. The recommendation to make the adjustment is my recommendation. The amount for a difference between a BBB and a BBB- was based on company internal information.

Q. Now, is it true that GMO because it does not have three years of financial statements, it could not issue this debt on its own?

A. That's what's been represented to me, and I have no reason to dispute that. I don't know what the private placement, if that would have -- if private investors may have, you know, given a little leeway in

regard to that requirement.
Q. And you did not factor in a new issue concession fee that likely would have been imposed on GMO if it had issued this debt on its own?
A. I disagree because in the surrebuttal testimony --
Q. My question is, did you or did you not? You did not, did you?
A. I did.
Q. You factored in a concession fee?
A. Yes.
Q. And what did you factor in as the concession fee?
A. It's in the surrebuttal testimony when I reviewed the internal documents. They showed a cost of debt differential between a BBB and a BBB- rating, and the idea with the pricing, indicative pricing schedule that was provided by the investment banks that work with Great Plains Energy, they provided what would be an offering debt yield. So the offering debt yield was all inclusive. Those are documents that were provided by Great Plains Energy.
Q. Well, no new issue concession fee is mentioned in those documents, is there?
A. I believe there was.

Q. Now, GMO also has a split rating between Standard & Poor's and Moody's; is that correct?

A. Yes, it does.

Q. And the rating that it has with Standard & Poor's is one notch higher than the rate with Moody's, correct?

A. That is correct.

Q. And most likely that would require GMO, if it were to go into the marketplace on its own, to have its debt priced at that lower rate rather than the higher BBB rate; isn't that true?

A. It would be a consideration, yes.

Q. Now, with regard to the second adjustment that you proposed on the GPE senior notes of $350 million ten-year term issued in May of 2011 at 4.85 percent, that's the one where you recommend an adjustment of 15 basis points, correct?

A. In direct testimony, that's correct.

Q. And am I generally correct that the same discussion that we just had if we compare what Mr. Bryant said in his rebuttal and surrebuttal to what you have to say, these are the same issues that are involved, correct?

A. Yes.

Q. Now, let's go to the GPE $287.5 million senior notes. Those senior notes resulted from -- well, they were components of the equity units that GPE issued a couple of years ago in the midst of the Iatan construction projects, correct?

A. Early 2009, that's correct.

Q. And so these senior notes were a bond that were contained in those equity units, correct?

A. It's an underlying security for part of the equity units, that's correct.

Q. And in March of 2012, those were essentially cashed out and then remarketed as new debt, correct?

A. Yes.

Q. And that's at the rate of 5.292 percent?

A. That was the coupon rate, yes. That's correct.

Q. And isn't it fair to say that those new senior notes that GPE issued could not have been issued by GMO because the terms of the equity units required them to be issued by the holding company?

A. That's my understanding, correct.

Q. And am I correct that in the Commission's 2011 Report and Order in the GMO rate case that was filed in 2010, that the Commission did find that the equity units had been issued in the best -- that they were reasonable and they were issued in the best interests of the ratepayers?

A. I believe that's what the Commission indicated, yes.

Q. And your proposal seeks to adjust that I think initially down by 104 basis points, and then in surrebuttal you increase that adjustment to 110 and 120 basis points; is that correct?

A. Yes. Once again, based on discovery of additional information, yes.

Q. And again, that's not based on anything that GPE or GMO had encountered in the marketplace when these senior notes were remarketed in March of 2012?

A. It was based on internal information once again as far as the reason why the cost was higher was due to the uniqueness of these -- of this security offering.

Q. Let me move on to return on equity.

MR. ZOBRIST: Can I proceed, Judge? Not up to a break time, I assume? I'm fine, so --

JUDGE JORDAN: I'm fine also. My preference would be to finish with the examination of this witness.

MR. ZOBRIST: Good. Thank you. That's absolutely fine.

BY MR. ZOBRIST:

Q. Now, Mr. Murray, in the Staff Report you stated that today's utilities compete for capital in a global market rather than a local market; is that correct?

A. Yes.

Q. And for reference, that's Staff Report page 23. I believe most of my references here are going to be in the KCPL rather than the GMO case, although I think the pages --

A. Thank you.

Q. -- are pretty much the same.

Now, that means that KCP&L and GMO compete not just with other utilities, they compete with other businesses; is that fair to say?

A. Yes, without a doubt.

Q. And the Hope and the Bluefield cases both refer to the Commission being obligated to compare the operations of the utilities with other enterprises and other businesses having corresponding risks?

A. Yes.

Q. Now, in this case, you and Dr. Hadaway have proposed a comparable group of companies to analyze with regard to your discounted cash flow analysis; is that correct?

A. Yes.

Q. And in doing so, you have stated that the estimate of a utility's cost of equity or its return on equity should pass the commonsense test when considering the broader current and capital market conditions; is that correct?

A. Of course, yes.

Q. Now, in this case, you used ten companies for your proxy group, correct?

A. Yes.

Q. And you used ten companies for your proxy group in the 2010 case?

A. I believe that's correct. I don't remember for sure.

Q. Okay. And in this case, Dr. Hadaway initially proposed a proxy group of 22 companies, which he then modified to 21 companies, dropping four that didn't meet his criteria and putting three in that did; is that correct?

A. Yes, I understand that to be the case.

Q. And is it fair to say that although Mr. Gorman and Mr. Kahal disagreed with some of the things that Dr. Hadaway did with the proxy group, when they sort out the numbers that -- pardon me -- the companies that they accept or do not accept, we're still talking a proxy group of 16 to 17 companies that Mr. Gorman and Mr. Kahal were working with?

A. I don't know what companies they're working with. I haven't looked at whether or not they've modified -- when I say they, Mr. Kahal or Mr. Gorman have modified their proxy groups.

Q. But their proxy groups are roughly, you know, 80 percent to 120 percent larger than yours. I mean, you're dealing with 10 companies, and they're dealing with 16, 17, 20, 21, 22 companies, correct?

A. I used the same number of companies as in the Ameren Missouri case.

Q. But it's a much smaller group than what the other experts in this case are using, correct?

A. It's ten companies.

Q. Now, would you agree that investors rely on historical data as well as projected data?

A. Without a doubt, yes.

Q. And most of the date that investors rely and study upon is probably historical rather than projected data?

A. I don't know that I would say that most. I don't know what's -- what they would define as most.

Q. Well, in any event, investors do not ignore historical data, do they?

A. No.

Q. And investors do not rely only on projections of economic data, they rely on both historical and trend information?

A. Yes.

Q. And particularly sophisticated investors, they look at what the futures market is doing, they look at future trends and projections; isn't that true?

A. And look at the current economic conditions. I mean, obviously you look, just as with anything with evaluating industry growth rates, looking at economic growth rates, looking at the past as a reasonableness check as to what could happen in the future is quite typical.

Q. Now, would you agree that the long-term average nominal GDP growth rate in the United States over the past 60 years is 6.6 percent?

A. I have not independently verified that.

Q. Well, I think Dr. Hadaway said in his testimony that while he was using a growth rate of 5.7 percent for the long-term, that the long-term average nominal GDP growth rate in the U.S. was 6.6 percent. I'm just asking whether you have a basis to disagree with that?

A. He had a strange weighting average. I'll tell you in my schedule what I have.

Q. Well, I'm not asking you about his weighting average. I'm just asking you about the

long-term U.S. GDP growth rate.
A. Well, I'll tell you what I have in my direct testimony if that's okay.
Q. All right.
A. Schedule 15 for the period -- this data should be from the Bureau of Economic Analysis or the Congressional Budget Office. I don't recall. But for the periods of 1947 through 1999, I have a 7.5 percent growth rate, and that's a rolling average. That's actually above his. And so I imagine since he included the ten years past that, that that brought his down.
Q. All right. Thank you. Now, are you familiar with the Brigham and Houston text The Fundamentals of Financial Management that was published in 2007?
A. There's been several editions. I don't remember what edition I've looked at.
Q. Well, that's the one that both Dr. Hadaway and Dr. Gorman quoted. Are you familiar in general with the text Brigham and Houston?
A. They've been publishing texts for some time.
Q. And would you agree that that's an authoritative text on the issues of financial management?
A. I believe it's one of the authoritative

texts.

Q. And would you agree that dividends for mature firms are often expected to grow in the future at about the same rate as normal gross domestic product?

A. No.

Q. You do not agree?

A. I do not agree.

Q. So if that's in Brigham and Houston, you don't agree with that?

A. It's in Dr. Damodaran, an NYU professor of finance book that publishes a textbook in the chartered financial analyst program, and he refutes the notion that mature companies with high dividend payout ratios and history of issuing equity on a frequent basis due to large capital expenditures, that they would grow anywhere near GDP growth. It's just a theory. I've reviewed practical information that shows that not to be the case.

Q. And so to the extent that Brigham and Houston offer a different view, you disagree with it?

A. That's theory, yes. Correct. I've looked at practical information.

Q. I'm just asking you --

A. I understand.

Q. -- if you agree or disagree.

A. I disagree.

Q. Okay. Now, in your Staff Report at pages 43 and 45, you quote in your Schedule 14 data that came from Mergent from 1968 to 1999; is that correct? And Mergent is M-e-r-g-e-n-t. I think it's specifically from the Mergent Public Utility and Transportation Manual.

A. I believe I cite a couple different sources on page 43 and 45.

Q. And you considered in that analysis that you discuss in the Staff Report data from ten electric utilities; is that correct?

A. Okay. If I can make sure the record's clear, as far as those ten utilities, that has nothing to do with the Mergent Public Utility Manual. That has to do with the ValueLine central regions utilities that we -- the financial analysis unit did its own analysis of growth rates over that period of time. So that did not come from that source.

Q. I apologize. I'm mistaken. This is from the ValueLine information, but it's also from that earlier period of 1968 to 1999; is that correct?

A. That is correct.

Q. Okay. And I know you're going to have to maybe turn your head around, but are those the ten companies that were reported in the Staff Report as Dayton Power & Light, Detroit Edison, Empire, IPALCO, which is

Indianapolis Power & Light, Kansas City Power & Light, Northern States Power, Oklahoma Gas & Electric, St. Joseph Light & Power, Wisconsin Public Service and Wisconsin Electric?

A. That is correct.

Q. And you chose those ten companies, not fewer, not more; is that correct?

A. Yes, I chose those ten companies.

Q. And you didn't choose 20 companies, correct?

A. That's correct.

Q. Did you have data from ValueLine that you could have used 20 companies?

A. Yes, there was several companies, but I explained my selection process in my testimony.

Q. Now, when you created the simple average of these three -- of these ten companies' growth rates from 1968 to 1999, am I correct that you weighted each of these companies evenly? In other words, Empire's data was 1/10 even though it's a much smaller company than, say, Detroit Edison?

A. That's correct.

Q. And your analysis indicated that if you took those ten companies treating for computational purposes Empire and St. Joseph Light & Power the same as

Northern States Power and Detroit Edison, the earnings per share of those companies was 3.62 percent, the book value per share was 3.18 percent, and the dividends per share was 3.99 percent; is that correct?
A. Yes, including those Missouri utilities, that's correct.
Q. And the average growth was 3.59 percent; is that true?
A. That is correct.
Q. And is it also correct that the U.S. gross domestic product growth rate for that period of time was over 8 percent, actually about 8.10 percent?
A. I was actually quite surprised to see the contradiction.
Q. Did you make any adjustment for the fact that the average growth rates for these companies over this 30-year period was so at odds with the U.S. GDP growth rate?
A. No, because I'm analyzing electric utilities, not the macroeconomic environment of the GDP.
Q. That's a pretty significant difference, the 450 basis points, isn't it?
A. It's very significant. It should be something to -- it should be thought about.
Q. Did you conduct any retest of your proxy

group to add any additional companies to see if the analysis that you were conducting was -- for that reasonableness that you talked about?

A. Actually, if you turn to my surrebuttal testimony, Schedule 7, I found it interesting because Empire, St. Joseph Light & Power and Kansas City Power & Light were in that proxy group, why not look at Ameren, at the time Union Electric, to determine why we removed it from that -- from that study, and the reason why we removed it is because they merged with Central Illinois Public Service in 1997.

So considering that, even though it wasn't a full additional two years of data, I believed what better way to test the reasonable of the potential growth of Missouri regulated electric utilities than to look at just those four companies. If you turn to Schedule 7 in my surrebuttal testimony, I show the ten-year compound average growth rates of Missouri regulated electric utilities, the four main ones, and that average growth rate is 3.09 percent.

Q. So it dropped when you put in Union Electric Company?

A. Yes, it did.

Q. So it was even farther from the U.S. GDP growth rate?

A. Calling that assumption into more question, in my opinion.

Q. And you didn't look at any other companies after that gap widened, did you?

A. I was looking at Missouri. I mean, we're looking at Missouri electric utilities in these cases.

Q. Now, later on in the Staff Report, you state that you did not rely on any information provided by commercial services that are the sources that relied -- that are relied upon by institutional investment such as Knowledge, Reuters or Ned Davis Research; is that correct?

A. Yes. We don't have access to that.

Q. And you made no effort to get your budget folks to get you the money so you could subscribe to those services?

A. I wouldn't say I didn't make any effort. I have discussed the cost of some of these sources that are used by institutional investors which drive the market to a great deal, and unless -- you know, unless there's some, I guess, consideration of wanting to do some further analysis to test these theories about GDP growth and what have you, yeah, at this point I don't know if it's money well spent.

Q. Well, in any event, you didn't take the step to either subscribe to them or seek the permission of

your supervisors to subscribe to such services?
A. No.
Q. Okay. Thank you. Now, you did look at the Bureau of Economic Analysis data; is that correct?
A. Yes, I did.
Q. And the Bureau of Economic Analysis is a division of the Department of Commerce, correct?
A. Yes. It's a government entity.
Q. Now, you did not find any studies about what GDP growth rates ought to be used in a DCF study to set a regulated public utility's ROE, did you?
A. No.
Q. And you didn't look at any other data after 1999; is that true?
A. That's not correct.
Q. Now, with the Mergent data that you did look at, you didn't rely on any Mergent data after 1999?
A. I did. I looked at through 2002 or 2003, but because of the noise of the disruption caused by the Enron bankruptcy and restructuring electric utility markets, I -- it would have shown lower growth, but I chose not to include it because of the disruptions in the markets at the time.
Q. So the point is, is that although you looked at some of the later data, you didn't have any data

that you thought was appropriate to consider that was less than 12, 13 years old, is that fair to state, as far as this analysis?

A. It was a practical issue. The data went as far as 2002-2003 from the Mergent bond record.

Q. Now, at page 49 of the Staff Report, as you're wrapping up your analysis of these ten central region electric utilities, you state that the fact that growth rates were about 450 basis points between the national GDP of 8.10 percent, that this, quote, would seem to imply that the utility industry is possibly in a state of decline or at least another building cycle, close quote; is that correct?

A. Yes.

Q. And you didn't know which, whether it was in decline or whether it was in a building cycle?

A. Well, it's in a building cycle, but as to whether or not that building cycle is going to drive any growth is fairly questionable considering it's not due to load growth. So it's -- to the extent that the building of additional plant is allowed into rate base and is allowed to pass through to ratepayers, there will be some growth in the electric utility industry. But to the extent that there's not increasing demand growth, then there's a pretty severe constraint on the potential growth for electric utility industry.

Q. Now, on the Mergent data, you had a statement on page 48 of your report that you had a problem replicating its data; is that correct?

A. That is correct.

Q. Okay. And then on page 51, when you were speaking of testing the hypotheses that electric utility growth would converge toward U.S. estimated GDP growth, you said that, quote, a key weakness in the data Staff analyzed is that it does not extend past 1998; is that correct?

A. I acknowledge that. That's correct.

Q. Now, a few pages later at 53 and 54, you talk about an article that was written by Steven Kihm who was an economist on the staff of the Wisconsin Public Service Commission?

A. Yes.

MR. ZOBRIST: Okay. I'm going to have marked a copy of that article and give it to the Bench and court reporter.

(KCPL EXHIBIT NO. 57 WAS MARKED FOR IDENTIFICATION.)

BY MR. ZOBRIST:

Q. Mr. Murray, is that a copy, Exhibit 57, of the article that you discussed on several pages of the

Staff Report?

A. It's not in the form that I remember, but it appears to be -- it appears to have the same content.

Q. The article that you did quote was by Steven Kihm, K-i-h-m. It was called Rethinking ROE, and it appeared in the August 1st, 2011 issue of the Public Utilities Fortnightly, volume 149, No. 8. Does that sound correct?

A. Yes.

Q. Now, Mr. Kihm states that a more reasonable standard and one that regulators have adopted implicitly is, for example, he says setting ROE at 10.2 percent above the cost of equity. Do you recall him stating that? And actually that's on page 5 of the article. I believe it's the second full paragraph under the heading that says regulatory policy.

MR. THOMPSON: I don't mean to burst in, Karl, but this one you gave me is missing pages 2, 3 and 4.

MR. ZOBRIST: That was intentional. I will fix that. I apologize. I'll fix that.

THE WITNESS: Yes, I'm on that paragraph.

MR. ZOBRIST: I'm going to give Staff counsel my secret copy with all the pages.

MR. THOMPSON: Thank you.

BY MR. ZOBRIST:

Q. So did I quote that correctly, Mr. Murray?

A. Yes, you did.

Q. And in the paragraph below that, which is indented, it's a quote attributed to Dr. Roger Morin, M-o-r-i-n. Do you see that subparagraph?

A. I do.

Q. Mr. Kihm quoting Professor Morin says, if regulation is a substitute for competition and if the cost of capital is to play the same role in the utility industry as in unregulated industries, then the allowed rate of return should be set in excess of the cost of capital; is that correct?

A. That is correct.

MR. ZOBRIST: I move the admission of Exhibit 57, Judge.

MS. BAKER: Will we get copies, full copies? I have no --

MR. ZOBRIST: I apologize. Judge, do you have full copies in yours?

JUDGE JORDAN: My copy is missing pages also.

MR. ZOBRIST: Well, if I could get that admitted, I promise I'll give you all the pages, not just page 5, or I can withdraw it and then submit tomorrow or later today full copies.

MR. THOMPSON: I trust you. I have no objection.

THE WITNESS: I have a copy.

MR. ZOBRIST: Is that a full copy?

THE WITNESS: No. I have a copy.

JUDGE JORDAN: I heard what sounded like an objection based on the completeness of these documents, of this document.

MR. ZOBRIST: I will mark the complete copy and I'll provide copies to the Bench and to counsel as soon as I can.

JUDGE JORDAN: I'm seeing nods all around. Subject to that event, I'll admit that document into evidence.

(KCPL EXHIBIT NO. 57 WAS RECEIVED INTO EVIDENCE.)

MR. ZOBRIST: Thank you, Judge.

BY MR. ZOBRIST:

Q. Mr. Murray, just a few more questions here. Toward the end of your surrebuttal, you cite a report by a company called ISI; is that correct?

A. I do, and I believe I attached the report as well.

Q. And again, that was provided in your

surrebuttal. It wasn't in the Staff Report and it wasn't in the rebuttal, correct?

A. Not the report, that's correct.

Q. And is it fair to say that the ISI folks are essentially stock pickers, that they're telling people what to buy and what not to buy?

A. They're investment advisors, yes.

Q. And did you have access to their proprietary model that they used in preparing their recommendations in the report that you attached to your surrebuttal?

A. I discussed the model with the analyst Greg Gordon. I discussed the general assumptions of the model. Did he send me an electronic copy of the model? No, he did not.

Q. And there's nothing in this document that recommends its analysis to public utility commissions in setting rates; is that true?

A. I believe it just points out that allowed returns are higher than the cost of equity, but I don't know that -- I mean, I believe he says he expects allowed returns to come down to get closer to the cost of equity.

Q. But he's not recommending his model for use by public utility commissions in setting utility returns on equity?

A. He's not a witness. I don't know why he would. No.

Q. That wasn't my question. My question is, in his article, is he recommending that his model and his recommendations be used by commissions to set utility returns on equity?

A. No. He's advising investors.

MR. ZOBRIST: Thank you, Judge. That's all I have.

JUDGE JORDAN: Questions from -- questions from the Bench. Commissioner Kenney, any questions for this witness?

COMMISSIONER KENNEY: No, thank you. Thanks, Mr. Murray?

THE WITNESS: Thank you.

JUDGE JORDAN: Commissioner Stoll?

COMMISSIONER STOLL: I have no questions, your Honor. Thank you.

THE WITNESS: Thank you.

JUDGE JORDAN: Recross, Department of Energy.

MR. BRUDER: I have just one question, if I may.

RECROSS-EXAMINATION BY MR. BRUDER:

Q. Earlier on you said that Dr. Hadaway had what you called a strange weighting average that he used to calculate his recommended long-term growth rate of 5.7 percent. Could you state why you characterized that average or the calculation as strange?

A. Well, it's fairly arbitrary. It's -- I believe he keeps on rolling it forward and has a 60-year period, a 50-year period, 40-year period, 30-year period, 20-year period, and then he indicates that he's trying to give more weight to more recent estimates by averaging those, the subsets within there. But by no means does that give weight to what our current economic conditions are.

I believe if you're really trying to project future growth rates, the idea would be to recognize that he wouldn't want to give any more weight to inflationary periods when GDP was 8 to 10 percent due mainly to inflation, high inflation rates. It's fairly widely known that we're expected to be in a low growth, low inflation environment. The capital markets and the security prices for treasuries and treasury inflation protected securities recognize that.

So that's what we're trying to measure, and we're not trying to -- I don't know of any capital market specialists of all the information that I provided and reviewed that advise investors that would do anything similar to what he did. So it is strange.

MR. ZOBRIST: Judge, I may be mistaken, but I don't think other non-parties get -- pardon me, other technically adverse parties get to recross on my cross, I think just Mr. Thompson in light of my cross; isn't that correct? Shouldn't it just be redirect? Because I was the last one to cross.

JUDGE JORDAN: Right. But we had questions from the Bench.

MR. ZOBRIST: I'm sorry. I guess I didn't think Commissioner Kenney had any questions from the Bench.

JUDGE JORDAN: You are correct. Thank you for correcting me. Which leaves us where?

MR. THOMPSON: Redirect.

JUDGE JORDAN: Leads us straight to redirect. I'm sorry. Yeah. Feel free correct me on those issues if I lose track.

MR. BRUDER: I'm not clear. Has counsel said that U.S. Department of Energy may not ask this witness questions or I have asked the question out of the proper order?

JUDGE JORDAN: The latter, and the fault is mine.

MR. BRUDER: Thank you very much.

JUDGE JORDAN: Redirect.
MR. THOMPSON: Why, thank you, Judge.
REDIRECT EXAMINATION BY MR. THOMPSON:
Q. Now, you will recall, Mr. Murray, you were asked some questions about the adjustments, debt adjustments that you've recommended?
A. Yes.
Q. And you were asked about whether you had included a new issue concession fee. Do you recall that?
A. I do.
Q. And could you tell me, did you, in fact, factor in a new issue concession fee?
A. I did. It's in the surrebuttal testimony. After I had an opportunity to review the documents from the board of director materials from Great Plains Energy, I was able to look at what their reoffer yields, proposed reoffer yields would be, which that includes a new issue cost. And so to the extent that we said this is internal company information, to the extent that I relied on internal company information, it does include that.
Q. Okay. And you were asked some questions about your proxy group and Dr. Hadaway's proxy group. Do you recall that?
A. Yes.
Q. And I think that the point was made that

Dr. Hadaway's group was larger than yours?
A. Yes.
Q. Well, to follow up on that, let me ask you, are you satisfied with the proxy group that you used?
A. Yes. And I think just the debate about what companies to include or not to include with this rather large proxy group proposed by Dr. Hadaway illustrates the problems with not doing a little more scrutinizing of the proxy group. I mean, for some time now Staff's obviously aware that Ameren has merchant generation operation issues. That's dragged the credit rating down of Ameren. It has increased the cost of equity to Ameren.
I'm aware of that situation with Edison, I believe it's Edison International. They have a merchant generation subsidiary that is causing significant financial strain to the parent company. These are things that I'm familiar with that I believe that the criteria that I used, that I used in the Ameren Missouri case results in the exclusion of companies that tend to have these problems.
Apparently Dr. Hadaway waits until some earnings analysts I guess finally start to catch up. Apparently they hadn't caught up two years ago because they weren't factoring in the negative growth of Ameren

that most of us have been aware of for two, three years. So I think that calls into question whether or not investors would rely on that because, if they are, they're in serious trouble.

Q. And you were asked about a text by Brigham and Howler -- or Houston. Excuse me.

A. Yes.

Q. Do you recall that?

A. Yes, I do.

Q. And you stated, I believe, that you disagreed with an assertion in that text that dividends from mature entities are likely to grow at GDP?

A. Yes.

Q. Could you explain that disagreement?

A. Yes. There's plenty of financial textbooks that folks cite to. That's just a general theory. I think if you dig a little deeper and look at what the capital market specialist investment analysts do when looking at potential growth for any specific industry, they're not going to rely on some generic GDP growth estimate and assume it's going to occur into perpetuity. Otherwise you're going to have very bad investment decisions.

It's important for the analysts to test theories, whether that means looking at historical growth rates, whether that means looking at the logical arguments for such an argument, whether that means looking to other folks outside the rate of return utility ratemaking arena, I mean, or even internal company information. I believe it's highly confidential, but the internal company information from the board of directors minutes shows that they don't expect a growth rate much -- well --

Q. Don't say the number, please.

A. It's consistent -- lower than mine, lower than my growth rates. This is company information. And so when the company has this information for its own internal financial decisions that's inconsistent with its rate of return witness, I think serious questions need to be asked. And I find this over and over again. The financial consultants hired by these companies have differing opinions with individuals such as Dr. Hadaway.

So when Dr. Hadaway indicates that he's concerned about my qualifications, I'm also concerned about his interest in testing the veracity of his -- of his methodologies. They're just not supported by third-party analysts in the real world. So I'll just -- I'll leave it at that. Thank you.

Q. I wonder if you have an opinion, Mr. Murray, do you expect either Kansas City Power & Light or GMO to grow at GDP in the near future?

A. No, and they don't either.

Q. Now, Mr. Zobrist put a chart up on the screen that showed some averages, averages in earnings per share, book value per share, dividends per share, with respect to the ten companies that you had followed over a period of time. Do you recall that?

A. Yes, I do.

Q. And that chart showed the average GDP at 8.10 percent. Do you recall that?

A. I do.

Q. And you stated that you were surprised to see the contradiction. Do you recall that?

A. I do.

Q. Could you please explain that?

A. Well, if there's theories that are indicated in textbooks and the data does not support those theories, then I think you need to go back to the drawing board. And to the extent that Dr. Hadaway's cost of equity estimates rely almost exclusively on these extremely high GDP growth rates, I think that calls most of his -- the credibility of his cost of equity estimates into question.

These are -- this is what investment analysts do. They look at what is a reasonable, sustainable growth rate, and if actual historical experience during a fairly high growth, high GDP economic growth period of time does not show that electric utility per share growth is anywhere close to GDP growth, then obviously you need to call that theory into question. It's just -- it just doesn't occur. The empirical evidence does not support it.

Q. Now --

JUDGE JORDAN: Counsel, microphone.

MR. THOMPSON: I apologize, Judge.

BY MR. THOMPSON:

Q. Mr. Zobrist I believe asked you whether or not you had looked at data after 1999 with respect to the analysis you did based on Mergent data. Do you recall that question?

A. Yes.

Q. And did you or did you not look at data later than 1999?

A. For the Mergent Public Utility Manual, that just had data going back past 2002/2003. They ceased publishing that data at that point in time. So for purposes of that source, I had no choice but to --

Q. I see. You commented there was something you disregarded because of noise caused by the Enron collapse. Do you recall that?

A. Yes.

Q. Could you explain what it was that you disregarded?

A. Actually, the growth rates were very negative in the periods after 1999, 2000, 2001, 2002. I believe that's why you'll find that cost of equity estimates for electric utility companies started to get quite variable during the past decade because rate of return witnesses were having a hard time picking -- or finding companies that were pure play electric utilities.

It wasn't until after the Enron bankruptcy and, unfortunately, our own utility Aquila realized very significant losses and were on the verge on bankruptcy that some of these companies went back to basics. And now that the companies are -- some companies are back to basics, you can find companies that are more pure play. Great Plains Energy is a perfect example. They had Strategic Energy, which was a nonregulated marketing affiliate. They divested that in 2008. So from this point forward, they should be a, I guess, a good proxy company for estimating cost of equity for a regulated utility.

Portland General Electric is another great example. They were owned by Enron. If you included them in your proxy group when they were owned by Enron, that would have been inappropriate, but now that Enron is no longer around, Portland General Electric is a pure play regulated electric utility, it makes complete sense to evaluate that company.

Q. And when you say pure play, for the laypeople among us, what does that mean?

A. Their operations are predominantly confined to the regulated utility operations, in this case specifically regulated electric utility operations.

Q. Okay. And Mr. Zobrist asked you some questions about page 49 of the Staff Report, about whether or not the industry was in a building cycle or in decline, and you said something about there being severe constraints on the further growth of electric utilities or of the electric utility industry. Do you recall that?

A. Yes.

Q. Could you explain that, please?

A. Well, and I think we just encountered some of the electric utility concerns about their growth in the Ameren Missouri rate case where they're proposing a specific accounting mechanism to try to -- because they say there's -- the projections for growth are not very high. So for whatever reason, it just does not make sense that you would expect a company or an industry that is in its mature stages or even possibly declining load growth to grow at the economic growth rate which is being driven by industries that are coming of age, iPhone, what have you, Microsoft. Those are the companies that are driving economic growth.

And actually I provide a schedule in my direct -- or excuse me -- in the Staff Report on page 48 that shows -- this is data directly from Bureau of Economic Analysis. There's no way I could have manipulated this data. This is data straight from their website on page 48 of my testimony that shows utilities' percentage of contribution to GDP has been declining since the late '80s. So, you know, there's information that completely refutes this theory that's in textbook.

Q. When you say page 48 of your testimony, do you mean page 48 of the Staff Report?

A. Yes, I do. I'm sorry.

Q. That's all right. And then finally, the article by Mr. Kihm about Rethinking ROE, now, did I understand correctly that Mr. Kihm recommended that public utility commissions should set the return on equity higher than the cost of equity?

A. Yes. That's been his general theory. I think he feels like it's important to look at the -- what the financial markets tell us, which is the cost of equity is lower, and -- and think a little bit harder about, you know, whether or not we should just go through and use GDP growth, which is what he was specifically addressing, that comes up -- that allows for upwardly biased cost of equity estimates.

I think he was -- he's trying to dig a little deeper and maybe think about things -- think outside the box, if you will, and recognize that in the real world these are not the cost of equity estimates in utility ratemaking with the various witnesses that have gotten used to their methodologies, that it just really does not -- it's not consistent with what the folks use that actually make investment decisions.

Q. Okay. And do you understand that article, then, as supporting your testimony that cost of equity and return on equity are not necessarily the same thing?

A. Yes.

MR. THOMPSON: And one last thing, Judge, if I could consult for a moment with Mr. Zobrist.

Judge, in Mr. Murray's surrebuttal testimony in the GMO case, but not in the KCPL case, and I could -- so that would be Exhibits 3006 and 3007 there is a Schedule 7, which is a presentation made to the board of directors of Great Plains Energy. Mr. Murray did not have this in time to attach it to the surrebuttal testimony in the KCPL case, although he would have had he had it. And I would like to ask for the Commission to take notice of it and apply it in both cases, even though it's only in his testimony filed in the GMO case.

JUDGE JORDAN: Do I take it that his surrebuttal testimony will provide the foundation for application in both cases?

MR. THOMPSON: Well, it was provided to the board of directors of the entity that owns both companies.

JUDGE JORDAN: I understand.

MR. ZOBRIST: Judge, I told Mr. Thompson that because we're trying these issues in both cases, that frankly anything filed in the GMO docket ought to be considered in KCPL and vice-versa, and I told him I have no objection to that.

Just as a point of clarity in what Dr. Hadaway said, the ROE figures that he quoted for the third quarter of 2012 were only in the GMO surrebuttal because they weren't available similarly when the KCPL surrebuttal was required to be filed. So I would hope that that would also be considered in both cases as well.

MR. THOMPSON: And certainly we would have no objection to that. I make this -- I move this only out of an abundance of caution.

JUDGE JORDAN: Well, that is among the reasons why we have consolidated these cases for hearing.

MR. THOMPSON: Thank you, Judge.

JUDGE JORDAN: Hearing no objection, that document will be admitted into the record.

MR. THOMPSON: Thank you. And I have no further redirect.

JUDGE JORDAN: Okay. Well, I'm going to explain the confusion that my ruling -- the basis for my ruling on Mr. Zobrist's earlier objection, and that is this: Mr. Bruder offered two possible grounds for sustaining the objection. I mentioned the latter, but the former is also correct. The reason is as follows: There is no recross upon cross. There is recross only upon the Bench. We had -- Bench questions. We had direct and so we had cross. We had nothing from the Bench, so we should have no recross, and so we went straight to redirect. So that will conclude the examination of this witness. You may stand down.

May I suggest a break at this point, 10 minutes, 15 minutes?

MR. THOMPSON: Thank you, Judge.

JUDGE JORDAN: Let's resume in 15 minutes.

(A BREAK WAS TAKEN.)

(OPC EXHIBIT NOS. 300, 301 307 AND 308 WERE MARKED FOR IDENTIFICATION.)

JUDGE JORDAN: We are back on the record. We're resuming our testimony on rate of return issues, including return on equity, and while we're doing that, I will mention to anyone watching us on the Internet that I have a proposed order of witnesses filed by Staff that suggests that there will be no testimony either on Wednesday of this week or Thursday of this week. That's the 24th and 25th. On that basis I will most likely issue orders excusing all parties, witnesses, attorneys from appearance on those days.

Anything else before we resume questioning of witnesses? I'm not seeing anything, so let's take up with the next witness.

(Witness sworn.)

MICHAEL GORMAN testified as follows:

DIRECT EXAMINATION BY MS. BAKER:

Q. Good afternoon. Could you please state and spell your name?

A. Name is Michael Gorman, M-i-c-h-a-e-l, G-o-r-m-a-n.

Q. And by whom are you employed?

A. Brubaker & Associates.

Q. Are you the same Michael P. Gorman who filed direct and rebuttal testimony in both the Kansas City Power & Light case and the Kansas City Power & Light GMO case on behalf of the Office of the Public Counsel?

A. Yes. Direct and surrebuttal, yes.

Q. Direct and surrebuttal. Do you have any changes or corrections to your testimony?
A. I do not.
Q. Is the testimony true and accurate to the best of your knowledge and belief?
A. Yes.
Q. And if asked the same questions today, would your answers be essentially the same?
A. They would.
MS. BAKER: I'd like to move for admission of Gorman direct, Gorman rebuttal NP and -- I'm sorry, surrebuttal NP and HC, Gorman -- those two in the Kansas City Power & Light, and then Gorman direct and Gorman rebuttal HC, surrebuttal HC and NP in the Kansas City Power & Light GMO case. They are -- they've been given to the court reporter, and the direct for Kansas City Power & Light is 300. Then there's 301NP and HC for the surrebuttal in Kansas City Power & Light, 307 for the direct and 308NP and 308HC for the surrebuttal in GMO.
JUDGE JORDAN: And to clarify, all these exhibits are either direct or surrebuttal?
MS. BAKER: Yes.
JUDGE JORDAN: I'm hearing no objection, so those documents are admitted into evidence.
(OPC EXHIBIT NO. 300, 301, 307 AND 308 WERE

RECEIVED INTO EVIDENCE.)

MS. BAKER: And I would tender the witness for questions.

JUDGE JORDAN: Any cross-examination from the Department of Energy?

MR. BRUDER: None, your Honor. Thank you.

JUDGE JORDAN: Anything from the Air Force or other Federal Executive Agencies?

CAPTAIN MILLER: No, your Honor.

JUDGE JORDAN: Staff?

MR. THOMPSON: No, thank you, Judge

JUDGE JORDAN: From GMO or KCPL?

MR. ZOBRIST: Thank you, Judge. I have a few questions for Mr. Gorman.

CROSS-EXAMINATION BY MR. ZOBRIST:

Q. Good afternoon.

A. Good afternoon.

Q. I want to ask you some questions about the proxy group issue. You initially accepted Dr. Hadaway's proxy group in your direct except for the Ameren company which you eliminated; is that correct?

A. Yes.

Q. And then when Dr. Hadaway filed his rebuttal and you responded in surrebuttal, you had an issue with the company's -- the other three companies that he deleted, Edison International, Clico and Vectren, and the three companies that he added, CMS Energy, Integrys Energy and UNS Energy; is that correct?

A. Well, no, that's not correct. What I did was criticize his interpretation of the DCF results based on the proxy group companies. I didn't specifically challenge his revised proxy group.

Q. All right. So that was going to be my question. You do not disagree with Dr. Hadaway that the three new companies that he added met the criteria; is that correct?

A. That is correct.

Q. And Dr. Hadaway when he eliminated certain companies did not eliminate all the low earning companies such as the IDACORP and the Xcel companies from his proxy group; is that correct?

A. Well, I haven't verified that specifically. That's my understanding of his testimony earlier, but I did not verify that.

Q. Now, when you filed your surrebuttal, you eliminated from your DCF analysis two companies at the higher end, Hawaiian Electric Industries and Great Plains Energy; is that correct?

A. Well, not -- no, it's really not. I did not eliminate any companies from the proxy group. I took issue with Dr. Hadaway's proposal to eliminate low lying estimates in interpreting the results of the proxy group but then not also eliminating high interest estimates from the same proxy group.

So my issue with what Dr. Hadaway did is he was skewing the interpretation of the results of the proxy group, not that it was modifying the proxy group to eliminate additional companies.

Q. You agree that Ameren no longer met the criteria and so you dropped it, correct?

A. It is not in my proxy group, that is correct.

Q. Well, and did you eliminate it because it didn't meet the criteria in Hadaway's proxy group?

A. It didn't meet the test I employed to develop an appropriate proxy group. I didn't simply accept Dr. Hadaway's proxy group. I reviewed it to determine whether or not I thought it was an appropriate proxy group, because in my experience, generally if you have a proxy group that reasonably approximates the investment risk of the subject company, then the proxy group's not much of an issue.

So in order to minimize the issues I was going to take with Dr. Hadaway, I attempted to see whether or not the proxy group he used was a reasonable proxy group to estimate a fair rate of return for KCP&L and KCP&L GMO in this case.

Q. But you eliminated Ameren on your own when you filed your direct?

A. I did.

Q. You did not eliminate Clico, Edison International or Vectren; is that correct?

A. It is.

Q. Did you conduct an analysis to see whether they continued to meet either your criteria or Hadaway's criteria?

A. I believe those companies still met my criteria for inclusion in the proxy group.

Q. Did you look at Dr. Hadaway's criteria and confirm whether or not they no longer met his criteria?

A. Well, his criteria for Clico, with Edison International was more subjective than what he employed in his original analysis. He essentially suggested that Clico was under study for potential merger and acquisition, and that was not part of his original proxy group criteria. Originally a company would be eliminated if it was actually involved in a merger or acquisition activity and not simply that it was suspected of being a target of a merger or acquisition. That's too subjective.

Edison International concern about the

merchant generation activity is valid, but Edison International has significant regulated operations, and I thought it was appropriate for inclusion.

Q. Dr. Hadaway eliminated Ameren later on and agreed with your eliminating Ameren; is that correct?

A. Yes.

Q. Why did you eliminate Ameren?

A. Because of the reduction in the dividend.

Q. Now, isn't it true that one of Dr. Hadaway's policy group criteria was that it needed to have consistent financial records not affected by recent mergers or restructuring?

A. Yes.

Q. And one of his other criteria were -- was that it -- that the utility derive at least 70 percent of its revenue from regulated utility sales, correct?

A. Yes.

Q. Did you determine whether he properly eliminated Vectren from his proxy group because its level of revenue from regulated operations fell below 70 percent?

A. I didn't validate that in his rebuttal. That's a standard review, and he's relying on published documents for that -- that metric, but I didn't validate whether or not they no longer met that criteria.

Q. Now, even with the changes in Dr. Hadaway's proxy group, his ROE range did decline from 9.9 to 10.4 percent to a new range of 9.8 to 10.3 percent; is that correct?

A. Yes.

Q. Now, you did not accept Mr. Murray's ten company proxy group; is that fair to say?

A. I didn't rely on it. I didn't specifically take issue with it either.

Q. Now, in your recommended ROE range of 9.1 to 9.5 percent, is it fair to say that you did not consider your CAPM analysis in coming to that recommended range?

A. Well, I considered it, but it did not play A significant role in my developing my recommended range.

Q. And the CAPM result was 8.40 percent; is that correct?

A. That sounds correct, yes.

Q. So you based your range on the risk premium of 9.10 percent and your DCF analysis of 9.5 percent; is that correct?

A. That is correct.

Q. And your recommendation to the Commission at the end of your surrebuttal was a return on equity of 9.4 percent; is that correct?

A. Well, based on my revisions and corrections to Dr. Hadaway's analysis, I found that his study would support a return on equity in the range of 9.3 to 9.5 percent. I did not intend to substitute my critique of his analysis in his rebuttal testimony for my analysis offered in my direct testimony. I think his -- the results of proper adjustments to his analysis falls within my recommended range.

Q. Well, your -- but your final recommendation in your surrebuttal was 9.4 percent, correct?

A. Based on my update and revisions to Dr. Hadaway's analysis, it is, yes.

Q. Now, let me just ask you to turn your attention please to the multistage growth analysis that you did. You had three growth rates that you used in each of the stages, if I understand this correctly, the first stage, the second stage and the third stage, correct?

A. Yes.

Q. And the first stage -- this is around page 25 of your direct testimony.

A. Okay.

Q. The first stage growth rate was 5.14 percent; is that correct?

A. It was the average of the analyst projected growth rates for the companies in the proxy group.

Q. And then for the years six through ten, you used a rate for each of those years that ranged between 4.94 percent and 5.10 percent; is that correct?

A. Essentially the transitional stage growth was the growth rate which would transition from the short-term growth rate in year -- from year 6 up through the long-term growth rate which started in year 11. So that second stage growth would actually change from year to year.

Q. Right. Right. And those -- those figures were lower than the first stage growth which was 5.14 percent. We go from 5.14 percent then to your five figures that range from 4.94 to 5.10, correct?

A. That's true. For the proxy group average, it was a decline from 5.14 percent down to 4.9 percent.

Q. And then in the third stage of the growth term, the longer term, you arrived at an even lower growth rate of 4.9 percent, correct?

A. Yes, the long-term steady state growth rate.

Q. So you're projecting decreased growth in the future; is that correct?

A. Relative to the next five and ten years, yes.

Q. Now, the projections that you used from the blue chip financial forecasts are only for five-year and ten-year periods; is that correct?

A. It is. They are.

Q. And so they don't project anything further into the future even though the DCF model is a long-term model; is that correct?

A. Yeah. That's the longest consensus economists published projection of long-term GDP growth rates.

Q. Now, you agree, and I believe you state this in your direct testimony, we're on page 26, that nominal GDP, which is real GDP plus inflation, that that's the most general measure of economic growth in the United States?

A. Well, I wouldn't say it quite like that. I mean, the issue with the long-term DCF analysis is long-term steady state growth rate really isn't -- can't be easily measured. So the most common proxy used for assessing what the long-term steady state growth rate for a mature company can be is equal to a long-term projection of the U.S. GDP growth rate. That's generally consistent with the academic literature. It's generally consistent with the investment practitioners' reports, and it's largely in my view an accepted outlook.

Q. And at the bottom of page 26, I believe, you quote the Brigham and Houston text Fundamentals of Financial Management; is that correct?

A. It is.

Q. And you believe that's an authoritative source?

A. I do.

Q. Now, do you recall the next sentence after the passage that you quoted that gave ranges of average or normal growth for mature companies?

A. I believe -- I don't have the exact words, but at the time of this publication, the GDP growth rate was around 8 percent.

Q. And they gave a range of 5 to 8 percent; is that correct?

A. That sounds correct, yes.

Q. Do you think that's still accurate today?

A. Well, the concept of reflecting the market's outlook for nominal GDP growth is accurate, but the nominal GDP growth referenced by those authors was based on the time period that they were looking at. So at that time, a 5 to 8 percent GDP growth rate was assumably reasonable. I haven't verified that. But it's not reasonable today.

Q. Now, let me ask you a couple questions about your risk premium analysis. You took U.S.

government bond equity risk premiums and then you took utility bond risk premiums; is that correct?

A. Yes.

Q. And without going into all the math, when you completed your calculation, you used a weighting mechanism, w-e-i-g-h-t-i-n-g, a weighting mechanism coming to your final calculations; is that correct?

A. Well, coming to the point estimate that I thought was an appropriate equity risk premium to use to estimate a fair return in the current marketplace.

Q. And I believe what you say at page 33 of direct is you gave a two-thirds weight to the high end risk premium and a lower one-third rate to the lower end of the risk premium; is that correct?

A. Yes.

Q. And you stated you made that adjustment because of the unusually large spreads between treasury bonds and utility bonds?

A. Yes.

Q. Now, you did not make any adjustment for the inverse relationship that Dr. Hadaway talks about between equity risk premiums and interest rates; isn't that correct?

A. I didn't make a separate adjustment for that, but I believe making an adjustment on that factor alone is incomplete and results in an unreliable market risk premium. My methodology instead relies on a measure of perceived investment risk of the industry relative to corporates and treasury securities.

I believe that the concept of estimating an appropriate equity risk premium is based on the market's perception of relative risk of the utility industry versus alternative investments and not simply on the current level of nominal interest rates. That's one factor, but it's simply not the only factor that goes into determining appropriate equity risk premium.

Q. So to contrast what you did with what Dr. Hadaway did, he made an adjustment for this inverse relationship through a standard regression analysis to calculate an interest rate adjustment factor and you did not; is that fair to say?

A. He made an adjustment to estimate an appropriate equity risk premium considering only changes to interest rates and to use that regression analysis. I attempted to use a methodology that gauged relative -- relative assessments of risk of equity versus bond investments. Part of that risk considered current levels of interest rates. Part of that risk assessment considered spreads, the utility interest rates to treasuries. Part of that assessment considered spreads of single A rated utility bonds to be AA rated utility bonds. All of that helped to gauge the current market demand for higher premiums to assume higher levels of investment risk.

Q. Well, Mr. Gorman, you know, Ms. Baker can ask you about that more on redirect or recross or whatever it's going be -- now I'm confused, Judge -- but I just want to contrast what you did and what Hadaway did.

Dr. Hadaway did this adjustment through a standard regression analysis because of this inverse relationship, and you didn't do it, but you did something else; is that what you're telling the Commission?

A. The problem that I'm having is you're suggesting I didn't consider changes in interest rates at all, and that's simply not accurate.

Q. I'm not doing that. What I'm asking simply is, did you conduct, like Dr. Hadaway, a standard regression analysis to calculate an interest rate adjustment factor, yes or no?

A. I did not use Dr. Hadaway's regression analysis, no.

Q. Now, we've had a lot of discussion this morning and this afternoon about the intervention of the Treasury Department, the intervention of the Federal Reserve Board through the Quantitative Easing process and through the Operation Twist. Do you believe that those steps taken by the Fed in particular have created any economic distortions with regard to the current economic interest rates and other factors that we're seeing?

A. I think they have brought down Treasury interest rates in particular and likely corporate and utility yields as well, and that is one of the main reasons why I didn't give weight to the CAPM results in formulating my recommended return on equity range.

Q. And would you agree that that causes a degree of economic distortion in these rates because of the intervention of the Fed?

A. I think it makes it more difficult to rely on bond yields alone to estimate an appropriate return on equity, but that's not what I did. The --

Q. I'm just asking you -- my question is, do you believe that the actions taken by the Fed have caused economic distortions in the market and has distorted the allocation of capital in the market?

A. I think they have certainly worked to reduce the interest rates on long-term fixed income securities.

Q. This is only a one-page exhibit, so I don't have to worry about the copy machine.

(KCPL EXHIBIT NO. 58 WAS MARKED FOR

IDENTIFICATION BY THE REPORTER.)
BY MR. ZOBRIST:
Q. Mr. Gorman, I've handed you what I've marked as Exhibit 58. It's an article from the Kansas City Star that's quoting a speech by Thomas Hoenig, H-o-e-n-i-g, the former president of the Kansas City Federal Reserve Bank and now director of the Federal Deposit Insurance Corporation, and invite your attention to the second paragraph. He states, low interest rates distort the market, distort the allocation of capital. Do you agree or disagree with that statement?
A. Well, I would need time to get a better sense of what he means by distort the allocation of capital, but if he is coming to the conclusion that current observable interest rates are caused by market factors alone, then I agree. I think that the -- the market actions for the different levels of risky securities might be different if not for Federal Reserve actions.
Q. And you yourself did not make an explicit adjustment for these policies of the Federal Government intervening in the money markets, so to speak?
A. No, sir. I did consider all the factors going on in the market today. If you look at my analysis, you'll see that I was quite conservative in interpreting

the results of my DCF and risk premium studies. I disregarded completely my CAPM study. So I was fully aware of the -- the implications of what's going on in the current marketplace in forming what I believe to be a balanced return on equity recommendation.

Q. Isn't it true what none of the experts in this case are relying upon a CAPM model analysis?

A. There's reasons for that, but that is true.

Q. Just a few more questions, and I'm going to shift to cost of debt. Mr. Murray in his rebuttal says that you and Dr. Hadaway should not have accepted the cost of debt on the company's debt instruments. Am I correct that you did not propose any adjustments to any of the GPE debt or the KCP&L debt instruments in this case?

A. That is correct.

Q. And in your surrebuttal, you did not respond to Mr. Murray's criticisms?

A. Correct.

Q. Now, Mr. Murray criticizes your use of long-term perpetual growth rates of 4.85 percent to 5.14 percent, and if you recall, Mr. Murray proposes 3 and a half percent. Does that sound correct?

A. I'd have to double check his number, but he did criticize my long-term growth rate.

Q. And he also criticized the weighting that

you did in the risk premium analysis. Do you recall that?
A. Yes.
Q. And he said it was arbitrary; is that correct?
A. Well, there is judgment involved in it, but I think that judgment is fully supported based on the risk spreads that I considered in giving more weight to the higher risk premiums in this case than I normally would.
Q. And you didn't respond to Mr. Murray in your surrebuttal, did you?
A. I did not.
Q. Now, Mr. Murray also disagreed with your use of A rated utility bonds in your risk premium analysis and says you should have used Baa rated bonds. Do you recall that?
A. I do.
Q. And I take it you disagree with Mr. Murray's criticism in that regard?
A. Well, I do. His -- over time the average bond rating for the utilities in the study was A. So to properly gauge the additional authorized return premium those utilities got over their contemporary bond yield, I had to use a bond yield that reflected the industry in general over that historical time period. After I then estimated that equity risk premium, I applied it to a bond

yield that reflected the investment risk of the subject company.

Q. Now, Staff noted that the Kansas Citizens Utility Ratepayer Board expert had recommended 8.5 percent in the KCPL rate case pending before the Kansas Corporation Commission. Do you recall that?

A. Yes.

Q. And you did not make any adjustment in your analysis as a result of that, did you?

A. I believe my recommendation is fairly strongly supported in a reasonable recommendation.

Q. So you did not revise your testimony based on KURB's expert witness J. Randall Wooldridge, did you?

A. No.

MR. ZOBRIST: That's all I have, Judge. Thank you. I'm going to move the admission of Exhibit 58, please.

JUDGE JORDAN: I'm not hearing any objection, so I will enter that exhibit into the record.

(KCPL EXHIBIT NO. 58 WAS RECEIVED INTO EVIDENCE.)

JUDGE JORDAN: I'm going to take just a moment here before we continue with our order. I'm going to read something that I received that has come from facilities operations. The Division of Facilities

Management Design and Construction will be posting signs throughout the buildings that are affected by the boil advisory issued today by Missouri American Water. With that, please do not drink the water at any posted location. In addition, please plan to bring your own drinking water until the boil advisory has been lifted. All water will be safe for use only when washing hands and using restrooms. Thank you for your patience and cooperation. If you have any concerns regarding water supply in your facility, please contact our office, and there's a phone number here.

And we have just concluded cross-examination. Are there any questions from the Bench?

COMMISSIONER STOLL: I have no questions, your Honor.

JUDGE JORDAN: And since we had no Bench questions, we will not have recross, but we will have redirect since we had cross.

MS. BAKER: Thank you.

REDIRECT EXAMINATION BY MS. BAKER:

Q. Mr. Gorman, you realize there's a little bit of confusion between your surrebuttal testimony and your direct testimony as to what your actual recommendation is in this case?

A. Yes.

Q. Can you explain a little bit of what your recommendation is and what your surrebuttal was meant to reflect?

A. My recommendation is outlined in my direct testimony. My recommended return on equity range is 9.1 to 9.5 percent, and it's based on the DCF risk premium and consideration of the CAPM studies as outlined in my direct testimony.

In my surrebuttal testimony, I found certain flaws and errors in Dr. Hadaway's comments on my direct testimony analysis. In my surrebuttal testimony, I responded to his method of revising my return on equity recommendations and showed where he skewed the results upward, in my opinion, and had he implemented the same type of procedure on that analysis in a more symmetrical and balanced way, that his adjustments would not have created a material change in my recommended return on equity.

Indeed, revising Dr. Hadaway's revisions to my direct case return on equity studies would support a return on equity in the range of 9.3 percent to 9.5 percent, which is within my recommended return on equity of 9.1 percent to 9.5 percent.

So my surrebuttal testimony was responding to Dr. Hadaway's comments and proposed revisions and modifications to my direct testimony. It was not intended to be a substitute for the analyses offered in my direct testimony.

Q. Mr. Zobrist had several questions based on making adjustments due to interest rates, and you were trying to talk about how you worked in the perception of investment risk. Can you explain exactly how you dealt with that given that you did not do the regression analysis that Mr. Zobrist tried to make you say that you didn't do?

A. Yeah. This deals with the risk premium methodology, and there's various methodologies that one could use to properly gauge what an appropriate equity market risk premium is in the current marketplace.

Dr. Hadaway in his analysis simply looks at changes to nominal interest rates. While that's one factor that helps gauge an appropriate risk premium, I believe it's fundamentally incomplete because it doesn't consider changes in investments risk. It also does not consider changes in nominal interest rates which may not change the level of equity risk premiums.

As an example, nominal interest rates can decline if perceived future levels of inflation decline. Inflation rates are built into the expected return on equity and the expected return on debt. If nothing else changes but the outlook for future inflation declines, then interest rates could decline and the equity risk premium wouldn't change at all.

Academic research indicates that equity risk premium changes when the market's perceived level of investment risk for an equity security changes in relationship to the market's perceived level of investment risk for a debt security. One factor that changes that perceived level of risk is changes to interest rates, but it's also many other factors that are unrelated to changes to interest rates but nevertheless affect that investment risk characteristics.

So Dr. Hadaway's analysis I think was a single factor method for trying to gauge an appropriate equity risk premium. I think that's flawed. I don't think it considers changes in other factors that change levels of investment interest rates and change the equity risk premium.

In my analysis, I looked at changes in interest rates. I looked at changes in spreads between treasuries and utilities, between single A and AA utilities and between utilities and corporate bonds to help gauge the level of investment risk assessments of the market for utility securities currently relative to other market instruments to help gauge what an appropriate risk premium is.

Therefore, I think my analysis is more complete because it's directed at market assessments of risk changes rather than simply changes in nominal interest rates.

Q. And some of the questions that also were based off of the interest rates were federal intervention and whether you had taken that into account, and you talked a little bit about economic distortion and disregarding your CAPM analysis. Can you explain a little bit more about that?

A. The idea was whether or not I considered whether or not there are factors in the market created by the Federal Reserve which are impacting capital market costs. My answer to that was yes, I did consider those distortions. As an example, I point to my capital asset pricing model which produced a return well below 9 percent, and the reason I didn't give considerable weight to that analysis is because of the relatively low level of treasury bond securities relative to corporate and utility bond yields. That yield spread is quite wide right now, but in that model, the CAPM model, the market risk premium is at more of a normalized level when all other indications that the risk premium should be at an above average level at this point.

So I think the CAPM analysis right now is not capturing a market risk premium that coincides with a relatively low treasury bond yield. So I think the result is a return on equity estimate that I'm not comfortable including within my recommended range.

I also considered the spread between treasury securities, utility bond securities and corporate bond securities in helping to gauge where the market risk premium is for these relative different levels of investment risk. And based on that assessment, I recommended in this case to go closer to the high end of my recommended equity risk premium range in this case when normally I would be somewhat closer to the middle of that range. The reason I did that in this case is because of a lot of the distortions in the spreads we're seeing in the marketplace, and all those factors are being determined by the market based on all market players, including the Federal Reserve right now.

So all of that was considered by me in assessing what an appropriate return on equity range and a point estimate is in this case.

MS. BAKER: I have no further questions. Thank you.

JUDGE JORDAN: Well, that completes the

examination of this witness. You may stand down. Next witness.

MR. BRUDER: The U.S. Department of Energy calls Mr. Matthew Kahal.

JUDGE JORDAN: Mr. Kahal, can you hear us all right?

THE WITNESS: Yes, I can.

JUDGE JORDAN: Very good. I will ask you to raise your right hand from your remote location.

THE WITNESS: It's raised.

(Witness sworn.)

JUDGE JORDAN: Thank you. You may proceed, counsel.

MR. BRUDER: Thank you, sir.

MATTHEW KAHAL testified as follows:

DIRECT EXAMINATION BY MR. BRUDER:

Q. Mr. Kahal, I have before me two documents. I presume you have the same two before you. The first is titled direct testimony of Matthew I. Kahal in Case No. ER-2012-0174. It is dated August 2nd, 2012. The second is titled rebuttal testimony of Matthew I. Kahal. It is dated October 8th, 2012, with the same docket number. I ask you now, are these your testimonies, the testimonies that you have filed in this proceeding?

A. Yes, they are.

Q. And are they, to the best of your knowledge, true and correct?

A. Yes, they are. I do have one typographical correction to make.

Q. Okay. Would you please do that?

A. Yes. The correction is on page -- excuse me. This is in the direct testimony, page 31 of the direct testimony. There's a little chart near the top. It starts at line 3. There's a row that shows numbers for the time periods 2019 to 2023, and that's shown as equal to 4.7, and then in parens there it says "range: 4.1 to 4.7." That should read "range: 4.1 to 5.4."

Q. Okay.

A. So the 4.7 should be -- that's within the parenthesis 5.4, which is the upper end of the range.

Q. Okay. Thank you.

A. And that's the only correction that I have.

Q. Okay. Thank you. Now, if I were to ask you here today the same questions as are set out in these documents, would your answers be the same as those that are set out in those documents?

A. Yes.

MR. BRUDER: Okay. I ask then that these two documents be marked US DOE Exhibits 550 and 551 respectively, and I do tender this witness for cross-examination.

JUDGE JORDAN: Hearing no objections, those exhibits are admitted into the record.

(DOE EXHIBIT NOS. 550 AND 551 WERE RECEIVED INTO EVIDENCE.)

MR. BRUDER: Thank you.

JUDGE JORDAN: Any cross-examination from the Air Force or related Federal Executive Agencies?

CAPTAIN MILLER: No, your Honor.

JUDGE JORDAN: Cross-examination from Staff?

MR. THOMPSON: None, thank you.

JUDGE JORDAN: Cross-examination from the Office of Public Counsel?

MS. BAKER: Thank you. Just a couple of questions.

CROSS-EXAMINATION BY MS. BAKER:

Q. Good afternoon, Mr. Kahal.

A. Good afternoon.

Q. Your recommendation in this case is a maximum of 9.5 percent ROE; is that correct?

A. 9.5 percent is my recommendation for return on equity. That's for both companies, yes.

Q. Okay. Did you develop a range for this particular case?

A. Yes. My estimated cost of equity range is 8.8 to 9.8 percent.

Q. And is it your opinion that anywhere within that range is a reasonable ROE --

A. Yes.

Q. -- for Kansas City Power & Light?

A. Yes. I think a number closer towards the middle is probably more appropriate than either of the extreme upper or lower bounds, but that's the reasonable range.

Q. Do you believe that the company's growth rate is a reasonable number?

A. I'm sorry. Which growth rate are you referring to?

Q. The 5.7 percent growth rate that's been discussed earlier.

A. Oh, as a -- as an expectation of investors, it's not, no. I don't believe there's any evidence -- any credible evidence really that supports that. In fact, all of the projections that I've looked at come in considerably lower than that.

Q. In your research, have you found that the capital market costs are lower now than in Kansas City Power & Light and GMO's last rate case?

A. Yes. That was -- those were decided in the second quarter of 2011. Clearly capital costs have declined by a fairly significant amount since that time.

Q. And also in your research, you found that the bond yields have also declined?

A. Yes, bond yields have declined. I show that on my Schedule MIK-2.

Q. And, therefore, does it surprise you that the ROE awards throughout the country have also declined?

A. ROE awards have declined. I think you have to be a little bit careful when you're looking at the ROE awards that are cited in some of these surveys because there's something called regulatory lag. As we look at some of these 2012 awards, they actually may reflect 2011 rate cases.

MS. BAKER: Okay. That's all the questions I have. Thank you.

JUDGE JORDAN: Questions from GMO or KCPL?

MR. ZOBRIST: Thank you, Judge.

CROSS-EXAMINATION BY MR. ZOBRIST:

Q. Mr. Kahal, can you hear me?

A. Yes, sir, I can.

Q. This is Karl Zobrist, and I'll be asking you some questions on behalf of the companies. My first topic just relates to the capital structure of the company. Am I correct that you have made no adjustments to any of the GPE or the other utility companies' debt issuances?

A. That's right. I've not -- I haven't proposed any changes to the company's embedded cost of debt.

Q. So you have accepted the interest rates on each of the issues that are in the company's consolidated capital structure?

A. Yeah. As I indicated in my testimony, I wasn't trying to necessarily validate it, but there's just nothing there that I'm proposing to change.

Q. And I believe Mr. Murray had some criticisms about your failure to respond -- pardon me. Mr. Murray had some criticisms in his rebuttal at pages 25 and 26 with regard to the debt issues, and you did not respond to his criticisms in your surrebuttal; is that correct?

A. That's right.

Q. Now, let me move on to the return on equity analysis. Am I correct that you did not make any explicit adjustments for the economic distortions or interventions that have been caused by the Federal Reserve Board?

A. I don't know what distortions you're referring. I -- I don't think that there are distortions. I think that the Federal Reserve has its -- do its undertaking and statutory responsibility that it's been given to conduct monetary policy, just as it always does, and it's -- the Federal Reserve is simply part of capital markets. I've heard some discussion about the distortions, but I haven't seen any evidence of distortions.

Q. Would you not agree that current interest rates are extraordinarily low as a result of the Federal Reserve Board's policies?

A. No. The Federal Reserve policies I think have had some effect on interest rates. I think that even without Federal Reserve action interest rates would still be very, very low. And I had a fairly lengthy discussion of that in my testimony. The Federal Reserve is simply one influence among many influences on market interest rates. The other influences happen to be the extremely low rate of inflation and the outlook for low inflation, the flight to quality problem -- or not problem, but the flight to quality phenomenon that's going on now, and simply the fact that we have sluggish -- a sluggish economy which means a low demand for capital.

So the Federal Reserve is part of that, but there would be extraordinarily low capital cost and interest rates even without the Federal Reserve's Quantitative Easing program.

Q. Would you turn please to page 9 of your direct testimony.
A. Yes.
Q. On page 7, didn't you state, quote, these extraordinarily low rates, paren, which are also reflected in non-Treasury debt instruments, close paren, are the result of an intentional policy of the Federal Reserve board of governors, paren, the Fed, close paren, to make liquidity available to the U.S. economy and to promote economic activity, close quote?
A. Yes, and that's a reference to --
Q. Sir, my question -- there's no question. Did I quote that correctly?
A. Yes, you did.
Q. And you use the term extraordinarily low interest rates, correct?
A. Yes, and I --
Q. Thank you.
A. -- I -- in my quotation I was --
Q. I'm not asking you anything further, sir. You've got another lawyer here, and he can have some further questions.
MR. BRUDER: Well, he's given the yes or no answer that was required. I think it's fair to, witness having done that, to permit him to amplify his answer.

MR. ZOBRIST: I just wanted to make sure the quote was accurate because the witness initially denied using the term extraordinarily low interest rates, Judge.

JUDGE JORDAN: Right. And that question's been answered, and you will be getting redirect.

MR. BRUDER: Thank you.

BY MR. ZOBRIST:

Q. Now, Mr. Kahal, am I correct that you did a CAPM analysis but you did not rely upon it?

A. I used it only as a check. I didn't rely upon it to develop my recommendation. I used it as a check just to ensure that my DCF was not understating the cost of equity. So it's not -- the CAPM is not the basis of my recommendation.

Q. And I believe at page 7, line 14 of your direct testimony, you said it was much less useful than the DCF method; is that correct?

A. Yes.

Q. Now, initially you accepted Dr. Hadaway's 22 company proxy group; is that correct?

A. That's correct.

Q. Now, after Dr. Hadaway filed rebuttal -- filed his rebuttal and removed four companies, which were Ameren, Clico, Edison International and actually a fourth

company Vectren, do you recall that generally?
A. I do.
Q. Okay. Now, you removed some companies; is that correct?
A. No. In terms of developing my DCF and my recommendation, no. That was simply a discussion that attempted to put what Dr. Hadaway did in perspective. I simply said, look, if you're going to remove the low numbers, then it may also make sense to remove the unusually high numbers, and if you did this, this is what the result would be. I didn't make any adjustments to the group for purposes of any sort of recommendation or presentation of results.
Q. Did you determine whether the companies that Dr. Hadaway eliminated from his proxy group failed to meet the criteria that he used in his direct testimony in February?
A. I'm sorry. That he removed?
Q. Right. In other words, did you --
A. The only one that I recall that he removed because it didn't meet the criteria I think was Vectren. The -- it may have been Ameren, too, but I had a problem with Ameren as well. But the other two, as I recall, Edison International and Clico Corporation, I believe he had -- oh, he -- he had certain problems with them, but I

don't think he said that they failed his criteria.
Q. Did you determine whether the three companies that he added, CMS Energy, Integrys and UNS Energy, whether they met Dr. Hadaway's criteria?
A. No. I didn't check his math. I just took his word for it that he -- that they met his criteria.
Q. And isn't it true that among the companies that remained in the proxy group, IDACORP, which is the holding company for Idaho Power, and Xcel Energy, that they were not removed?
A. IDACORP and Xcel were not removed.
Q. And they were among the lowest growth companies in the proxy group, were they not?
A. I'm sorry. Are you referring to his direct testimony or his rebuttal?
Q. Actually, both, because they remained in the proxy group in rebuttal.
A. Actually, can you give me just a second? I can verify that if you like.
Q. Sure. The schedule is SCH-5, if you need a point of referral.
A. I'm looking at his rebuttal. Xcel is 9.2, a little bit lower than the group average, and IDACORP is 7 -- I think it's 7.1. So yes, those two have lower than average DCF returns.

Q. Now, did you conduct any examination of Mr. Murray on behalf of Staff, his proxy group?
A. I mean, I read his testimony, but I didn't do any analysis of his proxy group.
Q. I believe that you stated in your direct around page 17 that you endorsed the use of appropriate and robust proxy groups; is that a fair statement?
A. Yes.
Q. By robust, do you mean more companies rather than fewer companies?
A. All else equal, more is better than less.
Q. And you talk about data anomalies, and you refer to them as having noise, and that fluctuations in stock price or other data that cannot be readily accounted for in a simple DCF study, that those kind of companies with that kind of -- exhibiting that kind of behavior should be carefully scrutinized?
A. Yes.
Q. You have criticized Dr. Hadaway's growth analysis, and I'm referring, sir, to your surrebuttal around page 9, and you stated that Dr. Hadaway cited no evidence of higher interest rates. Do you recall that?
A. I'm sorry. Can you give me the cite again?
Q. Sure. Surrebuttal testimony, page 9, around line 23.

A. That's correct. I stated that he does not demonstrate that the low capital cost environment is temporary and will soon go away.

Q. I was interpreting that to mean that you were pointing out that Dr. Hadaway did not point to any evidence of projections of increased interest rates. Did Dr. Hadaway cite projections of increased interest rates that you recall?

A. He is -- he does have a projection of higher interest rates, a little bit higher anyway in his -- in his risk premium analysis, that is he -- he does his risk premium analysis based upon current interest rates and projected -- and the projected -- I forget how much they are. They're about 20 or 30 basis points higher.

Q. Sir, if I could -- do you have Dr. Hadaway's rebuttal there?

A. Yes, I do.

Q. If you could turn to Schedule 8, page 2 of 2. It's labeled economic indicators. It's from the S&P Trends and Projections publication.

A. I've got that.

Q. If we look at the box, I call it a box, that's second from the bottom that says prices and interest rates. Do you see that, sir?

A. Yes.
Q. If we look at, for example, ten-year Treasury notes, it does indicate an estimate for 2012 of 1.8 percent and an increased estimate for 2013 of 2.2 percent; is that correct? It's actually in the second and third columns there.
A. I'm sorry. It's -- are you referring to, let's see, ten-year Treasury notes, and it's going from what to what?
Q. The second column says E2012. The third column says E2013, right?
A. Oh, I'm sorry. I was looking at the quarterly data. You want to use the annual?
Q. Right. I was just using column 2 and column 3.
A. Sure. Okay. Yeah. It goes from 1.8 to 2.2.
Q. And the 30-year Treasury bonds are moving through these projections from 2.9 to 3.2?
A. That's correct. That's an increase of about 3/10 of a percent.
Q. And then the new issue rate corporate bonds is moving from 3.8 percent to 4.0 percent?
A. That's correct. It's about 2/10 of 1 percent change.

MR. ZOBRIST: Judge, those are all the questions I have. Thank you, sir.

JUDGE JORDAN: Questions from the Bench?

COMMISSIONER STOLL: I have no questions, your Honor. Thank you, Mr. Kahal, for your testimony.

THE WITNESS: Thank you.

JUDGE JORDAN: And redirect?

MR. BRUDER: A couple, if I may.

REDIRECT EXAMINATION BY MR. BRUDER:

Q. There was some discussion of your redirect at page 9. Let's look at that.

A. Yes. I recall that.

Q. When you made the comment that you made there, were you describing interest rates in general or were you describing only short-term Treasury rates?

A. No. The quotation that was cited to me referred only to short-term rates, that is the short-term Treasury rates and similar types of instruments.

The larger point that I was making with regard to capital costs in general and interest rates where the Fed is only one factor and influencing interest rates and that there are multiple forces at work in the economy and in financial markets that lead to very low capital cost and very low interest rates, that was a reference to long-term interest rates.

So the comment in the first two sentences on page 9 beginning at line 6, that was strictly a reference to short-term interest rates. The short-term interest rates were really not used for any purpose in developing my cost of capital recommendation.

Q. Okay. Thank you. I don't have a transcript, of course, yet, but I believe I understood Dr. Hadaway to have testified earlier that a certain authority, it sounded like Ibbotson, has in fact put forward or adopted his 5.7 percent growth rate. Were you online possibly and listening when he so testified, Mr. Kahal?

A. I don't recall that specific testimony about what Ibbotson endorsed.

Q. Do you know from your own researches and efforts whether Ibbotson endorsed a 5.7 percent growth rate?

A. No, I have not. You're talking about the growth rate in U.S. gross domestic product?

Q. Correct.

A. No, I had not heard that he had endorsed any specific measure of U.S. GDP. All I know is that 5.7 percent is way out of line with the consensus of expert forecasters. It's way too high.

Q. Is the character of Ibbotson such that it would have endorsed or put forward any growth rate? Is that something that it does?

A. Yes. Ibbotson is an analyst who's published quite a bit, and he's worked quite a bit with historical data. What he's best known for is his work on the risk premium in which he's developed estimates of the risk premium based upon long-term returns on securities such as stocks and bonds. So he works with long-term historical trend data quite a bit. In what context he may have endorsed the 5.7, I just have no idea.

Q. Okay. Thank you. An earlier witness, Mr. Murray, testified that Dr. Hadaway presented what he referred to as a strange weighting average. That is a description, of course, of his weighting average where he uses a 10-year period, a 20-year period and so on and weights them in certain ways. Would you characterize this, as Mr. Murray did, as strange?

A. No. I wouldn't use the word strange. It's -- it's a method of obtaining a weighted average putting more weight on the more recent periods than the more distant periods. I haven't seen it used before, but I'm not going to call it strange either. That's not my criticism. My criticism is that I just don't think it -- it's reflective of going forward expectations.

Q. Can you explain in a little more detail why that is so?

A. Yes. Referring -- he's got a chart in his rebuttal, which is his latest data set where he derives the 5.7. The 5.7 which he shows being the historic average of these time periods, it appears to embody a 3 percent inflation expectation. Well, that's simply not what inflation expectations are. They're significantly lower than that. The blue chip consensus is for long-term inflation outlook of 2.1 percent for the GDP deflator.

In addition, going forward, it's my belief that we may see somewhat less economic growth in the future than in that -- over this historic trend period, not necessarily the last 10 years, but the 60-year trend period, because of expectations of slowing down in the labor force due to demographic shifts, greater retirements and things like that. The labor force in the future is just not expected to grow as rapidly as it has in the past.

Q. Does that complete your answer?

A. Yes. Yes, it does.

MR. BRUDER: I have nothing further. Thanks very much.

JUDGE JORDAN: That completes the examination of this witness. Mr. Kahal, you are free to hang up the telephone or you can stay on the line and listen to our little wrap-up.

THE WITNESS: Thank you, your Honor. I will hang up at this time.

JUDGE JORDAN: Very good. That completes all the witnesses and all the examination that we had scheduled for today. Is there any matter that anybody wants to take up before we go off the record?

I have just one thing. I'm issuing orders excusing everyone from everything tomorrow and the next day. Those are going out, starting to go out now. Yes, both orders have issued.

MR. THOMPSON: Thank you, Judge.

JUDGE JORDAN: Anything else? Last call for next couple days. All right. Then with that we will adjourn and we will go off the record.

(WHEREUPON, the hearing adjourned at 4:55 p.m.)

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C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____

Kellene K. Feddersen, RPR, CSR, CCR