

Exhibit No.:
Witness: Michael Gorman
Type of Exhibit: Surrebuttal Testimony
Issue: Revenue Requirement
Sponsoring Party: The Office of Public Counsel
Case No.: ER-2009-0090

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

**In the Matter of the Application of Aquila,
Inc. d/b/a KCP&L Greater Missouri
Operations Company for Approval to Make
Certain Changes in its Charges for Electric
Service.**

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) **Case No. ER-2009-0090**
)
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Surrebuttal Testimony and Schedules of

Michael Gorman

On behalf of

The Office of Public Counsel

Project 9074
April 9, 2009



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

 In the Matter of the Application of Aquila,)
 Inc. d/b/a KCP&L Greater Missouri)
 Operations Company for Approval to Make)
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 Service.)

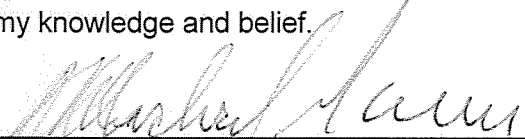
Case No. ER-2009-0090

STATE OF MISSOURI)
) SS
 COUNTY OF ST. LOUIS)

Affidavit of Michael Gorman

Michael Gorman, of lawful age and being first duly sworn, deposes and states:

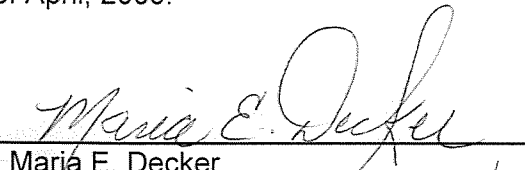
1. My name is Michael Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. We have been retained by the Office of Public Counsel in this proceeding on its behalf.
2. Attached hereto and made a part hereof for all purposes are my surrebuttal testimony and schedules.
3. I hereby swear and affirm that my statements contained in the attached testimony and schedules are true and correct to the best of my knowledge and belief.



 Michael Gorman
 Consultant

Subscribed and sworn to before me this 8th day of April, 2009.





 Maria E. Decker
 Notary Public

My commission expires May 5, 2009.

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COMMISSION OF THE STATE OF MISSOURI

In the Matter of the Application of Aquila,
Inc. d/b/a KCP&L Greater Missouri
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Certain Changes in its Charges for Electric
Service.) Case No. ER-2009-0090

Surrebuttal Testimony of Michael Gorman

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A My name is Michael Gorman and my business address is 16690 Swingley Ridge
3 Road, Suite 140, Chesterfield, Missouri 63017.

4 Q ARE YOU THE SAME MICHAEL GORMAN WHO FILED TESTIMONY
5 PREVIOUSLY IN THIS PROCEEDING?

6 A Yes, I am.

7 Q WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS
8 PROCEEDING?

9 A I will respond to Aquila, Inc. dba KCP&L Greater Missouri Operations Company
10 (“GMO” or “Aquila Missouri” or “Company”) cost of capital witness Dr. Samuel
11 Hadaway and his revised return on equity recommendation of 11.55%. I will also
12 respond to GMO witness Michael W. Cline and show that my return on equity of
13 10.3% and the Company’s proposed capital structure and cost of debt will support
14 GMO’s financial integrity.

1 **Response to Dr. Samuel C. Hadaway**

2 **Q IS DR. HADAWAY RECOMMENDING THAT HIS REVISED RETURN ON EQUITY**
3 **OF 11.55% BE ADOPTED IN LIEU OF HIS ORIGINAL RECOMMENDED RETURN**
4 **ON EQUITY OF 10.75%?**

5 A It is not entirely clear from his rebuttal testimony. At page 2 of his rebuttal testimony,
6 Dr. Hadaway states that 11.55% is his revised return on equity recommendation.
7 However, at page 21, he states that his updated analysis confirms his original
8 recommendation of 10.75% to be extremely conservative. Again, at page 22, he
9 summarizes what appears to be the Company's revised capital structure and overall
10 rate of return. It appears that GMO is now requesting a return on equity of 11.55%.

11 **Q HAVE UTILITIES IN GENERAL ATTEMPTED TO INCREASE THEIR AUTHORIZED**
12 **RETURN ON EQUITY TO REFLECT THE ABNORMAL MARKET CONDITIONS**
13 **AND TEMPORARILY INFLATED CAPITAL MARKET COSTS?**

14 A No. As an example, in AmerenUE's last rate case, its witness estimated that cost of
15 capital had increased by at least 25 basis points.¹ However, AmerenUE in that case,
16 in an effort to mitigate the rate impact on its customers, chose to honor its original
17 estimated return on equity.

18 GMO's proposal to set rates based on abnormal market conditions and cost
19 will unreasonably inflate utility profits, and rates. This is clearly evident from the fact
20 that current authorized returns on equity still indicate that authorized returns on equity
21 are around 10.5%. Dr. Hadaway's recommendation, and GMO's apparent proposal
22 for a significant increase in its authorized return on equity, are out of line with industry

¹ Case No. ER-2008-0318, Surrebuttal Testimony of Roger A. Morin, at 3.

1 practice, and inconsistent with Dr. Hadaway's own evidence that market costs are
2 being driven by anomalous market conditions. Therefore, adopting a return on equity
3 as high as 11.55% is egregious, and indeed, Dr. Hadaway's estimated return on
4 equity of 10.75% is still inflated for the reasons set forth below.

5 **Q WHY DOES DR. HADAWAY BELIEVE THAT CORPORATE CAPITAL COSTS**
6 **HAVE INCREASED?**

7 A Dr. Hadaway believes that the current Treasury and utility yields are moving in
8 opposite directions. The Treasury yields are artificially low and the utility yields have
9 increased significantly, which has resulted in widened utility-Treasury spreads over
10 the last three months, as shown in Table 1 of Dr. Hadaway's rebuttal testimony.
11 Further, he argues that the volatile stock market, which has declined approximately
12 50% since November 2007,² has also contributed to the increased borrowing costs.

13 **Q DO YOU AGREE WITH DR. HADAWAY THAT CORPORATE CAPITAL COSTS**
14 **HAVE INCREASED?**

15 A Yes. While Dr. Hadaway correctly observes that the spreads between utility and
16 government bond yields have increased, he fails to consider the bigger picture and
17 long-term implications. These widened spreads are not going to continue indefinitely.
18 The U.S. economy is currently in a recessionary stage, which directly or indirectly
19 affects almost all industry sectors. However, when the economy stops contracting
20 and recovers from the effects of the current market turmoil, the abnormal market
21 conditions will disappear and the utility costs will converge to the normalized level we

² Hadaway Rebuttal at 3-6.

1 have experienced in the past. Therefore, when setting utility rates, as I mentioned in
2 my direct testimony, we need to reflect capital costs on a normalized basis.

3 **Q DO YOU BELIEVE THAT THE CURRENT MARKET CONDITIONS REPRESENT A**
4 **MARKET ANOMALY?**

5 A Yes. The lower Treasury yields and the increased utility yields, which lead to
6 abnormally wide spreads, clearly represent a market anomaly that will be corrected
7 as the economy starts improving. This could be seen in the table below.

<u>Line</u>	<u>Year</u>	<u>“A” Yield</u> (1)	<u>“Baa” Yield</u> (2)
1	2004	6.16%	6.40%
2	2005	5.65%	5.93%
3	2006	6.07%	6.32%
4	2007	6.07%	6.33%
5	2008	6.51%	7.21%
6	Average	6.09%	6.44%

Sources: *Mergent Public Utility Manual 2003,*
and *Moody’s Daily News.*

8 As shown in Table 1 above, over the last five years the “A” rated utility yields
9 have ranged from 5.65% to 6.51%. Similarly, the “Baa” rated utility yields ranged
10 from 5.93% to 7.21%. The upper end of these ranges reflects the abnormal market
11 conditions observed in 2008. Importantly, over the last five years, the average “A”
12 and “Baa” rated utility yields were 6.09% and 6.44%, respectively. These yields are
13 significantly lower than the yields observed in the current market environment.

1 However, once the credit and financial markets stabilize, the Treasury and
2 public utility yields will converge to the normalized level experienced in the past.

3 **Q DOES DR. HADAWAY AGREE THAT THE ABNORMAL UTILITY SPREADS AND**
4 **LOW INFLATIONARY PRESSURE REPRESENT A MARKET ANOMALY?**

5 A Yes. Specifically, he states the following in regards to the low inflation level:

6 This indication is caused by current “flight to safety” anomalies in the
7 Treasury bond market and the differing impact that those anomalies
8 have had on nominal Treasury yields versus yields on the Treasury
9 Inflation Protected Securities (TIPS) used in that analysis.³

10 What Dr. Hadaway has apparently not recognized, however, is this flight to
11 Treasury securities, thereby bidding up the prices and reducing Treasury yields, has
12 had the exact opposite effect on corporate bonds, including utilities. Specifically, the
13 movement from corporate securities to Treasury securities, has produced a
14 temporary deflation in utility bond prices, and an increase in utility bond yields. Once
15 these abnormal market conditions correct, Treasury yields will likely increase, and
16 utility bond yields will likely decrease.

17 **Q HAVE OTHER UTILITY COMPANIES RECOGNIZED THE FACT THAT THE**
18 **HIGHER UTILITY YIELDS ARE A MARKET ANOMALY?**

19 A Yes, they have. Recently, Northern Indiana Public Service Company (NIPSCO)
20 purchased the Sugar Creek base load plant, and it had plans to finance the plant by
21 issuing long-term debt at a rate of 7.5%.⁴ However, in its December 5, 2008 Motion

³ Hadaway Rebuttal, at 13, footnote no. 4.

⁴ Indiana Utility Regulatory Commission Cause No. 43563, Rebuttal Testimony of Vincent Rea, at 3 and 4.

1 for Extension, NIPSCO recognized that the higher interest rates are a market
2 anomaly caused by the credit markets and the rates will stabilize in the future.

3 **Q IS THERE EVIDENCE THAT THE BORROWING COSTS FOR UTILITIES WILL**
4 **DECLINE AND THE INTEREST RATES WILL STABILIZE?**

5 A Yes. In December 2008, Consolidated Edison, an "A" rated utility, issued a 10-year
6 note at 7.125%. Three months later, on March 23, the company issued another
7 10-year note at 6.65% and a 5-year note at 5.55%. Clearly, the borrowing costs for
8 this utility declined by 50 basis points over the three-month period. The table below
9 summarizes the additional new debt issuances over the last month.

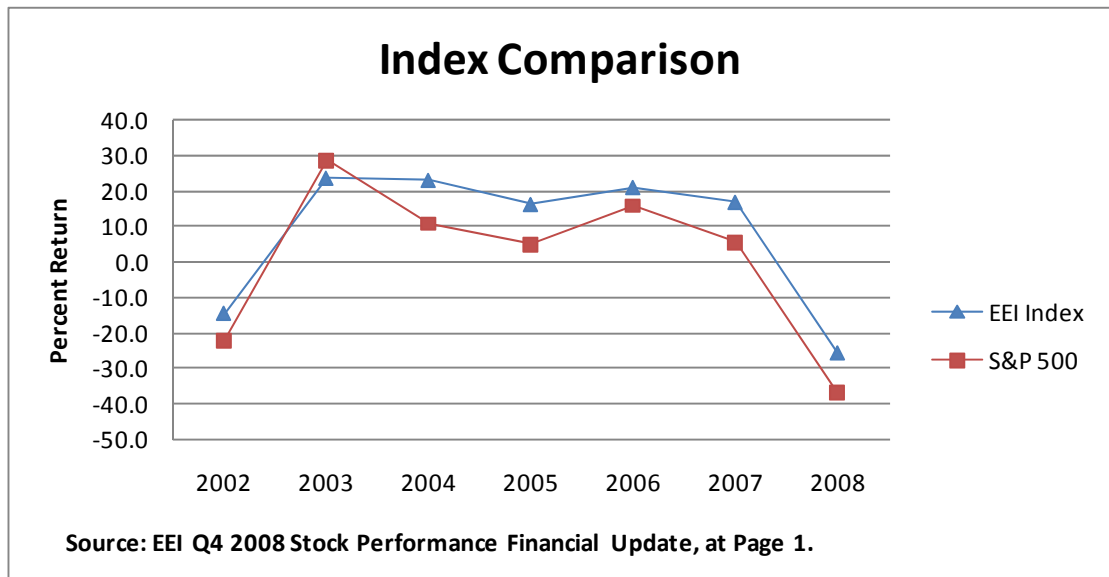
<u>Date</u>	<u>Issuer</u>	<u>Rating</u>	<u>Maturity</u>	<u>Type</u>	<u>Rate</u>
3/25/09	Idaho Power	BBB	20	Secured	6.15%
3/23/09	Consolidated Edison	BBB	10	Unsecured	6.65%
	Consolidated Edison	BBB	5	Unsecured	5.55%
3/20/09	Empire District	BBB	15	Secured	7.00%
3/19/09	Kansas City Power & Light	BBB	20	Secured	7.15%
3/16/09	Progress Energy	BBB	10	Unsecured	7.05%
	Progress Energy	BBB	5	Unsecured	6.05%

Source: SNL Financial.

10 As shown in the table above, the utility companies have been able to access
11 the credit markets and issue additional debt at costs much lower than what
12 Dr. Hadaway has shown in his Table 1. Therefore, the utility yields are on their way
13 to recovery and they are converging to the normalized level experienced in the past.

1 Q HAVE YOU CHANGED YOUR OPINION ABOUT THE UTILITY STOCK
2 PERFORMANCE AS SUGGESTED BY DR. HADAWAY?

3 A No. Dr. Hadaway falsely asserts that my outdated utility stock performance analysis
4 based on the data published by the Edison Electric Institute (EEI), as discussed on
5 pages 6-8 of my direct testimony, is “not consistent with the market conditions that
6 utilities face.” I have updated this analysis and my conclusions have not changed.
7 As shown on the graph below, the Electric Utility Stock Index has outperformed the
8 market in every year over the last five years.



9 Again, this strong stock performance indicates commission-authorized returns on
10 equity over the last several years have been positively received by the market.

11 Q DO YOU CONTINUE TO SUPPORT YOUR CONCLUSION THAT UTILITY STOCKS
12 ARE PERCEIVED AS “SAFE HAVENS?”

13 A Yes. While clearly the market performance for all securities has been dismal
14 throughout 2008, the only positive signal from the market performance is the fact that

1 electric utility stocks and bonds have continued to be perceived by the market as
2 “safe” investments. Indeed, during times of market turbulence, the market generally
3 exhibits a “flight to quality” and lower-risk securities generally perform better than the
4 overall market and higher-risk securities. This has happened through 2008. For
5 example, EEI noted the following concerning electric utility stock performance in
6 2008:

7 **Flight to Safety**

8 The relatively stronger performance of utility stocks in both the quarter
9 and the year offers a classic illustration of their traditional role as a
10 defensive investment in times of market stress. In a weakening
11 economy, investors are drawn to the relative stability offered by
12 utilities’ dividend yields and more predictable earnings (in comparison
13 with other sectors of the economy), made possible by the essential
14 role that electricity plays in the lives of Americans at work and at home
15 compared to other, more optional products and services.

16 Indeed, the comparative category returns shown in Charts II and VIII
17 highlight the theme that dividend stability and earnings predictability –
18 generally most associated with the regulated utility business model –
19 translated into better stock market performance in 2008. The
20 Regulated group’s -5.9% return in the fourth quarter was about
21 8 percentage points better than the Mostly Regulated group’s -14.0%
22 return, which in turn was slightly better than the Diversified group’s
23 -17.0% return. The Regulated group, with a -15.6% return for the year
24 as a whole, also outperformed the Mostly Regulated group’s -27.0%
25 return and the Diversified group’s -33.9% return for the year.

26 The stronger performance of Regulated company stocks is also
27 evident in Table XIV, as nine of the top-ten performing stocks in the
28 EEI Index in 2008 were those in the Regulated category. In fact, the
29 EEI Index’s quarterly and full-year 2008 returns were largely supported
30 by the performance of the Regulated group. However, to place this
31 performance in a broader context, the Mostly Regulated and
32 Diversified groups outperformed the Regulated group in 2003, 2004,
33 2005 and 2007. Each group offers investors a somewhat different risk
34 and return profile, and their changing performance patterns illustrate
35 changing investor preferences in relation to the broader trends taking
36 place in the industry’s structure and organization as well as trends in
37 global financial and commodity markets.⁵

⁵“Stock Performance,” EEI *Q4 2008 Financial Update*, emphasis added.

1 This stock price performance again supports the notion that regulated electric
2 utilities are perceived by the market as safe haven investments, which will help
3 support their access to capital during difficult financial times. This is clearly evident
4 through a review of their stable credit outlook and stable stock prices, relative to the
5 securities of non-regulated companies.

6 **Q DR. HADAWAY ARGUES THAT SIMPLY REMOVING YOUR CAPM RETURN**
7 **ESTIMATE WILL INCREASE YOUR RETURN ON EQUITY TO 10.74% FROM**
8 **10.3%. PLEASE RESPOND.**

9 A Dr. Hadaway erroneously reaches this conclusion by simply removing the low end of
10 my return on equity range. A more balanced approach would be, at a minimum, to
11 remove both the low-end return on equity estimate of 8.94%, and also the high-end
12 return estimate of 12.02%. Removing high and low return estimates would produce a
13 return on equity of 10.5%, which is very similar to my recommended return on equity
14 of 10.3%.

15 **Q DO YOU HAVE ANY COMMENTS CONCERNING DR. HADAWAY'S CRITICISM**
16 **OF YOUR DCF METHODOLOGY?**

17 A Yes. The primary disagreements between Dr. Hadaway and me are the reliability of
18 the constant growth model and the determination of a reasonable GDP growth rate.

19 As I discussed in my direct and rebuttal testimonies, the current return on
20 equity estimates produced by the constant growth DCF model are substantially higher
21 because they are driven by abnormally high growth rates that are not sustainable in
22 the long run. Even though I disagree with the return estimates produced by the

1 constant growth DCF model, I have included the result in my return on equity
2 recommendation because the preferred methodology of the Commission is to
3 average all DCF results.

4 **Q PLEASE DESCRIBE YOUR DISAGREEMENT WITH DR. HADAWAY ON THE**
5 **DETERMINATION OF A REASONABLE GDP GROWTH RATE.**

6 A In Dr. Hadaway's direct and rebuttal testimonies, he derived his own long-term GDP
7 growth rate of 6.5% and 6.2%, respectively. In significant contrast, in my
8 non-constant growth DCF models, I used a published economists' consensus GDP
9 growth rate over the next five and ten years of 4.9%. I also, considered Morningstar's
10 methodology since this is the Commission-preferred estimate for long-term
11 sustainable growth rate. In fact, in the 2009 Valuation Edition, which became
12 available to me after I filed my rebuttal testimony, Morningstar estimates a long-term
13 growth rate of 3.9%.⁶

14 Dr. Hadaway argues that my long-term sustainable GDP growth rate
15 projection is relatively short-term and it is based on inflation estimates that are
16 significantly lower than the long-term historical averages. Again, the GDP growth rate
17 projection I used in my non-constant DCF models is based on consensus economists'
18 estimates published by the *Blue Chip Economic Indicators* and it is a superior
19 estimate than the GDP growth rate projection provided by a single analyst such as
20 Dr. Hadaway or myself.

21 Dr. Hadaway's GDP growth forecasts are significantly higher than
22 independent consensus market economists' projections and do not reflect market

⁶2009 Ibbotson SBBI[®] Valuation[®] Yearbook at 53; Inflation of 0.6% and Real GDP of 3.3%.

1 consensus expectations. Further, as a result of Dr. Hadaway's use of an excessive
2 growth rate forecast, his DCF estimates are inflated and not reliable.

3 **Q PLEASE DESCRIBE DR. HADAWAY'S CRITICISMS OF YOUR RISK PREMIUM**
4 **ANALYSIS.**

5 A Dr. Hadaway acknowledged that my risk premium analysis is similar to his, excluding
6 his explicit adjustment to reflect an inverse relationship between interest rates and
7 equity risk premiums.

8 **Q ARE DR. HADAWAY'S RISK PREMIUM ARGUMENTS ACCURATE?**

9 A No. The clear finding in academic research on equity risk premiums is that the
10 relationship between interest rates and risk premiums changes over time based on a
11 multitude of factors. Second, academic research concludes that the relationship
12 between equity risk premiums and interest rates changes based on the perception of
13 the risk difference between equity investments and fixed income investments, and not
14 simply interest rates.

15 This relationship is not based on a simple inverse relationship between risk
16 premiums and interest rates, but rather is tied to perceived risk differentials between
17 the two competing investments, as described in my rebuttal testimony.

18 **Q PLEASE DESCRIBE THE ACADEMIC RESEARCH ON THE RELATIONSHIP**
19 **BETWEEN EQUITY RISK PREMIUMS AND INTEREST RATES.**

20 A The academic literature on the inverse relationship between interest rates and equity
21 risk premiums has observed that there has been a transient inverse relationship that

1 was not tied to changes in nominal interest rates. It was caused by changes to
2 perceived risk differentials between debt and equity investments. Further, the
3 relationship between interest rates and equity risk premiums is not constant, but
4 rather can change materially over time.

5 Most of the academic literature addressing this issue that I am familiar with is
6 based on market data from the 1980s and very early 1990s. During the 1980s and
7 very early 1990s, an inverse relationship did exist. However, that relationship did not
8 exist prior to 1980, and it has not been shown to be the case since the early 1990s.
9 For example, the abstract for a paper written by Eugene Brigham, Dilip K. Shome and
10 Steve R. Vinson, entitled "The Risk Premium Approach to Measuring a Utility's Cost
11 of Equity," published by the Public Utility Research Center, August 1984, states:

12 (4) Before 1980, equity risk premiums for utilities increased as interest
13 rates rose, but after that date an increase in interest rates was
14 associated with lower risk premiums. As a result, in recent years a
15 100 basis point increase in long-term interest rates has led to an
16 increase of about 37 basis points in the cost of equity. (5) Risk
17 premiums are not stable; they change substantially over relatively
18 short periods of time, and this volatility has implications for anyone
19 who seeks to measure equity capital costs on the basis of a debt yield
20 plus a risk premium, including advocates of the CAPM approach.
21 [Emphasis added.]

22 These academics found that there was a positive relationship between interest
23 rates and equity risk premiums before 1980, and an inverse relationship from
24 1980-1984. This study does not establish a consistent relationship between interest
25 rates and equity risk premiums over the entire period.

26 In the more recent, yet still outdated, study by Robert S. Harris and Felicia C.
27 Marston published in the *Journal of Applied Finance* – 2001, "The Market Risk
28 Premium: Expectational Estimates Using Analysts Forecasts," the authors expanded
29 an earlier study of risk premiums to cover the period of 1982-1998. In this study, the

1 authors did note a historical inverse relationship between equity risk premiums and
2 interest rates. However, the authors went into detail to explain why that historical
3 relationship was likely affected more by relative investment risk changes, and not
4 simply changes to nominal interest rates as Dr. Hadaway implies in his testimony.

5 The authors state as follows:

6 The market risk premium changes over time and appears inversely
7 related to government interest rates but is positively related to the
8 bond yield spread, which proxies for the incremental risk of investing in
9 equities as opposed to government bonds.

10 Importantly, the authors in that same study concluded as follows:

11 As a result, our evidence does not resolve the equity premium puzzle;
12 rather, the results suggest investors still expect to receive large
13 spreads to invest in equity versus debt instruments.

14 There is strong evidence, however, that the market risk premium
15 changes over time. Moreover, these changes appear linked to the
16 level of interest rates as well as ex ante proxies for risk drawn from
17 interest rate spreads in the bond market.

18 Clearly, the academic literature does not support a simplistic inverse
19 relationship between interest rates and equity risk premiums. Rather, the authors of
20 these studies recognize that equity risk premiums change with perceived changes in
21 investment risk. Dr. Hadaway's simplistic analysis takes no account of changes to
22 perceived risk, and inappropriately increases equity risk premiums for no other reason
23 than a reduction in nominal interest rates.

24 **Q ARE REDUCTIONS IN NOMINAL INTEREST RATES AN ADEQUATE REASON**
25 **FOR INCREASES TO EQUITY RISK PREMIUMS?**

26 **A** No, they are not. Reductions to nominal interest rates are simply not an adequate
27 reason for increases to equity risk premiums. Indeed, decreases to interest rates

1 over the last ten years have been likely caused by reduced inflation expectations,
2 which would decrease both bond interest rates and common equity required returns.
3 Reduced inflation expectations alone should not change relative debt to equity
4 investment risk, and thus would not cause equity risk premiums to increase.
5 Consequently, Dr. Hadaway's proposal to reflect an inverse relationship between
6 equity risk premiums and bond interest rates is flawed and unreliable, and it should
7 be rejected.

8 **Q DR. HADAWAY ARGUES THAT YOU ARE INCONSISTENT IN THIS CASE**
9 **COMPARED TO PRIOR CASES WHERE YOU ACCEPTED THE NEGATIVE**
10 **RELATIONSHIP BETWEEN RISK PREMIUMS AND INTEREST RATES. PLEASE**
11 **RESPOND.**

12 A Dr. Hadaway argues that in prior cases I have adopted his belief that there is an
13 inverse relationship between interest rates and equity risk premiums. This is an
14 incorrect assertion.

15 In prior cases, just as in this case, I have recognized that the relationship
16 between interest rates and equity risk premiums is tied to changing market
17 perceptions of investment risk outlooks for these two competing investments. In prior
18 cases, I attempted to measure the changing equity risk premiums based on changing
19 risk for bond investments. Bond investment risk was measured based on the "real"
20 return embedded in utility bond yields plus an inflation component. I found that the
21 changing real return component of bond yields corresponded to greater or lower bond
22 investment risk. Again, this was an attempt to measure equity risk premiums in
23 relation to the market's assessment of bond and equity risk.

1 However, in the current case, and more recently I have been relying on yield
2 spread of utility bonds and Treasury bonds to gauge the level of equity risk premium.
3 As noted in the Harris article discussed above, the authors found that a good proxy
4 for gauging the investment risk of industry equity and debt investments was to review
5 corporate bond spreads to Treasury investments. The authors found that when the
6 yield spread increased, the equity risk premiums increased.

7 Furthermore, there is no inconsistency of any kind in my position concerning
8 Dr. Hadaway's use of a simplistic inverse relationship between equity risk premiums
9 and nominal interest rates. The relationship is not that simple. Because
10 Dr. Hadaway assumes the existence of such a simplistic relationship, his risk
11 premium model is flawed.

12 **Q PLEASE DESCRIBE DR. HADAWAY'S CRITICISMS OF YOUR CAPM ANALYSIS.**

13 A Dr. Hadaway argues that the current market conditions understate the CAPM return
14 on equity simply because its inputs, the risk-free rate and the market risk premium,
15 are understated (Hadaway Rebuttal at 9-10). Therefore, he concludes that the CAPM
16 should not be used to estimate GMO's fair return on equity.

17 **Q DO YOU AGREE WITH DR. HADAWAY THAT THE CAPM SHOULD BE**
18 **DISREGARDED BECAUSE OF THE LOW TREASURY BOND YIELDS?**

19 A No. Dr. Hadaway seems to embrace the abnormally high utility bond yields based on
20 today's exceptional market conditions which drive up his return on equity estimates,
21 but he ignores the abnormally low yields on Treasury bonds also attributable to the
22 extraordinary economic conditions which decrease the return on equity estimates.

1 Predictably, Dr. Hadaway only relies on data which causes the return on equity
2 estimate to increase, while ignoring other information which could cause an offsetting
3 decrease to the return on equity estimate. Utility bond yields have been driven up
4 because the market has largely moved out of corporate securities and into safe
5 haven, low-risk Treasury securities. This shift in the capital market has caused utility
6 bond prices to decrease and yields to increase, and Treasury bond prices to increase
7 and yields to decline. All of the movement in the yields on Treasuries and utility
8 bonds is attributable to the anomalies taking place in the capital markets. Neither
9 utility bond yields nor the Treasury bond yields are reasonable estimates of long-term
10 valuations for these securities, after the markets return to more normal conditions,
11 and the economy recovers from the current recession. As such, it is inappropriate
12 and self-serving for Dr. Hadaway to rely on inflated utility bond yields despite these
13 economic circumstances, but propose to reject abnormally low Treasury bond yields
14 which are the result of the same extraordinary economic circumstances. I suggest
15 that either both are given fair consideration, or both should be rejected in an effort to
16 reach a more normalized sustainable return on equity estimate.

17 **Q DO YOU HAVE ANY OTHER COMMENTS CONCERNING YOUR RETURN ON**
18 **EQUITY ESTIMATES?**

19 A Yes. The current market conditions produce relatively high DCF and low CAPM
20 estimates. Therefore, it is important for any rate of return witness to create a
21 balanced return on equity recommendation, which will compensate GMO
22 shareholders and will not create a burden on the GMO ratepayers. By relying on both
23 the high and low estimates of my return on equity analyses, I have captured the

1 current abnormally high utility yields and growth rates and the abnormally low
 2 government bond yields. Hence, my return on equity recommendation fairly
 3 compensates GMO's ratepayers and investors.

4 **Dr. Hadaway's Updated Analysis**

5 **Q PLEASE DESCRIBE DR. HADAWAY'S UPDATED RETURN ON EQUITY**
 6 **ESTIMATES.**

7 **A** Dr. Hadaway's return on equity estimates are shown in the table below under
 8 column (1). Under column (2), I have summarized Dr. Hadaway's adjusted results
 9 after more reasonable estimates are applied.

TABLE 3		
<u>Summary of Dr. Hadaway's ROE Estimate</u>		
<u>Description</u>	<u>Hadaway Results</u>	<u>Adjusted Hadaway Results</u>
	(1)	(2)
<u>DCF Analysis</u>		
Constant Growth (Analysts' Growth)	11.6% - 11.9%	11.6% - 11.9%
Constant Growth (GDP Growth)	11.4%	10.3%
Multi-Stage Growth Model	<u>11.2%</u>	<u>10.3%</u>
DCF Return	11.55%	10.30%
<u>Risk Premium Analysis</u>		
Risk Premium (Projected Yields)	11.14%	10.29%
Risk Premium (Current Yields)	<u>11.56%</u>	<u>11.01%</u>
Risk Premium Return	11.35%	10.65%
Source: Hadaway Rebuttal at 21.		

1 **Q DOES DR. HADAWAY'S UPDATED RETURN ON EQUITY ANALYSIS CONTAIN**
2 **THE SAME FLAWS AS THE ANALYSIS IN HIS DIRECT TESTIMONY?**

3 A Yes. Dr. Hadaway's updated return on equity estimates contain the same flaws as
4 those in his direct testimony. Specifically, his DCF model is based on a GDP growth
5 rate of 6.2%, which significantly exceeds the consensus economists' GDP growth rate
6 projections of 5.1% (the average of the 5-year GDP growth projection of 5.2% and the
7 10-year GDP growth projection of 4.9%)⁷. He continues to rely on the inverse
8 relationship between risk premium estimates and interest rates in his equity risk
9 premium analysis. Therefore, Dr. Hadaway's analyses produce an inflated return on
10 equity recommendation and should be adjusted to reflect the current market
11 expectations.

12 **Q DO YOU HAVE ANY OTHER COMMENTS CONCERNING THE APPLICATION OF**
13 **THE CONSTANT GROWTH DCF MODEL IN THE CURRENT MARKET?**

14 A Yes. The constant growth DCF model parameters are particularly illogical and
15 irrational, and produce results that simply should not be relied upon. Specifically,
16 Dr. Hadaway's constant growth DCF model still contains growth rates that are far too
17 high to be sustainable in the long term. While that in and of itself is an irrational
18 outlook, use of those growth rates with today's yields compounds the irrational
19 outlook that this model is currently conveying. Specifically, this model contains a very
20 robust growth outlook despite the fact that utility sales growth is negatively impacted
21 by the economy, capital costs are at least temporarily out of line with normalized
22 costs, and many utility capital budgets have been reduced as utilities attempt to

⁷*Blue Chip Economic Indicators*, March 10, 2009 at 15.

1 conserve cash. All of these actions have been observed by the stock market and
2 have resulted in declines to utility stock prices.

3 It is simply irrational to expect, as Dr. Hadaway does, that the market expects
4 a robust growth outlook for utility stocks during a period when utility stock prices have
5 dropped due to reduce sales outlooks, lower capital expenditures and abnormal
6 capital market and service area economy conditions.

7 As such, Dr. Hadaway's constant growth DCF model should be rejected
8 initially for use of growth rates which are too high to be reasonable estimates of
9 long-term sustainable growth, but particularly in this instance should be disregarded
10 because the outlook for robust growth is completely contradicted by the decline in
11 stock price given the uncertainty of future earnings and growth outlook for utility
12 companies. Dr. Hadaway's constant growth DCF model should simply be given no
13 weight in this case.

14 Importantly, it is unreasonable to expect DCF returns in the range of 11.6% to
15 11.9%, as Dr. Hadaway suggests. Therefore, Dr. Hadaway's constant DCF return
16 estimates should be rejected.

17 **Q HOW WOULD DR. HADAWAY'S UPDATED DCF MODELS CHANGE IF THE**
18 **CONSENSUS ANALYSTS' GDP GROWTH RATE IS USED IN HIS STUDY?**

19 A On Surrebuttal Schedule MPG-1, I updated Dr. Hadaway's DCF analysis using the
20 consensus economists' projected GDP growth rate of 5.1%. The results of this
21 update are shown in Table 3 above. As shown in the table, Dr. Hadaway's updated
22 DCF return estimates would decline from 11.55% to 10.30%, excluding
23 Dr. Hadaway's constant growth DCF return estimates.

1 Q HOW WOULD DR. HADAWAY'S RISK PREMIUM STUDY CHANGE WITHOUT
2 APPLYING THE INVERSE RELATIONSHIP BETWEEN RISK PREMIUMS AND
3 INTEREST RATES?

4 A As shown in the table above, applying Dr. Hadaway's indicated risk premium of
5 3.19% to his projected "BBB" utility bond yield of 7.10% and his current "BBB" utility
6 bond yield of 7.82% will result in a risk premium return on equity range of 10.29% to
7 11.01%, with a midpoint of 10.65%.

8 Q PLEASE SUMMARIZE YOUR ASSESSMENT OF DR. HADAWAY'S UPDATED
9 RETURN ON EQUITY STUDY.

10 A Corrections to Dr. Hadaway's updated cost of equity estimates show that a fair return
11 on equity for GMO supports a return on equity in the range of 10.30% to 10.65%.
12 Therefore, my recommended return on equity of 10.3% for GMO is still reasonable
13 and fairly compensates investors.

14 **Response to Michael W. Cline**

15 Q PLEASE SUMMARIZE THE ISSUES YOU HAVE WITH MR. CLINE'S TESTIMONY?

16 A First, Mr. Cline continues to support the use of the parent company capital structure
17 when setting the rates for Missouri Public Service (MPS) and St. Joseph Light &
18 Power (SJLP). Mr. Cline argues that the proposed capital structure is reasonable
19 considering the business and financial risk profile of the regulated utility and that the
20 credit rating agencies consider the parent company profile when assigning credit
21 ratings to its affiliates, notching the credit rating of the subsidiaries higher because of
22 the seniority of their debt.

1 Second, he argues that the estimated financial ratios shown on my Schedule
2 MPG-21 and Schedule MPG-22 to my direct testimony will not support GMO's
3 financial integrity.

4 **Q DO YOU AGREE WITH MR. CLINE'S PROPOSED CAPITAL STRUCTURE?**

5 A No. Mr. Cline cannot have it both ways. If he is proposing to use the higher
6 embedded debt cost for SJLP and MPS, then it is inconsistent and imbalanced for
7 him to propose to use the capital structure for Great Plains Energy. Rather, the
8 capital structure, and the embedded debt cost, should be taken consistently either
9 from consolidated operations or from utility-specific operations. As such, if Mr. Cline
10 proposes to use Great Plains Energy's capital structure, then he should also use
11 Great Plains Energy's embedded cost of debt of 6.20%.⁸

12 Conversely, if he proposes to use the subsidiary cost of debt of SJLP and
13 MPS, then he should use the capital structure for these entities.

14 Mr. Cline's proposal to use a higher cost capital structure associated with the
15 parent company, and ignore the parent company's lower-cost embedded debt, but
16 instead substitute the higher embedded debt cost of the subsidiaries, is self-serving,
17 fatally flawed, and should not be permitted.

18 **Q PLEASE DESCRIBE MR. CLINE'S CRITICISM OF YOUR FINANCIAL METRIC**
19 **RATIOS.**

20 A Mr. Cline states that my credit metrics are flawed because I did not include short-term
21 debt and off-balance sheet debt equivalents. He also claims that my estimated

⁸ Case No. ER-2009-0089, Rebuttal Testimony of Dr. Samuel C. Hadaway, at 22.

1 interest expense is significantly lower than MPS/SJLP's actual interest expense,
2 which leads to overstatement of my FFO interest coverage ratios. Finally, Mr. Cline
3 asserts that my proposed debt to capital ratio understates the total long-term debt,
4 which leads to a higher FFO to total debt ratio.

5 **Q DO YOU BELIEVE MR. CLINE'S CRITICISMS OF YOUR CREDIT METRIC**
6 **CALCULATIONS ARE CORRECT?**

7 A In part, yes, but in large part, no. Specifically, Mr. Cline's claimed actual amount of
8 debt interest expense for MPS and SJLP significantly overstates the amount of debt
9 interest expense to be recovered in retail rates. Specifically, and as clearly stated in
10 my direct testimony, my credit metrics are synchronized to utility rate base. The
11 amount of long-term debt interest expense recovered in utility rates is based on the
12 embedded debt cost of the utility, weighted by the percentage of total capital, and
13 applied to the utility's rate base. While the utility may have more debt interest
14 expense than what this rate-making calculation produces, that additional debt interest
15 expense is not recovered from retail ratepayers. As such, Mr. Cline's analysis would
16 indicate that retail rates should be increased to provide coverages of debt that are not
17 supporting assets included in the utility's rate base, and cost of service.

18 Further, Mr. Cline's credit metric calculations include significant balances of
19 short-term debt and off-balance sheet obligations. However, Mr. Cline has not
20 provided any evidence of what amount of these debt obligations should be allocated
21 to retail operations. Again, he has overstated the financial obligations that should be
22 borne by Missouri retail customers. As such, Mr. Cline's methodology is not useful in
23 assessing the cash flow, earnings strength and credit metrics of Missouri retail rates.

1 This test is the primary objective of my analysis in support of my proposed rate of
2 return. I would note, that is also the objective of the credit metric based regulatory
3 plan at Kansas City Power and Light Company.

4 **Q DOES MR. CLINE'S REVISED CREDIT METRIC CALCULATIONS INDICATE**
5 **THAT YOUR RETURN ON EQUITY WILL NOT SUPPORT INVESTMENT GRADE**
6 **METRICS?**

7 A No. Mr. Cline's flawed methodology still shows that a 10.3% return on equity will
8 support investment grade credit metrics. Specifically, his revised FFO to interest
9 expense ratio of 2.4x is solidly within the investment grade utility credit metric range
10 of 2.0x - 3.5x. Also, his revised FFO to total debt ratio of 13.8%, is also within this
11 investment grade range of 10% - 30%. As such, while I believe he has overstated the
12 amount of these financial obligations that are the responsibility of Missouri retail
13 customers, his revised metrics still indicate that a 10.3% return on equity will support
14 an investment grade credit metric.

15 **Q WHILE YOU DISAGREE WITH THE ACCURACY OF MR. CLINE'S CREDIT**
16 **METRICS, ARE THERE ANY HIGH-LEVEL ADJUSTMENTS THAT COULD BE**
17 **MADE TO PROPERLY ADJUST THESE TO RETAIL OPERATIONS?**

18 A Yes. I synchronized long-term debt interest expense to the Missouri retail rate base.
19 In comparison, Mr. Cline relied on the total Company's interest expense. Mr. Cline's
20 method will not measure the metrics on jurisdictional cost of service. Second, it is
21 necessary to adjust the amount of imputed debt lease amortization expense as an
22 increase in FFO, if he plans to increase that leverage to reflect off-balance sheet debt

1 obligations. In effect, Mr. Cline only reflected the erosion to the credit metrics
2 associated with off-balance sheet debt obligations, without reflecting the
3 strengthening aspects of these off-balance sheet debt obligations by increasing FFO.

4 As shown on attached Surrebuttal Schedule MPG-2, if long-term debt interest
5 is synchronized to retail rate base, then the credit metrics calculated by Mr. Cline
6 improve significantly. Specifically, the FFO to interest calculation made by Mr. Cline
7 increases from 2.4x up to 3.5x. Again, these credit metrics are within the investment
8 grade credit rating category as published by S&P. This analysis, even with
9 Mr. Cline's overstatement of the financial obligations to be incurred by retail
10 operations, still supports an investment grade standing at a 10.3% return on equity.

11 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

12 **A Yes.**

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Aquila Missouri

Summary of Adjusted Hadaway DCF

<u>Line</u>	<u>Description</u>	<u>Hadaway¹</u> (1)	<u>Hadaway</u> <u>Adjusted^{2/3}</u> (2)
<u>Constant Growth DCF</u>			
1	Average	11.9%	11.9%
2	Median	11.6%	11.6%
<u>Long-Term Constant Growth DCF</u>			
3	Average	11.4%	10.3%
4	Median	11.4%	10.3%
<u>Multi-Stage Growth DCF</u>			
5	Average	11.2%	10.3%
6	Median	11.2%	10.3%

Sources & Notes:

¹ Schedule SCH-13, Page 1 of 5.

² Surrebuttal Schedule MPG-1, Pages 2 to 4.

³ The adjustment reflects changing the GDP Growth Rate to 5.10%.

Aquila Missouri

Adjusted Hadaway Constant Growth DCF Model Analysts' Growth Rates

Line	Company	Recent Stock Price (1)	Next Year's Dividend (2)	Dividend Yield (3)	Analysts' Growth Rates			Average Growth Rate (7)	Constant Growth DCF (8)
					Value Line (4)	Zacks (5)	Thomson (6)		
1	ALLETE	\$32.15	\$1.76	5.47%	N/A	6.50%	6.50%	6.50%	12.0%
2	Alliant Energy	\$29.17	\$1.50	5.14%	6.00%	5.00%	6.10%	5.70%	10.8%
3	Ameren	\$32.85	\$2.54	7.73%	4.50%	5.50%	4.00%	4.67%	12.4%
4	American Elec. Power	\$31.20	\$1.66	5.32%	5.00%	5.50%	4.84%	5.11%	10.4%
5	Avista Corp.	\$18.54	\$0.78	4.21%	9.00%	8.70%	4.67%	7.46%	11.7%
6	Central Vermont P.S.	\$20.78	\$0.92	4.43%	7.50%	N/A	8.90%	8.20%	12.6%
7	Cleco Corp.	\$21.95	\$0.95	4.33%	10.50%	15.00%	13.63%	13.04%	17.4%
8	Consol. Edison	\$39.95	\$2.36	5.91%	1.00%	3.30%	2.61%	2.30%	8.2%
9	DTE Energy	\$35.22	\$2.18	6.19%	5.00%	6.00%	3.50%	4.83%	11.0%
10	Edison Int'l	\$31.97	\$1.25	3.91%	6.00%	7.00%	6.83%	6.61%	10.5%
11	Empire District	\$17.34	\$1.28	7.38%	10.00%	N/A	6.00%	8.00%	15.4%
12	Entergy Corp.	\$80.78	\$3.00	3.71%	7.50%	8.50%	9.42%	8.47%	12.2%
13	FPL Group	\$47.87	\$1.88	3.93%	9.50%	9.20%	9.62%	9.44%	13.4%
14	FirstEnergy	\$51.87	\$2.45	4.72%	10.00%	7.70%	9.00%	8.90%	13.6%
15	Hawaiian Electric	\$23.99	\$1.24	5.17%	5.00%	4.50%	4.50%	4.67%	9.8%
16	IDACORP Inc.	\$28.83	\$1.20	4.16%	5.00%	6.00%	5.00%	5.33%	9.5%
17	Northeast Utilities	\$23.03	\$0.88	3.82%	12.00%	9.80%	8.32%	10.04%	13.9%
18	NSTAR	\$34.13	\$1.53	4.48%	7.50%	7.20%	6.00%	6.90%	11.4%
19	PG&E Corp.	\$36.95	\$1.68	4.55%	7.00%	7.10%	7.00%	7.03%	11.6%
20	Pinnacle West	\$31.08	\$2.10	6.76%	1.00%	5.50%	4.33%	3.61%	10.4%
21	Portland General	\$18.30	\$1.01	5.52%	7.00%	6.30%	5.92%	6.41%	11.9%
22	Progress Energy	\$38.62	\$2.48	6.42%	5.00%	4.90%	5.65%	5.18%	11.6%
23	Southern Co.	\$35.40	\$1.73	4.89%	5.50%	5.00%	5.59%	5.36%	10.3%
24	Teco Energy, Inc.	\$11.90	\$0.82	6.89%	7.50%	10.40%	7.44%	8.45%	15.3%
25	UIL Holdings	\$29.09	\$1.73	5.95%	4.00%	6.40%	4.80%	5.07%	11.0%
26	Vectren Corp.	\$25.82	\$1.35	5.23%	5.00%	6.40%	5.67%	5.69%	10.9%
27	Westar Energy	\$19.47	\$1.24	6.37%	2.00%	6.00%	4.45%	4.15%	10.5%
28	Wisconsin Energy	\$42.06	\$1.35	3.21%	8.00%	9.00%	9.49%	8.83%	12.0%
29	Xcel Energy Inc.	\$18.06	\$0.97	5.37%	7.50%	6.50%	6.90%	6.97%	12.3%
30	Average	\$31.32	\$1.58	5.21%	6.45%	7.00%	6.44%	6.65%	11.9%
31	Median			5.17%				6.50%	11.6%

Source:
Schedule SCH-13, Page 2 of 5.

Aquila Missouri

Adjusted Hadaway Constant Growth DCF Model Long-Term GDP Growth

<u>Line</u>	<u>Company</u>	<u>Recent Stock Price</u> (1)	<u>Next Year's Dividend</u> (2)	<u>Dividend Yield</u> (3)	<u>GDP Growth*</u> (4)	<u>Long-Term Constant Growth DCF</u> (5)
1	ALLETE	\$32.15	\$1.76	5.47%	5.10%	10.6%
2	Alliant Energy	\$29.17	\$1.50	5.14%	5.10%	10.2%
3	Ameren	\$32.85	\$2.54	7.73%	5.10%	12.8%
4	American Elec. Power	\$31.20	\$1.66	5.32%	5.10%	10.4%
5	Avista Corp.	\$18.54	\$0.78	4.21%	5.10%	9.3%
6	Central Vermont P.S.	\$20.78	\$0.92	4.43%	5.10%	9.5%
7	Cleco Corp.	\$21.95	\$0.95	4.33%	5.10%	9.4%
8	Consol. Edison	\$39.95	\$2.36	5.91%	5.10%	11.0%
9	DTE Energy	\$35.22	\$2.18	6.19%	5.10%	11.3%
10	Edison Int'l	\$31.97	\$1.25	3.91%	5.10%	9.0%
11	Empire District	\$17.34	\$1.28	7.38%	5.10%	12.5%
12	Entergy Corp.	\$80.78	\$3.00	3.71%	5.10%	8.8%
13	FPL Group	\$47.87	\$1.88	3.93%	5.10%	9.0%
14	FirstEnergy	\$51.87	\$2.45	4.72%	5.10%	9.8%
15	Hawaiian Electric	\$23.99	\$1.24	5.17%	5.10%	10.3%
16	IDACORP Inc.	\$28.83	\$1.20	4.16%	5.10%	9.3%
17	Northeast Utilities	\$23.03	\$0.88	3.82%	5.10%	8.9%
18	NSTAR	\$34.13	\$1.53	4.48%	5.10%	9.6%
19	PG&E Corp.	\$36.95	\$1.68	4.55%	5.10%	9.6%
20	Pinnacle West	\$31.08	\$2.10	6.76%	5.10%	11.9%
21	Portland General	\$18.30	\$1.01	5.52%	5.10%	10.6%
22	Progress Energy	\$38.62	\$2.48	6.42%	5.10%	11.5%
23	Southern Co.	\$35.40	\$1.73	4.89%	5.10%	10.0%
24	Teco Energy, Inc.	\$11.90	\$0.82	6.89%	5.10%	12.0%
25	UIL Holdings	\$29.09	\$1.73	5.95%	5.10%	11.0%
26	Vectren Corp.	\$25.82	\$1.35	5.23%	5.10%	10.3%
27	Westar Energy	\$19.47	\$1.24	6.37%	5.10%	11.5%
28	Wisconsin Energy	\$42.06	\$1.35	3.21%	5.10%	8.3%
29	Xcel Energy Inc.	\$18.06	\$0.97	5.37%	5.10%	10.5%
30	Average	\$31.32	\$1.58	5.21%	5.10%	10.3%
31	Median					10.3%

Sources:
Schedule SCH-13, Page 3 of 5.
* Blue Chip Economic Indicators, March 10, 2009.

Aquila Missouri

Adjusted Hadaway Low Near-Term Growth Two-Stage Growth DCF Model

Line	Company	Recent Stock Price (1)	2009 Forecasted Dividend (2)	2012 Forecasted Dividend (3)	Annual Change to 2012 (4)	Cash Flows					GDP Growth* (10)	Two-Stage Growth DCF (11)
						2009 Dividend (5)	2010 Dividend (6)	2011 Dividend (7)	2012 Dividend (8)	2013 Dividend (9)		
1	ALLETE	\$32.15	\$1.76	\$2.00	\$0.08	\$1.76	\$1.84	\$1.92	\$2.00	\$2.10	5.10%	10.5%
2	Alliant Energy	\$29.17	\$1.50	\$1.92	\$0.14	\$1.50	\$1.64	\$1.78	\$1.92	\$2.02	5.10%	10.7%
3	Ameren	\$32.85	\$2.54	\$2.54	\$0.00	\$2.54	\$2.54	\$2.54	\$2.54	\$2.71	5.10%	11.9%
4	American Elec. Power	\$31.20	\$1.66	\$2.40	\$0.25	\$1.66	\$2.00	\$2.20	\$2.40	\$2.56	5.10%	11.6%
5	Avista Corp.	\$18.54	\$0.78	\$1.15	\$0.12	\$0.78	\$0.90	\$1.03	\$1.15	\$1.22	5.10%	10.3%
6	Central Vermont P.S.	\$20.78	\$0.92	\$0.92	\$0.00	\$0.92	\$0.92	\$0.92	\$0.92	\$0.98	5.10%	8.9%
7	Cleco Corp.	\$21.95	\$0.95	\$1.50	\$0.18	\$0.95	\$1.13	\$1.32	\$1.50	\$1.60	5.10%	10.8%
8	Consol. Edison	\$39.95	\$2.36	\$2.42	\$0.02	\$2.36	\$2.38	\$2.40	\$2.42	\$2.54	5.10%	10.4%
9	DTE Energy	\$35.22	\$2.18	\$2.30	\$0.04	\$2.18	\$2.22	\$2.26	\$2.30	\$2.42	5.10%	10.8%
10	Edison Int'l	\$31.97	\$1.25	\$1.64	\$0.13	\$1.25	\$1.38	\$1.51	\$1.64	\$1.72	5.10%	9.5%
11	Empire District	\$17.34	\$1.28	\$1.40	\$0.04	\$1.28	\$1.32	\$1.36	\$1.40	\$1.49	5.10%	12.1%
12	Entergy Corp.	\$80.78	\$3.00	\$4.80	\$0.60	\$3.00	\$3.60	\$4.20	\$4.80	\$5.04	5.10%	10.1%
13	FPL Group	\$47.87	\$1.88	\$2.34	\$0.15	\$1.88	\$2.03	\$2.19	\$2.34	\$2.46	5.10%	9.3%
14	FirstEnergy	\$51.87	\$2.45	\$3.05	\$0.20	\$2.45	\$2.65	\$2.85	\$3.05	\$3.25	5.10%	10.1%
15	Hawaiian Electric	\$23.99	\$1.24	\$1.30	\$0.02	\$1.24	\$1.26	\$1.28	\$1.30	\$1.38	5.10%	9.8%
16	IDACORP Inc.	\$28.83	\$1.20	\$1.20	\$0.00	\$1.20	\$1.20	\$1.20	\$1.20	\$1.26	5.10%	8.7%
17	Northeast Utilities	\$23.03	\$0.88	\$1.03	\$0.05	\$0.88	\$0.93	\$0.98	\$1.03	\$1.10	5.10%	8.9%
18	NSTAR	\$34.13	\$1.53	\$1.85	\$0.11	\$1.53	\$1.64	\$1.74	\$1.85	\$1.97	5.10%	9.7%
19	PG&E Corp.	\$36.95	\$1.68	\$2.04	\$0.12	\$1.68	\$1.80	\$1.92	\$2.04	\$2.14	5.10%	9.8%
20	Pinnacle West	\$31.08	\$2.10	\$2.30	\$0.07	\$2.10	\$2.18	\$2.24	\$2.30	\$2.45	5.10%	11.5%
21	Portland General	\$18.30	\$1.01	\$1.20	\$0.06	\$1.01	\$1.07	\$1.14	\$1.20	\$1.28	5.10%	10.7%
22	Progress Energy	\$38.62	\$2.48	\$2.55	\$0.02	\$2.48	\$2.50	\$2.53	\$2.55	\$2.68	5.10%	10.9%
23	Southern Co.	\$35.40	\$1.73	\$2.00	\$0.09	\$1.73	\$1.82	\$1.91	\$2.00	\$2.10	5.10%	10.0%
24	Teco Energy, Inc.	\$11.90	\$0.82	\$0.90	\$0.03	\$0.82	\$0.85	\$0.87	\$0.90	\$0.96	5.10%	11.7%
25	UIL Holdings	\$29.09	\$1.73	\$1.73	\$0.00	\$1.73	\$1.73	\$1.73	\$1.73	\$1.84	5.10%	10.3%
26	Vectren Corp.	\$25.82	\$1.35	\$1.47	\$0.04	\$1.35	\$1.39	\$1.43	\$1.47	\$1.54	5.10%	10.0%
27	Westar Energy	\$19.47	\$1.24	\$1.32	\$0.03	\$1.24	\$1.24	\$1.28	\$1.32	\$1.41	5.10%	11.0%
28	Wisconsin Energy	\$42.06	\$1.35	\$1.60	\$0.08	\$1.35	\$1.43	\$1.52	\$1.60	\$1.68	5.10%	8.3%
29	Xcel Energy Inc.	\$18.06	\$0.97	\$1.06	\$0.03	\$0.97	\$1.00	\$1.03	\$1.06	\$1.11	5.10%	10.2%
30	Average	\$31.32	\$1.58	\$1.86	\$0.09	\$1.58	\$1.68	\$1.77	\$1.86	\$1.97	5.10%	10.3%
31	Median											10.3%

Sources:

Schedule SCH-13, Page 4 of 5.

* Blue Chip Economic Indicators, March 10, 2009.

Aquila Missouri

Financial Metric Ratios

<u>Line</u>	<u>Description</u>	<u>MPS</u> (1)	<u>SJLP</u> (2)	<u>Gorman</u> <u>Combined</u> (3)	<u>Cline</u> <u>Rebuttal</u> (4)	<u>Cline</u> <u>Revised</u> (5)
1	Rate Base	\$ 1,202,225,058	\$ 305,034,038	\$ 1,507,259,096		
2	Funds From Operations (FFO)	\$ 127,443,088	\$ 31,323,703	\$ 158,766,791	\$ 158,766,791	\$ 158,766,791
3	Interest Expense	\$ 42,364,515	\$ 11,992,205	\$ 54,356,720	\$ 105,813,882	\$ 54,356,720
4	Interest on Short-Term Debt				\$ 850,000	\$ 850,000
5	Interest on OBS Debt				\$ 8,876,231	\$ 8,876,231
6	Total Interest				\$ 115,540,113	\$ 64,082,951
7	FFO Plus Interest	\$ 169,807,603	\$ 43,315,908	\$ 213,123,511	\$ 274,306,904	\$ 222,849,742
8	FFO Interest Coverage	4.0	3.6	3.9	2.4	3.5
9	Total Debt Ratio	51.59%	51.59%	51.59%		
10	Total Long-Term Debt	\$ 620,227,907	\$ 157,367,060	\$ 777,594,968	\$ 1,033,697,200	
11	Short-Term Debt				\$ 17,000,000	
	<u>Debt Attributed to Off-Balance Sheet Items</u>					
12	Present Value of Operating Leases				\$ 18,064,038	
13	Present Value of Power Purchased Agreements				\$ 51,946,721	
14	Tax-effected Asset Retirement Obligations				\$ 23,279,100	
15	Tax-effected PostRetirement Benefit Obligations				\$ 7,576,400	
16	Total OBS Dent				\$ 100,866,259	
17	Total Debt			\$ 777,594,968	\$ 1,151,563,459	
18	FFO to Total Debt	20.5%	19.9%	20.4%	13.8%	

Source:

Cline Rebuttal Schedule MWC-6.