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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

FINANCIAL ANALYSIS

REBUTTAL TESTIMONY

OF

DAVID MURRAY

KCP&L Greater Missouri Operations Company
Great Plains Energy, Incorporated

CASE NO. ER-2016-0156

Jefferson City, Missouri
August 2016

** **<u>Denotes Highly Confidential Information</u>** **

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DAVID MURRAY

KCP&L Greater Missouri Operations Company
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REBUTTAL TESTIMONY

OF

DAVID MURRAY

KCP&L Greater Missouri Operations Company

Great Plains Energy, Incorporated

CASE NO. ER-2016-0156

Q. Please state your name.

A. My name is David Murray.

Q. Are you the same David Murray who prepared the Rate-of-Return Section of Staff's Cost of Service Report ("Staff Report")?

A. Yes, I am. I filed rate-of-return ("ROR") testimony on July 15, 2016.

Q. What is the purpose of your Rebuttal Testimony?

A. The purpose of my Rebuttal Testimony is to respond to the direct testimonies of Robert B. Hevert, Kevin E. Bryant and Michael P. Gorman. Mr. Hevert sponsors ROR testimony on behalf of KCP&L Greater Missouri Operations Company ("GMO"). Mr. Bryant sponsors capital structure testimony on behalf of GMO. Mr. Gorman sponsors ROR and capital structure testimony on behalf of the Office of the Public Counsel ("OPC"). I will address issues related to estimating the cost of common equity ("COE") and how this should impact a fair and reasonable allowed return on common equity ("ROE") to be applied to GMO's electric utility rate base for ratemaking purposes in this proceeding.

I will also address the appropriate capital structure and cost of debt for purposes of setting GMO's allowed ROR. In past rate cases, GMO, and Kansas City Power & Light Company ("KCPL") for that matter, proposed the use of GPE's consolidated capital structure for purposes of setting each subsidiaries' allowed ROR. However, now GMO is proposing the use of a subsidiary-specific capital structure. This change in approach is not logical considering the fact that Standard & Poor's ("S&P") assigns GMO and KCPL ("the Companies") credit ratings based on GPE's consolidated financial and business risk profile. Staff will explain why this change in approach is not consistent with matching capital costs with the financial risk that causes the capital costs. Staff will also show how GMO and KCPL have been financially managed for GPE's best interest and not the best interest of each subsidiary. It is important to note that although GPE's proposed acquisition of Westar may cause significant debate and possibly different approaches to setting GMO's and KCPL's allowed rates of return in the future, at this point, it is not an issue in this case.

<u>EXECUTIVE SUMMARY</u>

Q. What should the Commission consider when evaluating the reasonableness of the various recommendations in this case?

A. Each of the ROR witnesses in this case (Staff included) has consistently sponsored ROR testimony before this Commission in recent years. Mr. Hevert started sponsoring testimony in Missouri in 2011 in an Ameren Missouri rate case, Case No. ER-2011-0028. He not only sponsors testimony regularly for Ameren Missouri, but he now has sponsored testimony for GMO, KCPL and Laclede Gas Company. Mr. Gorman has been sponsoring ROR regularly in Missouri for at least ten years, frequently sponsoring testimony for either industrial customers or the OPC. I have been sponsoring ROR testimony in Missouri for fifteen years. Consequently, the Commission is familiar with our approaches and can determine if our analyses seem to track the logic of changing capital markets. Staff's approach to recommending an allowed ROE has been shaped by knowledge, experience, understanding, and direction. Consequently, although Staff has consistently supported its analysis and position that investors' required return on equity, i.e., the COE to the utility, is much lower than allowed ROEs, Staff also understands that the Commission considers allowed ROEs awarded to other utilities throughout the country when determining a fair and reasonable allowed ROE for utility assets in Missouri. Therefore, Staff attempts to provide the Commission with relevant information and analysis to assist it with determining whether a change is warranted to recent allowed ROEs for Missouri utilities.

Q. Is there currently a difference in the capital structure recommendations of the ROR experts?

A. Yes. Staff used Great Plains Energy, Inc.'s ("GPE") actual capital structure as of December 31, 2015. Mr. Bryant recommends the use of GMO's projected per-books, capital structure as of July 31, 2016. Mr. Gorman recommends the use of an adjusted GMO capital structure.

STAFF RESPONSE TO KEVIN E. BRYANT'S RECOMMENDED CAPITAL STRUCTURE AND COST OF DEBT FOR GMO

Q. What capital structure does Mr. Bryant recommend the Commission use for purposes of setting GMO's allowed ROR?

A. Mr. Bryant recommends the use of GMO's projected per books capital structure as of the true-up period, July 31, 2016, to set GMO's allowed ROR. This projected per books capital structure is expected to contain approximately 54.83% common equity and 45.17% long-term debt.[1]

[1] Hevert Direct Testimony, p. 59, l. 11 through p. 60, l. 3.

Q. Did Mr. Bryant recommend the same subsidiary-specific approach in the recently filed KCPL rate case, Case No. ER-2016-0285?

A. Yes. Mr. Bryant's testimony in the recently-filed KCPL rate case recommends the Commission set KCPL's allowed ROR based on KCPL's projected per books capital structure which is expected to contain approximately 49.88% common equity as of December 31, 2016.[2]

Q. Is Mr. Bryant's recommended use of subsidiary-specific capital structures consistent with the Companies' past practice?

A. No. In the past, the Companies have recommended the use of GPE's consolidated capital structure to set the allowed ROR for both KCPL and GMO ("Companies").

Q. Why does Mr. Bryant now believe the best approach is to use subsidiary-specific capital structures to set the allowed ROR for the Companies?

A. Mr. Bryant indicates that the preferred long-term approach is to base the revenue requirement on the costs that are specific to that utility.[3] While I agree with Mr. Bryant that it is desirable to attempt to reconcile costs to each utility in setting the revenue requirement, it is imperative that the costs be consistent with the risk-profile of the regulated utility operations. If the financial management of the regulated subsidiaries is not performed based on the individual financial interests and risk profiles of each subsidiary, the costs, including capital structures and debt costs, are no longer consistent with what they would be absent their affiliation with the consolidated entity. It should be noted that at times, a utility's affiliation with its holding company's financing activities may result in a lower

[2] Bryant Direct, p. 6, l. 20.

[3] *Id*, p. 4, ll. 6-7.

cost of capital because the holding company will issue debt to minimize capital costs at the consolidated level, rather than at the subsidiary level. Being that shareholders own the equity of the publicly-traded holding company, this is a method employed to increase shareholder value.

Q. In Mr. Bryant's opinion, why wasn't it appropriate to use GMO's capital structure in the past?

A. Mr. Bryant indicates that GMO needed time to transition from the "legacy Aquila capital structure and cost of debt that had been under considerable credit strain to one that better reflected its improved credit profile and ratings as part of GPE."[4]

Q. Does Staff agree that GMO's credit profile was supported by GPE?

A. Yes. In past testimonies involving KCPL and GMO rate cases, Staff has consistently explained and supported its arguments that the affiliated loan transactions between GPE and GMO were detrimental to KCPL's ratepayers. KCPL was able to maintain a strong investment grade credit rating during the period of KCPL's Experimental Alternative Regulatory Plan ("Regulatory Plan"), Case No. EO-2005-0329, which allowed for higher rates during the period of the plan (2005-2010) than otherwise was possible under traditional ratemaking. GPE's credit rating benefited from the Regulatory Plan. Because GPE issued shorter-term tenor debt and loaned the funds to GMO, GMO's embedded cost of debt actually dropped below that of KCPL. In Staff's view, this was inherently unfair to KCPL ratepayers because KCPL's ratepayers provided GPE the strong credit rating that allowed it to financially support GMO.

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[4] *Id.*, p. 4, ll. 12-14.

Q. What was Staff's proposed solution to allow for a fair and reasonable allowed ROR for the Companies?

A. Because it was obvious that GPE was financially managing the two subsidiaries to achieve the lowest overall capital cost for GPE as a consolidated entity, Staff simply recommended the Commission determine each company's allowed ROR by using GPE's consolidated capital structure and consolidated cost of debt.

Q. Has Staff always recommended KCPL's allowed ROR be set based on GPE's consolidated capital structure?

A. Yes. Staff recommended this approach before GPE acquired Aquila and assumed its legacy debt.

Q. Did KCPL recommend the use of GPE's consolidated capital structure to set KCPL's allowed ROR before it acquired Aquila?

A. Yes.

Q. Has Staff always recommended that the consolidated debt costs be applied to both KCPL and GMO after GPE acquired GMO?

A. No. Because GPE's acquisition of Aquila included the assumption of non-investment grade cost Aquila legacy debt which remained on GMO's books for the first couple of rate cases after the transaction, Case Nos. ER-2009-0090 and ER-2010-0356, and this debt still carried a very high cost due to Aquila's troubled past non-regulated investments, Staff recommended GMO's allowed debt return be based on Empire's cost of debt. Staff recommended KCPL's cost of debt be based on GPE's consolidated cost of debt, net of any of the assumed GMO debt since at that time its inclusion would have caused

KCPL ratepayers to pay a higher ROR than would have been the case absent the acquisition of Aquila.

Q. Does GMO still have any debt outstanding that carries higher-than-reasonable costs due to Aquila's failed non-regulated investments?

A. No. The last of these high-cost debt issuances was retired on July 1, 2012. GMO still has four legacy debt issues that were issued prior to Aquila's financial troubles. This debt was issued at fixed rates so the historical cost of these debt issuances was not affected by Aquila's financial distress. The percentage of debt on GMO's books that was assumed by GPE now accounts for less than 10% of total GMO debt.

Q. At the time Aquila issued most of the legacy debt on its books, was GMO its primary asset?

A. No. At the time Aquila issued $131.75 million of debt in March 1999 it was already well on its way to expanding its non-regulated and international operations. It is very important to understand that even though this debt was issued while Aquila was investment grade, it is not accurate to claim this debt is tied to the GMO operations. It can be tied to Aquila, but not the GMO assets. In fact, in 1999, GMO's Missouri Public Service ("MPS") division accounted for less than 12% of UtiliCorp's (subsequently Aquila) total assets.[5]

The ability to reconcile debt to the original Missouri Public Service Company and St. Joe Light & Power Company has not been possible for quite some time. This is the consequence of pursuing other business interests, mergers, acquisitions and then divestiture of assets and companies that still had value in order to attempt to meet financial obligations. Because GMO's assets were held directly by Aquila (not in a separate subsidiary) all of the

[5] UtiliCorp United Inc. d/b/a Missouri Public Service's 1999 Annual Report to the Public Service Commission of Missouri and UtiliCorp United Inc.'s 1999 Annual Report to Shareholders.

debt issued by Aquila for all of its other investments remained with GMO when GPE acquired Aquila.

Q. How much of the debt currently on GMO's books was issued directly by GPE and then loaned to GMO?

A. As of December 31, 2015, slightly less than 60% of the debt assigned to GMO was issued by GPE. GPE has been providing capital to GMO since it acquired it in July 2008. It has also guaranteed and continues to guarantee GMO's debt, credit facilities and commercial paper program.[6]

Q. What percentage of debt assigned to GMO was issued directly to third party investors by GMO since it was acquired by GPE?

A. A little over 30%.

Q. When GMO issued this debt, what credit rating did S&P assign to GMO?

A. 'BBB'.

Q. Did S&P assign GMO's credit rating based on the financial risk implied in its capital structure?

A. No.

Q. What capital structure did S&P evaluate for purposes of assigning GMO a 'BBB' credit rating?

A. GPE's consolidated capital structure.

Q. What has been a typical common equity ratio for GPE's consolidated operations?

[6] Great Plains Energy's 2015 SEC Form 10-K Filing, p. 16.

A. As shown in Schedule DMr-1, GPE typically targets a common equity ratio of approximately 47% when short-term debt is included. As seen in Schedule DMr-2, if only long-term capital components are considered, GPE's consolidated common equity ratio is approximately 50%.

Q. How does this compare to GMO's historical per books capital structures?

A. As can be seen in Schedules DM-r3 and DM-r4, GMO's per books capital structures with and without short-term debt have averaged approximately 55% common equity over the last 5 years.

Q. If GMO's debt rating is based on a capital structure that contains approximately 50% common equity, is it fair to apply the cost of debt and the recommended allowed ROE to a capital structure that contains an equity ratio of approximately 55%?

A. No.

Q. Mr. Bryant indicates that GPE manages GMO to a higher common equity ratio than KCPL because it has lower credit quality. First, have GMO's financial statements been readily available to the public to allow for this determination?

A. No. GMO does not have financial statements filed with the Securities and Exchange Commission similar to KCPL and GPE. This fact alone should cause the Commission to hesitate as to the legitimacy of Mr. Bryant's position that GMO has stand-alone credit quality, and therefore, a legitimate stand-alone capital structure. Second, as Staff has already discussed, GMO's S&P credit rating is assigned based on GPE's consolidated credit quality, not that of GMO. Consequently, KCPL, GMO and GPE would be assigned the same S&P corporate credit rating if they all had the same per books capital structure.

Q. Has Staff analyzed financial statements specific to GMO?

A. Yes. Staff requested highly confidential information on GMO's private debt placement memorandum and also reviewed highly confidential rating agency presentations that included GMO's financial statements.

Q. What did this information indicate about how GPE managed GMO's capital?

A. That GMO has been able to largely provide for its financing needs through internally generated funds and has still been able to fund a moderate dividend to the parent company. While GPE has been investing in KCPL more heavily and at a more rapid pace than GMO, it had still been supporting over 60% of the dividends to GPE. However, in 2015 KCPL did not pay any dividends to GPE, leaving GMO to fund all of the dividends ultimately distributed to GPE's shareholders. While this may sound unfair to GMO, it actually allows GMO's capital structure to start moving in a direction that allows it's equity ratio to be more consistent with that of KCPL's and GPE's on a consolidated basis, which is more typical for regulated electric utilities.

Q. Did GPE's decision to have GMO fund all of the dividends in 2015 illustrate how each subsidiary's capital is managed for the benefit of GPE?

A. Yes.

Q. Is Staff concerned about Mr. Bryant's position that GMO should have a higher common equity ratio due to its lower credit quality?

A. Yes. It is Staff's understanding that GMO's lower credit quality is due to lingering effects of the financial burdens imposed on GMO's system by the failed Aquila business model. The cost of this lower credit quality should not be assessed to GMO's captive customers. Although rating agencies claim that GMO has more business risk due to the Missouri regulatory environment, it is also important to consider the fact that these same rating agencies consistently cited GMO's ability to have a fuel adjustment clause ("FAC") as being a business risk offset as compared to KCPL. Additionally, just the mere fact that GMO hasn't filed as many rate increase requests as KCPL since 2012 proves that it has not experienced the same business risks as KCPL. Additionally, Missouri's other regulated electric utilities have not been required to maintain an equity ratio of this magnitude to attract capital at reasonable costs. Again, this is why Staff defaults to the parent-company consolidated capital structure because this is a market-tested capital structure that is of consequence for raising capital.

STAFF RESPONSE TO ROBERT B. HEVERT'S RECOMMENDED RETURN ON COMMON EQUITY FOR GMO

Q. Did Mr. Hevert sponsor ROR testimony in GMO's last rate case in 2012, Case No. ER-2012-0175?

A. No. Dr. Samuel C. Hadaway sponsored ROR testimony on behalf GMO in its 2012 rate case.

Q. Did Mr. Hevert sponsor ROR testimony in KCPL's last rate case in 2014, Case No. ER-2014-0370?

A. Yes.

Q. Did Mr. Hevert sponsor ROR testimony in Ameren Missouri's last rate case in 2014, Case No. ER-2014-0258?

A. Yes.

Q. Should the comparison of Mr. Hevert's testimony in this case to the testimony he filed in 2014 be helpful to the Commission in assessing whether it should authorize a lower allowed ROE to GMO in the current case as compared to its authorizations for KCPL and Ameren Missouri in 2014?

A. Yes. This will especially be true when Mr. Hevert updates his ROR recommendation in his rebuttal testimony, but because he just recently filed testimony in the KCPL rate case in Case No. ER-2016-0285, it is possible to evaluate his DCF cost of equity estimates using recent market data.

Q. Does Mr. Hevert typically update his recommendation when he files rebuttal?

A. Yes. Because a significant amount of time lapses between a company's direct filing and when the other parties file direct testimony, typically company ROR witnesses update their recommendations to capture more recent capital market data. Mr. Hevert has normally done so in each case in which he has sponsored ROR testimony.

Q. Based strictly on comparing Mr. Hevert's final estimated cost of equity ranges he provides in his testimony in the current GMO rate case to final estimated cost of equity ranges in the 2014 KCPL rate case, what do his cost of equity ranges imply about his own view about the change in the cost of equity since 2014?

A. His cost of equity ranges imply that he believes that the cost of equity has declined by 10 to 45 basis points since 2014. In KCPL's 2014 electric rate case, Mr. Hevert estimated KCPL's cost of equity to be in the range of 10.2% to 10.6%. His cost of equity estimate for GMO in this case is in the range of 9.75% to 10.5%. This difference supports the Commission lowering the allowed ROEs for its electric utilities to closer to 9%.

Q. Why would an update to Mr. Hevert's cost of equity analysis support a lower estimated cost of equity range?

A. Because utility stocks have rallied significantly since the beginning of the year.

Q. What was the most recent market data Mr. Hevert used for purposes of his cost of equity analysis in the GMO rate case?

A. January 15, 2016.

Q. What was the most recent market data Mr. Hevert used for purposes of his cost of equity analysis in the KCPL rate case?

A. May 31, 2016.

Q. Did Mr. Hevert use the same proxy group in the KCPL rate case as he did in the GMO rate case?

A. No. Mr. Hevert eliminated two companies, Dominion Resources, Inc., and Westar Energy, Inc., in the KCPL rate case. Therefore, for purposes of evaluating changes to certain capital market data between these two time periods, Staff will not include these two companies in order to ensure consistent and reliable comparisons.

Q. What happened to utility stock prices for the period January 15, 2016, through May 31, 2016?

A. They have increased dramatically. The following graph shows the performance of Mr. Hevert's proxy group for the period January 15, 2016, through May 31, 2016:

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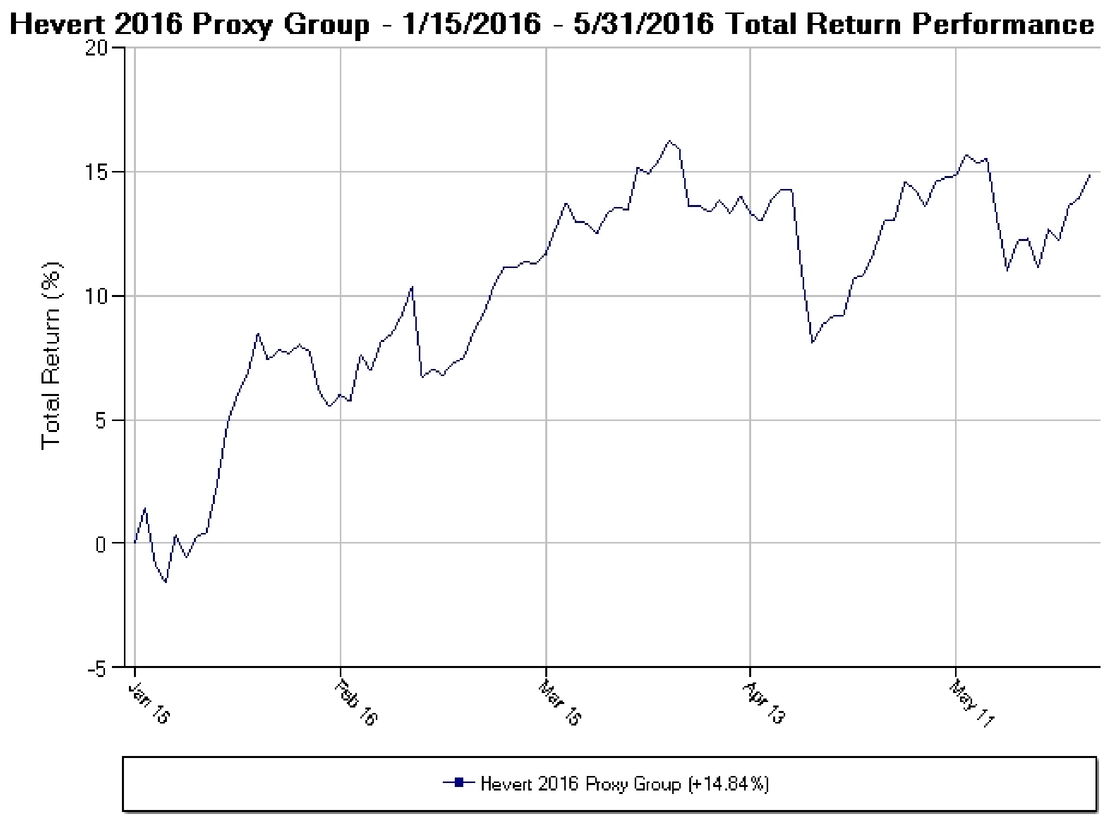

Although annualizing returns over periods less than a year is not advisable for purposes of evaluating performance or projecting future returns, in order to appreciate the magnitude of the 14.84% total return over this 4.5 month period, if this return is annualized, this would translate into a 44.63% return for a year.

Q. What has the total return been for Mr. Hevert's proxy group for the one-year period May 31, 2015, through May 31, 2016?

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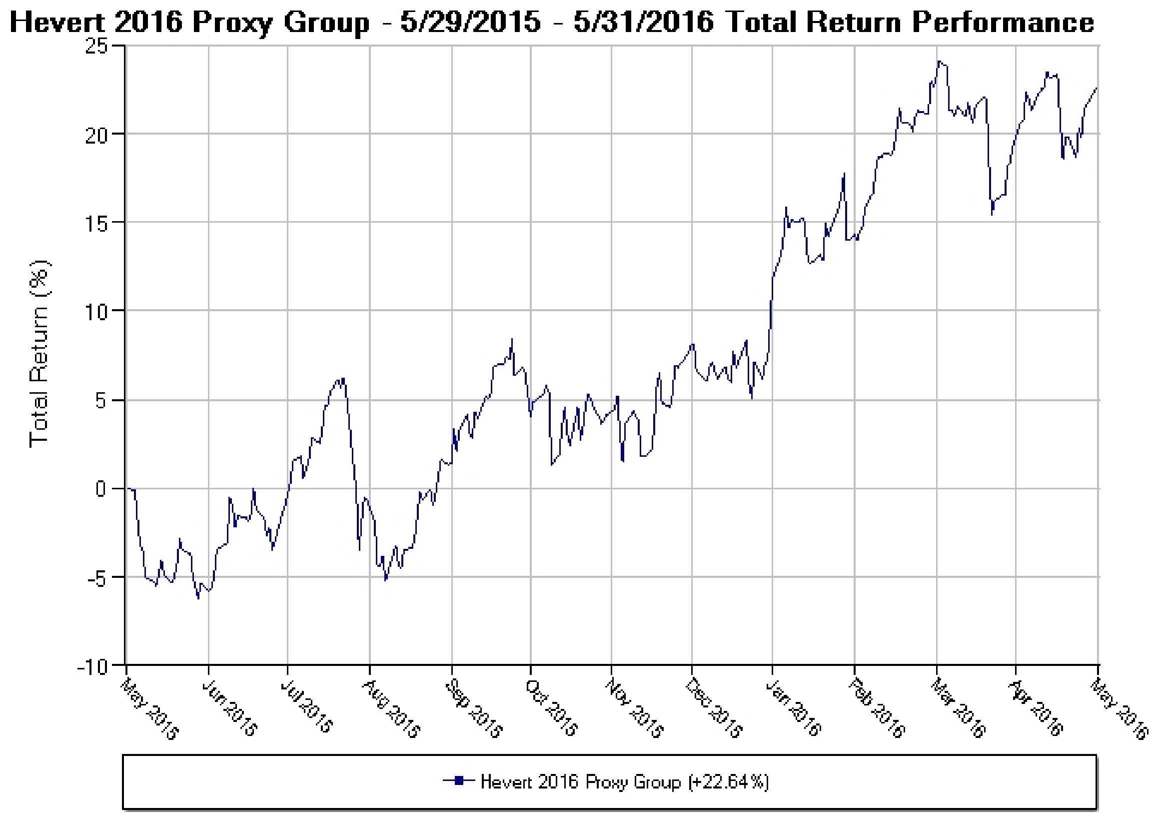
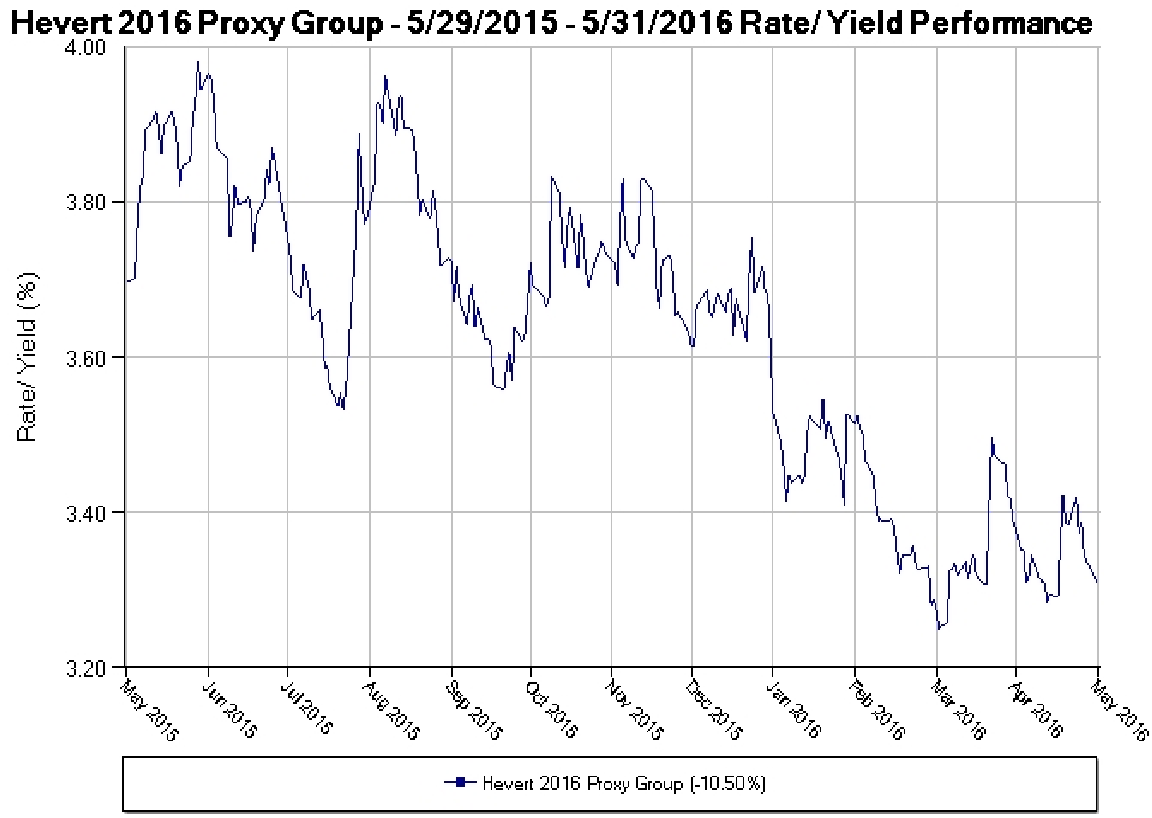
A. It was 22.64% as can be seen below:



As can be seen, the rally in utility stock prices began at the beginning of December 2015. Consequently, Mr. Hevert's updated DCF analyses in the KCPL rate case implies a much lower cost of equity than the DCF analyses he performed in the GMO rate case, which only used data through January 15, 2016.

Q. How have the increases in the stock prices of Mr. Hevert's proxy group affected their dividend yields?

A. They have declined considerably. The graph below shows that the dividend yields have decline by approximately 40 basis points since the middle of last year. Considering there has been little change in growth expectations, this implies a decrease in the cost of equity by about the same amount.



Comparison of Mr. Hevert's DCF Cost of Equity Estimates Since 2014

Q. Did you compare Mr. Hevert's DCF analyses in the current KCPL and GMO rate cases to the DCF analyses he performed in the KCPL and Ameren Missouri rate cases in 2014 and 2015?

A. Yes. Because Mr. Hevert performed DCF analyses in the 2014 Ameren Missouri rate case using market data from the fall of 2014 and in the 2014 KCPL rate case using market data from the spring of 2015, Staff compared these results to the analyses he performed for his direct testimony in the GMO rate case using market data through January 15, 2015, and the analyses he performed for his direct testimony in the recently filed KCPL rate case in which he used data through May 31, 2016 (see Schedule DM-r5).

Q. Are the proxy groups constant over these cases?

A. No.

Q. Do you think it is important to keep the proxy group constant when analyzing trends over periods?

A. Yes. Therefore, I determined which companies in Mr. Hevert's recent KCPL DCF analyses were in common with his GMO direct testimony in 2016 as well as with his "combined proxy group" analyses he provided for purposes of the Ameren Missouri and KCPL 2014 rate cases.

Q. What companies were common to Mr. Hevert's DCF analyses over all of these cases?

A. Alliant Energy, Ameren Corporation, American Electric Power, CMS Energy Corporation, DTE Energy Company, IDACORP, OGE Energy Corporation, Otter Tail Corporation, Pinnacle West Capital Corporation, PNM Resources, Portland General Electric Company and Xcel Energy.

Q. Do you consider this an ideal proxy group for purposes of evaluating the change in the cost of equity for the utility industry over time?

A. No, but I will still evaluate all of these companies since Mr. Hevert selected them for purposes of his 2016 analyses. However, because averages without the inclusion of OGE Energy and Otter Tail can easily be observed, Staff will also review this information for purposes of its analyses.

Q. What did your analysis of the results of the various DCF analyses Mr. Hevert performed indicate about the changes in the cost of equity since the fall of 2014?

A. The current cost of equity to utilities is much lower than it was when Mr. Hevert performed his analyses for purposes of the 2014 Ameren Missouri rate case, but somewhat similar to the cost of equity at the time he performed his analyses for the 2014 KCPL rate case. This is consistent with Staff's conclusions in the Staff COS Report.

Q. What did Mr. Hevert's DCF analyses for purposes of his GMO direct testimony indicate about the general level of the cost of equity for utilities in the few months leading up to January 15, 2016?

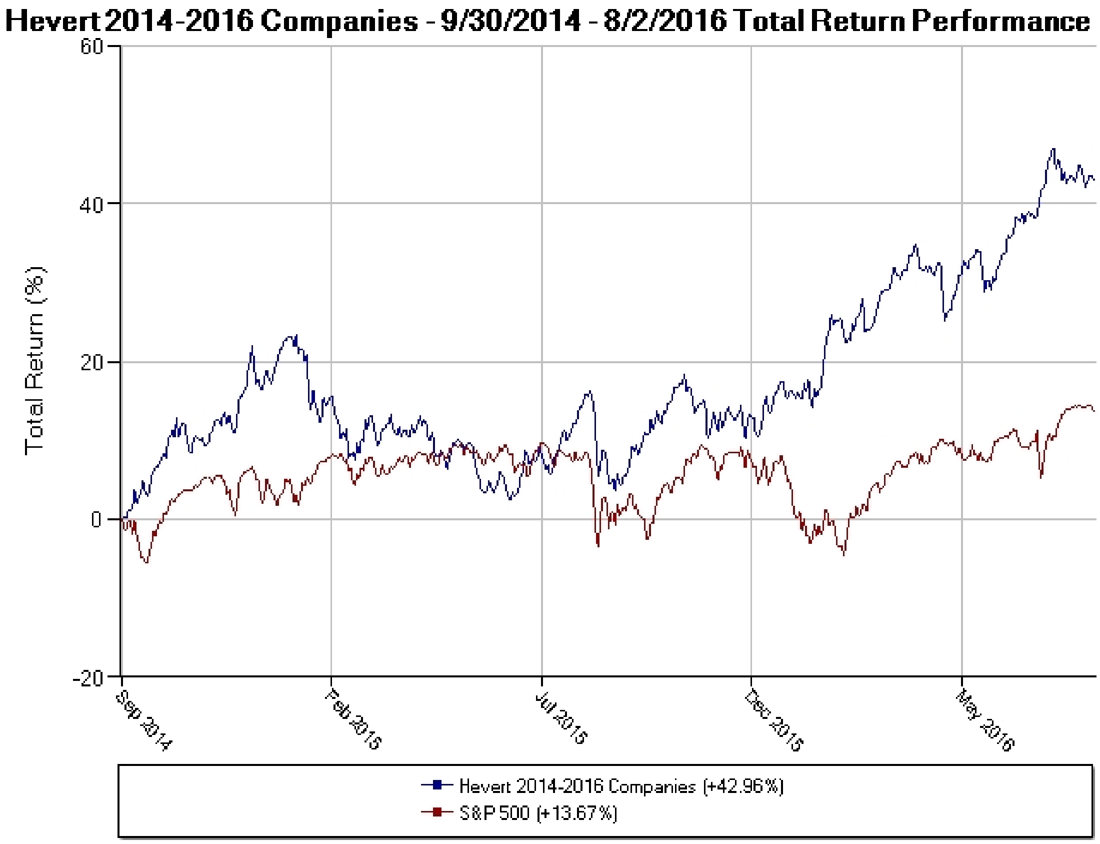
A. It was not that much different than when he prepared his rebuttal analyses in the 2014 Ameren Missouri rate case.

Q. How should the Commission consider this information in deciding whether to authorize an allowed ROE lower than 9.5% in this case?

A. Because the Commission authorized Ameren Missouri and KCPL similar ROEs in 2015, the Commission had the opportunity to evaluate similar changing market information in those cases as it will in the current rate cases before the Commission. If the Commission gives more weight to recent capital market evidence, this information supports the Commission authorizing an allowed ROE closer to 9.0%. However, if the Commission believes it should give consideration to the capital market evidence at the beginning of the year, then the Commission may not want to deviate too far from its allowed ROEs in 2015.

Q. Can you provide a graphical illustration of the total returns and dividend yields for period from the fall of 2014 until now for the companies Mr. Hevert analyzed in the 2014 and 2016 rate cases?

A. Yes. The first graph shows the total return of these companies as compared to the S&P 500 since September 30, 2014. The total return for these utility companies has far outpaced that of the broader markets. The compound annual return for the utility companies included in this group was 21.52% for this period.



The second graph shows the change in dividend yields for the same period for the proxy group as compared to the change in the 10-year US Treasury yields.

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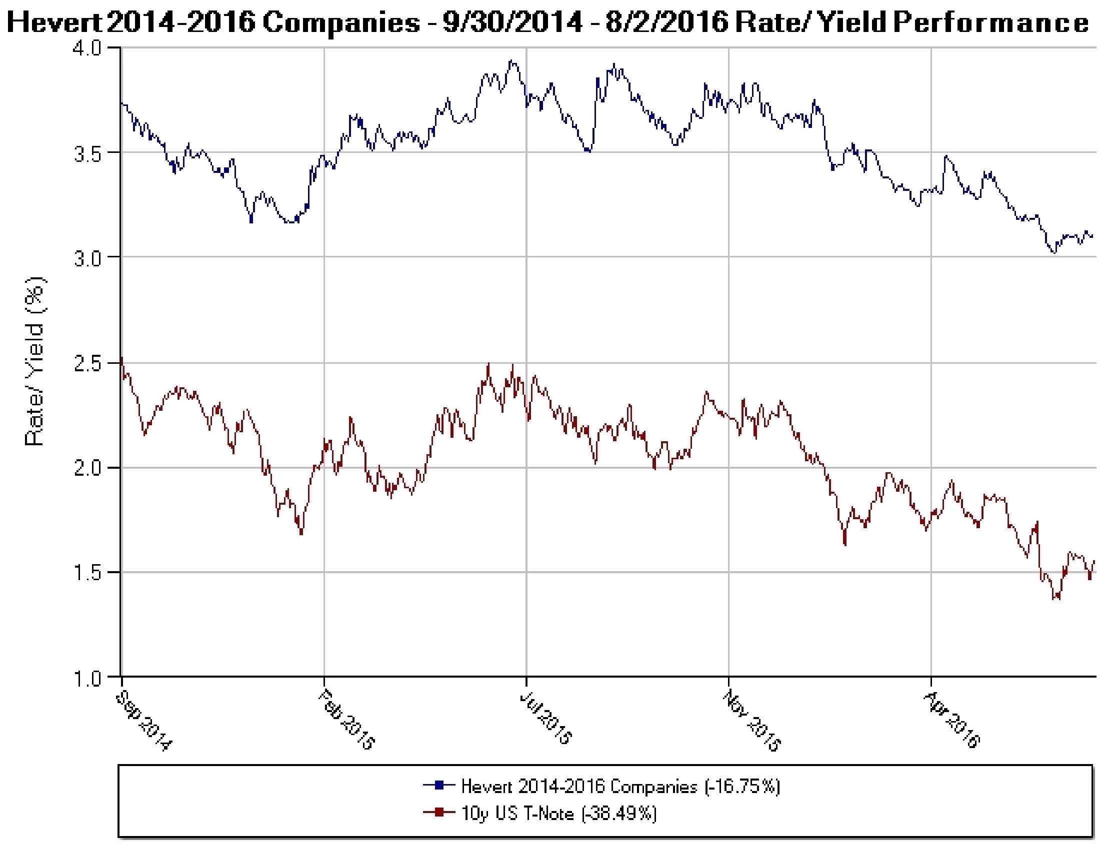

As can be seen, the dividend yields for this proxy group are now below levels they achieved in early 2015. This recent data certainly supports the Commission lowering allowed ROEs to lower levels.

Q. Will utility stock prices continue to trade at their current higher valuation levels?

A. I don't know. Providing these opinions is outside the scope of a rate of return witness' role in estimating the cost of capital. A ROR witness' role is to analyze the capital markets and report on investors' expectations and requirements.

Q. Has Staff seen investment analysis that models the possibility of interest rates staying low for a prolonged period of time?

A. Yes. Staff discussed this example in the Staff COS Report. If interest rates remain low for a prolonged period of time, then investors expect commissions will gradually lower allowed ROEs to achieve a more reasonable cost of equity to allowed ROE spread.

Q. How quickly do investors expect regulators to react to the lower cost of capital environment?

A. It's difficult to know for sure what all of the modeling scenarios are, but the example Staff analyzed in the COS Report showed an approximate 25-basis point reduction each year in allowed ROEs.

Q. Did Mr. Hevert opine about the sustainability of higher valuation levels of utility stocks during the first couple of months in 2015?

A. Yes.

Q. What did Mr. Hevert specifically state in his testimony in the 2014 rate cases about the higher valuation levels, and therefore lower dividend yields, for the utility industry in early 2015?

A. Mr. Hevert stated the following in his rebuttal testimony in the Ameren Missouri rate case, Case No. ER-2014-0258:

> For example, the market prices used to calculate the dividend yield portion of the Constant Growth Discounted Cash Flow model were taken from a period during which utilities in general, and the proxy companies in particular, traded at unusually high, and likely unsustainable, levels.
>
> In fact, during Opposing ROE Witnesses' study period, utility Price/Earnings ("P/E") ratios exceeded their long-term average, to the point that they were greater than the market P/E ratio (as measured by the Standard & Poor's ("S&P") 500). As would be expected, utilities (including the proxy group companies), generally have traded below the market P/E ratio; there is no reason to believe that the currently elevated P/E ratios will remain in perpetuity. Yet, several of the Opposing ROE

> Witnesses give considerable weight to the Constant Growth Discounted Cash Flow model, which assumes that the current P/E ratio will not change, ever. The inconsistency between model assumptions and market data should cause us to view those results 1 with great caution rather than giving them undue weight in developing ROE recommendations.[7]

Mr. Hevert's testimonies in both the Ameren Missouri and KCPL rate cases consistently criticized the weight the other ROR witnesses gave to their DCF analyses because he didn't think utility valuation levels were sustainable. He indicated this was a reason to be more cautious about the results inferred from the DCF methods. He indicated that the elevated p/e ratios for the utility industry as compared to their historical industry averages and as compared to the S&P 500 should not be used as justification to lower allowed ROEs because this situation was abnormal.

Q. Did Mr. Hevert state anything else in his testimonies expressing his concern about the Commission giving too much consideration to the higher utility valuation levels and low interest rates?

A. Yes. Mr. Hevert stated the following in his surrebuttal testimony in the Ameren Missouri rate case, Case No. ER-2014-0258:

> The notion that the Commission should dramatically reduce the Company's ROE based on the current utility valuation multiples also is misplaced. P/E ratios tend to revert back toward their mean over time; various forward-looking market indices support that view. If the Opposing ROE Witnesses believe that the current levels represent a fundamental shift in how investors value stocks in general, and utility stocks in particular, they have not explained that position. If they see the shift as temporary change based on trading, rather than fundamental valuation precepts, they have not adequately reflected that change in the assumptions included in their ROE estimation methods and recommendations. In either case, the conclusion that the Commission should reduce the Company's

[7] Case No. ER-2014-0258, Robert B. Hevert Rebuttal Testimony, p. 5, l. 9 – p. 6, l. 2.

> ROE simply is not supported by observable and relevant market data.[8]

Considering that Mr. Hevert sponsored the above testimony 18 months ago and utility stock valuation metrics are now above the levels Mr. Hevert then claimed were unsustainable, it seems the markets have proven Mr. Hevert wrong. Considering the fact that utility valuation levels have been higher on average due to lower long-term rates for approximately seven years, it seems appropriate to at least gradually reduce allowed ROE's until long-term interest rates have a prolonged period of higher levels. Using higher projected interest rates to estimate the cost of capital is inconsistent with economic theory and the efficient market hypothesis. The Commission should rely on the principle of what is known and measurable when it evaluates a fair rate for return, and current low long-term interest rates and low utility dividend yields are known and measurable and reflective of current low capital costs.

Q. Are lower costs of capital fueling high premiums in recent merger and acquisition activity the utility industry?

A. Yes. The very low cost of capital applied to consistent cash flows offered by regulated utilities is driving the valuations of regulated utilities to much higher levels. We need to look no further than the two proposed transactions involving Missouri utility companies or the parent company of Missouri utility companies to see the high multiples being offered. Liberty Utilities is offering 1.49x Empire's rate base for its proposed acquisition.[9] GPE is offering 1.72x rate base for its offer to acquire Westar Energy.[10]

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[8] Case No. ER-2014-0258, Robert B. Hevert Surrebuttal Testimony, p. 13, l. 15 – p. 14, l. 2.

[9] Algonquin Power & Utilities Company and The Empire District Electric Company Investor Presentation, February 9, 2016.

[10] Great Plains Energy's Investor Presentation, May 31, 2016.

Q. ** ____ **

A. ** ____ **

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STAFF RESPONSE TO MICHAEL GORMAN'S RECOMMENDED RETURN ON COMMON EQUITY FOR GMO

Q. Does Staff agree with the premise underlying Mr. Gorman's recommended allowed ROE?

A. No. Mr. Gorman claims that the premise for his recommended ROE of 9.25% is that this is GMO's cost of equity. I believe GMO's cost of equity is much lower. However, because his ROE recommendation is within the range of Staff's recommended allowed ROEs for GMO, Staff will not delve into the details of Mr. Gorman's testimony.

STAFF RESPONSE TO MICHAEL GORMAN'S RECOMMENDED CAPITAL STRUCTURE FOR GMO

Q. Does Staff agree with Mr. Gorman that GMO's recommended common equity ratio is not reasonable?

A. Yes. The approximate 55% equity ratio GMO proposed to use for ratemaking is inconsistent with market-tested capital structures of comparable Missouri utilities, such as Empire, which has consistently had a ratemaking common equity ratio of around 50%. Because GMO doesn't have a market-based capital structure and it hasn't been financially managed as a stand-alone entity, and it not viewed as such by S&P, Staff still recommends GPE's consolidated capital structure be used to set GMO's allowed ROR.

SUMMARY AND CONCLUSIONS

Q. What are the main points the Commission should consider in determining an appropriate capital structure and fair rate of return for GMO?

A. First, because GMO's assets were associated with the former Aquila operations and its financial difficulties, it is impossible to claim that its capital structure and cost of capital are a function of MPS's and L&P's stand-alone business and financial risk.

Although Mr. Bryant correctly points out that S&P and Moody's assign GMO a higher business risk rating, Staff also notes that the rating agencies have consistently highlighted the fact that GMO had a FAC, which Mr. Hevert considers important enough to specifically address in his cost of capital testimony. Additionally the fact that GMO hasn't had to file in four years should be taken into consideration when considering Mr. Bryant's testimony about GMO having higher business risk than KCPL, which has filed twice in four years. In theory, Mr. Bryant is correct that a company with more business risk needs to have less financial risk, i.e. the use of debt, to achieve the same credit rating. But The Empire District Electric Company ("Empire") has 90% of its operations regulated by the Missouri Public Service Commission and it has consistently had a common equity ratio of approximately 50%. Because S&P assigns GMO and Empire the same business risk profile of "strong," Staff does not agree with Mr. Bryant that GMO's capital structure is a matter of logic. Considering Empire is a publicly-traded entity, and therefore has a market-tested capital structure, Mr. Bryant's use of theory is not supported by practice. Consequently, Staff recommends the Commission continue to use GPE's market-tested capital structure to determine a fair and reasonable ROR to allow for GMO.

Second, the Commission has recent experience with evaluating and deciding on a fair and reasonable allowed ROE for its electric utilities. Because the ROR witnesses and their methodologies in this case also sponsored ROR testimony in the UE and KCPL rate cases in 2014, the Commission can simply evaluate relative changes to the results of the various witnesses' methodologies to determine if an allowed ROE of below 9.5% is appropriate. The evidence Staff reviewed supports consideration of an allowed ROE of 9.0%. Staff will update the Commission on the relevant utility capital market information as the case progresses.

Q. Does this conclude your Rebuttal Testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW DAVID MURRAY and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing Rebuttal Testimony and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

David Murray

DAVID MURRAY

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 12th day of August, 2016.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public

Case No. ER-2016-0156

Historical Consolidated Capital Structures for Great Plains Energy

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	$2,960.9	$3,340.0	$3,474.4	$3,586.1	$3,656.5	$3,403.6
Preferred Stock	39.0	39.0	39.0	39.0	39.0	39.0
Long-Term Debt	3,543.7 *	3,019.9 *	3,516.8 *	3,480.8 *	3,746.2 *	3,461.5
Short-Term Debt	384.0	716.1	292.2	533.3	409.0	466.9
Total	$6,927.6	$7,115.0	$7,322.4	$7,639.2	$7,850.7	$7,371.0

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	42.74%	46.94%	47.45%	46.94%	46.58%	46.13%
Preferred Stock	0.56%	0.55%	0.53%	0.51%	0.50%	0.53%
Long-Term Debt	51.15%	42.44%	48.03%	45.56%	47.72%	46.98%
Short-Term Debt	5.54%	10.06%	3.99%	6.98%	5.21%	6.36%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Sources:

Great Plains Energy's SEC 10-K for 12/31/2011.
Great Plains Energy's SEC 10-K for 12/31/2013.
Great Plains Energy's SEC 10-K for 12/31/2014.
Great Plains Energy's SEC 10-K for 12/31/2015.

Note: *Includes current maturities of long-term debt.

Case No. ER-2016-0156

Historical Consolidated Capital Structures for Great Plains Energy
Excluding Short-Term Debt

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	$2,960.9	$3,340.0	$3,474.4	$3,586.1	$3,656.5	$3,403.6
Preferred Stock	39.0	39.0	39.0	39.0	39.0	39.0
Long-Term Debt	3,543.7 *	3,019.9 *	3,516.8 *	3,480.8 *	3,746.2 *	3,461.5
Short-Term Debt	0.0	0.0	0.0	0.0	0.0	0.0
Total	$6,543.6	$6,398.9	$7,030.2	$7,105.9	$7,441.7	$6,904.1

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	45.25%	52.20%	49.42%	50.47%	49.14%	49.29%
Preferred Stock	0.60%	0.61%	0.55%	0.55%	0.52%	0.57%
Long-Term Debt	54.16%	47.19%	50.02%	48.98%	50.34%	50.14%
Short-Term Debt	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Sources:

Great Plains Energy's SEC 10-K for 12/31/2011.
Great Plains Energy's SEC 10-K for 12/31/2013.
Great Plains Energy's SEC 10-K for 12/31/2014.
Great Plains Energy's SEC 10-K for 12/31/2015.

Note: *Includes current maturities of long-term debt.

SCHEDULE DM-r2

Case No. ER-2016-0156

Historical Consolidated Capital Structures for KCP&L Greater Missouri Operations

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	$1,356,821.0	$1,385,128.0	$1,425,969.0	$1,440,496.0	$1,349,907.0	$1,391,664.2
Long-Term Debt	1,238,439.0 *	1,008,524.0 *	1,097,039.0 *	1,083,614.0 *	1,082,489.0 *	1,102,021.0
Short-Term Debt	40,000.0	169,070.0	15,000.0	0.0	43,700.0	53,554.0
Total	$2,635,260.0	$2,562,722.0	$2,538,008.0	$2,524,110.0	$2,476,096.0	$2,547,239.2

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	51.49%	54.05%	56.18%	57.07%	54.52%	54.66%
Long-Term Debt	46.99%	39.35%	43.22%	42.93%	43.72%	43.24%
Short-Term Debt	1.52%	6.60%	0.59%	0.00%	1.76%	2.09%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: FERC Form 1 Filings through SNL Financial

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Historical Consolidated Capital Structures for KCP&L Greater Missouri Operations
Excluding Short-Term Debt

Capital Components	2011		2012		2013		2014		2015		5-Year Average
Common Equity	$1,356,821.0		$1,385,128.0		$1,425,969.0		$1,440,496.0		$1,349,907.0		$1,391,664.2
Long-Term Debt	1,238,439.0	*	1,008,524.0	*	1,097,039.0	*	1,083,614.0	*	1,082,489.0	*	1,102,021.0
Short-Term Debt	0.0		0.0		0.0		0.0		0.0		0.0
Total	$2,595,260.0		$2,393,652.0		$2,523,008.0		$2,524,110.0		$2,432,396.0		$2,493,685.2

Capital Components	2011	2012	2013	2014	2015	5-Year Average
Common Equity	52.28%	57.87%	56.52%	57.07%	55.50%	55.85%
Long-Term Debt	47.72%	42.13%	43.48%	42.93%	44.50%	44.15%
Short-Term Debt	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: FERC Form 1 Filings

Case No. ER-2016-0156

Comparison of Hevert's Various Mean DCF Results in KCPL, UE and GMO Rate Cases

	Hevert UE-Rebuttal ER-2014-0258[1]		Hevert KCPL-Rebuttal ER-2014-0370[2]			Hevert GMO-Direct ER-2016-0156[3]		Hevert KCPL-Direct ER-2016-0285[4]	
30-Day Constant Growth DCF	9.82%		9.04%			9.21%		8.89%	
without OGE and Otter Tail		9.36%		8.93%			9.02%		8.85%
90-Day Constant Growth DCF	9.95%		8.94%			9.24%		8.95%	
without OGE and Otter Tail		9.51%		8.82%			9.07%		8.89%
180-Day Constant Growth DCF	9.98%		9.06%			9.30%		9.13%	
without OGE and Otter Tail		9.54%		8.96%			9.17%		9.07%
30-Day Multi-Stage DCF	9.85%		9.31%			9.80%		9.15%	
without OGE and Otter Tail		9.78%		9.29%			9.63%		9.10%
90-Day Mutli-Stage DCF	10.00%		9.19%			9.83%		9.22%	
without OGE and Otter Tail		9.94%		9.17%			9.69%		9.14%
180-Day Multi-Stage DCF	10.02%		9.32%			9.90%		9.41%	
without OGE and Otter Tail		9.98%		9.32%			9.80%		9.35%
Average	**9.94%**		**9.14%**			**9.55%**		**9.13%**	
without OGE and Otter Tail		**9.69%**		**9.08%**			**9.40%**		**9.07%**
Multi-Stage Only Average	**9.96%**		**9.27%**			**9.84%**		**9.26%**	
without OGE and Otter Tail		**9.90%**		**9.26%**			**9.70%**		**9.20%**
Difference Between 2014 UE Rebuttal and 2016 KCPL Direct				**0.70%**					
without OGE and Otter Tail					**0.70%**				
Difference Between 2014 KCPL Rebuttal and 2016 KCPL Direct				**0.01%**					
without OGE and Otter Tail					**0.06%**				

Notes:
1. Used market data through November 14, 2014.
2. Used market data through April 30, 2015.
3. Used market data through January 15, 2016.
4. Used market data through May 31, 2016.