STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Evidentiary Hearing

October 2, 2007
Jefferson City, Missouri
Volume 6

In the Matter of the)
Application of Kansas City)
Power & Light Company for)
Approval to Make Certain)Case No. ER-2007-0291
Changes in Its Charges for)
Electric Service to Implement)
Its Regulatory Plan)

RONALD D. PRIDGIN, Presiding,
SENIOR REGULATORY LAW JUDGE

JEFF DAVIS, Chairman,
CONNIE MURRAY,
TERRY JARRETT,
LINWARD "LIN" APPLING,
COMMISSIONERS.

REPORTED BY:

PAMELA FICK, RMR, RPR, CCR #447, CSR

APPEARANCES:

KARL ZOBRIST, Attorney at Law
Sonnenschein, Nath & Rosenthal
4520 Main Street, Suite 1100
Kansas City, Missouri 64111
(816) 460-2545

JAMES M. FISCHER, Attorney at Law
Fischer & Dority, PC
101 Madison Street
Jefferson City, Missouri 65102
(573) 636-6758

WILLIAM RIGGINS, Attorney at Law
CURTIS D. BLANC, Attorney at Law
Kansas City Power & Light Company
1201 Walnut - 20th Floor
Kansas City, Missouri 64141
(816) 556-2483

FOR: KCP&L.

DIANA C. CARTER, Attorney at Law
Brydon, Swearengen & England
312 E. Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102-0456
(573) 635-0427

FOR: Missouri Gas Energy, the Empire District Electric Company and Aquila, Inc.

ARTHUR PERRY BRUDER, Attorney at Law
1000 Independence Avenue SW
Washington, D.C. 20585
(202) 586-3409

LEWIS CAMPBELL, Attorney at Law
P.O. Box 51508
811 Lamp Post Cir SE
Albuquerque, New Mexico 87181-1508
(505) 323-8292
Lcampbell4@comcast.net

FOR: U.S. Department of Energy/NNSA.

LEWIS R. MILLS, JR. Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, MO 65102-2230
(573)751-4857

FOR: Office of the Public Counsel and the Public.

KEVIN THOMPSON, General Counsel
P.O. Box 360
200 Madison Street
Jefferson City, MO 65102
(573)751-3234

FOR: Staff of the Missouri Public Service Commission.

P R O C E E D I N G S

JUDGE PRIDGIN: All right. Good morning. We're back on the record. It is about 8:35, Tuesday morning, October 2nd, 2007. We're resuming the hearing in ER-2007-0291. And if I'm not mistaken, we will begin with cost of capital, and Dr. Hadaway, he'll be the first witness; is that correct, counsel?

MR. ZOBRIST: That's correct.

JUDGE PRIDGIN: All right. Is there anything else counsel needs to bring to my attention before Dr. Hadaway gets to the stand, Mr. Fischer?

MR. FISCHER: Yes, Judge. One of the open items from yesterday is I did not give you or the parties a list of KCPL witnesses that are not listed as contested witness -- or a -- listed for contested issues, and I just wanted to do that to make sure there wasn't any cross or questions from the bench.

And those particular witnesses would be Ed Blunk on fuel, Sue Nathan who would be -- actually Kevin Bryant would adopt her testimony, but Sue Nathan is the witness who filed testimony on customer programs, Burton Crawford on fuel annualization, Dana Crawford on maintenance annualization, Christine

Davidson on cash working capital, John Grimwade on resource plan monitoring and in-service criteria, Bill Herdegen on distribution asset management plan, George McCollister on weather normalization, Richard Spring on transmission asset management plan.

And then one of the contested issues, we have Michael Schnitzer who's an out-of-town witness who we have -- is not on the list of witnesses now, but we wanted to make sure there wasn't a reason to bring him in.

JUDGE PRIDGIN: Any new filed testimony on off-system sales?

MR. FISCHER: Yes.

JUDGE PRIDGIN: Okay. As far as you know, Mr. Fischer, those are the witnesses for whom you believe no counsel have cross-examination?

MR. FISCHER: That's my understanding. There's not a list or a list of issues that would apply to those witnesses with the exception of Michael Schnitzer, and I don't think anyone has cross on that, but I wanted to make sure.

JUDGE PRIDGIN: All right. Does counsel have any comment on Mr. Fischer's list? Would counsel anticipate having cross-examination for any of those witnesses he just named?

MR. THOMPSON: None from Staff, your Honor.

MR. MILLS: At this point, no, unless something odd comes up or something changes, but no, at this point we don't.

MR. BRUDER: We don't anticipate that.

JUDGE PRIDGIN: What I will do, Mr. Fischer, is I will alert the Commission that no parties have questions for these witnesses and ask, if they believe they would have questions, to alert me as soon as possible to make travel arrangements. But unless you hear otherwise, you know, I would assume that these witnesses would not need to appear.

MR. FISCHER: Would it be appropriate for me to offer their testimony as well?

JUDGE PRIDGIN: That's perfectly fine with me.

MR. FISCHER: I would offer that list of testimony then. And I can go through the numbers if you need it, but --

JUDGE PRIDGIN: Please give counsel that in case they have an objection.

And I think I have a list. And if anybody has a different number -- I see Blunk's testimony is NP and HC. His direct is Exhibit

No. 1.

MR. FISCHER: That's correct. Bryant -- well, actually Sue Nathan, her testimony is listed as --

JUDGE PRIDGIN: 18?

MR. FISCHER: -- 18 NP. Burton Crawford has direct, No. 5 HC and NP. Dana Crawford is No. 6 HC and NP. Chris Davidson is No. 7, direct. John Grimwade is No. 10 NP. Bill Herdegen is No. 16. George McCollister is No. 17. Michael Schnitzer is No. 22 HC and NP and 23 HC and NP. And Richard Spring is No. 25 NP. Thank you.

JUDGE PRIDGIN: Okay. And those have all been offered. Mr. Fischer, I'm sorry, did you offer all those?

MR. FISCHER: Yes.

JUDGE PRIDGIN: All right. Any objections to those exhibits being admitted?

MR. THOMPSON: No objections, your Honor.

JUDGE PRIDGIN: All right. Hearing no objection, let me make sure I get the exhibit numbers right. I see Exhibit No. 1 HC and NP, Exhibit 5 NP and HC, Exhibit 6 NP and HC, Exhibit 7, Exhibit 10, Exhibit 16, 17, 18, 22 NP and HC, 23 NP and HC and 25 as all being offered, and hearing no objections, they are all admitted.

(EXHIBIT NOS. 1 HC AND NP, EXHIBIT NO. 5 NP AND HC, EXHIBIT NO. 6 NP AND HC, EXHIBIT NO. 7, EXHIBIT NO. 10, EXHIBIT NOS. 16, 17, 18, 22 NP AND HC, 23 NP AND HC AND 25 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE PRIDGIN: Okay. Anything else from counsel before Dr. Hadaway takes the stand?

MR. ZOBRIST: Mini opening statements?

JUDGE PRIDGIN: Yes, I'm sorry. If you have a mini opening. I'm sorry.

MR. ZOBRIST: May it please the Commission, Karl Zobrist for Kansas City Power & Light Company. I'd like to give you just a brief overview of the two issues that we'll be handling this morning and probably most of the day; the first dealing with capital structure, the second dealing with return on equity.

The capital structure was initially presented in Dr. Hadaway's testimony that was done in January of this year, and as the company indicated in the data they've provided that was included as part of the reconciliation, KCPL expects that that capital structure will be modified.

The projection as of the end of the third quarter, September 30th, was debt at 40.76 percent, preferred stock at 1.44 and equity at 57.8 percent, and those figures are listed in the Kansas City Power & Light Company list of issues.

Dr. Hadaway is not going to and did not present any update of that, but as Michael Cline indicated in his rebuttal testimony -- and he's the treasurer of Great Plains Energy -- KCPL expects that those figures will be updated as of the year once the books have totally closed, and he will be providing the company's recommended capital structure in the true-up direct testimony to be filed in November.

Now, turning to return on equity. I'm gonna try to go over -- if it's all right with you, Judge, and I'll keep my voice up -- to try to use the magic board over there, and if I fail to do what I think I'm going to do, I've got my trusty sidekick over here.

We have three ROE recommendations in the case today. And I am right-handed, so I'm gonna be standing in front of you, but I'll try to move over

JUDGE PRIDGIN: And Mr. Zobrist, if you'd like, if you want to hit that microphone over the witness stand, that might project your voice.

Hopefully, there's just an on button there.

MR. MILLS: I think that one's always on.

JUDGE PRIDGIN: Is it? Okay.

MR. ZOBRIST: I'll try to do it this way. The lowest ROE recommendation that you'll hear is from Staff, from Mr. Barnes, and it's 9.14 to 10.83. That is his range and he chooses a midpoint of 9.72.

The second one is from Office of the Public Counsel which ranges from 9.50 to 10.70 with a midpoint of 10.1. And the third which you -- which is sponsored by Dr. Hadaway on behalf of KCPL is 10.75 base, plus a 50-point adder for construction risk, which is 11.25.

Now, the reason that I'm putting these up here is so that you can see the divergence. And what we have is a range from a low 9.72 to 11.25. And based on what the Commission did in 2006, what it used is a zone-of-reasonableness analysis.

If you took the average of the past three quarters, the average ROE issued by US Utility Commissions is 10.31. And so for this case, each of the recommendations does fall within the zone of reasonableness because it would go from 9.31 down to

11.31.

If you remember in the case in 2006, we had four ROE recommendations. In '06 the lowest was a 9.0 offered by the Department of Energy which did not fall within the zone of reasonableness. The others were 9.32, 42 offered by Staff -- see, if I can do my eraser here. How do you like that?

OPC was 9.9 and Dr. Hadaway's was a total of 11.25 which was -- I'm sorry, that was 11.50. It was 11.0 plus a 50-basis adder. And what the Commission arrived at was 11.25.

And what I'm here to tell you and what the witness -- what Dr. Hadaway will say on behalf of the company is that the Commission in 2006 struck the right balance, it did the right thing. And if, indeed, the figure, 11.25, is the highest ROE that was voted on by any state commission in this country, there could not be a better candidate for this than KCPL.

A moderate-sized utility, not a big utility, a well-performing utility, a well-run utility and a utility that has embarked upon a massive construction program. Comparing 2005 with 2006 data going forward, approximately 95 percent of the plant -- of its plant was subject of construction.

Now, Mr. Gorman has provided us some update which shows that it's still at 84.4 percent, so it's really uncontested among the parties that this company, a moderate-sized, well-run utility, has embarked upon a very important and ambitious construction project.

Now, I have to go to my board because I can't figure it out. I've saved that but I can't figure out how to save the screen. The other question that the commissioners and the parties are going to ask themselves is why do we have that divergence? Why do we have this divergence from 9.72 to 10.1 to 11.25?

And there are a couple of reasons. If we were all economists, we could probably spend hours going through this. But the major reason is the growth rates that are chosen by the experts. The growth rate -- this is the gross domestic product growth rate -- long-term growth rate advocated by Dr. Hadaway is 6.6 percent.

The lowest growth rate advocated by any witness is by Office of Public Counsel, Mr. Gorman, which is a 5.1 percent.

Now, Mr. Barnes does not try to

calculate a long-term growth rate. He uses other growth rates. All of his growth rates are in between the 6.16 and the 5.10. And this is the growth rate of what the economy is expected to grow in the future. And his range from a low of 5.34 to a high of 6.50 which he derives from Standard & Poors. He had one other one that falls in the middle from the Institutional Brokers' Estimate System of 6.37. And these are critical inputs to the discounted cash flow analysis, and so I'd ask that you pay attention when the witnesses speak of why they justify particular ROEs.

Our position on behalf of the company is that the GDP growth rate advocated by Mr. Gorman is well below what it should be; it projects significantly low growth for the economy; and that Dr. Hadaway's, of which Staff's upper-level growth rate is only ten points shy, is the appropriate growth rate.

The return on equity is important in this case because it does provide earnings to the company, and it should not be under any circumstances confused with the additional amortizations that I know Mr. Giles spoke of yesterday and has been spoken about by the witnesses.

This is a critical component of the health of this company. The Commission should not be embarrassed, it should not back away from the analysis that it employed in 2006, and if it follows that same analysis, it will accept numbers either advocated by Dr. Hadaway or in the range advocated by Dr. Hadaway. Thank you very much.

JUDGE PRIDGIN: Mr. Zobrist, thank you. Anything further from counsel before Dr. Hadaway takes the stand?

MR. THOMPSON: Are we gonna do all the little opening statements at once or do you want us to wait until before our witness?

JUDGE PRIDGIN: At your option.

MR. THOMPSON: Well, I'll go ahead and go now if that's okay with you, Judge.

JUDGE PRIDGIN: Certainly.

MR. THOMPSON: May it please the Commission. Determining a return on common equity is one of the most important things the Commission will do in this case. It's also one of the most difficult things the Commission will do in this case.

We've all read the testimony of these three witnesses and the other witnesses who support the ROE positions of these parties in one way or another, and I'm here to tell you that I personally lack the expertise to judge between the methods used by Mr. Barnes or Mr. Gorman or Dr. Hadaway.

In fact, they use similar methods but slightly different inputs, slightly different comparable company lists, and they arrive at significantly different recommendations.

Now, unless you have a master's degree in finance and have read a lot of literature in the field, I don't know how you're gonna pick the Gorman recommendation over the Hadaway recommendation over the Barnes recommendation. So as lay people, we're here faced with the differing testimony of three experts, three experts. How do you choose between these experts?

Well, this Commission has been doing what's called benchmarking. That zone-of-reasonableness analysis that was mentioned by Mr. Zobrist in his magisterial opening statement, very good, very good.

That zone-of-reasonableness analysis is a benchmarking analysis. You take the report of ROEs awarded by other commissions during a recent period of time -- and that's varied from case to case depending, I guess, on what's in the evidence -- you look at the average. And then this zone of reasonableness that we've been dealing with in the past several cases has been defined as 100 points, 100 basis points; that is, 1 percentage point on either side of that average.

Now, Mr. Zobrist tells you the average for the past three quarters is 10.31. And I don't dispute that. I can tell you that the average for two quarters in 2007 is 10.27. A little bit lower, but not significantly lower, not a whole lot lower. Just a few million dollars in rates.

So, yes, the three recommendations presented here today are all within the zone of reasonableness. So you know what? Benchmarking in the way you've been doing it isn't going to pick the winner, right? You're not gonna get Miss ROE through benchmarking alone.

But that doesn't mean that these reports of the ROEs awarded by other commissions are not useful. For example, I look over this list -- and this is awards in the first --

CHAIRMAN DAVIS: Excuse me, Judge. Is that list in evidence?

MR. THOMPSON: Not yet.

CHAIRMAN DAVIS: Okay. You're gonna put

it in evidence and get us a copy of it?

MR. THOMPSON: Absolutely.

CHAIRMAN DAVIS: Thank you.

MR. THOMPSON: As I look over this list, I see that the lowest ROE that's been awarded this year was 9.67, Public Service of New Hampshire. And the highest ROE awarded yet this year is 10.9 to Wisconsin Public Service. And I think in the last case we heard some talk about Wisconsin and how maybe they tend to go on the high side of those ROEs.

Now, looking at that chart, I think you'll agree with me that 11.25 is above 10.9. So in other words, if you do what Dr. Hadaway is asking you to do, you will once again be awarding Kansas City Power & Light the highest return on equity in the land.

Now, there's still time left this year. Maybe another commission will give someone else a higher ROE, but that's speculation. We don't know that. What we do know with certainty is that if you give them 11.25, that's gonna be the highest.

Well, so what, you say. Maybe that's the right ROE. That, after all, is what Mr. Zobrist just told you: Do the right thing, don't shrink from doing the right thing just because it might be the highest ROE. But I think the question you have to ask yourself is, is it the right thing? Is it the right thing?

Now, I told you yesterday that Kansas City Power & Light is in the position of a homeowner who wants to make a significant home improvement and now faces the problem of financing it.

I don't know if you've ever done much home improving, but I can tell you the financing issue is a significant one. And the financing of Iatan 2 is a significant problem for this company.

The Commission has already given them the equivalent of a home equity line of credit. The Commission has said, go ahead and build the plant. We're going to let you accelerate the depreciation of your plant in service in order to keep your credit metrics high.

But Kansas City Power & Light is not content with that home equity line of credit. I said yesterday that what they want is a windfall. And I'll say it again: They want to do that home improvement with free money. They don't want to have to pay it back, they don't want to mortgage the future, they don't want to see their rate base and, thus, their profits reduced for the future by taking that depreciation now.

Instead, they want money with no strings and no obligations from their customers. They want their customers to keep their credit metrics high by paying higher rates.

Now, Mr. Conrad told you -- and he was absolutely right. He was absolutely right that whether they're paying higher rates because you give them a high ROE or they're paying higher rates because there's a lot of additional amortizations under the regulatory plan, from the point of view of a customer, it's still money coming out of their pocket and going to the company. So from the point of view of the customer, paying that bill is gonna feel just as bad either way.

But there's a difference. There's a difference. If that funding is through additional amortizations, then in the future, rates will be lower because rate base will be lower because depreciation will have been accelerated and they will get less of a return, less plant in service.

So in conclusion, I will simply say that there's a story we all know about the young man who takes an animal to market and instead of getting a sensible price for that animal, trades the animal for magic beans.

Well, I'm here to tell you that this company brought a pig to market last year and got magic beans. They're looking for another magic bean today, and I suggest that you don't give it to them. Thank you.

CHAIRMAN DAVIS: Judge, I'd like to ask Mr. Thompson a few questions.

JUDGE PRIDGIN: Certainly.

MR. THOMPSON: Yes, Commissioner.

CHAIRMAN DAVIS: Mr. Thompson, is that your signature on the KCP&L experimental regulatory plan or was that before your time as General Counsel?

MR. THOMPSON: That was before my time as General Counsel.

CHAIRMAN DAVIS: But your predecessor or someone on behalf of this Commission did sign it?

MR. THOMPSON: Absolutely. And Staff is bound by it.

CHAIRMAN DAVIS: Well, can you tell me why Staff agreed to that experimental regulatory plan, why -- why you -- why did you think that KCP&L should issue -- or GXP or GPE should issue 500 million dollars in equity for this plant if you weren't gonna intend to pay any dividends? Is that free ridership? Is that what you were seeking?

MR. THOMPSON: Staff agreed to the mechanism of additional amortizations, and Staff still believes that that's a sensible and appropriate mechanism by which this company can build that plant and maintain its credit rating.

CHAIRMAN DAVIS: Okay. Were you seeking free ridership? Do you think the Staff was seeking free ridership?

MR. THOMPSON: I don't know what you mean by that term.

CHAIRMAN DAVIS: Do you think they were trying to get something for nothing?

MR. THOMPSON: No, sir, I don't.

CHAIRMAN DAVIS: Get GPE to issue a half a billion dollars in stock to fund a power plant? Could you have done this all through amortizations? Couldn't we have just divided it up and sent the bill to the ratepayers and just done it all through amortizations?

MR. THOMPSON: I think the bill's going to the ratepayers however you do it.

CHAIRMAN DAVIS: So why didn't -- why did -- why do you think Staff chose a model where GPE would be issuing half a billion dollars worth of stock approximately versus just saying let's -- let's fund it all, let's own it all, and that way the company can just run it and won't -- won't get a return on rate base?

MR. THOMPSON: Mr. Chairman, you're talking in terms of extremes. I think what Staff and the other signatories anticipated --

CHAIRMAN DAVIS: Well, isn't it -- isn't a -- trading a pig for magic beans an extreme?

MR. THOMPSON: I think it's a colorful mental picture.

CHAIRMAN DAVIS: Okay. Well, let's go to another -- let's go to another extreme. How many customers in Missouri does KCP&L serve?

MR. THOMPSON: I don't know.

CHAIRMAN DAVIS: 270,000 roughly, does that sound about right?

MR. THOMPSON: If you say so.

CHAIRMAN DAVIS: Okay. Do you know how many customers KCP&L serves in Kansas?

MR. THOMPSON: No, sir.

CHAIRMAN DAVIS: Okay. Do you have any idea, is it more or less?

MR. THOMPSON: I have no idea.

CHAIRMAN DAVIS: Okay. So if I told you

it was less, you wouldn't have any reason to dispute that, would you?

MR. THOMPSON: No, sir.

CHAIRMAN DAVIS: Okay. So if KCP&L serves roughly 270,000 customers and -- in Missouri and around 230,000 in Kansas, then just ballpark math, if 54 percent of KCP&L's customers are in Missouri, 46 percent of them are in Kansas; is that a fair statement?

No, we don't know what their load is, so their load characteristics, they may have more load in Kansas, but, you know, assuming with their 4,000-plus megawatts of existing generation, that it mirrors the -- the -- the customer base. Are you aware of the Kansas settlement?

MR. THOMPSON: No, sir.

CHAIRMAN DAVIS: Okay. So if I told you that Kansas gave them 28 million dollars and that all the parties agreed to it, what do you say about that?

MR. THOMPSON: That's Kansas.

CHAIRMAN DAVIS: Well, okay.

MR. THOMPSON: We in Missouri have always had a healthy suspicion of Kansas.

CHAIRMAN DAVIS: So you think Governor Sebelius is over there giving away the store?

MR. THOMPSON: I have no idea.

CHAIRMAN DAVIS: You don't know. So it's possible that she wasn't?

MR. THOMPSON: It's possible --

CHAIRMAN DAVIS: Yes, no or maybe, Mr. Thompson? Yes, no or maybe?

MR. THOMPSON: I don't know.

CHAIRMAN DAVIS: You don't know. Okay. That's an acceptable answer. So ROE is the big issue in this case, isn't it?

MR. THOMPSON: Absolutely.

CHAIRMAN DAVIS: Now, of those companies that you listed there, how many of them do you know are vertically integrated utilities where they owned a generation, transmission and distribution? I could see you were confused so I --

MR. THOMPSON: Companies that I listed?

CHAIRMAN DAVIS: Well, you were discussing the averages. Do you know in those -- in those groups, how many of them were vertically integrated versus how many of them were distribution companies?

MR. THOMPSON: That's something I hope to learn through cross-examination of our fact witnesses, sir.

CHAIRMAN DAVIS: Oh, well, maybe -- maybe we will -- maybe we will learn that. Maybe we'll learn -- we'll be able to ask a few more questions about what they did in Kansas too.

MR. THOMPSON: Absolutely.

CHAIRMAN DAVIS: All right. Thank you, Mr. Thompson.

MR. THOMPSON: Thank you, Mr. Chairman.

JUDGE PRIDGIN: Mr. Chairman, thank you. Is there anything further from counsel before Dr. Hadaway takes the stand?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Dr. Hadaway, come forward to be sworn, please.

(THE WITNESS WAS SWORN.)

JUDGE PRIDGIN: Thank you very much, sir. If you would please have a seat.

Mr. Zobrist, any cleanup before he's tendered for cross?

MR. ZOBRIST: Thank you, Judge.

DIRECT EXAMINATION BY MR. ZOBRIST:

Q. Now just please state your name and address.

A. My name is Samuel C. Hadaway. My business address is Austin, Texas.

Q. And Dr. Hadaway, we have premarked your exhibits as Kansas City Power & Light Company Exhibit 11, 12 and 13 consisting of your direct, rebuttal and surrebuttal testimony, all public versions, no confidential versions, correct?
A. Yes, sir.
MR. ZOBRIST: I would move the admission of those exhibits at this time, Judge.
JUDGE PRIDGIN: Excuse me. Exhibits 11, 12 and 13 have all been offered. Any objections?
MR. THOMPSON: No objection from Staff, your Honor.
JUDGE PRIDGIN: Hearing no objections, Exhibits 11, 12 and 13 are admitted.
(EXHIBIT NOS. 11, 12 AND 13 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)
MR. ZOBRIST: Okay. Thank you, Judge. I tender Dr. Hadaway for cross-examination.
JUDGE PRIDGIN: Mr. Zobrist, thank you.
Mr. Thompson, will you wish cross of this witness?
MR. THOMPSON: Yes, I will, thank you.
JUDGE PRIDGIN: Mr. Mills?
MR. MILLS: I have no cross-examination

for Dr. Hadaway.

JUDGE PRIDGIN: Any other counsel have questions for Dr. Hadaway?

MR. BRUDER: Yes, Department of Energy has a few.

JUDGE PRIDGIN: Thank you. Any other counsel other than DOE and Staff?

(NO RESPONSE.)

JUDGE PRIDGIN: Mr. Bruder, when you're ready, sir.

MR. BRUDER: Thank you.

CROSS-EXAMINATION BY MS. BRUDER:

Q. Good morning, sir.

A. Good morning.

Q. I'll direct your attention, if I may, to page 32 where you discuss your DCF models and how you use them to calculate your return on equity.

A. This is in my direct testimony, Exhibit 11?

Q. Sir?

A. From Exhibit 11, my direct testimony?

Q. Yes.

A. Yes, sir, I have that.

Q. Okay. As I understand it, looking at schedule SCH-5 on the first page, third column at the bottom, you chose a figure 6.6 percent for growth; is that correct?

A. It's used in some of those models, yes, sir.

Q. So just to tie up that answer a little bit more specifically, you did use that 6.6 percent figure to go on to calculate return on equity; is that right?

A. I used it exclusively in one of the models, and I used it as part of the growth rate in some of the other models.

Q. And if we wanted to know where exactly you used and did not use it, we could find that pretty easily by going through your testimony; is that right?

A. Yes, sir, in the DCF schedule.

Q. Okay. Could you please explain how you calculated, how you derived that 6.6 percent figure we've been talking about?

A. Yes, sir, I'll be glad to try. If we look at schedule SCH-5, I have a listing there from the St. Louis Federal Reserve Bank's database of nominal gross domestic product beginning in 1947 up through 2005, which was the data that were available when we prepared this testimony.

In the second column we list the GDP price deflator which is effectively the interest rate -- I'm sorry, the inflation rate for each year over that period. In the third column we list consumer price index which is another measure of inflation that people are often more familiar with than they are the GDP price deflator.

We analyze those data over that entire 58-year period, and you see down next to the bottom row of that exhibit, 58-year average. That average is the simple average of all 58 years since 1947 of the growth rate in the US economy as measured by gross domestic product. That number is 7.0 percent.

However, if you look at the sub-periods of the data -- this is often done in attempts to forecast the future -- it is fairly evident that inflation has been lower in the more recent years than it was, for example, back in the late 1970s and really up to the early part of the 1980's.

Q. If I may interrupt just by way of clarification, when we see there cited on that first line in the group of figures that's lowest on the page, ten-year average, that's going to be the most recent ten years; is that correct?

A. Yes, sir, that's right.

Q. And the 20-year average, the most recent 20 years and so on?
A. Yes, sir. They're overlapping averages.
Q. Okay. I do apologize for interrupting you. I just wanted to make sure we didn't miss it.
A. No. Thank you. It's -- it's -- it's a fairly complicated set of weighted averages, and it's helpful that everybody understands just exactly what you just said, and you're exactly right.
Q. Okay. Thank you, sir.
A. What we did, then, was to take seven -- six averages, one for ten years, one for 20, one for 30, one for 40, one for 50 and one for 58. Each one of those six includes the most recent ten years, so it's included six times.
The 20-year average is included five times. And so we gave more weight to that more recent slightly lower inflation-influenced GDP growth. That weighted average, then, is the bottom line there, the 6.6 percent forecast.
In effect, it says that we expect the growth in real gross domestic product to be 3.2 percent and the change -- excuse me, the GDP price deflator to be 3.2 percent and real growth -- it's not listed there, but you subtract the 3.2 from the

6.6 to be 3.4 percent approximately.

Those numbers are consistent with the long-term average in the US economy. They are not consistent with the most recent ten years which is shown the lowest inflation that we've seen in our economy over this entire time period.

And that's sort of the nut of the difference between my and Mr. Gorman's estimate of GDP.

Q. I now believe I understand it's kind of a weighted average of averages, is it not?

A. Yes, sir.

Q. So if you take those -- the 20-year, 30-year and so on figures are not equally weighted in the calculation of that average; is that right?

A. That's right. In econometric forecasting, typically the literature says that people, if they're developing expectations, will place greater weight on more recent data.

Q. And that's exactly what you've done here?

A. That's what I've attempted to do.

Q. However, we really can't ignore the fact that a significant percentage of the year-to-year data that make up the 6.6 percent are figures for as long ago as 1949 to 1957; is that not right?

A. Yes, sir.

Q. Sir, can you explain, why did you choose this 6 percent -- 6.6 percent figure calculated the way you did rather than some other figure? I'm particularly asking why not something newer?

A. I'm sorry. Something -- I didn't understand your last word.

Q. Something that does not take -- that doesn't give so much weight or gives no weight to areas that are so far distant from our present time.

A. I see. The discounted cash flow model requires a G term, the growth rate term that technically goes to infinity. You cannot derive the constant growth traditional DCF model without making that assumption.

It has in the past been a reasonably good approximation of the way investors treated utility companies. They were stable, steady-dividend-payment-type companies. I've argued in my testimony here and tried to demonstrate with changes in analyst growth rates and all sorts of things why that model, particularly the traditional version of it, really doesn't apply.

We've seen changes in dividend policy,

we've seen all sorts of things that have caused growth rates to fluctuate wildly, and it just doesn't fit the constant growth DCF model.

So what I have attempted to do is to say if the long-term growth experience that we've seen through all sorts of economic conditions is what people might expect for the very, very long term and not simply a shorter period like the most recent ten or 20 years which are the only ones that are lower than 6.6, then their expectation in the constant growth DCF model has to be something like long-term gross domestic product.

There are people, Dr. Moore in the book that is widely accepted, describes this methodology. The FERC has routinely used this type of methodology in gas pipeline cases where they blended analyst growth rates with gross domestic product growth.

So it's -- it's not the received or the most common way that the DCF model is applied, but more and more people are saying that the traditional model just doesn't work as well as it used to in other alternatives.

Mr. Gorman and many other economists use these other alternatives. We argue about what the right growth rate is, but we certainly agree that there are other models that need to be looked at.

Q. A moment ago -- and you mentioned and those of us that have been in the field for a while will certainly agree -- that there was a time when electric utilities were stable and steady payers of dividends. Did you say -- did you say that or something akin to that?

A. Yes.

Q. Okay. Would you say that characterizes electric utilities today or in the past five years?

A. During the past five years, I don't think it does. Many utilities are attempting to move back toward that model, back to basics, but certainly the stability that characterized utility dividends 15 or 20 years ago does not exist today.

Q. In fact, I think it's probably fair to say that the further back you go, beginning with 20 years, the more the overall and really individual cases would show stability and steady dividends; is that not right?

A. Most companies had a different approach to dividends previously, and many companies with the consolidation of the industry and with the restructuring of many of the companies have simply changed to more like an industrial company dividend policy that will fluctuate with earnings and will not just go along steady growth to keep up with inflation and that sort of thing.

Q. Now, what I'd like to ask you, sir, is to suppose with me for a moment that you or anyone had adopted, instead of the average period 6.6 percent, the 20-year average that you show which is 5.6 percent.

A. I understand that.

Q. Sir, if you took that number and held everything else constant, what would your recommended ROE be? Can you ballpark or make the calculation?

A. I can tell you that mechanically in the traditional DCF model, if you reduce the growth rate by 100 basis points, that reduces the ROE estimate by 100 basis points. I couldn't go beyond that because it would depend on how that ROE estimate compares to the capital asset pricing model or to a risk premium model or to some other test of reasonableness, to other commissions' allowed rates of return, those kinds of thing.

Q. Well, again, I'll ask the question because here we're really dealing with a barebones calculation that I'm asking for. Don't change anything except the 6.6 to the 5.6, and how does that

affect the recommended ROE?
A. As I said --
Q. Just what you said, 100 basis points?
A. Yes, sir. Mechanically the number that you would receive from the model would go down 100 basis points.
Q. I'm only asking mechanically. We're not talking theory. Theory's not gonna help us. I understand. Okay.
One moment, please.
JUDGE PRIDGIN: Certainly.
MR. BRUDER: No more questions. Thank you very much.
JUDGE PRIDGIN: Mr. Bruder, thank you.
Mr. Thompson?
MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good morning, Dr. Hadaway.
A. Good morning, Mr. Thompson.
Q. Are you being compensated for your testimony here today?
A. I am.
Q. How much compensation are you receiving for your testimony here today?
A. I have an hourly rate, and it, I guess,

depends on how many hours we spend.
Q. What's your hourly rate?
A. The hourly rate that my firm charges -- I don't receive all of that, but the hourly rate that my firm charges is $350 per hour.
Q. Do you happen to know as of today how much your firm has billed Kansas City Power & Light for your services with respect to this case?
A. I don't know as I sit here. It's a matter of record. We have all the invoices.
Q. Okay. And you understand that these are questions that are typically asked of an expert witness in order to establish compensation as a possible motive for bias?
A. No, I don't understand that.
Q. If I told you that, would you be surprised?
A. I would say it's fairly unusual to be asked for that purpose, and I've been doing this for a long time.
Q. Really?
(EXHIBIT NO. 121 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)
BY MR. THOMPSON:
Q. I'm gonna show you what I've marked as

Staff's Exhibit 121. I only have one copy of this, so I'll have to produce additional copies for the Commission and for the court reporter.

I wonder if you could tell me if you recognize that document?

A. Yes, sir.

Q. What is it?

A. It's the Regulatory Focus publication done by Regulatory Research Associates as of July 3rd, 2007.

Q. And is that the latest edition available so far as you know?

A. As far as I know, it is.

Q. And I wonder if you would take a look at page 4.

A. Okay.

Q. And what do you see on page 4?

A. This is a listing of the electric utility decisions that RRA has reported for the first two quarters of 2007.

Q. Okay. And do you see anywhere an indication of what the average is for the first quarter of 2007?

A. Yes, sir. It's in the second column. It is 10.27 percent.

Q. And how many observations is that based on, if you can see that?
A. I believe there are eight.
Q. Thank you. And how about for the second quarter, what was the average reported for that quarter?
A. It was also 2 -- 10.27 percent.
Q. And again, how many observations were there in that quarter, sir?
A. Looks like there are ten.
Q. Okay. So a total of 18 observations; would you agree?
A. Yes, that's right.
Q. Okay. And if you could take a moment to look over those and tell me what is the lowest ROE awarded among those 18 awards?
A. I believe it's the 9.67 percent, Public Service of New Hampshire case that you mentioned earlier.
Q. Thank you. And how about the highest?
A. It appears to be the Wisconsin Public Service company case that occurred in January at 10.9 percent.
Q. Okay. And if you know, is there anything unusual or remarkable about the way ROEs are

awarded in Wisconsin?
A. You and I have had this conversation before, and I know that it's your position that they give too high a rate of return. Their average rates of return have been in the upper end of the typically allowed rates of return.
Q. Okay. Fair enough. Now, as far as you know or in your professional opinion as a professional in this field, is this a reliable publication?
A. The RRA publication?
Q. Yes, sir.
A. Yes, sir. It's the one that most people use.
Q. Do you use it yourself?
A. I do.
Q. Okay. Do you have any reason to doubt the figures that it publishes?
A. I haven't investigated the figures, and -- and I have -- you know, I've looked at it for many years. Sometimes they adjust them later. Sometimes they receive reports from the Staff and the company that are different, and I've talked to them about how they resolve that. But on average, I think it reflects what people believe the regulatory

commissions are doing. Not the FERC, but state regulatory commissions.

Q. I understand. And, in fact, do you rely on it yourself?

A. I do.

Q. Okay. And, now, of those companies, do you have any way of picking out the ones that are not vertically integrated electric utilities? That is, that own their own generation assets and also transmission and distribution systems?

A. There are footnotes in the far right-hand column and one can look at those. And then I think --

Q. Could you do that now for me on --

A. -- the footnotes are --

Q. -- page 4?

A. Yes, sir. The footnotes are explained on page 5.

Q. Okay.

A. So if one wants to go and find that. The ones with a D beside them are distribution-only cases.

Q. Okay. And how many of those are there, if you could --

A. In the first quarter, three of the eight

cases were distribution-only cases.
Q. Okay. How about the second quarter?
A. And in the second quarter there was only -- let's see. There are actually two cases, but one of them is not -- doesn't report an ROE so --
Q. Okay.
A. -- one out of the ten reported ROEs.
Q. So is it fair enough to say that four of the -- is it 18 with numbers or only 17 with reported ROEs?
A. I believe it's 18 with numbers.
Q. Okay. Now, if you know, do the ROEs for distribution-only companies, the ones marked with a D, are they typically higher or lower than those for vertically integrated companies that also have generation assets?
A. In these data the average for the distribution-only companies is 9.9 percent, so they're much -- they're significantly lower.
Q. Significantly lower. Okay. Thank you very much.
MR. THOMPSON: I would offer that exhibit. I think it's, what did I say, 121.
JUDGE PRIDGIN: I have it marked as 121.
MR. THOMPSON: Yes. I'd offer Staff

Exhibit 121 at this time.

JUDGE PRIDGIN: 121 has been offered.

MR. ZOBRIST: Can I at least --

MR. MILLS: Judge, I don't think I'm gonna have objection to it, but I don't have a copy and I would like to reserve any possible objections until I look at it.

MR. THOMPSON: Want to look at it?

MR. MILLS: Sure.

MR. THOMPSON: I'm sorry I didn't bring more than one company, Mr. Mills.

MR. MILLS: I have no objection.

JUDGE PRIDGIN: Any other objection? I'm sorry. Mr. Zobrist?

MR. ZOBRIST: May I voir dire the witness just briefly?

JUDGE PRIDGIN: You may.

VOIR DIRE EXAMINATION BY MR. ZOBRIST:

Q. Dr. Hadaway, have you had an opportunity to look at Exhibit 121?

A. I've had a chance.

Q. Does this appear to be a full and complete copy as far as you know?

A. It's limited to just those first two quarters. Many times there are other quarters that go back and explain all the cases in 2006, for example.

Q. All right.

A. And the comparison that Mr. Thompson is making here of a few -- or a small number of distribution cases in 2007 is different than that in 2006.

Q. All right. But as his examination was limited to those two quarters, are you satisfied that this is a true and accurate copy of this report?

A. Of that limited part of the data, yes.

MR. ZOBRIST: Given that, your Honor, I have no objection.

JUDGE PRIDGIN: All right. Hearing no objection, then, Exhibit 121 is admitted.

(EXHIBIT NO. 121 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. THOMPSON: Thank you. I have no further questions for this witness.

JUDGE PRIDGIN: Thank you, Mr. Thompson.

MR. THOMPSON: Thank you, Dr. Hadaway.

THE WITNESS: Thank you, Mr. Thompson.

JUDGE PRIDGIN: Let's see if we have any bench questions. Mr. Chairman?

QUESTIONS BY CHAIRMAN DAVIS:

Q. Good morning, Dr. Hadaway.
A. Good morning, Mr. Chairman.
Q. Going back to your direct testimony on schedule 5.
A. Yes, sir, I have that.
Q. US Department of Energy asked you a lot of questions about how you calculated your 6.6 percent change in gross domestic product growth rate. Do you recall those questions?
A. Yes, sir.
Q. If you used the 30-year average which is 7 percent, would that yield a higher ROE than what you calculated?
A. Yes, sir, it would.
Q. Okay. Are you aware of state public service commissions using 30-year averages for any other calculations?
A. Yes, sir. When I was a staff economist at the Texas Commission, we sometimes used 30-year averages for weather data and things like that and for other kinds of forecasting.
Q. Okay. On page 2 -- or I'm sorry. Going to your direct testimony, going back to the front. Page 4, lines 2 through 6 of your direct testimony.
A. Yes.

Q. You stated that to be included in your proxy group, the reference companies must have at least a triple B investment grade bond rating and must derive at least 70 percent revenues from regulated utility sales, and they must have consistent financial records not affected by recent mergers or restructuring. Is that a fair statement?

A. Yes, sir.

Q. When you selected your proxy group, why did you not distinguish between utilities operating strictly as distribution companies or primarily as distribution companies and those who were your traditional vertically integrated utilities?

A. There are two reasons: One is that the Value Line data is reported for the holding companies that typically include not just the distribution operations.

Q. Uh-huh.

A. But, two, the data in the Regulatory Research Associates is for the individual operating companies and their rate cases, so those are focused on just distribution companies only. But the stock market data, right now we just don't have enough companies so that you could, you know, get a sample of just T and D companies if you were doing a T and D case because the companies even where the rate cases are not integrated cases are, in fact, integrated companies.

Q. And based on your review of all the relevant information, T and D utilities are less risky than vertically integrated utilities?

A. I've had the opportunity to deal with that question in a number of different places, and certainly the rating agencies apply business-position rankings that indicate that the business risks of the T and D companies are lower. Utility commissions that have made decisions on the appropriate ROE have come to a decision that a lower ROE is appropriate for those companies, but it's still a debate that goes on.

Many T and D companies point to other risks that they have, but most regulatory bodies haven't bought into those arguments.

Q. Okay. On page 5, lines 11 through 13 and in schedule SCH-1 of your direct testimony, you stated that "KCP&L's capital expenditures over the next five years are expected to equal 95 percent of the company's current net plant." Is that -- do you recall that --

A. Yes, sir.

Q. -- statement? Are you aware of any other electric utility out there in the United States or anywhere else that would have a higher forecasted capital expenditure to net plant ratio than KCP&L?

A. Yes, sir, there may be some. CLECO is one that comes to mind that I have recently visited with.

Q. Okay.

A. We could look at my schedule 1 --

Q. Okay.

A. -- and you can see the company-by-company numbers. The average is about 60 percent for the comparable companies, but there are some of the companies that are a bit higher.

Q. Is it fair to say that KCP&L is -- is outside the norm?

A. Yes, sir.

Q. Would you characterize it as far outside the norm?

A. At the time we prepared this, based on the data really through 2005, because we were preparing the testimony at the end of 2006, and all of 2005 data, that's all we had complete, theirs was one and a half times the average of these companies. 95 percent of net plant versus 62 percent.

Q. Right.
A. As the company goes forward with its construction program as it has, and as we update those numbers so that more of it is completed, and depending on how it might be treated or other things coming into rate base, that percentage will come down.
Q. All right. But, Dr. Hadaway, going back to your schedule SCH-1, you had -- if I am looking at the far right-hand column there for CLECO, it looks like that last column is Total Capital Spending Relative to Net Plant, and CLECO was 89.2 percent; is that correct?
A. Yes, sir.
Q. And KCPL was 95?
A. Yes, sir.
Q. So they are the highest in that column?
A. In that column they are. I recall CLECO because I knew that they were very high. They're building a very large coal plant in Louisiana, but I've never really made the comparison to 95 percent until you asked about it.
Q. Okay. Can you do your best to explain to me in laymen's terms what the difference is between the constant growth DCF model and the

multistage growth DCF model?

A. Yes, sir. The DCF model comes from taking the present value of all the dividends that investors expect to get. In that model you discount all the dividends back to today. That tells you the price of the stock. You assume that you know what the required rate of return is in that calculation.

ROE witnesses flip the model around and they say we want to take today's price of the stock, the estimates of the dividends and we want to derive the rate of return.

Q. Uh-huh.

A. So it's a little bit different calculation. Professor Gordon, and really others before him back in the 1950s said, if we make the assumption that those dividends grow at a constant rate forever, we can simplify all these calculations.

And he demonstrated that mathematically, if you make that one assumption that the dividends are gonna grow at a constant rate every year all the way out to infinity, then the model just breaks down to ROE equals the dividend yield plus that constant growth rate.

Q. Uh-huh.

A. Now, people have looked at the

industry's fluctuations and they've said, you know, that assumption is pretty tough. The industry's been restructured, we've seen analyst growth rates fluctuate all over the place; that constant growth assumption is troubling.

And so some people many years ago, Professor Moran that I mentioned before, has one of the widely followed regulatory textbooks, demonstrates that --

Q. Is that New Regulatory Finance or --

A. That's the most recent edition of his book that I've seen.

Q. Okay.

A. But in there he shows -- and other people have done this too -- that if we think there's an unusual period of time, maybe five years or even ten years, that we can specifically try to forecast those near-term growth rates, and then after, say, five years, as Mr. Gorman and I do, we assume that then a constant growth rate will take up.

It's not a perfect assumption. It's just -- it's just a model. But the two-stage or nonconstant growth model has that difference in it. It has five years in my model and Mr. Gorman's model where we have explicit forecasts of growth. And then after your five, we assume that the constant growth model takes over.

Q. Okay. And that's growth of dividends?

A. Most people, because analysts forecast earnings growth, and in the DCF model it's assumed that earnings and dividends grow at the same rate, most people pick earnings forecasts --

Q. Correct.

A. -- or some other more general forecast, like GDP, like I do --

Q. Okay.

A. -- because there aren't very good forecasts for dividend growth out there.

Q. Right. Had KCP&L's earnings been consistent over the last ten years?

A. I know that they've fluctuated.

Q. They've fluctuated. Dr. Hadaway, do you at all find it ironic that your recommended ROE in this case is the same ROE that the Commission awarded in its last KCPL rate case in which you were a witness?

A. Mr. Chairman, I will say honestly to you that if I had thought about that, I think I would have asked the company to change the recommendation by five basis points or something so that that argument didn't come up.

It came up in a prior case where your order had some rather harsh words for me and mistakenly thought that I had done something that I did not do in that case.

My base ROE went down by 25 basis points from 11 percent to 11.25.

Q. Uh-huh.

A. I'm sorry, to 10.75 because interest rates and interest rate forecasts had gone down a little bit since I prepared --

Q. Right.

A. -- the prior case.

Q. Uh-huh.

A. I had testified to that 10.75 as a base ROE in at least ten other cases, and Mr. Gorman is involved in about half of those, so it had nothing to do with the rate of return that you allowed this company in the prior case.

The 50-basis-point adder with which you disagreed, and I think that's certainly your prerogative, is exactly the same 50-basis-point adder that I recommended in the prior case. It is simply a coincidence that the number turned out to be the same.

I've heard this discussion recently, and I'm very sorry that it has come up because it is -- it's not a correct reflection of what I did.

Q. Okay. Dr. Hadaway, the capital market line analysis, can you just once again give me a brief synopsis in laymen's terms of what that capital market line analysis is and how it differs from the DCF model?

A. And I can tell you what it is and show you, if we could, the picture in my direct testimony.

Q. Okay.

A. That last part that you asked about is not quite as easy to connect it to the DCF model, but I'll certainly try.

Q. I'm not asking you to connect it. I'm just asking you to tell me how it's different.

A. Sure, and I certainly can do that. If we look at --

Q. At page 12?

A. -- page 12 of my direct testimony, Exhibit 11, that graph or chart is in every textbook in one form or another that I know of in finance. It just says that if people take more risk on the horizontal axis, they expect a higher rate of return on the vertical axis.

Different kinds of assets are listed there, where Treasury bills are typically considered to be the lowest risk and they're expected to have the lowest return. The Ibbotson data that you've probably heard discussed here many times --

Q. Uh-huh.

A. -- confirm this capital market line diagram. That is, if we go back historically, the historical rate of inflation has been about 3.1 percent, and the historical rate of return on Treasury bills has been in the 3 percent range, 3.8 percent, I think, is the Ibbotson number, going back to the 1920's.

If we go out to common stocks, the historical average number is about 12.2 percent if you use the arithmetic average. It's lower than that with the compound average. There aren't as many studies and they're not as -- there's not as much data about the more speculative investments. I don't think people know on average what commodity traders actually make. It's certainly believed that they make a lot of money because they take a lot of risk.

So the capital market line that is depicted in this graph on page 12 is just a way that

that relationship is described. It's also the way that that relationship is described. It's also the way that the relationship is described in what's called the capital asset pricing model.

Beta is the risk measure in that model. I haven't been that specific here --

Q. Uh-huh.

A. -- but that model would tell you the numbers that go along with this line if the model worked exactly as the theory says it does.

Now, with respect to the discounted cash flow model, it's usually said that the connection to risk and return is reflected in the market price. So companies that are more risky for any given dividend or any given earnings expectation, if they're viewed as more risky, their price would probably be a little bit lower, and their return, if you bought it at 10 dollars instead of 12 dollars, the return on the 10-dollar investment would be a little bit higher for that more risky company if everything turned out as people expected.

So it's the same kind of connection, but it's just not as explicit as this capital market graph.

CHAIRMAN DAVIS: Dr. Hadaway, thank you.

I have no further questions.

THE WITNESS: Thank you, Mr. Chairman.

JUDGE PRIDGIN: Mr. Chairman, thank you.

Commissioner Murray?

QUESTIONS BY COMMISSIONER MURRAY:

Q. Thank you. I think most of my questions have been answered this morning, but I have a couple I'd like to clarify a little bit. In terms of the market capital line that you were just referencing -- and I believe that's on page 12 of your direct testimony -- why are KCP&L's current construction investments considered speculative investments?

A. I don't think that they would be considered speculative investments, but I think they would be considered above-average risk investments because the capital requirements and the exposure to the company's shareholders for the additional capital that has to be raised is greater for KCP&L than it is for other utilities.

Q. So in terms of looking at your capital market line, you would categorize them somewhat like speculative investments because of the size of the investments required?

A. If we think about numbers that would go with places on that line, the common stock line is sort of intended to be in the middle, and that would be about 12 percent, a little bit over 12. The adjusted ROE that we're asking for for KCPL starts with 10.75 as the base, and then we add the requested 50-basis-point adder, so we're still at only 11 and a quarter, so we're really on the left-hand side of that common stock part there.

Q. And if we analyzed your testimony exact -- and the testimony of the other witnesses exactly as we did in the last KCP&L case, we would award an 11 percent ROE; is that correct?

A. If you accepted my base ROE at 10.75 and added the same 25 basis points that you did in the prior case, yes, ma'am, that's exactly right.

Q. Schedule 14, page 1 of 5 in your rebuttal testimony.

A. Yes, ma'am, I have that.

Q. You show the traditional constant growth DCF model and then constant growth DCF model long-term due to peak growth. Is that traditional, the ten-year?

A. No. It's actually based on Value Line's forecast for earnings growth over a three- to five-year period, Zack's five-year forecast and the b times r sustainable growth rate that's based on

Value Line's three- to five-year forecast. I believe those are shown on page 2 of 5 in columns 9, 10 and 11.

So it's -- there's a lot of different places that growth rates come from, but they're really the analyst forecast that drive that particular model.

Q. And then this constant growth long-term GDP growth is the one that you spoke of that you just assumed a constant for an indefinite period of time?

A. Yes, ma'am. The GDP growth rate of 6.6 percent that I was asked about before.

Q. And how -- what did you use? Did you use in -- in KCP&L's last case in your recommendation, did you use a combination of the five years plus the constant thereafter as you're doing here?

A. Yes. I used the last two models -- or the -- the middle one and the right-hand one.

Q. All right.

A. And the middle one is just based on the GDP growth rate, the long term. The one on the right-hand side is a little more of a blend because it uses Value Line's dividend growth for the first five years, and then it switches to the long-term GDP growth rate. That's the model I think I was describing earlier is the difference between constant growth and two-stage growth.

Q. And when you testified for other utility companies concerning their ROE, do you use the same blend or does it vary from case to case?

A. Sometimes it varies from case to case, but I always present this same analysis. And I say it varies because there's more and more concern about the traditional constant growth DCF model like Mr. Barnes uses. And I and many other witnesses have come to give more reliance to other models.

And I personally have concerns about the capital asset pricing model, but in recent cases I have given it weight because something I think needs to be done to replace the traditional constant growth model.

And the CAPM is the one that, for example, the Texas staff gives 50 percent weight to it, the Illinois staff gives considerable weight to it in a case that I'm doing for ComEd up there.

Q. All right. So the combination of models that you use does vary somewhat from utility to utility?

A. It does, but relative to the 2006 case and this case, the models are exactly the same. Relative to some new cases that I'm currently preparing and have recently filed, they are slightly different because the circumstances do evolve.

COMMISSIONER MURRAY: All right. Thank you.

THE WITNESS: Thank you.

JUDGE PRIDGIN: Commissioner Murray, thank you.

Commissioner Appling?

QUESTIONS BY COMMISSIONER APPLING:

Q. Good morning, sir.

A. Good morning, Commissioner Appling.

Q. Chairman Davis was talking to you a few minutes ago about a '06 and the '07 ROE, the 11.25. And what has been asked for here this year in '07 is 11.25.

Help me out here. Can I make the assumption that for KCPL that the risk looking forward and the financial need based on the ROE of which we awarded last year and what is being asked for this year, is the risk and the financial need somehow closely related, closely parallel?

A. If we look at the bond ratings, it's my understanding -- and you can ask Mr. Cline about this -- but I think there's been no change in the company's bond ratings.

Q. Okay.

A. So at least from that prospective, the risks are exactly the same.

Q. You're looking out a little bit. I'm showing you to kind of peek over the horizon to see what's happening as far as this company is concerned. But anyway, what do you see over there? Do you see the ROE staying constant throughout these next two requests? How could I expect to see them coming out?

A. A little bit of issue has been made of the September 18th reduction in the short-term Federal Funds rate because for the past almost three years, the Federal Reserve System had increased short-term rates 17 times.

And on September 18th, as we all saw in the papers, they reduced the Federal Funds rate for the first time in about three years. And so some people have said, well, that indicates a new trend that interest rates now are gonna turn and go down.

But interestingly, long-term rates and particularly corporate utility rates have actually gone up since September 18th. The spreads off -- or it varies from day to day, but they have certainly not gone down since September 18th.

Q. Okay.

A. The rate -- and I looked at this at the 1st of August, for example, on long-term Treasury bonds --

Q. Uh-huh.

A. -- was the same as it was on September 26th. So it's difficult to say.

People fear that if inflation resumes at a higher level than it has been for the past four or five years, then interest rates -- long-term interest rates will go up.

On the other hand, if inflation remains mild and if the Feds should force down short-term rates further to keep the housing problem and the economy under control and all that, then long-term rates might go down. No one knows.

Professor Greenspan, in his new book as you may have seen, says that the biggest problem we have is that he expects inflation to be 4 percent, that we're ignoring the realities of where long-term inflation is really gonna go.

His focus is on what's gonna happen to the Medicare system when that happens. But nonetheless, the recent inflation period causing interest rates to be low may continue, but it may not.

So the request from the company a year from now or two years from now may even be higher than it has been. If interest rates go down, then I would expect it would be lower.

Q. Last question. On -- from your perspective in watching KCPL pretty constantly here, the Commission's concern is that these guys stay on course, that we end up at point A to point B where we started. From your perspective, do you see KCPL doing -- how do you see them doing?

A. I'm afraid that I am not qualified and I haven't studied the issue well enough to give you as good an answer to that as the company people could.

Q. Okay.

A. I -- I -- I have not seen anything, any rating reports or any concerns in Value Line that they are falling off track. But you may know other things that are going on right here on the ground that I might not be aware of. I just don't know.

COMMISSIONER APPLING: Thank you very much for your time, sir.

THE WITNESS: Thank you, Commissioner Appling.

JUDGE PRIDGIN: Commissioner Appling, thank you.

Commissioner Jarrett.

COMMISSIONER JARRETT: Thank you.

QUESTIONS BY COMMISSIONER JARRETT:

Q. Good morning.

A. Good morning, Commissioner Jarrett.

Q. I had a question. I wasn't here during the last rate case, so I'm interesting in learning about your adder, the 50 basis points.

Could you explain to me, first of all, why you believe an adder is necessary, and then second of all, how you calculated or arrived at the 50 basis points.

A. Okay. That's two parts. And the first part, again, is easier than the second part. The first part is, though, that when this company embarks on one of the very largest construction programs in the country for its size, that it has external capital requirements that expose its existing bondholders and shareholders to additional risks that are higher, and so the basic premise is that those capital requirements create additional risk and cause those investors to expect a higher rate of return; simple as that.

But the second part, how does one measure what the adder might be or what the requirement would be, I was asked about this a lot in the 2006 case, and I tried to explain there and the Commission's order I believe even picked up some words about this.

I looked at what other commissions had done. And the FERC, although I don't think is necessarily a perfect example of how we all want to regulate utilities, but it has the most explicit record under the -- under EPACT to encourage transmission investment about adders.

For ceding control of one's transmission assets in joining a regional transmission organization, one receives a 50-basis-point increment to the rate of return on equity.

For innovative construction techniques and innovative technologies up to the very top end of the range that they find reasonable may be awarded. And for some companies that is given rates of return, United Illuminated -- Illuminating I believe got 13.1 percent in a case back in spring.

So I look at all those. I looked at a prior case here for Empire District where this Commission had granted a 30-basis-point adder. I think that had to do with the capital structure difference if I remember.

And I looked at all the cases that I could find where various things like that had been discussed, and I said as best as I can tell, the 50-basis-point number that we selected is a conservative estimate of the kind of risk adders investors might expect.

The Commission didn't agree with that entirely. They said 25 basis points. And I have no basis for saying that 25 versus 50 versus 75, I don't know the model that will tell you which one of those is right. It's a subjective issue.

COMMISSIONER JARRETT: Thank you. I have no further questions.

JUDGE PRIDGIN: Commissioner Jarrett, thank you. I have no questions, Dr. Hadaway.

Any recross based on bench questions?

MR. THOMPSON: I have some.

MR. MILLS: (Shook head.)

JUDGE PRIDGIN: Mr. Bruder?

MR. BRUDER: I would yield to Staff counsel if that were appropriate.

MR. THOMPSON: Thank you, Mr. Bruder. I won't take long.

JUDGE PRIDGIN: Mr. Thompson.
RECROSS-EXAMINATION BY MR. THOMPSON:
Q. I want to follow up on the question that Commissioner Jarrett asked you about the adder. What I want to know is how did you come up with the 50 basis points? I mean, why not 32 or 81? How come 50?
A. I think the standard RTO FERC adder, a minimum of 50 basis points was probably the thing that stuck in my mind more than anything from my review. Nothing any more elaborate than that.
Q. Okay. So is it something -- I mean, you can quantify, can you not, how much more construction risk or how much larger of a construction project that KCPL has compared to your comparable companies; isn't that correct?
A. That's what I did in my Exhibit 1 in my direct testimony.
Q. And remind me what it told us. How much larger?
A. It's one and a half times as large.
Q. Okay. So can you calculate an adder or an adjustment from those numbers?
A. I have seen economists attempt to do that, but there is nothing in the economic literature

that I'm aware of that provides a model that people have confidence in to do that.

Q. Okay. So the adder, then, would you agree with me, it is more art than science?

A. I think what I said was I thought it was a subjective matter.

Q. Okay. So it is based on your long experience in this field?

A. Well, in my review of what this Commission, the FERC and other Commissions have done with adders.

Q. Well, what if I said Staff thinks a 15 point adder is more appropriate, what would your comment on that be?

A. I would say that's above the zero that Mr. Barnes has recommended, but that it's certainly less --

Q. You realize I'm speaking hypothetically.

A. Well, I can't tell you that 15 basis points would be de minimis, but it would be approaching that.

Q. Okay.

A. So something that investors can recognize, whether it's 25 basis points or 50 basis points, I can't tell you. But when you start to approach zero, then I think it's clear that that's not the appropriate number.

Q. So am I correct in understanding from your answer that the important thing is what investors expect?

A. It's what the Commission wishes to signal to investors they're willing to do to support this company's half a billion dollar investment in equity as the Commission -- as the Chairman mentioned earlier this morning, and what the Commission wishes to do to attract the capital in the most reasonable terms that it can to get this plant built as reasonably priced as it can.

Q. Okay. Are adders common in the industry?

A. They are becoming more common, and they're certainly becoming requested for all kinds of cases. They are, indeed, common. They're present in every FERC transmission case that I'm aware of in the last two or three years.

Q. Okay. And does the FERC have rules about how you calculate them or what size to use or where they're applicable?

A. They have an Order 679 that describes various categories of adders. The fundamental adder is for joining an RTO and ceding control of one's transmission to the RTO. The others are more subjective on their part.

Q. Okay. Now, that RTO adder that you mentioned, that's the one that stuck in your mind and that you applied here, isn't it?

A. It's the smallest of the FERC numbers.

Q. Okay.

A. And you asked me how did I come to 50 basis points. That's the one that's the same as I've settled in on.

Q. Okay. But the circumstances under which the FERC would apply that particular 50-basis-point adder, those are not applicable here, are they?

A. They are intended to reflect a perceived increase in risk for the transmission companies ceding control of their assets to another organization. So -- so if investors perceive that risk and if the FERC's logic is correct, then they are rewarded for that additional risk with 50 basis points.

If investors perceive that your construction program is one of the largest in the country, which they certainly do, and if they did the analysis that I did that showed it was one and a half times as large as the average for this comparable group, then the 50 basis points would be a similar kind of compensation for that additional financing risk.

Q. Okay. You would agree with me, though, that KCPL is not ceding control to an RTO here?

A. I didn't say that. I said if investors --

Q. Yes or no, sir? You would concede that they haven't done that, right?

A. I don't know what they have done with respect to the FERC. I would agree that Iatan 2 has nothing to do with that issue.

Q. Okay. So what about subtracters or deflators, are they common in the industry?

A. They are sometimes recommended by witnesses such as Mr. Gorman. I was in a recent case in Washington state where he recommended such a reduction. The Commission didn't accept it. Said it was already taken into account in the data. But they are sometimes recommended by witnesses.

Q. What sort of circumstances are they recommended in?

A. In that case it had to do with there being a purchased-power pass-through clause to be allowed, and we demonstrated that most companies have purchased-power and fuel-adjustment clauses, and therefore in the DCF analysis, that issue was already taken into account.

MR. THOMPSON: Thank you. No further questions.

JUDGE PRIDGIN: Mr. Thompson, thank you.

Any other recross based on bench questions?

MR. BRUDER: Yes, if I may.

JUDGE PRIDGIN: Mr. Bruder.

RECROSS-EXAMINATION BY MR. BRUDER:

Q. Sir, you're familiar, are you not, with the regulatory plan and the additional amortization that the plant contemplates; is that correct?

A. Generally so, yes, sir.

Q. Generally so?

A. I was not here and not part of the development of the plan, but I've read it and I've heard it discussed a number of times over the past two years.

Q. Okay. Now, the aim, the reason for the adoption of that additional amortization was and is to reduce the company's financial risk, is it not?

A. I think explicitly it is to attempt to

maintain an investment grade bond rating.
Q. And that's done by the device of reducing the company's risk, is it not?
A. It's done by enhancing the company's cash flow metrics that the rating agencies, particularly Standard & Poor's, that Standard & Poor's uses to determine whether a triple B bond rating would be appropriate.
That has the effect -- a higher bond rating indicates less overall risk. So overall what you're saying is correct, but it's a little more specific than that.
Q. And does this additional amortization in your view, in fact, actually reduce the company's risk?
A. Relative to the company's becoming noninvestment grade, yes.
Q. Sir, I'm gonna ask you for a yes or no answer to that question, and then please feel free to indulge your answer all you wish. But let me answer [sic] the question again, and it is a yes or no question.
This additional amortization that is provided by the regulatory plan, does it, in fact, reduce the company's risk.

A. It reduces the bondholder's risk; it does not necessarily reduce the shareholder's risk. However, as I have admitted -- or however Mr. Thompson characterized it last time, if the company should become noninvestment grade, that much of a decrease in the bondholder's circumstance would spill over to the equity holders. But amortization revenues or cash flows in place of earnings is not necessarily risk-reducing for the shareholders.
Q. So it's your testimony that the bondholder's risk might be reduced, and yet there might not be any concomitant reduction of risk for shareholders, none at all, sir?
A. I didn't say that. I said in the extreme where the company's investment grade bond rating was lost, then clearly the shareholder's risk would be increased. On the other hand, if the plan and the amortizations maintain financial metrics, cash flow metrics, to help the company not to increase its bond rating but simply to keep its bond rating, then that does not necessarily reduce the equity holder's risk because the process itself may reduce the equity holder's earnings, and some of them may view that as an increase in their risk.
Q. What process is that, sir?

A. If we, as Staff has recommended, substitute lower ROE at a higher amortization, the shareholder's earnings are lower even though the bondholder's metrics are quite sound.

Q. Well, I think what you're doing here is answering my question by adding an assumption to it which isn't inherent in the question. I believe what you said is that if we had the additional amortization but we had a concomitant decrease in the return on the Commission's adopted return on equity, that there would be no lessening of risk.

What I'm asking you is, holding everything else constant, is it not so that the additional amortization lessens the risk both for bondholders and for shareholders.

A. As long as amortization simply maintains the bond rating at its triple B level, there may be a tiny reduction in the risk to shareholders, but that's -- you can't hold everything else constant. That's relative --

Q. Sir?

A. -- to --

Q. Sir, the question isn't whether you can hold everything else constant. We understand that no one can hold everything else constant. What I'm asking and I'm gonna ask one more time is, assuming for the purposes of this Commission and this question, that you held everything else constant, isn't it true that the significant additions to an amortization that the regulatory plan calls for will reduce the risk for bondholders and for shareholders?

A. It might reduce both of them, but not to the same degree. It would mostly reduce the bondholders.

Q. I'm gonna ask once again for a yes or no answer.

A. There's not a yes or no answer to that question.

MR. BRUDER: Your Honor, I believe I've asked a yes or no answer, and I will request that the witness be directed accordingly. Again, he can modify, modulate his answer after that all he wants to, but I will ask for a yes or no.

JUDGE PRIDGIN: It sounds like, Dr. Hadaway, he's asking for a yes, no or I don't know, and then it sounds like he's giving you permission to explain your answer. So the best that you can, if you can answer yes, no or I don't know, then if he'll allow you to narrate, to explain your answer, that's fine with me.

THE WITNESS: Yes, your Honor. The answer is yes, and my explanation is that the reduction to the shareholders would be very minor to the extent that the bond ratings didn't change. The reduction to shareholders would be large, reduction in risk to shareholders would be large if the potential is that the bond rating would go below investment grade. At that point the cost of equity would go up very, very significant.

BY MR. BRUDER:

Q. Are you saying that the additional amortization is liable to cause the bond rating to go below investment grade, sir?

A. No, sir, I'm saying just the opposite of that. The amortization will keep that from happening. To the extent it does, then it keeps the risk the same for the shareholder basically.

Q. All right. I believe we've established that there is some significant lessening of risk that comes along with the additional amortization. So I'll ask you now, that lessening of risk that comes along with the additional amortization, has the company, have you taken that lessening of risk into account in calculating your ROE request?

A. Counsel, it makes it very difficult for a witness to answer yes or no when you add words to the question, including "significant" reduction in risk as you did in your predicate. I've already said the answer to that question is no.

Q. I'm sorry. The answer to which question is no, sir? Maybe I --

A. The question that there would be a significant reduction to shareholder's risk because of this program is no. The answer that I gave you, yes or no, is, is there any reduction, and the answer to that is yes.

Q. Okay. What other reduction you have heretofore conceded, there is a reduction in risk. Whatever the degree of that reduction in risk is, sir, has the company taken that into account in calculating its rate of return -- return on equity request?

A. I have reviewed the amortization program, I have considered the tradeoff between amortization and earnings, and so the answer to that question is yes.

Q. Can you please tell me what you mean by the tradeoff between amortization and earnings?

A. Yes, sir. If the metrics that are required in the program are not met, then additional amortizations is allowed to improve the cash flow coverage ratios, et cetera. But that can be done with additional amortizations at a lower ROE, as Mr. Barnes has recommended.

The two are tradeoffs with each other to some extent, not one to one, but to some extent. So that's the kind of analysis that one has to make. If we simply said that we could just pay to have the customers just pay for the plan as they go and the shareholders get no earnings whatsoever, then their shareholders' risk would be reduced, but their earnings would be drastically reduced.

Q. So you've testified just now that there's a tradeoff between higher amortization and lower ROE?

A. To create the metrics, yes.

Q. Okay. And -- but in effect, a higher amortization and lower ROE, you're really saying it would be offsetting in some extent, not perfectly offsetting, but -- is that right?

A. That's partially true because the metrics are cash-flow based. The rating agencies have come to focus more and more on what they call funds-from-operations coverage ratios. And funds from operations are earnings plus depreciation and amortization and other noncash expenses. So the amortization process has a greater effect on the metrics than simply changing ROE.

Q. Now, when we go through your schedules and we go through your description of how you came to your recommended ROE, where in those numbers do we find the effect of this higher amortization that we get through the regulatory plan?

A. There's nothing in any of those models that explicitly take that into account. That's why I said that I've read the plan, I've considered its effect on amortization versus ROE, and it's my best judgment that the 10.75 base ROE that I recommended reflects those issues.

Q. Well, you say it reflects it, but can you be any more specific as to the manner in which you reflected it and which you took it into account, then, to say generally that it's reflected? And again, if you can't, that's all right, but that's what we need to know.

A. I can say that I did not recommend the top end of the range at 11 percent. I could have said the base ROE should have been 11 percent as it was in the prior case.

Q. Are you saying that that's what you

would have done absent the regulatory plan's
additional amortization?
A. I can say that I just filed a case recently for a company that's in a similar situation and does not have a regulatory plan, and I am recommending an 11 percent base ROE in that case. But it's not that explicit, you're right. It's a subjective kind of thing. There's no particular model to try to say we add 25 basis points for this or 50 basis points for that or we go to the top of the range for one thing or another. It's just not that explicit.
Q. Okay. So just to wrap it up, if we went carefully through your exhibit -- and Lord knows no one is trying to deprecate your exhibits or your efforts here -- but we wouldn't find anything specific where we can say in the formulas and the underlying numbers and so on, here's the number, here's the formula portion that takes into account the amortization.
You say it's taken into account in some way, but we really can't go beyond that and explain what you're taking into account; is that right?
A. There's no verbiage that describes that. There are data in the schedules that the top end of

the range is 11.1 percent. In a similarly situated company, the testimony that was filed just this last week, I recommended 11.0 percent. They do not have any kind of a plan or anything else to assist with the construction and other activities that they have going on.

So implicitly that's the way I went through the analysis. There is no verbiage, there is nothing in those schedules other than that I have basically set the 10.75 near the midpoint of the range, not at the top of the range.

Q. Is it your testimony, sir, that absent the amortization additions, you would have set it at the top of the range?

A. If the company were not an investment grade company, if they didn't have a plan in place and if they lost their investment grade bond rating, I would set it even higher.

Q. Well, those are a bunch of hypotheticals that we haven't put forward. I'm asking again, holding everything else constant, if the company didn't have the additional amortization, would you have set your recommended ROE as much higher than at the top of the range as you've just now discussed? That's yes or no. You just --

A. I don't know.

MR. BRUDER: Okay. Nothing further. Thank you very much.

JUDGE PRIDGIN: All right, Mr. Bruder, thank you. If there's no further recross, Mr. Zobrist, do you have quite a bit of redirect?

MR. ZOBRIST: I think it's fairly short, Judge.

JUDGE PRIDGIN: All right. And then after this, we'll take a break.

REDIRECT EXAMINATION BY MR. ZOBRIST:

Q. Dr. Hadaway, just a couple of corrections. When you talked about Professor Greenspan, you did mean Alan Greenspan?

A. Yes.

Q. The former Chairman of the Federal Reserve board?

A. That's correct.

Q. All right. And I think that in response to one of Commissioner Jarrett's questions, you talked about an EPACT, what did you mean by that?

A. The Energy Policy Act in 19 -- or 2005.

Q. All right the Energy Policy Act of 2005, correct?

A. Correct.

Q. And why did you mention that in response to the commissioner's question?

A. The FERC has set up under its Order 679 a series of adders that they may do, or a series of items that they will consider for adders. And that order -- and I've read it, and to the best of my knowledge, not as a legal interpretation, of course, but it is intended to respond to what EPACT requires the FERC to do to encourage transmission investment.

Q. And Dr. Hadaway, in response to Commissioner Appling's question about what you saw over the horizon, you spoke about the reduction of the Fed Funds rate that occurred on September 18th. As a result of that change, did you prepare an update to your schedule SCH-10?

A. Yes, I did.

Q. Okay. And would you describe that exhibit?

And Judge, I've got copies here for the bench. I have copies for counsel here too.

MR. THOMPSON: Thank you.

MR. ZOBRIST: And I guess for identification purposes, I'll mark this as KCPL Exhibit 28.

(EXHIBIT NO. 28 WAS MARKED FOR

IDENTIFICATION BY THE COURT REPORTER.)
BY MR. ZOBRIST:
Q. Would you describe what the court reporter has marked as Exhibit 28?
A. Yes. This is an update of a schedule that exists in I think both my direct and my rebuttal testimony. Schedule 10 I believe is from the rebuttal testimony as it originally was filed. It only went through July of 2007.
Recently there's been a fair amount of newspaper discussion and what some people call buzz with what the Federal Reserve has done with short-term interest rates, and what I was referring to in my prior discussion with Commissioner Appling was that long-term rates really haven't gone down.
And in the benchmark time period, if you look at the backup pages that are attached to the updated schedule, if we look over at the -- maybe the last page --
Q. That's page 4?
A. Page 4, they're not very artfully numbered by me, but the very last page, page 4, this is the daily listing of the 30-year Treasury bond rate from the Federal Reserve System databank. And everybody can just go directly to that. It's free.

It's very easy to get to.

And the thing that struck me last week when I was doing this update in preparation for this hearing was that if we look at August the 1st, the Treasury bond rate was 4.90. And if we look at last Thursday -- or I guess this is probably Wednesday's number, but it was 4.90. You can see on September 18th when the Fed actually made its decision, announced its decision to reduce the Fed Funds rate, the 30-year Treasury bond went up five basis points, not down.

So the impact of the Fed's change in monetary policy with respect to short-term rates has tradeoffs in it. And long-term rates are more influenced by the effects of expected inflation and things like that. Short-term rates are more influenced by the direct actions of the Federal Reserve System.

But in case there might be any mistake that somehow interest rates have reversed at this point or that they're somehow lower today than they were when you made your decision back in December of '06, you can compare the rates. They're right there.

The Treasury rates are slightly lower, but the utility rates are 40 to 50 basis points higher because risky corporate securities have now got wider spreads off of treasuries because of all the turbulence we've seen in the capital markets in recent months than they had back eight months ago.

So anyway, this is an update just to provide the actual data that exists and the backup documents for where the data came from.

Q. And just to explain once more, the fourth page where says Y 30 at the bottom of the page, that's the 30-year bond rate, correct?

A. Yes, sir. The footnotes at the bottom of each page, they're sort of cryptic, but they're just the way the Federal Reserve System does it.

Q. Okay.

A. The lower right-hand corner tells the date the thing was printed out, and the Y 30 indicates that that's the nominal 30-year Treasury bond rate.

Q. And then on the previous page, page 3 where it says Y 10, what does that ten mean?

A. That means it's a ten-year Treasury bond.

Q. Okay. And then finally page 2, just describe that if you would, please.

A. This is a daily printout that one can get from Moody's web site. They produce for utilities, industrials and to a little more general extent the Treasury bond rates a summary of interest rates each day. And so that same day or a day, I guess, earlier than the Treasury bonds, I printed out last week where the interest rates are, and that's where the Baa utilities rate that's in the first column about the third item down, that 6.52 percent, as opposed to last December it was 6.05 percent.

MR. ZOBRIST: Your Honor, I just offer that as an update and move its admission.

JUDGE PRIDGIN: All right. Exhibit No. 28 has been offered. Any objections?

MR. THOMPSON: No objection.

JUDGE PRIDGIN: Hearing none, Exhibit 28 is admitted.

(EXHIBIT NO. 28 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. ZOBRIST: Thank you. Nothing else.

JUDGE PRIDGIN: All right. Thank you. Dr. Hadaway, thank you very much.

THE WITNESS: Thank you, your Honor.

MR. ZOBRIST: May the witness be excused?

JUDGE PRIDGIN: Seeing no objection, yes, sir. Thank you very much.

MR. ZOBRIST: Thank you, Judge.

JUDGE PRIDGIN: All right. I show the time on the clock at the back of the wall being roughly 10:25. Let's break till about 10:40. And just as a heads-up, I believe the commissioners have an agenda meeting around noon, so we will need to adjust our schedule possibly to allow them to attend agenda and a USB meeting as well.

So we may have to adjust their schedule somewhat for them to attend their meetings.

All right. We'll go off the record.

(A RECESS WAS TAKEN.)

JUDGE PRIDGIN: We're back on the record. And I see that Mr. Cline from KCPL is the next witness. Just to let parties know, we will need to break in about a half an hour.

And I apologize for the abrupt break, but we have a USB meeting that Lewis Mills needs to attend as secretary, and we would also break for agenda which is scheduled to begin about noon, and so at about 11:15 we will shut down and just have an early lunch, and I would plan to reconvene about 12:45 or so to give folks time to either attend USB or agenda and also grab lunch. So just to let folks know the schedule.

Mr. Zobrist?

MR. ZOBRIST: Judge, and I'm all right with going with Mr. Cline, but I was assuming we'd go through the ROE witnesses first and then take Mr. Cline, but if that's not what everybody wants, that's okay.

JUDGE PRIDGIN: And I'm sorry. I just saw Mr. Cline as the next listed witness. If somebody else --

MR. ZOBRIST: All right.

JUDGE PRIDGIN: I'm here for the whole thing anyway. I get it all.

MR. ZOBRIST: Mr. Cline is available.

JUDGE PRIDGIN: Very good.

(THE WITNESS WAS SWORN.)

JUDGE PRIDGIN: Thank you very much, sir. If you'll please have a seat.

Mr. Zobrist, when you're ready.

DIRECT EXAMINATION BY MR. ZOBRIST:

Q. Please state your name.

A. Michael W. Cline.

Q. And by whom are you employed?

A. Great Plains Energy.

Q. And what's your position there?
A. I'm treasurer and chief risk officer.
Q. And Mr. Cline, we have marked your direct examination, both public and highly confidential version, as Exhibit 3, and your rebuttal, both public and highly confidential version, as Exhibit 4; is that correct?
A. Yes.
MR. ZOBRIST: Your Honor, at this time I move the admission of Exhibits 3 and 4.
MR. THOMPSON: No objection.
JUDGE PRIDGIN: 3 and 4 have been offered. Any objections?
(NO RESPONSE.)
JUDGE PRIDGIN: Hearing none, Exhibits 3 and 4 are admitted.
(EXHIBIT NOS. 3 AND 4 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)
MR. ZOBRIST: Tender the witness for cross-examination.
JUDGE PRIDGIN: Mr. Zobrist, thank you.
Mr. Thompson, will you have cross for this witness?
MR. THOMPSON: None, your Honor.
JUDGE PRIDGIN: Mr. Mills?

MR. MILLS: I have no cross for this witness.

JUDGE PRIDGIN: Any cross for this witness?

MR. BRUDER: We have some limited cross, your Honor.

JUDGE PRIDGIN: Mr. Bruder.

CROSS-EXAMINATION BY MR. BRUDER:

Q. You are the company's officer who is most familiar with and whose job on -- requires the most consideration of risk and relative degree of risk?

A. Yes, sir.

Q. So then you're very familiar with the regulatory plan and the additional amortization that the plant contemplates; is that correct?

A. Yes, sir.

Q. And once again, just for the completion of the record, the aim, the reason for adoption of that additional amortization was and is to reduce the company's financial risk; is that not correct?

A. No. The purpose was to maintain credit ratings during the period of construction.

Q. And does the maintenance of credit ratings reduce the company's risk, sir?

A. For bondholders, indeed.

Q. And are we agreed, does it also to some degree, although that degree may be debatable, reduce the risk for shareholders as well?

A. To some degree, yes.

Q. Thank you. Now, again I will ask you as I asked the prior witness, has the company taken into account in calculating its return-on-equity request the effect of that available additional amortization upon its risk? Here I'm gonna ask for a yes or no, and then please feel free to amplify your yes or no answer as much as you choose.

A. Yes. I would refer you to Dr. Hadaway's testimony on KCPL's behalf in terms of calculating the recommendation for ROE.

Q. And beyond what we find in that testimony, sir, is there nothing else in the record to indicate how or to what degree the company has taken into account in calculating its rate of return-on-equity request the effect of available amortization on its risk?

A. I can't speak to that.

Q. As far as you know, is there anything in the record or otherwise available to the parties that would indicate in theory or in numbers the manner or

degree in which the company has taken into account this additional amortization in calculating its return-on-equity request?
A. I believe Dr. Hadaway spoke to that earlier.
Q. And there's nothing else available to us other than what he said on that question; is that right?
A. I don't know.
Q. I'm asking you if you know if there's anything else that's available?
A. Yeah, I don't know.
Q. Okay. Do you know of any electric utility in the country that has gotten 50 additional basis points in its return on equity for this sort of risk in a situation that's similar to what you believe KCP&L's to be?
A. I don't know.
Q. Do you know of any companies similarly situated who's gotten additional amortization of the sort that Kansas City Power & Light has gotten?
A. I'm not aware of any.
Q. So it's fair to say you don't know of any company that has both?
A. Yes.

MR. BRUDER: Okay. Nothing further. Thank you.

JUDGE PRIDGIN: Mr. Bruder, thank you.

Further cross?

(NO RESPONSE.)

JUDGE PRIDGIN: Any questions from the bench? Mr. Chairman?

CHAIRMAN DAVIS: No questions for Mr. Cline. Thank you.

JUDGE PRIDGIN: Thank you. Commissioner Jarrett?

COMMISSIONER JARRETT: None, thanks.

JUDGE PRIDGIN: I have no questions.

Redirect?

MR. ZOBRIST: Nothing, your Honor. Thank you.

JUDGE PRIDGIN: Parties ready to go on to Mr. Barnes?

(THE WITNESS WAS SWORN.)

JUDGE PRIDGIN: Thank you very much, sir. If you would please have a seat.

Mr. Thompson, anything before he's tendered for cross?

MR. THOMPSON: Just a moment, if you would, Judge.

JUDGE PRIDGIN: Certainly.

DIRECT EXAMINATION BY MR. THOMPSON:

Q. Mr. Barnes, your direct testimony has been marked as Staff Exhibit 105. Do you have any corrections to this exhibit?

A. No, I do not.

Q. And your rebuttal testimony, sir, has been marked as Exhibit 106. Do you have any corrections to this exhibit?

A. No, I do not.

Q. And finally, your surrebuttal testimony has been marked as Exhibit 107. Do you have any corrections to this exhibit?

A. No, I do not.

MR. THOMPSON: I would move the admission of Exhibits 105, 106 and 107 and tender the witness for cross-examination.

JUDGE PRIDGIN: Mr. Thompson, thank you. Exhibits 105, 106 and 107 have been offered. Any objections?

MR. ZOBRIST: No objections.

JUDGE PRIDGIN: Hearing none, Exhibits 105, 106 and 107 are admitted.

(EXHIBIT NOS. 105, 106 and 107 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE

RECORD.)

JUDGE PRIDGIN: Mr. Zobrist, will you or anyone else from KCPL have cross for this witness?

MR. ZOBRIST: Yes, Judge.

JUDGE PRIDGIN: Mr. Mills, will you have cross?

MR. MILLS: (Nodded head.)

JUDGE PRIDGIN: Any other counsel have cross for Mr. Barnes?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Hearing none, Mr. Mills?

CROSS-EXAMINATION BY MR. MILLS:

Q. Good morning, Mr. Barnes.

A. Good morning.

Q. Do you believe that regulation should provide protection to both customers -- to both the company and to its customers?

A. Yes.

Q. Do you believe that in order to protect customers, regulation should ensure that a utility's cost structure reflects prudently managed costs and costs that are just and reasonable for setting rates?

A. Yes.

Q. Do you believe that the end result for protecting the public interest is that rates should be no higher than necessary in order to fairly compensate investors and preserve the utility's financial integrity and access to capital?

A. Yes.

Q. Can you describe the capital structure you're proposing to use to set KCPL's rates in this proceeding?

A. My capital structure is based on a consolidated capital structure of Great Plains Energy and -- which is based as of March 31st, but I believe that's gonna be updated through true-up. They have some debt issuances in May and September.

Q. As -- as your filed position, though, what capital structure are you recommending?

MR. THOMPSON: Objection. He's already stated that that's going to be trued up, and consequently his filed position is no longer of any relevance.

MR. MILLS: Well, it was just admitted into the record and this witness says that's what he's talking about. We don't know what he's going to update it to. All we know is what's in the record right now, and I think it's reasonable to ask him what that is. It's just a series of three numbers.

JUDGE PRIDGIN: I'll overrule and certainly understand that these numbers may be updated for true-up.

I'm sorry. Mr. Barnes, do you need the question asked again?

THE WITNESS: Yes, please.

BY MR. MILLS:

Q. What is that capital structure?

A. Capital structure is 66.01 percent common equity, 1.67 percent preferred stock and 32.32 percent long-term debt.

Q. What analyses have you done that show a 66 percent common equity ratio represents prudent utility capital structure cost management in this proceeding?

A. Just my analysis here. I have not done any other analysis to that effect.

Q. And which portion of your analysis goes to showing that a 66 percent common equity ratio represents prudent utility capital structure cost management?

A. I don't have an analysis that shows that 66 percent is prudent.

Q. Okay. And similarly, what analyses have you done to show that a 66 percent common equity ratio would reflect just and reasonable costs for the development of retail rates?

A. Same answer: Again, I have not done an analysis.

Q. Have you done any analyses to determine whether or not KCPL plans to finance its utility operations with a 66 percent common equity ratio during the period in which rates determined in this case will be in effect?

A. No, I have not.

Q. Are you familiar with the KCPL regulatory plan and the financial objectives used to help support KCPL's credit rating and credit method -- credit metrics during the construction of Iatan 2?

A. I'm generally familiar with it.

Q. Okay. Would you agree that one of the credit metrics included in the plan is to set KCPL's rates to maintain a total debt to total capitalization ratio of around 51 percent?

A. Subject to check, I would -- I would agree with that.

Q. I have a copy of the regulatory plan here. Would you like to check?

A. If you wouldn't mind.

MR. MILLS: May I approach?
JUDGE PRIDGIN: You may.
THE WITNESS: Could you point me to a page number or appendix?
BY MR. MILLS:
Q. There you go. It's appendix E.
A. Could you state your question one more time, please?
Q. Yes. Would you agree that one of the credit metrics included in the KCPL regulatory plan is to set KCPL's rates to maintain a total debt to total capitalization ratio of around 51 percent?
A. Yes, I'd agree with that.
Q. Okay. Under your proposed capital structure, what is the total debt ratio?
A. 32 percent -- 32.32 percent as of March 31st.
Q. Now, if KCPL reduces its debt ratio from 51 percent as specified in the regulatory plan to the 32 percent that you just suggested, will that increase the common equity capital as a percent of total capital in setting rates for KCPL in this proceeding?
A. Would that increase their equity ratio?
Q. Uh-huh.

A. Yes.

Q. By increasing the equity ratio, would you agree that you are increasing the revenue requirement for KCPL in this proceeding?

A. I don't know how that would affect the revenue requirement, but I would speculate that it probably would.

Q. And at the current time, is equity not more expensive than debt?

A. Yes.

Q. So that if you increase the equity ratio, you increase the revenue requirement?

A. Yes.

Q. Have you calculated the approximate increase in the revenue requirement created by moving from 51 percent total debt ratio to a 32 percent debt ratio?

A. No, I have not.

Q. How did you decide to use for the purpose of your testimony in this case the Great Plains actual capital structure as of March 31st, 2007?

A. I used that date because that was known and measurable at the time I was doing my testimony. And I believe one reason the equity ratio is higher is because KCPL at that time had paid off some debt or refinanced some debt, and they actually issued some more after I -- in May, I believe it was, when they issued some more debt and -- but as of -- the update period was March 31st and that was known and measurable to me at that time, so that's why I chose to use that date and capital structure.

Q. Did you update the capital structure in either your rebuttal or surrebuttal testimony?

A. No. I chose to wait until true-up because I believe the other two witnesses used a pro forma September 30th capital structure.

Q. And when we get to the true-up, what is your intention to use that?

A. While I'll update my capital structure as soon as I get the information from the company as Mr. Zobrist pointed out, I believe it's gonna be around 58 percent.

Q. Updated to what point in time?

A. September 30th, 2007.

Q. And you will update it to whatever the actual is at that point?

A. That's correct.

Q. And is there a level at which you would say that that level, be it 66 percent, 58 percent, 98 percent, that that is too much equity for ratepayers to be required to pay?

A. I don't have any benchmark, so to speak. Is that -- that your question?

Q. That certainly is an answer to my question.

A. It's gonna be whatever the data is as of September 30th.

Q. So regardless of whether -- regardless of what that number is, you don't plan to do any sort of an analysis as to whether that's a prudent number?

A. No.

Q. Okay. Do you have any objective standard by which you would judge the prudence of that number?

A. Of the equity number or ...

Q. Yes. Well, looking at it either way. I mean the equity ratio or the debt ratio.

A. Ask your question one more time.

Q. Do you have any sort of a benchmark, do you have any means of analyzing a company's equity ratio to determine whether or not that's a reasonable level?

A. The only thing that we have is the credit metrics that S&P publishes. I could use what you pointed out, the total debt to total capital, as a benchmark compared to the credit rating as a start, but I don't have any other analysis of my own that we -- that we completed.

MR. MILLS: That's all the questions I have. Thank you.

JUDGE PRIDGIN: Mr. Mills, thank you.

Mr. Zobrist?

MR. ZOBRIST: Thank you, Judge.

CROSS-EXAMINATION BY MR. ZOBRIST:

Q. Mr. Barnes, I just have a few questions. Briefly on your qualifications, since you testified in the last KCPL rate case in 2006, you still haven't attended any of the regulatory schools, either New Mexico State or at Michigan State; is that correct?

A. That's correct.

Q. All right. And have you attended any other major university programs like the one that's -- the water rate school that they hold in San Diego or any other rate schools that are offered around the nation?

A. No, I haven't.

Q. And you've now been with the PSC a little over four years; is that correct?

A. Yes.
Q. Okay. And you've got a Bachelor of Science from Columbia College that you received in 2002 and an MBA from William Woods in May of 2005; is that correct?
A. That's correct.
Q. Any other degrees that you've earned since then?
A. No.
Q. Okay. And you've been in state government, as I recall, since January 1997?
A. That's correct.
Q. Okay. And from January 1997 until you joined the Commission in June of 2003, you were with the Department of Conservation and the Department of Natural Resources?
A. That's correct.
Q. Okay. And you weren't doing this kind of financial analysis, rate-of-return analysis --
A. No, I wasn't.
Q. -- with those agencies, were you?
A. No.
Q. Okay. Now, since the time that the Commission issued its Report and Order on December 21, 2006, have the credit ratings for Great Plains Energy

Holding Company of Kansas City Power & Light, have they changed?
A. Not recently, no, not -- I don't believe they have.
Q. Okay. So since the Commission issued its order, they have maintained their triple B with stable outlook rating, correct?
A. That's correct.
Q. Okay. And am I also correct that KCP&L has maintained its credit rating?
A. Yes.
Q. Okay. It didn't go up as a result of the Commission's order, did it?
A. No.
Q. Okay. And neither did that other holding company?
A. No.
Q. Okay. And KCPL's rating was also a triple B with stable outlook?
A. That's correct.
Q. Okay. Now, the primary method that you used to arrive at your ROE recommendation was the discounted cash flow model that we've referred to here as the DCF model, correct?
A. Yes.

Q. And then you use the CAPM or CAPM, capital asset pricing method, as a check on reasonableness, correct?

A. That's correct.

Q. But the primary tool that you used was the DCF analysis?

A. That's correct.

Q. Okay. And I know that the Commission has heard Dr. Hadaway speak about that model. You used what Dr. Hadaway called the traditional DCF model, correct?

A. Correct.

Q. Okay. And you did not use the other two models that he ran which he called the long-term GDP growth rate model, and you did not use the two-stage growth rate model, correct?

A. That's correct.

Q. And he relies upon those latter two models as preferred over the traditional constant growth model that you use, correct?

A. Yes.

Q. All right. He gave more weight to his long-term model and his two-stage model, correct?

A. Correct.

Q. And is it true that you are the only

expert testifying in this area that relies exclusively on the traditional constant growth DCF model?

A. Yes, that's correct.

Q. Okay. Mr. Gorman for Office of Public Counsel did not rely exclusively on the traditional constant growth DCF model, correct?

A. I believe he gave it some weight, but he also used a two-stage DCF model, yes.

Q. And didn't he testify that he placed more emphasis upon his two-stage model?

A. Yes, I believe so.

Q. Now, the other two witnesses, both Mr. Gorman and Dr. Hadaway, attempted to arrive at a long-term growth rate; is that correct?

A. Yes.

Q. And Dr. Hadaway's was 6.6 percent and Mr. Gorman's was 5.1 percent, correct?

A. Correct.

Q. And you did not even try to calculate a long-term GDP, gross domestic product, growth rate, correct?

A. Not a GDP growth rate, that's correct.

Q. Okay. And again, that distinguishes you from both the other experts on this issue in this case?

A. Yes.

Q. Okay. Now, you relied primarily on what you called projected growth rates; is that correct?

A. Yes.

Q. Okay. And the ranges that you used -- and I think I rather sloppily wrote it up here -- but you used a range of 5.34 which was your Value Line figure; is that correct?

A. Yes, that's correct.

Q. And these are found at around page 18 of your direct testimony?

A. I believe so. Or schedule 15 of my schedules that are attached.

Q. All right. That's fine. And the high growth rate that you used was a 6.50 provided by Standard & Poor's, correct?

A. Yes, that's correct.

Q. Okay. So your lowest growth rate at 5.34 was 24 points above Mr. Gorman's at 5.10, correct?

A. Yes.

Q. Okay. And your highest one at 6.50 was just ten points shy of Dr. Hadaway's at 6.6; is that correct?

A. That's correct.

Q. Okay. Now, have you ever run either a two-stage or a multistage DCF model?

A. No, I have not.

Q. Okay. And I think you stated in your testimony, in your direct testimony, that you didn't believe you needed to do that because KCPL is a mature company in a mature industry, correct?

A. Yes.

Q. Okay. So in analyzing any American utility, you would not use any of these nontraditional DCF models; is that correct?

A. That's correct.

Q. Okay. And so you, again, would disagree with any expert who would attempt an ROE analysis using any of those other approaches?

A. Yes.

Q. Okay. And isn't it true, then, that your analysis by utilizing the traditional DCF model places utilities in what Dr. Hadaway called the declining-industries category of companies?

A. Could you restate that question?

Q. Well, let me -- let me put it this way: When a company like Dell Computers starts out, you know, it's a small company and it's kind of limping along and then it hits its stride and the curves go way up, and then there comes a point in time when it becomes mature, correct?

A. Correct.

Q. All right. And when you say mature, what do you mean that it's become a mature company?

A. That it's at the peak of that curve and it's either going flat or it could be on a declining side of that curve.

Q. Okay. Now, in looking at the utility industry, is it your belief that we've now gone over the curve and that we're in a declining industry mode?

A. I think we're still at the top, myself. I don't think we're going down, but it's -- it's -- it's at the top of that curve.

Q. Okay. Can you think of any utility in the country that you would not call a mature utility even if it's in a mature industry?

A. Not off the top of my head, no.

Q. And getting back to growth rates, you essentially disagreed with both Dr. Hadaway and Mr. Gorman. You felt that Dr. Hadaway's at 6.6 was too high and that Mr. Gorman's at 5.1 was too low, is that correct, in terms of growth rates?

A. The way you have it presented there, I'm in between them, so I would not agree or disagree with them; I just don't agree with the use of the GDP growth rate as a growth rate in the DCF model.

Q. All right. Fair enough. Now, your analysis produced three results, correct?

A. Yes.

Q. And in your direct testimony on page 30, those three figures were an 11.33 percent ROE which used the long-term arithmetic average; is that right? And this is actually in your check of reasonableness. Pardon me. I'm moving on now to your CAPM.

A. Yes. CAPM -- arithmetic CAPM did produce 11.33 percent.

Q. And that was -- so that was your top CAPM rate, correct?

A. Yes.

Q. And your lowest was a short-term risk to premium period at 5.76, correct?

A. Based on a ten-year CAPM, yes.

Q. Now, you discarded that 5.76, didn't you?

A. That's correct.

Q. Okay. And that's clearly unreasonable because it's well below the current cost of utility

debt, correct?
A. Correct.
Q. Your middle figure was a 9.92 long-term geometric average; is that correct?
A. That's correct.
Q. Okay. And that's what you relied upon as your check for reasonableness, correct?
A. That's correct.
Q. Okay. Why didn't you, as a check of reasonableness, take the midpoint between your high figure of 11.33 and your mid figure of 9.92?
A. I relied on a geometric CAPM of 9.92 because I believe that is the appropriate method to use as a check of reasonableness for the DCF model because that takes into effect compounding returns over time.
Q. Okay. And -- and I think you cited in your either rebuttal or surrebuttal testimony some academic studies that endorse that concept; is that correct?
A. Could you point me to where ...
Q. I think you said in your surrebuttal at 5, you said you rejected the arithmetic mean because it took into account the average return over numerous holding periods as if one bought and sold securities

and you thought the geometric would be better because it's more of a long-term holding model?
A. That's correct.
Q. Okay. But it is true that there are folks who do not hold on to their utilities securities over long periods of time; that they do trade, they buy and they sell, correct?
A. Yes.
Q. Okay. But again, you did not average the 11.33, your arithmetic risk premium, with the 9.92?
A. No, I did not.
Q. Okay. But if you had, you would have arrived at a higher midpoint, which my math says is about 10.63 percent, correct?
A. If I averaged the two, yes.
Q. Correct.
A. Yes.
Q. And that 10.63 would be generally within striking range of Dr. Hadaway's overall ROE of 10.75; is that correct?
A. That's correct.
MR. ZOBRIST: No further questions, Judge.
JUDGE PRIDGIN: Mr. Zobrist, thank you.

CHAIRMAN DAVIS: Do you want to see if Commissioner Jarrett has anything?

COMMISSIONER JARRETT: No questions.

JUDGE PRIDGIN: Mr. Chairman.

QUESTIONS BY CHAIRMAN DAVIS:

Q. All right. We'll see if we can't get this done really quick. Mr. Barnes, you're a State employee, correct?

A. Yes, sir.

Q. And as an employee, you get a pension, don't you?

A. Yes, sir.

Q. And is that the Missouri State Employees Retirement System?

A. Yes, it is.

Q. Are you vested in the MOSERS system?

A. Yes, I am.

Q. Do you think that MOSERS' expectations on earning a rate of return for future retirees like yourself is a reasonable expectation of what investors in this area might want to earn?

A. I think so, yes.

Q. Do you ever recall getting a newsletter from MOSERS?

A. Yes, I believe we get them quarterly, but don't quote me on that. But I believe it is quarterly.

Q. Do you ever read those newsletters?

A. I haven't recently but I have before, yes.

Q. Okay. Do you recall reading anything about the assumed rate of return that MOSERS is trying to earn?

A. No, I don't.

Q. So if I told you that for forecasting purposes, MOSERS assumes a rate of return of 8 and a half percent, you'd have no reason to doubt that?

A. I would not, no.

Q. And I guess that forecasted rate of return that they're using for their assumptions, that actually falls in line with your -- the upper end of your rate of return testimony in your direct, does it not?

A. The 8 and a half percent?

Q. Uh-huh.

A. It's below my recommended return on equity.

Q. It was -- no, rate of return.

A. Oh, rate of return.

Q. You recommended, what was it, 7.97 to

8.73?

A. Yes, yes. I'm sorry, yes.

Q. So sort -- it's sort -- it's -- it's sort of towards the upper end?

A. Yes.

Q. Now, do you know what -- what MOSERS' annual return -- annualized return has been for the last five, ten, 15 years?

A. Not -- not off the top of my head, I don't know.

Q. So if I told you that the 15-year annualized return for MOSERS was actually 10.1 percent, you wouldn't have any -- any reason to doubt that, would you?

A. No, I would not.

Q. And then you don't know what their annualized rate of return for 2006 was, do you?

A. No, I don't.

Q. So if I told you it was 11 and a half percent, you wouldn't have any reason to doubt that either?

A. No, I wouldn't.

Q. So if MOSERS is seeking to average at least an 8 and a half percent rate of return but they're actually making an average of 10.1 percent over the last 15 years and made better than 11 last year, based on your rate of return recommendation in this case, based on what you know of other Staff recommendations in recent rate cases, do you think that's going to attract any investment from MOSERS?

A. I don't know.

CHAIRMAN DAVIS: Thank you. No further questions.

JUDGE PRIDGIN: Mr. Chairman, thank you.

Mr. Thompson, first of all, do you have redirect?

MR. THOMPSON: What about cross based on questions from the bench?

JUDGE PRIDGIN: I apologize. You're right. I'm trying to get Mr. Mills out of here and I apologize. You are correct, Mr. Thompson.

MR. THOMPSON: Don't let me slow you down in getting Mr. Mills out of here.

JUDGE PRIDGIN: Any recross based on bench questions?

MR. MILLS: No.

JUDGE PRIDGIN: All right. Redirect?

MR. THOMPSON: I have redirect, yes.

JUDGE PRIDGIN: Do you know if it will be extensive? I know we have an 11:15 meeting, and it's already past 11:15.

MR. THOMPSON: I would be happy to do it after the break.

JUDGE PRIDGIN: That would be great. Let's break so the Commission and Mr. Mills can get to the USB and noon agenda. We will plan on reconvening at 12:45.

Anything further from counsel before we go off the record?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Hearing nothing, we will be in recess until 12:45.

(THE NOON RECESS WAS TAKEN.)

JUDGE PRIDGIN: Good afternoon. We are back on the record. If I recall correctly, we had left off with Mr. Barnes being on the stand and Mr. Thompson having some redirect. And I believe the next witness would be Mr. Trippensee from Office of Public Counsel and Mr. Gorman from Office of Public Counsel; is that correct?

MR. MILLS: That's my understanding.

JUDGE PRIDGIN: All right.

MR. ZOBRIST: Judge, did you want to talk about two other witness issues?

JUDGE PRIDGIN: Certainly.

MR. ZOBRIST: On Mr. Schnitzer we did not receive any notification that he was required for cross-examination, and you told me during the break that you had not received any commissioner inquiries. We were prepared to let him go.

JUDGE PRIDGIN: That's fine. I'll let the commissioners know if anybody has any questions for him, I'll tell them he's -- due to travel arrangements, he's been called off and we'll see if they're really serious about questions and how we could get him here.

MR. ZOBRIST: Right, right. Okay. That's fine, Judge.

JUDGE PRIDGIN: Okay.

MR. ZOBRIST: And then the other is Kansas City Power & Light's witness Spielberger on advertising costs. And I'm gonna ask Mr. Blanc to talk about that, whether he would be needed.

JUDGE PRIDGIN: Okay.

MR. BLANC: Basically Staff were the only other party that entered testimony contesting Mr. Spielberger's -- or contesting the advertising issue, and through the exchange of testimonies, the two witnesses came to an agreement. In our position statement we actually said that we adopted

Mr. Vesely's position in his surrebuttal, so we don't believe there's a contested issue.

JUDGE PRIDGIN: Okay. Mr. Thompson, do you see any reason to have that witness here for advertising for cross-examination?

MR. THOMPSON: Absolutely not.

JUDGE PRIDGIN: Very good. We'll just plan to -- any other objection from counsel? It doesn't sound like any other party contested advertising.

(NO RESPONSE.)

JUDGE PRIDGIN: Okay. We'll just plan for you to excuse him.

MR. BLANC: Would it be appropriate to offer his testimony at this time?

JUDGE PRIDGIN: That's certainly fine.

MR. ZOBRIST: Judge, I have that marked as Exhibit 24, rebuttal testimony only.

MR. BLANC: Correct.

JUDGE PRIDGIN: Exhibit 24, rebuttal testimony. And I'm sorry, Mr. Zobrist, that's being offered?

MR. ZOBRIST: It's being offered, rebuttal testimony of KCPL witness Robert Spielberger.

JUDGE PRIDGIN: All right. Any objections?

MR. THOMPSON: No objection from Staff.

JUDGE PRIDGIN: All right. Hearing none, Exhibit 24 is admitted.

(EXHIBIT NO. 24 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE PRIDGIN: Anything else from counsel? Mr. Zobrist?

MR. ZOBRIST: Has Mr. Schnitzer's testimony been admitted?

JUDGE PRIDGIN: I don't believe it's been admitted or offered.

MR. ZOBRIST: It's Exhibit 22, the direct testimony, both public and highly confidential, of Michael Schnitzer, and Exhibit 23, his surrebuttal, both public and highly confidential versions. I offer Exhibits 22 and 23.

JUDGE PRIDGIN: Okay. And I may be mistaken. My notes show that it has been offered and admitted.

MR. ZOBRIST: All right. Thank you. Thank you, Judge.

JUDGE PRIDGIN: All right. Thank you. Okay. Anything further from counsel?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. It's about one o'clock and we'll see how the schedule goes. I think we're pretty much right on schedule. If we're done before five with these witnesses, I'll simply ask the parties if they would be willing and able to go forward with other witnesses.

If not, I understand because we would be on schedule and I'm sure not gonna make you, but we'll just wait and see how the afternoon goes, just to make you aware of that possibility.

Okay. Mr. Barnes, you're still under oath.

Mr. Thompson, any questions?

MR. THOMPSON: Thank you, your Honor.

REDIRECT EXAMINATION BY MR. THOMPSON:

Q. Good afternoon, Mr. Barnes.

A. Good afternoon.

Q. Mr. Mills asked you some questions about capital structure. Do you recall that?

A. Yes.

Q. Could you tell me where you got the 66.01 figure that you used in your direct testimony, I believe it was, for common equity?

A. That was based on a data request from the company as of March 31st, 2007.

Q. In other words, it represented the actual proportion of common equity in their capital structure as of some date?

A. Yes.

Q. Can you think of any reason why you would not use the actual capital structure?

A. No.

Q. So -- now, some of the questions Mr. Mills asked you, to me, hearing them, made it sound like you had somehow manipulated the data or your testimony in order to use that 66.01 number. Did you manipulate that data in any way?

A. No, I didn't --

MR. MILLS: I object to the first part of that question which was simply testimony and characterization of my question. And I don't object to the question, but the statement that it made it sound -- the first portion of the question was a speechifying and not a proper cross-examination question, and I object to it on that basis. But the portion where he actually asked the question, did you manipulate it, I don't object to.

JUDGE PRIDGIN: Mr. Thompson?

MR. THOMPSON: I asked the question that

I asked, Judge.

JUDGE PRIDGIN: All right. I'll sustain it and if you can ask questions not quite as argumentative.

MR. THOMPSON: Thank you.

BY MR. THOMPSON:

Q. Did you manipulate that data in any way?

A. No, I did not.

Q. Now, I think Mr. Mills asked you why you didn't use a pro forma capital structure. What does pro forma mean?

A. Pro forma is just a -- it's a projection of where the company thinks they're gonna be at a certain -- at a certain date.

Q. Is a pro forma figure known and measurable?

A. No, it is not.

Q. Does Staff typically use known and measurable figures in its case?

A. Yes, they do.

Q. Now, you were also asked some questions by the Chairman about MOSERS. Do you recall those questions?

A. Yes, I do.

Q. For example, the Chairman asked you if you had any reason to disagree with him if he told you that their assumed return -- rate of return is 8.5. Do you recall that?

A. Yes, I do.

Q. Do you have any idea what is in MOSERS' portfolio?

A. I think they're invested in quite a few lines of businesses, but I don't know exactly what their portfolio consists of.

Q. That's not something you've studied for this case, is it?

A. No, it's not.

Q. And the returns that one might expect on various securities and stocks can vary hugely from one to another, right?

A. Yes.

Q. In fact, didn't we have a discussion while Dr. Hadaway was on the stand about a graph in his testimony that suggests that as risk goes up, the investor's expectation of return also goes up?

A. Yes.

Q. So far as you know, is there any reason why MOSERS' expected return is relevant to the rate of return or return on equity to be assigned to Kansas City Power & Light?

A. No, I -- I have not done an analysis on that.

MR. THOMPSON: Thank you. No further questions.

JUDGE PRIDGIN: Mr. Thompson, thank you. Mr. Barnes, thank you.

All right. Mr. Mills, is Mr. Trippensee ready?

MR. MILLS: Yes.

(THE WITNESS WAS SWORN.)

JUDGE PRIDGIN: Thank you very much, sir.

Mr. Mills, anything before he's tendered for cross?

DIRECT EXAMINATION BY MR. MILLS:

Q. Mr. Trippensee, do you have any corrections to your direct testimony?

A. No, I do not.

Q. How about to your rebuttal testimony?

A. No, I do not.

MR. MILLS: I have nothing further and he's tendered for cross.

JUDGE PRIDGIN: All right. Mr. Thompson, will you have cross for this witness?

MR. THOMPSON: No, I will not.

JUDGE PRIDGIN: Mr. Zobrist, you or anybody from KCPL?

MR. ZOBRIST: We have cross.

JUDGE PRIDGIN: All right. Any other parties have cross for Mr. Trippensee?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Mr. Zobrist, when you're ready, sir.

MR. ZOBRIST: Thank you, Judge.

CROSS-EXAMINATION BY MR. ZOBRIST:

Q. Mr. Trippensee, you did not file a surrebuttal in response to Mr. Cline's rebuttal testimony; is that correct?

A. No, I did not.

Q. And would you generally agree that with regard to the additional amortizations mechanism that's in the Stipulation & Agreement that was approved by the Commission and return on equity, that for this company neither is a substitute for the other?

A. They are -- should be independent of each other. We're setting rates -- from Public Counsel's viewpoint, the Commission should set rates based on a traditional rate of return calculation that would not take into consideration the construction or anything along that lines.

Once that is done, the revenues and the expenses are then put into the financial matrix test to see if adequate cash is generated to meet certain financial matrix measures. But something such as taking construction risk as Dr. Hadaway has done, while Mr. Gorman can address it more fully, would be inappropriate because the regulatory plan addresses the construction risk for Kansas City Power & Light through both the decisional prudence component and through the additional amortization.

Q. Now, you're familiar with the terms of the Stipulation & Agreement, correct?

A. Stipulation & Agreement --

Q. Right.

A. -- in what case?

Q. The 2005 case.

A. The regulatory plan? Yes.

Q. Right, right. And --

A. Very familiar with it.

Q. Yeah. And --

A. Excuse me.

Q. -- that preserves all parties' right to contend that the company has not been prudent as it embarks upon these construction investments, correct?

A. As it embarks?

Q. Well, let me put it this way --

A. No, it does not. In fact, just the opposite.

Q. Well, it says that there are certain limitations on prudency as far as technology, but in terms of the cost of the projects, that prudency evaluation is preserved to the parties to argue?

A. I believe it would be a little better characterization that the cost -- if the plan is implemented imprudently, that is subject to question.

Q. Right. And -- and that's -- that's what I meant. In other words, that the dollars that the company spends on the case, any party, including Public Counsel, can attack those expenses as saying, you know, those expenses for a program that we think is wise, we think those expenses were imprudent, they were too high?

A. If the -- again, the regulatory plan, I believe it's appendix D, contains cost estimates for these projects. If the projects come in -- if those projects are implemented and let's say they spend $100,000 an hour for, you know, a consulting fee that the market rate is a thousand dollars an hour, that would be subject to prudence.

But so long as they implement the plan, there has been known technological changes or other factors that change the economics of the plan during the construction period, the decisional prudence to implement that plan is not in question.

That is something that Dr. Hadaway in his discussion about all the risk factors today didn't address whatsoever, and that's a factor that goes directly against the risk that the stockholders face.

Q. And -- I'm sorry.

A. That the stockholders face. His focus was on the additional amortization which addresses bond risk and getting them to invest, but the stockholder risk is -- the decisional prudence was the key component to address risk stockholders faced.

Q. And so although the decisional portion of the company's plans cannot be challenged, the execution can, correct?

A. The implementation -- yes. If Kansas City Power & Light management does not implement and act in a prudent manner, that, of course, is something that could be challenged. Those are people, though, that are ultimately hired by the stockholders acting in their stead.

Q. And the additional amortizations are designed under the 2005 stipulation approving the regulatory plan to provide incremental cash flow to maintain credit ratios, correct?

A. Two credit ratios that are set out in the plan.

Q. And they are not a substitute for earnings, because that's what's decided in a case like this?

A. That is correct. Conversely, earnings in this case are not to be substituted or inflated to make up for risk the regulatory plan addresses.

MR. ZOBRIST: Thank you. Nothing further.

JUDGE PRIDGIN: All right. Thank you. No bench questions. Redirect?

MR. MILLS: No redirect.

JUDGE PRIDGIN: All right. Thank you. Mr. Trippensee, you may step down.

THE WITNESS: Thank you.

JUDGE PRIDGIN: And Mr. Mills, did you want to offer his testimony?

MR. MILLS: Mr. -- Mr. Trippensee testifies again later in the proceedings.

JUDGE PRIDGIN: Thank you.

MR. MILLS: So I think it was our intention to offer his testimony when he testifies for the last time.

JUDGE PRIDGIN: Thank you very much. All right. Would that then leave Mr. Gorman?

MR. MILLS: Correct.

JUDGE PRIDGIN: All right. If you'd come forward to be sworn, please, sir.

(THE WITNESS WAS SWORN.)

JUDGE PRIDGIN: Thank you very much, sir. Please have a seat.

Mr. Mills, anything before he's tendered for cross?

DIRECT EXAMINATION BY MR. MILLS:

Q. I'd just ask the same sorts of questions. Mr. Gorman, do you have any corrections to any of your prefiled testimony?

A. I do not.

MR. MILLS: Okay. Then the witness is available for cross-examination.

JUDGE PRIDGIN: All right. Mr. Gorman is ready for cross-examination.

Mr. Thompson, any cross?

MR. THOMPSON: I have no cross.

MR. MILLS: And I do plan to offer his

testimony for this appearance. I can offer it now or when he's done.

JUDGE PRIDGIN: At your option.

MR. MILLS: Okay. I'll wait till he's done.

JUDGE PRIDGIN: Mr. Zobrist, cross? Any other parties have cross for Mr. Gorman?

(NO RESPONSE.)

JUDGE PRIDGIN: Mr. Zobrist, when you're ready, sir.

CROSS-EXAMINATION BY MR. ZOBRIST:

Q. Good afternoon.

A. Good afternoon.

Q. Mr. Gorman, I'm Karl Zobrist. I represent Kansas City Power & Light Company in this case. Just a couple of words about your background. You received your bachelor's degree in electrical engineering; is that right?

A. Yes.

Q. And that was from Southern Illinois University; is that correct?

A. It is.

Q. Okay. And then an MBA in -- with a finance/construction from the University of Illinois at Springfield; is that right?

A. Yes.
Q. I'm not familiar. That's not the Champaign-Urbana campus, is it?
A. No, it's the Springfield campus.
Q. When -- did that used to be called -- was that Sangamon State University or a different university for a while?
A. No, you're correct.
Q. Okay. All right. You stated, I believe, in your direct testimony that you had several graduate level economic courses that you have taken; is that correct?
A. Yes.
Q. Where have you taken those?
A. Sangamon State or University of Illinois-Springfield.
Q. And since you've worked in the utility area, you've held positions with the Illinois Commerce Commission and then with the consulting firms that Mr. Brubaker, Maurice Brubaker has been involved with; is that correct? Since 1990, I think?
A. I'm sorry. Can you repeat that question?
Q. Yeah. I said since you left the Commission -- I think you were at the Illinois

Commission from -- in the 1980's?

A. Well, I left the Commission initially to go to Merrell Lynch, and then from Merrell Lynch I went to work for Drazen-Brubaker which was the predecessor to the current company, which is Brubaker & Associates.

Q. So what I was saying is you've worked with Mr. Brubaker's company since 1990?

A. Yes.

Q. Okay. And have you ever been retained by an investor-owned utility since becoming a private consultant?

A. Well, just once. There was a Wyoming gas company that I worked for.

Q. Okay. Thank you. Now, Mr. Trippensee and I had a discussion about the regulatory plan. Have you read the Stipulation & Agreement that was approved in that plan?

A. Yes.

MR. ZOBRIST: When you asked the last witness, Mr. Mills, about that, did you get it in the record or was that -- did you just hand that to the witness?

MR. MILLS: I did not move the Stipulation & Agreement into the record.

MR. ZOBRIST: Okay. I've got some copies, Judge, and so I'll just have those marked. I think the next -- 29?

JUDGE PRIDGIN: Yes, sir.

MR. ZOBRIST: These are rather bulky, but I'll go ahead and have them marked. Do you want six copies for the bench, Judge?

JUDGE PRIDGIN: Are they simply copies of the stip?

MR. ZOBRIST: Right.

JUDGE PRIDGIN: Okay. No, thank you.

(EXHIBIT NO. 29 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. ZOBRIST:

Q. Now, Mr. Gorman, you understood that there were several parties to this case who did not sign the stipulation?

A. I didn't verify that specifically.

Q. So you were not aware that neither the Department of Energy nor Trigen refused to sign?

A. I did not seek to verify that.

Q. Okay. And if I'm correct that they did not sign, they would be able to make any objection for any of the plans that KCPL is implementing or will implement in the future with regard to this

regulatory plan, correct?
A. Well, I'm not a lawyer but I assume that's correct.
Q. Now, you read this section dealing with the additional amortizations, correct?
A. Yes.
Q. And do you understand that additional amortizations that are approved by the Commission do serve as an offset to rate base in the next rate case?
A. Yes.
Q. And therefore they do have the effect of diminishing or eroding the rate base of the company?
A. They have the effect of accelerating recovery of that rate base.
Q. But it also -- when the rate -- when -- when they -- when we get to the next rate case, then it does reduce the rate base and the amount of the additional amortizations, correct?
A. Well, it reduces it because part of the investment has been recovered.
Q. But you're not disputing that it does have a reduction or an offset to rate base?
A. Well, to the extent the company recovers an investment, it would no longer have an outstanding

investment to include in a rate base. So yes, rate base would be lower as the company recovers its investments.

Q. Now, sir, do you have your direct testimony in front of you?

A. Yes.

Q. Could you turn to page 6?

A. I'm there.

Q. I'm sorry. Your rebuttal testimony, page 6. Pardon me.

A. Okay. I'm there.

Q. Now, beginning on line 4, you state that, "This regulatory plan and amortization expense significantly strengthens KCPL's cash flow during construction which mitigates its construction risk at significant cost to retail ratepayers." Is that correct?

A. Yes.

Q. And if you calculated the degree to which in your view that significantly strengthens cash flow, is it the amount of the amortization per se, just that dollar amount?

A. It would be consistent with the regulatory amortization amount. The after-tax effect of that would be the enhancement to the utility's cash flow.

Q. Now, on line 10 of this same page, you state that the plan, quote, mitigates construction and regulatory risks by commission review and approval of construction cost budgets and rate treatment after the asset is placed in-service, closed quote. Did I read that correctly?

A. Yes.

Q. Now, are you saying that the Commission has approved a particular construction budget in this case or in any previous case?

A. Well, that was not worded very well. What the Commission did approve was the plan which included construction cost estimates.

Q. Okay. And so strictly speaking, no construction cost budgets were approved by this Commission, correct?

A. Well, the overall plan was -- was approved by it, but we may be -- it may be a semantical difference, but I'm not aware of the Commission actually approving a construction amount.

Q. Or a construction budget?

A. Yes.

Q. Okay. And similarly, no rate treat -- ratemaking treatment is guaranteed or provided in this agreement, correct, as far as return on equity? Let me be specific.

A. There's no guarantee of a return on equity. To do so I think would impose too much risk on the company and investors -- or pardon me, the company and ratepayers. The idea behind the plan was to mitigate risk.

Q. But the point is, there was no specific ratemaking treatment as far as return on equity because the agreement itself set forth four rate cases, this being the second one that the company is either obligated or permitted to bring, correct?

A. Correct. And again, the plan was designed to mitigate risk and because capital costs can fluctuate over time, it would be inconsistent with the objective of mitigating risk to set a return on equity not knowing what future capital market costs will be.

Q. Now, sir, turn to page 8, please, in your rebuttal. On line 3, you state that KCPL has been permitted to set rates based on regulatory principles that are designed -- specifically designed to ensure that KCPL cash flows meet specified credit metrics in order to enhance KCPL credit rating during this construction period, closed quote.

Did I read that correctly?
A. Yes.
Q. And when you say KCPL has been permitted to set rates, you're not saying that the company can unilaterally set rates, are you?
A. Well, the company did set its rates, but it was allowed to by the Commission.
Q. Right. In other words, the company filed the tariff and then it went through a rate case in 2006?
A. And the rates that were approved by the Commission the company has been permitted to implement.
Q. Right. But the company did not set its rates itself. Again, it's a semantical difference, but the utilities in this state don't set their own rates, correct?
A. Well, I didn't say they did in my testimony. I clearly stated that KCP&L has been permitted to set rates.
Q. Okay.
A. There is no suggestion that they could do -- set whatever rates they feel is appropriate without Commission approval.
Q. And the latter part of that sentence

indicates that the plan was designed to enhance KCPL's credit rating during the construction period, correct?

A. I'm sorry. Could you repeat that question?

Q. Yes, sir. The latter part of your sentence beginning on line 4 of page 8 of your rebuttal states that the regulatory plan was specifically designed to ensure that KCPL cash flows meets specified credit metrics during this period of construction?

A. Yes.

Q. Okay. Now, if you could -- if you would hand the witness -- I'll get it for you. I've handed you Exhibit 29 I believe it's been marked, the Stipulation & Agreement. Would you turn to page 34?

A. I'm there.

Q. Now, this is the section that deals with this 2007 rate case which is called the No. 2 rate filing; is that correct? It's subpart B there in the middle of the page, page 34.

A. I'm looking for the -- for the phase 2 language.

Q. It's below B --

A. It says --

Q. It says rate -- on page 34.

A. Page 34.

Q. It says, "Rate filing No. 2 (2007 rate case)."

A. Okay. Yes.

Q. Okay. So this is the section of the agreement that covers this case; is that correct?

A. Yes.

Q. Okay. Now, if you would turn to page 36. it's subsection Roman Numeral 5, a little 5 in parentheses at the top. It says "Infrastructure." Do you see that sir?

A. Yes.

Q. Now, if you go to the second sentence, it states, "The signatory parties agree that they will not take the position that these investments should be excluded from rate base on the grounds that the projects are not necessary or timely." Is that correct?

A. Well, it says what it says, yes.

Q. All right. And that's what Mr. Trippensee and I were speaking of, that the parties have agreed, who signed this, that they wouldn't challenge the projects on the basis of necessity or timeliness. And then the sentence goes on to say that they can't claim that alternative technologies or certain other fuels should have been used.

Is that your understanding of this agreement?

A. Well, it's a long agreement, but with respect to this paragraph you're referencing, that's how it reads, yes.

Q. Right. And that's all I'm asking you to comment on is just right now this section dealing with the 2007 rate case.

Then the third sentence goes on to say, "Nothing in this agreement shall be construed to limit any of the signatory parties' ability to inquire regarding the prudence of KCPL's expenditures or to assert that the appropriate amount to include in KCPL's rate base or its cost of service for these investments is a different amount (for example, due to imprudent project management) than that proposed by KCPL."

Did I read that correctly?

A. Yes.

Q. Okay. So while certain decisions made by the company cannot be challenged, the method in which they implement their decisions can be challenged by anybody, including the parties who have signed this agreement, correct?

A. Oh, there are limitations to how much risk that has been eliminated through the regulatory plan. The company is still expected to act in a prudent manner.

Q. And, in fact, sir, if you turn back to page 19 which is the additional amortizations section, there is -- I'd like to call your attention to the last sentence in this carryover paragraph. It's about a third of the way down, and it begins, "KCPL further recognizes that any finding by the Commission" --

A. Wait, I'm sorry. Where are you at again?

MR. ZOBRIST: Judge, may I approach the witness? I can probably point it out a little easier.

JUDGE PRIDGIN: You may. Thank you.

BY MR. ZOBRIST:

Q. Yeah. It says, "KCPL recognizes its obligation 7to continue to prudently manage costs, continuously improve productivity and maintain quality during the regulatory plan. KCPL further recognizes that any finding by the Commission that

KCPL has failed to prudently manage its costs, continuously improve productivity and maintain service quality during the regulatory plan will negate the obligation of the signatory parties contained in this section."

Did I read that correctly?

A. Well, you lost me on that second sentence.

Q. Well, that's the most important sentence, so I'll read that one again. What it states is the --

A. Well, you're starting with the sentence, "KCPL further recognizes..."?

Q. Correct.

A. Okay.

Q. And what I'm gonna ask you, sir, is did you understand that if KCPL is found to have not prudently managed its costs, continuously improved productivity and maintained service quality during the regulatory plan, the whole amortizations mechanism could be negated?

A. Could be negated. Again, the plan mitigates risk, it doesn't eliminate it.

Q. Right, right.

A. The company's intended to manage its

affairs prudently.

Q. And, in fact, more than just prudent management of its cost; to continuously improve productivity, correct?

A. Yes.

Q. And to maintain service quality during the regulatory plan?

A. Yes.

Q. And let's jump to the back of the agreement, page 52, section 10, that's entitled, "The effect of this negotiated agreement ..."

It's in bold. Do you see that, sir?

A. Yes.

Q. And that first sentence says, "None of the signatory parties shall be deemed to have approved -- to have approved or acquiesced in any question of Commission authority," and then it lists a whole bunch of other things, going down about five or six other lines, correct?

A. Yes.

Q. So none of the parties has approved or acquiesced with regard to any cost of capital methodology, correct?

A. Yes.

Q. And they have been deemed to have

neither approved nor acquiesced in any capital structure, correct?

A. Yep.

Q. Or any ratemaking principle, correct?

A. Correct.

Q. Or any cost of service methodology or determination, correct?

A. Yes.

Q. And ultimately not in any issue with regard to cost recovery or prudence that may underlie the agreement, correct?

A. Correct.

Q. All right. And then finally as we go on later, you understand that this agreement among the parties is not a contract with the Commission? It's not an agreement with the Public Service Commission of Missouri, is it?

A. I'm not a lawyer, so I'm not sure how this binds the Commission.

Q. Well, let me -- let's go to page 53, just the next page there. Subsection G at the bottom of page 33 --

A. Okay.

Q. -- it states, "This agreement does not constitute contract with the Commission," correct?

A. That's what it says.
Q. Okay. And it says, "Acceptance of this agreement by the Commission shall not be deemed as constituting an agreement on the part of the Commission to forego during the regulatory plan the use of any discovery, investigative or other power, which the Commission presently has." Correct?
A. Yes.
Q. And then the sentence that is five lines down begins with the word "Thus." Do you see that, sir?
A. "Thus, nothing in this agreement ..."?
Q. Correct, yeah. It says, "Nothing in this agreement is intended to impinge or restrict in any manner the exercise by the Commission of any statutory right, including the right to access information or any statutory obligation."
And then it goes on to state, "Nothing in this agreement is intended to impinge, restrict or limit in any way Public Counsel's discovery powers, including the right to access information and investigate matters related to KCPL." Correct?
A. It does.
Q. Okay. All right. Let's turn to the issue of construction risk. Now, in your rebuttal

testimony, you took Dr. Hadaway's schedule 1 and you prepared your rebuttal schedule MPG-1; is that correct?

A. Yes.

MR. ZOBRIST: And just for kind of ease of our discussion here over the next few minutes, I'm gonna have this marked, Judge, if it's all right, as a separate exhibit.

What I've done is I've just stapled -- I've stapled Dr. Hadaway's schedule 1 to Mr. Gorman's rebuttal schedule 1, so I'll provide the bench with six copies here.

JUDGE PRIDGIN: All right. And that will be Exhibit 30?

MR. ZOBRIST: That's correct, I believe.

(EXHIBIT NO. 30 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. ZOBRIST:

Q. Mr. Gorman, the court reporter has marked as Exhibit 30 what I believe is Hadaway's schedule 1 and your rebuttal schedule 1; is that correct?

A. Yes.

Q. And what Dr. Hadaway's schedule presents is 2005 net plan compared with total capital spending from 2006 to 2011; is that correct?

A. Yes.

Q. And what you did in your schedule is, I believe you called it an update; is that correct?

A. I updated his schedule, yes.

Q. Yeah. And -- and your schedule shows 2006 net plan for total capital spending from 2007 to 2012, correct?

A. Yes.

Q. Okay. And I believe that the figures that you used for Great Plains Energy, the parent company of Kansas City Power & Light, were estimated for 2012, correct?

A. I'm sorry. Can you repeat that?

Q. Yeah. My understanding is that for 2012, the company has not yet published an estimated or projected budget?

A. The company hasn't? This is based on Value Line data --

Q. Oh --

A. -- not company data.

Q. This is not based on company data?

A. Right.

Q. All right. And the point of these two schedules is to compare total plant with construction, correct?

A. Yes.

Q. And you didn't dispute what Dr. Hadaway had in No. 1, you just said that's last year's data, correct?

A. Well, yeah. I updated it, that's correct.

Q. There wasn't anything in schedule 1 that was erroneous, correct?

A. It's based on Value Line's projection of 2005 net plant and projected cash flows and capital -- number of shares outstanding and capital expenditures per share.

Q. Right. And in your update, KCPL dropped down to basically a tie for second place among American utilities, correct?

A. My update showed that the capital expenditures as a function in that plant went from around 95 percent, and Dr. Hadaway's use of the 2005 data to around 84 percent when it's updated for one year further down the road.

Q. Okay. And so it was 84.4 percent for KCPL, correct, on page 2 of Exhibit 30 at the bottom there?

A. I'm sorry. Can you repeat that now?

I've got Great Plains Energy, Aquila and Burch companies.

Q. And I assume Great Plains Energy is KCPL, correct?

A. It's the parent company.

Q. Well, did you include construction in there by Strategic Energy or some other company?

A. Whatever Value Line projects for construction activity. We'd include everything.

Q. At any rate it's 84.4 percent, correct?

A. That's correct.

Q. Okay. And the highest in your update was CLECO which is, I understand, the acronym for Central Louisiana Electric Company; is that correct?

A. Well, they used to have that name. Now it is known as CLECO Corp.

Q. Okay.

A. But that is the utility that CLECO Corp. owns.

Q. It's the old Central Louisiana, right?

A. Yes.

Q. And they went up from 89.2 percent in the Hadaway exhibit to 95.1 percent in your exhibit, correct?

A. Yes.

Q. And Progress Energy, where is that utility? Is that a Florida utility?
A. Yes.
Q. Okay.
A. Well, Florida and South Carolina.
Q. Okay. And it went up from 71.2 in the Hadaway schedule to 85 percent in your schedule, correct?
A. Yes.
Q. And then right behind that at 84.4 percent is Great Plains Energy?
A. Correct.
Q. Okay. And included in the top list of companies with high percentages of construction is Empire District Electric; is that correct?
A. Yes.
Q. And they were at 76.5 percent in your updated exhibit, page 2 of Exhibit 30, correct?
A. Yes.
Q. Okay. And were you aware that in its last rate case that Empire received a 30-point construction adder to its ROE?
A. I'd have to look at that order again. I do recall reviewing it and there might have been an adjustment made to it, but ...

Q. Let me move on, if I may, to the DCF models. Now, I know that you and Dr. Hadaway have different numbers as far as the constant growth, but would you agree that you and Dr. Hadaway agree that for a proper analysis in this case using the DCF model, you should use something other than the constant growth model?

A. In this case, yes.

Q. And do you agree with Dr. Hadaway that these near-term circumstances reflected in the constant growth DCF model do not reasonably reflect longer term expectations for higher capital costs?

A. No.

Q. Okay. You think it's gonna be lower capital cost, correct?

A. No.

Q. Okay. What is your opinion in that regard?

A. My opinion is that current projected capital costs are just as reliable as projected increases in capital cost. The bottom line is nobody knows what future capital costs are gonna be because the market is highly uncertain. The difference in the projections I relied on and those that Dr. Hadaway has relied on relate to the growth rate.

Q. All right. So --

A. And the growth rate I relied on available market information that investors rely on in making decisions. Dr. Hadaway produced his own growth rate forecast that is not available to the public and is almost certainly not part of the investment public's assessment of future growth prospects.

Q. Now, the growth rates that you're speaking of, or the rate that you utilized was the 5.1 percent; is that correct?

A. It's a consensus analyst economists' projected growth rate to the GDP. It's not my growth rate. It's a publicly available, published consensus economists' projections of future GDP growth.

Q. Well, this comes from this Blue Chip Economic Forecast company. Correct?

A. Correct.

Q. And they take a survey of 40, 50, 60 people and that's what that figure results from, correct?

A. 40 or 50 people that are in the marketplace making investment decisions or providing advice to others who do make investment decisions.

Q. Okay. And -- so you did not conduct a study per se of what growth rate to use. You used the growth rate that was in the Blue Chip forecasting survey?

A. That's correct, because the purpose of my study is to try to estimate what KCP&L's cost of capital is in the market today. So the marketplace sets that capital cost; it's not me or Dr. Hadaway.

So what's important is to try to understand what the market expectations are about future growth prospects and future changes in capital costs that are reflected in observable stock prices which where the valuation is determined by the marketplace. It's not determined by me, it's not determined by Dr. Hadaway, it's determined by the market.

Q. Well, Dr. Hadaway relied upon other data that you chose not to rely upon, correct?

A. He relied on historical information and manipulated it to come up with an excessive growth rate.

Q. The growth rate forecast that he used is contained in his schedule 5, correct?

A. Right.

Q. All right. And that was the schedule that he described this morning where he had a weighted average of nominal GDP giving more weight to recent averages than the longer averages, correct?

A. Well, that's what he represented it to be, but even as he acknowledged --

Q. Well, sir, that's all -- I'm just asking you what he did. Is that what he did?

A. Would you repeat your question?

Q. Okay. Dr. Hadaway used GDP growth rates on ten-year rolling averages giving higher weight to the more recent averages than the later averages, correct?

A. He created ten-year rolling averages at various time periods and then took the average of those averages and developed his growth rate.

Q. And that's where his 6.6 comes from at the bottom of that first column on schedule SCH-5, correct?

A. Yes.

Q. Now, in -- would you look at Exhibit 28? It's the exhibit that's right in front of you actually up on the ledge there.

A. Okay.

Q. This was the update that Dr. Hadaway performed his schedule 10 that shows the long-term interest rate trends. Have you had a chance to look at that, Mr. Gorman, since this morning?

A. Yes.

Q. Does this data appear to be accurate as far as you know?

A. Well, there's been a lot more variation in utility bond yields than what's shown on this, but -- and I can verify the 9/26/07 bond yield, but generally it does look consistent with what I've seen.

Q. Okay. And so in recent months, utility bond rates have gone up, correct?

A. Not since I've done my testimony. They've been flat and Treasury bond yields have come down.

Q. Okay. So you dispute the --

A. No, sir. I filed my testimony in July. In July triple B utility bond was about 6.5 percent, and it's about 6.5 now.

Q. Well, it says here it was 6.51 in August and 6.52 as of September 26.

A. Actually in July it was 6.49 and now it's 6.52. Based on my recommendation I used a single digit to estimate a return on equity. So if you round these to single digits, interest rates for utility bonds haven't changed at all since I filed my testimony.

Q. So in -- in the process of coming to your opinions, you have done averaging occasionally, you've done rounding with the data that you have utilized, correct?

A. Well, it has to be usable in the ratemaking construct, so, yeah you've got to take complicated information and put it down to a point estimate that can be used to derive a utility's revenue requirement and then ultimately a utility's rates.

Q. Now, both you and Dr. Hadaway moved on from the traditional constant growth DCF to a multistage model; is that correct?

A. Yeah, for the reasons set forth in my testimony which aren't necessarily the same as Dr. Hadaway's.

Q. All right. Well, you both used different models of the DCF going beyond the constant growth traditional model that Mr. Barnes used, correct?

A. That's correct.

Q. And is it fair to say that the most significant difference between you and Dr. Hadaway is the long-term GDP growth rate?

A. Well, certainly for the DCF model, I think that's a fair assessment.

Q. And that's what I meant, just on the DCF model. And what was the figure that Dr. Hadaway used for the first part of the two-stage? You used the, am I correct, the 5.1 for the year 6 through perpetuity, correct?

A. In my two-stage model? It had the long-term sustainable growth rate was 5.1 percent which was based on consensus economists' projected of future long-term GDP growth.

Q. And for your short-term or five-year period, you used 6.7 percent, correct?

A. Yeah.

Q. And Dr. Hadaway used -- what did he use, 6.31, I think?

A. For my proxy group, the group average growth rate was 6.7, and for Dr. Hadaway's group it was 6.3. I don't have Dr. Hadaway's testimony with me.

MR. ZOBRIST: Judge, I'd like to mark two additional exhibits, and I think they would be --

JUDGE PRIDGIN: I have 31 and 32.

MR. ZOBRIST: 31 and 32.

(EXHIBIT NOS. 31 AND 32 WERE MARKED FOR

IDENTIFICATION BY THE COURT REPORTER.)

BY MR. ZOBRIST:

Q. Now, Mr. Gorman, I've handed you what I've marked as Exhibit 31 which has three pages which are three pages from Dr. Hadaway's schedule SCH-6. It's pages 2, 3 and 4. And then I've handed you Exhibit 32 which is your rebuttal schedule MPG-2. Does that appear to be correct?

A. Yes.

Q. And is it fair to say that the most significant difference between the way that you and Dr. Hadaway ran these three models is the GDP growth figure that you used and the one that he uses?

A. Well, yeah. That was the purpose I filed these schedules was to show that had he used a reasonable GDP growth rate that reflects current market expectations, that the results of his DCF study would have been considerably lower.

Q. Okay. And so when we look to, for example, on the first page of both exhibits, it's column 12, Dr. Hadaway gets a group average of 9.5 percent and a group median of 9.4 percent, and on Exhibit 32 which is your schedule MPG-2, if we used the 5.10 percent, yours drops down to 9.1 and 9.0 percent respectively, correct?

A. Yeah. I believe you said that's column 12. I believe that's column 14. Maybe I misheard you.

Q. Well, the GDP column is No. 12, and then the final column, you're correct, is the ROE which is column 14.

A. Yeah, but the numbers you cited came out of column 14.

Q. That's correct. I'm sorry. That's correct, 9.1 and 9.0. So, I mean, this is a dramatic illustration of the choice that the Commission has whether it utilizes your growth rate or whether it utilizes Dr. Hadaway's growth rate, correct?

A. Well, this is the smallest impact on the DCF result. If you look at the two pages attached to 31 and 32, you'll see that the impact on the long-term GDP growth rate is much more dramatic than the traditional constant growth DCF as well as the two-stage, the impact on the two-stage growth.

So this is the smallest impact on the DCF analysis, and that's mostly because in this traditional model, the GDP growth forecast is -- is mitigated to a certain extent because it's averaged with two other growth rate forecasts.

Q. And I didn't mean to exclude the other two studies, either the long-term GDP or the two-stage. But you're correct, it has a dramatic effect on all three actually later when you go through the other exercises, correct?

A. Yes. I just wanted to be clear because your suggestion that there's a relatively insignificant impact on the DCF result is -- is incorrect.

Q. I did not mean to imply that, by the way.

A. Thank you.

Q. But at any rate, I appreciate your correction. So if we go to the growth rates that you refer to in your rebuttal testimony, we have, for example, on rebuttal schedule MPG-4, if you would turn to that, sir?

A. We're back to my testimony again?

Q. Correct. I believe this is in your direct testimony.

A. Rebuttal schedule MPG-4?

Q. I'm sorry. Direct, direct testimony.

A. Okay. Thank you. I'm there.

Q. And here you use what you call the Gorman proxy rate -- proxy group, and then you use the Hadaway proxy group, correct?

A. Yes.
Q. Okay. And the growth rates that you estimated in MPG-4, for your proxy group it was 6.7 percent; for the Hadaway group it was 6.31 percent, correct?
A. Yes.
Q. And then on the next exhibit, schedule MPG-5, for the constant growth DCF model, the growth rate was 10.7 percent and 10.6 percent, correct?
A. Yes.
Q. And then on MPG-6, again, of your direct testimony which I understand are the historic growth rates for the last five and ten years; is that correct?
A. Well, dividend growth, inflation and nominal GDP, that's correct, yes.
Q. And for the last five years you had 5.5 percent and then 5.4 percent for the last ten years?
A. For GDP?
Q. Correct.
A. That's right.
Q. Okay. And so of all the growth rates that we have discussed here, the growth rate that you -- that you use in your second stage is the lowest of all those, 5.10, correct?

A. It's consistent with current market expectations are for future growth so it reflects the future growth, not historical growth, and it's the likely growth rate that the analysts and investors use to make investment decisions.

So it wasn't selected on the basis of being the lowest growth, but it's the most rational growth-rate estimate to use in the GDP study for a multistage GDP growth analysis.

Q. Now, you and Dr. Hadaway both used inflation projections, correct?

A. We both used GDP growth rate projections -- no, I'm sorry, no. We both used -- I used a projected GDP growth based on consensus economists' published projections. He formulated his own projected GDP growth by using historical information.

Q. Well, I'm sorry. Maybe I was not clear. It's your rebuttal on page 11. I thought there was a specific choice that you used of 2.1 percent for inflation.

A. Page 12, table 3, is that what you're --

Q. I think that's correct.

A. Well, what I'm illustrating there is the difference between Dr. Hadaway's projected nominal

GDP growth rate of 6.6 percent and the underlying major factors that go into a nominal GDP growth rate.

Q. And --

A. One is the GDP growth inflation, and the second is real GDP. I compare Dr. Hadaway's 6.6 numbers and how that would break out by inflation and real growth relative to the published consensus economist projection of GDP growth in real terms and inflation for the next five and ten years to show that the most significant differential between Dr. Hadaway's projected growth and those available to the marketplace and relied on by the marketplace is he's overstating future expected rates of inflation.

Q. But you chose the GDP inflation rate of 2.1 percent, correct?

A. Well, I chose that --

Q. Well, I'm just asking you, did you choose it, sir?

A. I didn't choose it. It's what's available in the marketplace.

Q. Pardon me.

A. It's what I used.

Q. Is this what you used?

A. That's what I used.

Q. 2.1 percent?

A. I used a GDP growth rate of 5.1 percent.
Q. No, no, no. I'm asking you about table 3, GDP inflation rate --
A. Look at column --
Q. -- for the consensus five-year projection, the consensus ten-year projection, you chose 2.1 percent to use in this model?
A. Sir, look at column 3 of that table.
MR. ZOBRIST: Judge, I need an answer to my question, please. I'm just asking if that's what it was.
JUDGE PRIDGIN: He'd asking if you used it. Answer yes, no --
THE WITNESS: I did not use the column, "GDP Inflation." I used the column "Nominal GDP" for a growth rate in my DCF study.
BY MR. ZOBRIST:
Q. Is a component of that the GDP inflation rate of 2.1 percent that's in your first column -- I guess it's the second column, table 3, rebuttal, page 12?
A. Yes.
Q. All right. And Hadaway used 3.3 percent, right?
A. Yes.

Q. All right. So he thinks there's gonna be more inflation than you do, right?
A. He thinks there's gonna be more inflation than the consensus of economists that publish GDP growth forecasts.
Q. Have you read Alan Greenspan's book yet?
A. I've heard -- no, I haven't read it.
Q. So you don't know what growth rate the former Chairman of the Federal Reserve Board --
A. Well, I heard Dr. Hadaway suggest there's gonna be growth to medical cost, but medical cost is only a small element, albeit a growing element, of the overall economy.
Q. Well, I'm not sure that's what he testified. I think what he stated is that Mr. Greenspan had projected inflation over the next few years to occur at 4 percent.
A. I'm sorry, but what I heard him to say is Mr. Greenspan has projected inflation based on Medicare and Social Security benefits to be something in the area of 4 percent. That's what I heard Dr. Hadaway say.
Q. All right. Okay.
A. And there's a significant difference there.

Q. Well, there's no question pending, sir. Thank you.

Let's turn to your risk premium analysis. Now, this is based upon a review of two elements as I understand it, Treasury bonds and utility bonds; is that correct?

A. Well, there's a expected common equity return element also.

Q. All right.

A. And that is the common element to both analyses. The risk premium is measured in relationship to Treasury bonds, and in a second study the risk premium is measured in relationship to utility bonds.

Q. Now, the -- in your testimony in your direct, if you could turn to your direct, sir, page 23.

A. I'm there.

Q. On line 18 you state that you relied on a Treasury bond risk premium of 5.2 percent, correct?

A. Yes.

Q. And then do I understand that you take that 5.2 percent and then you sum that with the bond yield portion of the formula? And that's what you did on the next page, page 24?

A. Yeah. I add that to a projected utility bond yield to develop an estimated cost of common equity.
Q. Okay. And requested rate of common equity is ROE, correct?
A. Yes, return on equity, correct.
Q. So you take the 5.4 percent bond yield which is mentioned there on page 24, page [sic] 5, and then you added to that the 5.2 that you say you relied upon on the previous page?
A. Yes.
Q. All right. Why didn't you get 10.6 percent if it's 5.4 and 5.2? How did you get 10.5 percent?
A. Well, there's some rounding that goes into that. If you go back to page 23 on line 19, the 5.2 percent is the midpoint of 4.4 to 5.9, so I applied the 4.4 to 5.9 to project a 5.4 percent yield and developed a return on equity of 9.8 percent to 11.3 percent which produced a midpoint estimate of 10.5 percent.
Q. Well, actually what it produced, if you did the math right, was 10.55; isn't that correct?
A. I'm sorry. Could you repeat that?
Q. If you add 9.8 and 11.3, what do you

get?

A. If I add 9.8 and 11.3 --

Q. Don't you get 21.1?

A. It could be -- it would be 10.55, I suppose.

Q. Yeah. So even using your range, you get 10.55 and then you knocked it down to 10.5 instead of 10.6. And you would have gotten 10.6 had you simply added the 5.4 and the 5.2; isn't that correct?

A. That wasn't done intentionally.

Q. Well, no, I mean, I was able to figure it out. But the point is, is that you rounded it down to 10.55, correct?

A. Yeah, I did.

Q. Okay. Then the final model that you ran was the capital asset pricing model; is that correct?

A. No. I did another risk premium as set forth in relationship to utility bond yields.

Q. I'm sorry. You're right, you did. And for that your midpoint estimate was 10.1 percent, correct?

A. Yes.

Q. Okay. And the midpoint of those two, according to your testimony, was 10.3, correct?

A. Yes.

Q. And if you had simply added on the bond analysis, the 5.2 and the 5.4, you would have gotten 10.6. Adding the 10.6 to the 10.1 and dividing by 2 would get us 10.35, not 10.3, correct?
A. Correct.
Q. Then the final model that you ran was the capital asset pricing model as discussed on page 29 of your direct?
A. Yes.
Q. And there you relied upon Ibbotson's Stocks, Bonds, Bills and Inflation 2007 Yearbook, correct?
A. Yes.
Q. And that produced a CAPM return at 11.1 percent, correct?
A. Correct, with the other factors I identified.
Q. Okay. Now, beginning on page 29 and then page 30, you summarize for the Commission your ROE analysis; is that correct?
A. Yes.
Q. And what you did there -- and I'm quoting line 1 of your testimony. You said, My recommended return on equity is 10.1 percent -- pardon me. "My recommended return on equity of 10.1

percent is at the midpoint of my estimated return on equity range for KCPL from 9.5 percent to 10.7 percent." Is that correct?

A. Yes.

Q. And you say, "I take the high end of my estimated range based on my CAPM risk premium and constant growth DCF," correct?

A. Yes.

Q. Okay. I'm not gonna use the board because I don't know how to save stuff anymore, but I'm not sure where to put this.

It's these three -- it's these four figures, isn't it, Mr. Gorman? The CAPM at 11.1, the constant growth at 10.7, the risk premium at 10.3 and the two-stage at 9.5, correct?

A. Well, not exactly, no. The two-stage DCF model's at a range of 9.3 to 9.6.

Q. Okay. Well, I thought in -- I thought in your testimony on line 2 you said 9.5.

A. Yeah, that was my recommended low point, low end of my recommended range.

Q. Okay. Well, what I'm trying to do is the math and how we get to your final recommendation.

A. Well, I mean, you're identifying numbers above the high end of my recommended range and you're ignoring numbers that go below the low end of my recommended range, so I don't think your presentation is balanced.

Q. Sir, all I'm -- I'm just reading your testimony. You said here at line 2 that the ROE range was 9.5 to 10.7, right?

A. Yes.

Q. Okay. And then on the second sentence you say, "The high end of my range is based on the CAPM of 11.1," right?

A. Yes.

Q. "The risk premium which is 10.3"?

A. Yes.

Q. "And the constant growth which is 10.7," right?

A. Yes.

Q. All right. So what you did is you took those three and added them up and divided by two, and that gets you 10.7, correct?

A. Well, no. Actually, I looked at the risk premium which is distinct from the DCF model and the CAPM and risk premium range of 10.3 to 11.1 at a midpoint of about 10.7 which is the same as my constant growth DCF model, so I used that to establish the high end of my recommended range.

Because of all the problems identified with the constant growth DCF model, particularly the five-year growth rate not being a reasonable estimate of sustainable growth, I relied on the two-stage DCF model to establish the low end of my recommended range.

Q. Okay.

A. And those two-stage DCF numbers range from 9.3 to 9.6. And I used a little judgment there because the average of those two would be less than 9.5, but I just thought 9.5 percent was a reasonable low end of the range.

Q. All right. But for your high end you took the CAPM, the risk premium and the constant growth DCF, right?

A. I did what I just described.

Q. All right. But, I mean, didn't I describe that correctly? Isn't that how you get to the 10.7?

A. I'm not sure what you described to get to the 10.7, but what I described got to the 10.7.

Q. All right. Well, what I'm asking you, tell me if I'm wrong here.

Pardon me, Commissioner. I'll turn this around.

You get to the 10.7 by adding these three and dividing by 3; isn't that how you get to the 10.7?

A. I just explained that's not what I did.

Q. Well, then, I thought later in your testimony you said that that's how you get to the 10.1 because the high end and the low end balance out to 10.1. How do you get there then?

A. Well, I'll explain it one more time.

Q. Well, let me ask you one thing and then I'll let you explain it. Is this involving the exercise in judgment? Because I think I heard you say that.

A. Well, that was -- that was increasing the low end of the range involved judgment. The development of the high end of the range was a distinction between the risk premium studies and the DCF studies.

And again, as I just explained a few minutes ago, I distinguished the risk premium and the DCF numbers. The risk premium range of 10.3 to 11.1 averaged about 10.7, which was the same as my constant growth DCF number of 10.7. So I used 10.7 as the high end of my recommended range.

The low end was based on the two-stage

DCF model because of all the problems in the constant growth DCF model that I discussed in my testimony. While the average of my two-stage DCF of 9.3 to 9.6 is less than 9.5, I used judgment to set it at 9.5 because I thought that was a reasonable low end of the range.

Q. Did you consider taking a straight average of all four of these numbers: the CAPM, the constant growth DCF, the risk premium and the two-stage DCF?

A. No, I don't do that because I think it unnecessarily transforms what is a pretty complicated determination into nothing more than a arithmetic exercise. I never do that.

Q. If you did do that, what would you get? You'd get 10.4 percent, correct?

A. I'll agree to that subject to check.

Q. Okay.

A. But if I did that, I probably would not have rounded up the low end of the range.

Q. Okay. Well, it's fair to say the process that you just testified to is not described here on page 30 of your direct testimony, is it?

A. It is described there, just not in detail.

Q. Okay.

A. I clearly say the high end of my estimated range is based on; it doesn't say the average of. So I accurately described in that testimony what I just described to you in more detail right now.

Q. Right. Well, in fact, you did not describe the process by which you arrived at the high end in your testimony.

A. Well, I didn't -- that description is not consistent with what you are suggesting I did, but it is consistent with what I did do.

MR. ZOBRIST: All right. Nothing further, your Honor.

JUDGE PRIDGIN: Mr. Zobrist, thank you. Let me see if we have any bench questions. Commissioner Jarrett?

COMMISSIONER JARRETT: No questions.

JUDGE PRIDGIN: Redirect?

MR. MILLS: Yeah, I have just a few.

REDIRECT EXAMINATION BY MR. MILLS:

Q. Mr. Gorman, you had some questions from Mr. Zobrist that essentially went to the difference between decisional prudence and implementation of prudence. Do you recall that line of questioning?

A. Yes.

JUDGE PRIDGIN: I'm sorry. Mr. Mills, is your microphone on?

MR. MILLS: It is. At least the light's lit.

JUDGE PRIDGIN: All right. Thank you. I'm sorry.

BY MR. MILLS:

Q. And let me just run you through a couple of quick hypotheticals and see if I can illustrate that difference. If a utility builds a 100 million dollar power plant and the decision to build that is later imprudent -- later found to be imprudent, how much of that is at risk?

A. The full investment cost.

Q. If a utility has been given some sort of a -- a blessing on its decisional prudence to build a 100 million dollar power plant and does, in fact, build that power plant for 110 million dollars, how much of that investment is at risk?

A. I would expect 10 million dollars.

Q. Okay.

A. The difference between the amount related to the prudence decision and the actual construction expenditures.

Q. And in the regulatory plan, KCPL is given deference on its decisional prudence; is that correct?
A. Based on my reading of it, yes.
Q. But not on its implementation prudence?
A. Correct.
Q. So that the effect of the regulatory plan is to significantly limit KCPL's risk by only having the implementation prudence that it played?
A. Correct.
MR. MILLS: Okay. That's all the questions I have.
JUDGE PRIDGIN: Mr. Mills, thank you.
MR. ZOBRIST: Judge, I need to offer some exhibits. I believe I've marked Exhibit 29, the stipulation which the record should reflect was approved in Case No. EO-2005-0329. The document just doesn't have the docket number. Exhibit -- I'll offer that at this time.
MR. MILLS: With respect to Exhibit 29, it's my understanding -- and I haven't gone through word for word and checked it, but this is probably the document as it was filed, but as you know, through the course of that case, there were significant changes made to this document and the

ultimate order in the -- in the docket approved some changes to this document.

So if it's meant to represent the stipulation that was filed in that case, perhaps it's accurate. If it's meant to represent the ultimate outcome of the regulatory plan that the Commission approved in that case, it's missing some stuff.

So if -- if Mr. Zobrist is intending to offer it as the filed Stipulation & Agreement, I have no problem with that. If it's designed to represent the regulatory plan as approved, I don't think it's accurate.

JUDGE PRIDGIN: Mr. Zobrist?

MR. ZOBRIST: It's for the former purpose. And Mr. Mills is correct, there were some other filings. I don't believe they changed the language that I cross-examined Mr. Gorman on. But he's correct, and I offer it subject to his statement.

MR. MILLS: And with respect to the questions that Mr. Zobrist and Mr. Gorman went through, I think that is correct, I don't believe any subsequent changes impacted that line of questioning.

JUDGE PRIDGIN: All right. Any other objections?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Exhibit 29 is admitted.

(EXHIBIT NO. 29 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. ZOBRIST: All right. And then Exhibit 30, 31 and 32, these were really just drawn from with respect to testimonies of the -- from Dr. Hadaway and Mr. Gorman.

JUDGE PRIDGIN: Exhibits 30, 31 and 32 have been offered. Any objections?

(NO RESPONSE.)

JUDGE PRIDGIN: Hearing none, Exhibit 30, Exhibit 31 and Exhibit 32 are all admitted.

(EXHIBIT NOS. 30, 31 AND 32 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. THOMPSON: Judge, did you receive Mr. Gorman's direct, rebuttal and surrebuttal testimony?

MR. MILLS: I was just about to offer that.

JUDGE PRIDGIN: May Mr. Gorman be excused? All right. Mr. Gorman, thank you.

MR. MILLS: At this time I'd like to

offer Exhibits 201, 202 and 203, and I believe that 202 has both highly confidential and nonproprietary versions.

JUDGE PRIDGIN: I also show 203 as being NP and HC. I don't know if that's accurate.

MR. MILLS: Okay.

JUDGE PRIDGIN: Okay. 201, 202 and 203 have been offered. Any objections?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Exhibit 201 is admitted. Exhibit 202 NP and HC is admitted. Exhibit 203 NP and HC is admitted.

(EXHIBIT NOS. 201, 202 NP and HC AND 203 NP and HC WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE PRIDGIN: All right.

MR. MILLS: And that's all I have to offer on this issue.

JUDGE PRIDGIN: All right. Thank you. I show that Mr. Gorman was the last scheduled witness for the day, and I would encourage the parties, if you know already, certainly to let me know, and if not, if you could at least spend a few minutes speaking to see if there's any other witness that we would have ready to go since we're still pretty early in the afternoon.

Obviously, if you know now, you may speak, and if you need a few minutes to talk, that's certainly fine.

MR. ZOBRIST: Ms. Cheatum is the next witness. She's not here, but Mr. Giles is here, but we need to just have a break to be able to prepare something that I understand one of the commissioners requested yesterday.

We're not quite there yet, so we'd like to have a recess before we come back. And that's -- you know, I don't know if the commissioners wanted to be here to talk with him, but he is ready and we could do Mr. Giles now or tomorrow. I think that's our only choice. I don't think we have any other witnesses.

JUDGE PRIDGIN: So what I'm hearing is after recess, KCPL would be willing to put Mr. Giles on the stand for off-system sales?

MR. ZOBRIST: Correct.

JUDGE PRIDGIN: Any -- any objection from counsel?

MR. MILLS: How long a break are we planning before we get to that?

MR. ZOBRIST: We just need to copy some

exhibits. So, I mean, maybe 15 minutes, 20 minutes.

JUDGE PRIDGIN: 15, 20 minutes?

MR. MILLS: Sure.

JUDGE PRIDGIN: Okay. All right. I show the clock at the back wall to be 2:20. Let's make it 20 minutes and we'll resume at 2:40. All right. We'll stay in recess until 2:40.

(A RECESS WAS TAKEN.)

JUDGE PRIDGIN: All right. We're back on the record. It's about 2:35, and as I went off the record, I believe the parties and I agreed that Mr. Giles would be testifying on off-system sales. And since we went off the record, I believe the parties have decided that they can make better use of this time doing something else.

Mr. Dottheim, did you have an announcement?

MR. DOTTHEIM: Yes, Judge. I wasn't in the room at the time, and I'm the attorney on off-system sales. The Staff witness on off-system sales is engaged in some meetings with the company relating to issues for tomorrow and Thursday where there is even some chance of either settlement or narrowing the issues.

If Mr. Giles took the stand, I would

like to have my witness in the hearing room which would cause us not to have those meetings. And in that we are making, it looks like, good progress on the schedule.

On behalf of Staff I would like to request that we stay with the schedule and keep off-system sales on the Wednesday schedule tomorrow because I think we will be able to maintain schedule the way things are looking this week.

JUDGE PRIDGIN: Mr. Dottheim, thank you. Any objection or any statement from counsel?

MR. ZOBRIST: The company agrees with Mr. Dottheim's position and has no objection to take up all those issues tomorrow as scheduled.

MR. MILLS: And I agree, I support that. I would have been willing to go ahead with Mr. Giles if necessary, but I would prefer to do him tomorrow as scheduled.

JUDGE PRIDGIN: All right. Seeing as how we are on schedule and counsel believes it would be better to use this time for Staff and company members and OPC staff, perhaps, to talk on some issues rather than proceed, that's certainly fine with me.

What I see next on the schedule would be to take up talent assessment program employee severance cost and employee severance cost, beginning with Ms. Cheatum from KCPL at roughly 8:30 in the morning. Is that counsel's understanding on where we'll begin?

MR. ZOBRIST: Yes, it is.

JUDGE PRIDGIN: With the understanding that some issues may narrow or fall away and we'll certainly fill in -- and I'm sure counsel will be sensitive that if an issue goes away, we can start plugging in issues as we go.

MR. DOTTHEIM: Yes.

JUDGE PRIDGIN: All right. Is there anything further from counsel?

(NO RESPONSE.)

JUDGE PRIDGIN: All right. Hearing nothing, we will stand in recess. We will readjourn at 8:30 in the morning. Thank you very much. We're off the record.

(WHEREUPON, the hearing of this case was recessed until October 3, 2007, at 8:30 a.m.)

I N D E X

RATE OF RETURN
Return on Common Equity (Issue 1)
Capital Structure (Issue 2)

MINI OPENING STATEMENTS

COMPANY'S EVIDENCE

SAMUEL C. HADAWAY, Ph.D.

MICHAEL W. CLINE

STAFF'S EVIDENCE

MATTHEW BARNES

OFFICE OF PUBLIC COUNSEL'S EVIDENCE

RUSSELL TRIPPENSEE

MICHAEL GORMAN

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EXHIBITS INDEX (CONTINUED)

EXHIBITS INDEX (CONTINUED)

* Marked for identification in a previous volume.