

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

DIRECT TESTIMONY OF

MICHAEL W. CLINE

**ON BEHALF OF
KANSAS CITY POWER & LIGHT COMPANY**

**IN THE MATTER OF THE APPLICATION OF
KANSAS CITY POWER & LIGHT COMPANY
TO MODIFY ITS TARIFFS TO BEGIN THE
IMPLEMENTATION OF ITS REGULATORY PLAN**

DOCKET NO. 06-KCPE-____ - ____

- 1 **Q:** **Please state your name and business address.**
- 2 A: My name is Michael W. Cline. My business address is 1201 Walnut, Kansas City,
3 Missouri, 64106-2124.
- 4 **Q:** **By whom and in what capacity are you employed?**
- 5 A: I am employed by Great Plains Energy, the parent company of Kansas City Power &
6 Light Company (“KCPL”), as Treasurer and Chief Risk Officer.
- 7 **Q:** **What are your responsibilities?**
- 8 A: My responsibilities include financing and investing activities, cash management, bank
9 relations, rating agency relations, enterprise risk management, and insurance.
- 10 **Q:** **Please describe your education, experience and employment history.**

1 A: I graduated from Bradley University in 1983 with a B.S. in Finance, summa cum laude. I
2 earned an MBA from Illinois State University in 1988. From 1984-1991, I was employed
3 by Caterpillar Inc. in Peoria, Illinois and held a number of finance and treasury positions.
4 From 1992-93, I was Manager, International Treasury at Sara Lee Corporation in
5 Chicago, Illinois. From 1994-2000, I was employed by Sprint Corporation in Overland
6 Park, Kansas, initially as Manager, Financial Risk Management and then as Director,
7 Capital Markets. During most of 2001, I was Assistant Treasurer, Corporate Finance, at
8 Corning Incorporated in Corning, New York. I joined Great Plains Energy in October
9 2001 as Director, Corporate Finance. I was promoted to Assistant Treasurer in
10 November 2002. During 2004, I was assigned to lead the company's Sarbanes-Oxley
11 compliance effort on a full-time basis, though I retained the Assistant Treasurer title
12 during that time. I was promoted to Treasurer in April 2005 and added the title of Chief
13 Risk Officer in July 2005.

14 **Q: Have you previously testified in a proceeding at the State Corporation Commission**
15 **for the State of Kansas ("KCC" or "Commission") or before any other utility**
16 **regulatory agency?**

17 A: Yes. In 2005, I submitted testimony to the Kansas Corporation Commission in Docket
18 No. 04-KCPE-1025-GIE (the "1025 Docket") concerning KCPL's Regulatory Plan, and I
19 also testified before the Missouri Public Service Commission ("MPSC") concerning the
20 Missouri counterpart to the Regulatory Plan. The Regulatory Plan is set forth in the
21 Stipulation and Agreement ("Regulatory Plan Stipulation and Agreement") that was
22 approved by the Commission in the 1025 Docket, which collectively includes, among

1 other things, the Resources Plan (Appendix A), the Demand Response, Efficiency and
2 Affordability Programs (Appendix B), and the Rate Plan (Appendix C) . .

3 **Q: What is the purpose of your testimony?**

4 A: My testimony is in two sections. In Section 1, I will do the following: (1) review the
5 conceptual rationale for, and methodology for determining, Contributions in Aid of
6 Construction (“CIAC”) amortization amounts to help maintain KCPL’s financial ratios as
7 outlined in the Regulatory Plan; and (2) describe the amount of CIAC amortization for
8 which KCPL is filing in this case. Then, in Section 2 of my testimony, I will support an
9 adjustment related to accounts receivable sales fees as discussed in the direct testimony
10 of KCPL witness Don A. Frerking.

11 **SECTION 1**

12 **Q: The Regulatory Plan Stipulation and Agreement discussed additional CIAC**
13 **amortization amounts to help maintain KCPL’s financial ratios. Please explain the**
14 **significance of such amortization amounts and the maintenance of financial ratios**
15 **for KCPL.**

16 A: The Signatory Parties to the Regulatory Plan Stipulation and Agreement agreed that it is
17 desirable that KCPL maintain its debt at an investment grade rating during the
18 implementation period of its comprehensive Regulatory Plan. For its part, KCPL
19 acknowledged its responsibility and commitment to take prudent and reasonable actions
20 to maintain its investment grade rating during this period. The non-KCPL Signatory
21 Parties, in turn, agreed to support the CIAC accounting mechanism that is described in
22 the Regulatory Plan Stipulation and Agreement to give KCPL an opportunity to maintain
23 its bonds at investment grade during the period when the Regulatory Plan is being

1 implemented. The Signatory Parties agreed that CIAC amortization amounts could be
2 proposed by KCPL in any rate case only when the Kansas jurisdictional revenue
3 requirement in that case fails to satisfy the financial ratios shown in Appendix E of the
4 Regulatory Plan Stipulation and Agreement

5 **Q: Why is it important for KCPL to maintain investment grade ratings during the**
6 **implementation of the Regulatory Plan?**

7 A: Maintaining high credit quality at KCPL is vital to debt and equity investors, banks, and
8 rating agencies for three primary reasons. First, KCPL and its parent, Great Plains
9 Energy, will rely extensively on the capital markets for financing over the next several
10 years. Total capital expenditures (including Plan-related expenditures and “normal
11 course” capital expenditures) over the 2006-2010 period are expected to exceed **
12 **██████████****. KCPL estimates that approximately **
13 **██████████**** of this amount will need to be raised through issuance of equity and debt. Investors will need to have confidence in
14 KCPL’s credit strength and financial wherewithal to feel comfortable making this capital
15 available to KCPL on attractive terms, particularly given the number of investment
16 alternatives otherwise available to them. Second, in addition to new funding required for
17 the Regulatory Plan, KCPL will have a significant amount of debt subject to refinancing
18 during the period of the Regulatory Plan. KCPL has \$225 million of senior notes
19 maturing in March 2007; further, KCPL has \$257 million of tax-exempt debt that is
20 either subject to remarketing during the Regulatory Plan period or is in a weekly or
21 monthly “auction” mode and essentially refinanced at those intervals. KCPL’s ability to
22 refinance its debt efficiently, effectively, and on favorable terms will be heavily
23 dependent on bondholder and rating agency views of KCPL’s creditworthiness. Finally,

1 equity investor views of KCPL's financial strength and credit quality will be a major
2 influence on the Great Plains Energy stock (NYSE ticker: GXP) price for the next several
3 years. Clearly, a number of other factors will also impact the performance of GXP;
4 however, because KCPL constituted **■■■■** of Great Plains Energy's core earnings
5 and approximately **■■■■** of Great Plains Energy's assets in 2005, assurance of
6 KCPL's continued strength is, and will remain, essential to GXP investors.

7 **Q: What is the purpose of the CIAC mechanism?**

8 A: During negotiation of the terms of the Regulatory Plan Stipulation and Agreement, the
9 Signatory Parties had a number of opportunities to gain insight from the rating agency
10 Standard & Poor's ("S&P") into the credit ratios they deemed most important in
11 determining a company's credit quality. These three ratios are: (i) Total Debt to Total
12 Capitalization; (ii) Funds from Operations ("FFO") Interest Coverage; and (iii) FFO as a
13 Percentage of Average Total Debt. The fundamental purpose of the CIAC accounting
14 mechanism is to ensure that KCPL achieves an amount of FFO sufficient to sustain levels
15 of ratios (ii) and (iii) above that are consistent with the low end of the top third of the
16 range for BBB-rated companies, per the guidelines published by S&P in 2004. S&P's
17 ranges for, and definitions of, these ratios are shown in the attached Schedule MWC-1.
18 Schedule MWC-1 is identical to Appendix E of the Regulatory Plan Stipulation and
19 Agreement.

20 **Q: How does the CIAC mechanism work?**

21 A: An illustration of the calculation of CIAC mechanism is attached as Schedule MWC-2.
22 The mechanism results in an additional amortization amount being added to KCPL's cost
23 of service in a rate case when the projected cash flows resulting from KCPL's Kansas

1 jurisdictional operations, as determined by the KCC, fail to meet or exceed the Kansas
2 jurisdictional portion of the low end of the top third of the BBB range shown in Schedule
3 MWC-1 for the FFO Interest Coverage and FFO as a Percentage of Average Total Debt
4 ratios. The amount of CIAC amortization is the amount needed to achieve that threshold.
5 Any CIAC amortization granted to KCPL would result in an offset to rate base, which
6 results in lower rates, in any future KCPL rate proceedings, beginning with the first rate
7 case after the 2006 Rate Case.

8 **Q: What is the actual amount of Additional Amortization for which KCPL is filing in**
9 **this rate case?**

10 A: KCPL is not seeking any additional amortization in Kansas or Missouri. Based on the
11 components of KCPL's case, as described in the testimony of numerous witnesses from
12 the Company and experts testifying on the Company's behalf, KCPL estimates that cash
13 flow will be adequate to achieve the thresholds for the two key credit metrics previously
14 discussed without the need for additional amortization.

15 **Q: Does the fact that KCPL is not filing for additional amortization in this case imply**
16 **that the CIAC mechanism is no longer needed?**

17 A: No. As described earlier, maintaining credit quality is of critical importance to KCPL
18 during the period of the Regulatory Plan. The CIAC mechanism is an effective tool to
19 support KCPL in achieving this objective. Though KCPL's current projections do not
20 indicate the need for CIAC amortization amounts in 2007, the company cannot predict
21 whether the same will be true in periods covered by other rate cases during the term of
22 the Regulatory Plan. Therefore, KCPL must preserve the right to deploy the CIAC
23 mechanism in the future as cash flow requirements dictate. Furthermore, a CIAC may be

1 required to achieve the thresholds in this proceeding if the KCC does not approve or
2 substantially modifies KCPL's requested rates.

3 **SECTION 2**

4 **Q: What is the purpose of this section of your testimony?**

5 A: In this section of testimony, I will support an adjustment related to accounts receivable
6 sales fees as discussed in the direct testimony of KCPL witness Don A. Frerking

7 **Q: Briefly explain how the sale of KCPL's accounts receivables is structured.**

8 A: The sale of KCPL's receivables is structured as follows: (i) KCPL sells all of its electric
9 receivables at a discount to Kansas City Power & Light Receivables Company
10 ("KCREC"), a wholly-owned subsidiary of KCPL; (ii) KCREC sells the receivables to a
11 bank entity ("Bank"), up to a maximum commitment of \$100 million; (iii) the Bank
12 issues commercial paper to generate cash to pay KCREC for the receivables it buys;
13 (iv) KCREC uses the cash it receives from the Bank to pay KCPL for a portion of the
14 receivables it purchased; (v) KCREC issues a note to KCPL for the difference between
15 the cash it pays to KCPL and the total receivables purchased; and (vi) KCREC pays the
16 Bank sales fees on the amount of Commercial Paper it issued and pays KCPL interest on
17 the note.

18 **Q: How are the Accounts Receivable sales fees calculated?**

19 A: KCREC pays (i) the weighted average interest rate on the commercial paper issued by the
20 Bank, plus 30 basis points multiplied by (ii) the average amount of commercial paper
21 outstanding during each calendar month, divided by 360 and then multiplied by the
22 number of days in a month. KCREC also pays 15 basis points on the average of the

1 difference between the maximum commitment by the Bank and the actual amount of
2 receivables purchased by the Bank.

3 **Q: Why is an adjustment necessary?**

4 A: A/R sales fees are recorded on the books of KCREC. Test year expenses in this case
5 were based on nine months of actual and three months of budgeted data for KCPL,
6 excluding KCREC. Therefore, this adjustment is necessary so that these fees can be
7 included in cost of service.

8 **Q: How was the adjustment determined?**

9 A: The adjustment was determined by estimating commercial paper rates by month for 2006,
10 adding 30 basis points, and applying this total rate to the maximum possible advance
11 under the accounts receivable facility for each month. The maximum advance is
12 estimated at \$70 million for the months of November through May and \$100 million for
13 the months of June through October.

14 **Q: What is the amount of the adjustment?**

15 A: The adjustment is for \$3,931,861 and is shown as Adj-54 on the summary of adjustments
16 attached to the direct testimony of KCPL witness Don A. Frerking as Schedule DAF-2.

17 **Q: Does this conclude your testimony?**

18 A: Yes.

Credit Ratio Ranges & Definitions

	AA		A		BBB			BB	
	Min.	Max.	Min.	Max.	Min.	Top 1/3	Max.	Min.	Max.
Total Debt to Total Capitalization ⁽¹⁾	32%	40%	40%	48%	48%	51%	58%	58%	62%
Funds From Operations Interest Coverage ⁽²⁾	5.2x	6.0x	4.2x	5.2x	3.0x	3.8x	4.2x	2.0x	3.0x
Funds From Operations as a % of Average Total Debt ⁽³⁾	35%	45%	28%	35%	18%	25%	28%	12%	18%

Ratio Definitions:

(1) **"Total Debt to Total Capitalization"** is calculated as Total Debt + Total Capitalization where Total Debt and Total Capitalization are defined as below:

- Total Debt is calculated as:
 - Notes Payable + Current Maturities of Long-Term Debt + Current Capitalized Lease Obligations + Long-Term Debt + Capitalized Lease Obligations + Total Off-Balance Sheet Debt
 - "Total Off-Balance Sheet Debt" includes off-balance sheet financings such as:
 - Operating and synthetic leases, accounts receivable securitizations, contingent liabilities and other potential off-balance sheet obligations
- Total Capitalization includes:
 - Total Debt + Minority Interest + Total Preferred and Preference Stock + Common Stock Equity

(2) **"Funds From Operations Interest Coverage"** is calculated as (Funds From Operations + Gross Interest Expense) ÷ Gross Interest Expense where Funds From Operations and Gross Interest Expense are defined as below:

- Funds From Operations is calculated as:
 - Cash From Operations – Working Capital
- Gross Interest Expense is calculated as:
 - Interest Expense (net) + Allowance For Borrowed Funds Used During Construction + Interest on Off-Balance Sheet Debt

(3) **"Funds From Operations as a % of Average Total Debt"** is calculated as Funds From Operations + Average Total Debt where Funds From Operations and Average Total Debt are defined as below:

- Funds From Operations
 - As defined above
- Average Total Debt is calculated as:
 - The average total debt over the period subject to analysis

Illustration of the method used in Kansas to determine amortization amounts required through the CIAC mechanism for KCPL to meet investment grade credit guidelines.

Method

An example of the method is shown in the Attachment to this Exhibit. For the purpose of this example, the base financial information in a 2004 surveillance report and other KCPL financial statements was used. KCPL made adjustments to this base financial information to include certain off balance sheet items. These adjustments were made to conform to rating agency methods for balance sheet preparation. KCPL identified these accounting adjustments such as the equivalent debt treatment of operating leases and capacity contracts. The equivalent debt treatment of these off balance sheet items was determined by calculating the net present value of the future stream of lease or contract payments. The base 2004 financial information was adjusted by the equivalent debt balances and the interest expense associated with these off balance sheet items. From this adjusted information, KCPL then applied an allocation factor to calculate the three "guideline" ratios defined in Exhibit MWC-1 allocated to the Kansas jurisdiction. The calculations of the two "guideline" ratios that include Funds From Operations were then compared to the criteria defined in Exhibit MWC-1 and shown in (b) and (c) below. If one or both of the "guideline" metrics, as calculated, had fallen below these criteria, then KCPL would have determined the amount of additional Funds From Operations that would have been required, in the form of additional amortization, through the CIAC mechanism for KCPL to achieve the thresholds listed. In the example, both ratios that include Funds From Operations were above the thresholds, so no additional amortization was required.

Current guidelines for top third of BBB category for company with an S&P Business Profile of 6 (equivalent Business Profile to KCPL):

- a. 51% Total debt to total capital
- b. 3.8x Funds from operations interest coverage
- c. 25% Funds from operations as a percentage of average total debt

Attachment to Schedule MWC-2

Line		Total Company	Jurisdictional Allocation	Jurisdictional Adjustments	Jurisdictional Proforma
Information from the Company's annual Surveillance Report					
7	Rate Base	2,249,487	978,817		
8	Jurisdictional Allocator for Capital		43.5%		
9					
10	Total Capital	2,120,092	922,513	-	922,513
11	Equity	1,139,789	495,955	-	495,955
12	Preferred	0	0	-	0
13	Long-term Debt	980,303	426,558	-	426,558
14	Cost of Debt	5.33%	5.33%	-	5.33%
15	Interest Expense	52,273	22,746	-	22,746
16					
17	Retail Sales Revenue	873,089	372,478	0	372,478
18	Other Revenue	216,978	86,542	-	86,542
19	Operating Revenue	1,090,067	459,020	0	459,020
20					
21	Operating & Maintenance Expenses	572,457	246,721	-	246,721
22	Depreciation	137,293	56,684	-	56,684
23	Amortization	9,689	4,095	0	4,095
24	Interest on Customer Deposits	0	117	-	117
25	Taxes other than income taxes	98,912	27,786	-	27,786
26	Federal and State income taxes	61,428	38,598	0	38,598
27	Gains on disposition of plant	49	0	-	0
28	Total Electric Operating Expenses	879,827	374,001	0	374,001
29					
30	Operating Income	210,239	85,019	0	85,019
31	less Interest Expense	(52,273)	(22,746)	-	(22,746)
32	Depreciation	137,293	56,684	-	56,684
33	Amortization	9,689	4,095	-	4,095
34	Deferred Taxes	8,171	3,555	-	3,555
35	Funds from Operations (FFO)	313,118	126,608	-	126,608
36					
37	Net Income	154,776	60,885	-	60,885
38	Return on Equity	12.8%	11.6%	0.0%	11.6%
39	Unadjusted Equity Ratio	53.8%	53.8%	0.0%	53.8%

Additional financial information needed for the calculation of ratios

43	Capitalized Lease Obligations	2,369	1,031		1,031
44	Short-term Debt Balance	-	-		-
45	Short-term Debt Interest	480	209		209

Adjustments made by Rating Agencies for Off-Balance Sheet Obligations

49	Debt Adjustments for Off-Balance Sheet Obligations				
50	Operating Lease Debt Equivalent	76,800	33,418		33,418
51	Purchase Power Debt Equivalent	25,000	10,878		10,878
52	Accounts Receivable Sale	70,000	30,459		30,459
53	Total OBS Debt Adjustment	171,800	74,755	-	74,755
54					
55	Interest Adjustments for Off-Balance Sheet Obligations				
56	Present Value of Operating Leases	7,680	3,342	-	3,342
57	Purchase Power Debt Equivalent	2,500	1,088	-	1,088
58	Accounts Receivable Sale	3,500	1,523	-	1,523
59	Total OBS Interest Adjustment	13,680	5,953	-	5,953

Ratio Calculations

63	Adjusted Interest Expense	66,433	28,907	-	28,907
64	Adjusted Total Debt	1,154,472	502,344	-	502,344
65	Adjusted Total Capital	2,294,261	998,299	-	998,299
66					
67	FFO Interest Coverage	5.71	5.38	-	5.38
68	FFO as a % of Average Total Debt	27.1%	25.2%	0.0%	25.2%
69	Total Debt to Total Capital	50.3%	50.3%	0.0%	50.3%

Changes required to meet ratio targets

73	FFO Interest Coverage Target	3.80	3.80	0.00	3.80
74	FFO adjustment to meet target	(127,105)	(45,668)	-	(45,668)
75	Interest adjustment to meet target	45,395	16,310	-	16,310
76					
77	FFO as a % of Average Total Debt Target	25%	25%	0%	25%
78	FFO adjustment to meet target	(24,500)	(1,022)	-	(1,022)
79	Debt adjustment to meet target	98,001	4,088	-	4,088
80					
81	Total Debt to Total Capital Target	51%	51%	0%	51%
82	Debt adjustment to meet target	15,601	6,789	-	6,789
83	Total Capital adjustment to meet target	(30,591)	(13,311)	-	(13,311)

Amortization and Revenue needed to meet targeted ratios

87	FFO adjustment needed to meet target ratios	-	-	-	-
88	Effective income tax rate	40.07%	40.01%	40.01%	40.01%
89	Deferred income taxes *	-	-	-	-
90	Total amortization required for the FFO adjustment	-	-	-	-
91					
92	Retail Sales Revenue Adjustment	-	372,478	-	372,478
93	Percent increase in retail sales revenue	-	-	0.0%	-

* Adjusted for known and measurable changes including changes related to new plant in-service