

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

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**REBUTTAL TESTIMONY OF**

**MICHAEL W. CLINE**

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

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**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-828-RTS**

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.

4 **Q: By whom and in what capacity are you employed?**

5 A: I am employed by Great Plains Energy Incorporated as Treasurer and Chief Risk  
6 Officer. I hold the same title at Kansas City Power & Light Company ("KCPL" or  
7 the "Company"), a subsidiary of Great Plains Energy.

8 **Q: Are you the same Michael Cline who pre-filed direct testimony in this case?**

9 A: Yes, I am.

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

11 A: The purpose of my testimony is to challenge the assertions in Ms. Andrea C. Crane's  
12 Direct Testimony filed on behalf of the Citizens' Utility Ratepayer Board, specifically  
13 regarding (i) the impact of her recommended changes to the Company's revenue

1 requirement on the Company's credit rating; and (2) the appropriate use of the  
2 Contribution in Aid of Construction ("CIAC") mechanism.

3 **Q: What recommendations does Ms. Crane make with respect to KCPL's revenue**  
4 **requirement in this case?**

5 A: Ms. Crane recommends several adjustments that would result in a cumulative  
6 reduction of \$43.8 million to the Company's revenue requirement. These are outlined  
7 in detail in Schedule ACC-42 of her testimony. Of the total amount, the most  
8 significant items are a \$20.8 million reduction from Ms. Crane's use of a Return on  
9 Equity of 9.48%, compared to an 11.5% ROE filed by Company witness  
10 Dr. Samuel C. Hadaway; and (2) a \$14.0 million reduction related to treatment of  
11 off-system sales. It is not my intent to challenge Ms. Crane's specific  
12 recommendations in my testimony. In their respective rebuttal testimonies,  
13 Dr. Hadaway will address Ms. Crane's ROE recommendation, Company witness  
14 Chris B. Giles will addresses Ms. Crane's recommendation concerning off-system  
15 sales, and a number of other Company witnesses will challenge Ms. Crane's other  
16 recommendations.

17 **Q: Does Ms. Crane assess the implications of her recommendations on KCPL's**  
18 **credit rating?**

19 A: Yes, though in an indirect way. In Schedule ACC-44 of her testimony, Ms. Crane  
20 calculates the two key credit metrics, Funds from Operations ("FFO") Interest  
21 Coverage and FFO to Total Debt, on a Pro Forma basis using her recommended  
22 revisions to Operating Income and Depreciation and Amortization, as well as other  
23 inputs from the Company's filing in this case, including Schedule MWC-2 from my

1 Direct Testimony. Using the revised assumptions results in an FFO Interest Coverage  
2 ratio of 4.19 and an FFO to Total Debt ratio of 19.96%.

3 **Q: Do Ms. Crane's ratio calculations include the impact of a CIAC?**

4 A: No.

5 **Q: How does Ms. Crane assess the FFO Interest Coverage metric that results from**  
6 **her recommendations?**

7 A: At page 71 of her testimony, Ms. Crane comments that the FFO Interest Coverage  
8 ratio of 4.19 is above the target ratio of 3.8 established in the Regulatory Plan and  
9 therefore concludes "*no CIAC is required in order for the Company to meet this*  
10 *ratio.*"

11 **Q: How does Ms. Crane assess the FFO to Total Debt metric that results from her**  
12 **recommendations?**

13 A: At page 72 of her testimony, Ms. Crane comments that the FFO to Total Debt ratio of  
14 19.96% is "*well below the 25% target specified in the Regulatory Plan.*" However,  
15 she then attempts to diminish the potential impact of this shortfall by indicating that  
16 the ratio is "*still in the range for BBB debt, as shown in Appendix E to the Regulatory*  
17 *Plan.*" She further deflects the significance by implying that calculating this ratio  
18 pursuant to KCPL's methodology, as she did, may result in a lower-than-appropriate  
19 result due to overstated debt in the denominator. She attributes this to KCPL's  
20 potential overstatement of, or even inappropriate inclusion of, the effect of  
21 off-balance sheet items on total debt.

22 **Q: What is your reaction to Ms. Crane's calculations and related comments?**

1 A: First, as mentioned earlier, I am not attempting to challenge the assumptions and  
2 adjustments Ms. Crane made in arriving at her calculations in Schedule ACC-44, as  
3 numerous other Company witnesses will do so in their respective testimonies. With  
4 that caveat, I see nothing with respect to the FFO Interest Coverage metric that causes  
5 me undue concern. Ms. Crane correctly states that the ratio of 4.19 as calculated  
6 exceeds the target for a high BBB credit as outlined in the Regulatory Plan. With  
7 respect to the FFO to Total Debt metric, however, the story is entirely different. A  
8 ratemaking process that would result in such a significant cash flow metric falling to  
9 below 20% (the “weak-BBB” range) would cause significant concern on the part of  
10 both rating agencies and almost certainly result in a downgrade of KCPL by both.  
11 This would likely occur not only due to the weak level of the ratio itself, but also  
12 from broader rating agency concerns about the overall level of regulatory support in  
13 Kansas. In a July conference call with parties to the Company’s case in both  
14 Missouri and Kansas, Standard & Poor’s (“S&P”) indicated that, while they had been  
15 encouraged with the tone of regulatory support and focus on credit quality that had  
16 pervaded the development of the Regulatory Plan, they would be watching the  
17 outcome of the current case for concrete evidence of that continued support as they  
18 re-evaluate the Company’s Business Risk Profile and its ratings. An outcome such as  
19 that outlined by Ms. Crane would severely taint the credibility of the process to date  
20 and we would expect the Company’s ratings to reflect that.

21 **Q: Do you have any additional reactions?**

22 A: Yes. I dispute Ms. Crane’s implication that the Company may be overstating the  
23 denominator of the FFO to Total Debt ratio by attributing more impact from

1 off-balance sheet items, including leases, than is appropriate. The Company's  
2 methodology in calculating the debt attributable to off-balance sheet obligations  
3 shown in the Attachment to Schedule MWC-2 of my Direct Testimony, was entirely  
4 consistent with S&P's methodology as of the time of the filing of the case. In  
5 addition, no parties to the Kansas case have taken issue with the prudence of the off-  
6 balance sheet items included.

7 **Q: You indicated that Ms. Crane's credit metrics calculations did not include any**  
8 **CIAC. Does this indicate a disagreement on her part with the CIAC**  
9 **mechanism?**

10 A: No. Though she did not recommend a specific CIAC amount, Ms. Crane's testimony  
11 references approval of a CIAC as a viable option for the Kansas Corporation  
12 Commission ("KCC") to consider.

13 **Q: How does Ms. Crane suggest that a CIAC could be used?**

14 A: On page 73 of her testimony, Ms. Crane offers, "*.....the KCC could set the return*  
15 *on equity at a lower rate than the [9.48%] recommended herein, and instead include*  
16 *CIAC sufficient for the Company to meet its cash flow coverage ratios.*" Later on the  
17 same page, she states, "*....regardless of the need for CIAC resulting from my revenue*  
18 *requirement recommendations, it would be entirely appropriate for the KCC to*  
19 *replace operating income with CIAC during the plant construction period.*"

20 **Q: What is your reaction to potential use of the CIAC mechanism in this way?**

21 A: Ms. Crane's suggestions reflect a basic understanding of the relationship between  
22 ROE and CIAC but very little appreciation either for (1) how the CIAC mechanism is

1 designed to be used; or (2) the implications of over-reliance on CIAC at the expense  
2 of rate relief, from the standpoint of creditors, stockholders, and ratepayers.

3 **Q: How is the CIAC designed to be used?**

4 A: The CIAC mechanism was developed for a very specific purpose: To provide KCPL  
5 with an amount of incremental cash flow, in the form of accelerated depreciation,  
6 needed to attain certain key credit ratio thresholds, *to the extent that cash flow*  
7 *provided through rate relief is otherwise insufficient for this purpose.* The  
8 mechanism was not contemplated to be a substitute for an appropriate and fair level  
9 of rate relief derived through the traditional ratemaking process. It was negotiated by  
10 the parties in Docket No. 04-KCPE-1025-GIE as a compromise to reflect (a) the  
11 common recognition of the importance of credit quality to KCPL; and (b) the impact  
12 on KCPL's financial status as it implements its 5-year Regulatory Plan involving  
13 large capital expenditures over a short period of time.

14 **Q: What are the consequences of over-reliance on CIAC at the expense of return on**  
15 **equity and other means of rate relief?**

16 A: As stated above, the sole purpose of the CIAC mechanism is to ensure that the  
17 Company maintains target levels for certain key credit metrics, thereby increasing the  
18 likelihood of maintaining an investment grade credit rating from its rating agencies.  
19 As such, it is a mechanism structured primarily for the benefit of bondholders and  
20 other creditors. It does not address, however, the fundamental concern of equity  
21 investors. While equity investors are encouraged by a utility's ability to maintain its  
22 credit rating, they are much more focused on a utility's ability to earn a fair return  
23 over time. During this period when KCPL will be funding a significant level of

1 capital expenditures with contributions from Great Plains Energy's issuance of  
2 common stock, it is imperative that the investment community has confidence in  
3 Kansas' regulatory process. A just, fair, and reasonable outcome will improve  
4 investor risk perception and ensure KCPL's access to capital on attractive terms. It is  
5 also true that rating agencies and creditors, while taking a positive view of KCPL's  
6 ability to maintain a targeted level of credit metrics through the CIAC, if needed,  
7 would likely view the Company's creditworthiness with considerable concern and  
8 caution if the regulatory process were to result in heavy reliance on CIAC at the  
9 expense of rate relief. Finally, ratepayers are disadvantaged in the short-run if a high  
10 level of cash flow for financing is provided through the CIAC rather than the cash  
11 being sourced through traditional ratemaking. This concept is illustrated in the  
12 attached exhibit MWC-3. The Exhibit illustrates two scenarios for financing a  
13 \$1 million capital expenditure. The first solves for the mix of equity and debt  
14 required to generate the necessary earnings needed to reach an FFO to Total Debt  
15 ratio of 25% without a CIAC. The second scenario assumes the expenditure is  
16 financed with 100% debt. Since there are no marginal earnings under this scenario,  
17 full reliance on the CIAC is required in order to maintain a 25% FFO to Total Debt  
18 ratio. The resulting CIAC is \$400,000, or 40% of the expenditure amount. *The*  
19 *revenue requirement in the second scenario is over 300% greater than that of the*  
20 *scenario with no CIAC.*

21 **Q: Is the Company opposed to the inclusion of a CIAC in this case?**

22 A: No. As I stated in my Direct Testimony in this proceeding, KCPL recognizes that a  
23 reasonable level of CIAC may be required to meet the credit metrics thresholds

1 outlined in the Regulatory Plan. Before authorizing a CIAC, however, the KCC  
2 should place its primary focus on determining a just and fair allowed ROE for the  
3 Company. As stated earlier, the amortization mechanism was not designed as a  
4 substitute for fair, traditional cost of service ratemaking. Determination of an  
5 appropriate return on equity commensurate with KCPL's risk profile was a  
6 cornerstone of the Regulatory Plan and is an essential element of this rate case. In his  
7 Direct and Rebuttal Testimony, KCPL's witness Dr. Samuel C. Hadaway has made  
8 thorough, compelling and well-supported arguments that an 11.5% ROE is an  
9 appropriate level for the Company. Dr. Hadaway's recommended level of ROE is  
10 independent of the existence of the CIAC mechanism.

11 **Q: Does that conclude your testimony?**

12 **A:** Yes, it does.

**Exhibit MWC-3**  
**Impact of Financing on Revenue Requirements**

	<u>Equity</u> <u>Financing</u>	<u>Debt</u> <u>Financing</u>
Capital Investment	1,000,000	1,000,000
Equity Financing	684,932	
Debt Financing	315,068	1,000,000
Total Financing	<u>1,000,000</u>	<u>1,000,000</u>
Return on Equity	11.50%	11.50%
Earnings	78,767	-
Amortization		400,641
Deferred Taxes	-	(150,641)
Funds from Operations	<u>78,767</u>	<u>250,000</u>
FFO / Debt Ratio	25%	25%
Interest Rate	6%	6%
Interest Expense	18,904	60,000
Tax Rate	37.60%	37.60%
Total Income Taxes	47,462	-
Deferred Taxes	-	(150,641)
Current Taxes	47,462	150,641
<b>Revenue Requirement</b>	<b>145,133</b>	<b>460,641</b>
<u>Proof</u>		
Revenue	145,133	460,641
Amortization	-	400,641
Interest Expense	18,904	60,000
Pre-tax Income	<u>126,229</u>	<u>-</u>
Income Taxes	47,462	-
Earnings	<u><u>78,767</u></u>	<u><u>-</u></u>

