

**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 CONTINUE THE
IMPLEMENTATION OF ITS REGULATORY PLAN**

DOCKET NO. 07-KCPE-____-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, the parent company of Kansas City Power &
6 Light Company (“KCPL” or “Company”), 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 1992-1993, 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 Act 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 Kansas Corporation**
15 **Commission ("KCC" or "Commission") or before any other utility regulatory**
16 **agency?**

17 A. Yes. In 2006, I provided Direct and Rebuttal testimony in KCPL's Kansas rate case,
18 Docket No. 06-KCPE-828-RTS. Also in 2006, I provided Direct, Rebuttal, and
19 Surrebuttal testimony in KCPL's Missouri rate case, Case No. ER-2006-0314, and also
20 testified before the Missouri Public Service Commission related to the aforementioned
21 docket. In 2005, I testified before the Missouri Public Service Commission in Case No.
22 EO-2005-0329 and submitted testimony to the KCC concerning KCPL's Regulatory Plan
23 in Docket No. 04-KCPE-1025-GIE ("Regulatory Plan").

1 **Q. What is the purpose of your testimony?**

2 A. My testimony is in two sections. In Section 1, I will do the following: (1) review the
3 conceptual rationale for, and methodology for determining, the Contribution in Aid of
4 Construction (“CIAC”) to maintain KCPL’s financial ratios as outlined in the Regulatory
5 Plan Stipulation and Agreement in Docket No. 04-KCPE-1025-GIE (“1025 Stipulation”);
6 (2) review the amount of pre-tax payment on plant authorized by the Commission in its
7 Order in Docket No. 06-KCPE-828-RTS dated December 4, 2006; (3) describe the
8 impacts to KCPL of achieving targeted credit metrics through earnings compared to
9 CIAC; and (4) describe the amount of CIAC that KCPL is requesting in this case. In
10 Section 2, I will support an adjustment related to accounts receivable sales fees as
11 discussed in the Direct Testimony of KCPL witness John P. Weisensee.

12 **SECTION 1**

13 **Q. The 1025 Stipulation discussed CIAC to maintain financial ratios. Please explain**
14 **the significance of the CIAC mechanism and the maintenance of financial ratios for**
15 **KCPL.**

16 A. The Signatory Parties to the 1025 Stipulation agreed that it is imperative that KCPL
17 maintain its debt at an investment grade rating during the implementation period of its
18 Comprehensive Energy Plan (the “Plan”). For its part, KCPL acknowledged its
19 responsibility and commitment to take prudent and reasonable actions to maintain its
20 investment grade rating during this period. The non-KCPL Signatory Parties, in turn,
21 agreed to support the “Contribution in Aid of Construction to Maintain Financial Ratios,”
22 (the “CIAC”) as defined in the 1025 Stipulation and related appendices, in KCPL’s
23 general rate cases filed prior to June 1, 2010. The Signatory Parties agreed that the CIAC

1 would be an element in any KCPL rate case only when the Kansas jurisdictional revenue
2 requirement in that case fails to satisfy the financial ratios shown in Appendix E of the
3 1025 Stipulation.

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

6 A. Maintaining high credit quality at KCPL is vital to debt and equity investors, banks,
7 rating agencies, and ratepayers for three primary reasons. First, KCPL and its parent,
8 Great Plains Energy, will rely extensively on the debt and equity capital markets for
9 financing over the next several years. Total capital expenditures (including Plan-related
10 expenditures and “normal course” capital expenditures) over the 2007-2011 period are
11 expected to exceed \$2.5 billion. Approximately 45% of this amount will need to be
12 raised through issuances of debt by KCPL and equity by Great Plains Energy. Investors
13 will need to have confidence in KCPL’s credit strength and financial wherewithal to feel
14 comfortable making this capital available to KCPL and Great Plains Energy on attractive
15 terms, particularly given competing opportunities for deployment of capital. Second, in
16 addition to new funding required for the Regulatory Plan, KCPL will have a significant
17 amount of debt subject to refinancing during the period of the Plan. KCPL has
18 \$225 million of senior notes maturing in March 2007. Further, KCPL has \$257 million
19 of tax-exempt debt that is either subject to remarketing during the Regulatory Plan period
20 or is in a weekly or monthly “auction” mode and essentially refinanced at those intervals.
21 KCPL’s ability to refinance its debt efficiently, effectively, and on favorable terms will
22 be heavily dependent on bondholder and rating agency views of KCPL’s
23 creditworthiness. Finally, the strong financial profile required for an investment grade

1 rating benefits ratepayers by enabling KCPL to (a) attract the capital needed to make
2 infrastructure investments; (b) reduce its interest costs; (c) meet its obligations in a timely
3 fashion; (d) attract and retain a high-quality workforce; and (e) invest in the communities
4 it serves.

5 **Q. What is the purpose of the CIAC?**

6 A. The 1025 Stipulation identified three credit ratios deemed most important to the credit
7 rating agency Standard & Poor's ("S&P") in determining a utility's credit quality. These
8 three ratios are: (i) Total Debt to Total Capitalization; (ii) Funds from Operations
9 ("FFO") Interest Coverage; and (iii) FFO as a Percentage of Average Total Debt. The
10 fundamental purpose of the CIAC is to provide a means by which KCPL may achieve an
11 amount of FFO sufficient to sustain levels of ratios (ii) and (iii), above, that are consistent
12 with the low end of the top third of the range for BBB-rated utility companies with an
13 equivalent Business Risk Profile to KCPL, per S&P's guidelines.

14 **Q. Does S&P publish these guidelines?**

15 A. Yes. The ratio guidelines upon which the 1025 Stipulation were based were published in
16 2004 and are attached as Schedule MWC-1. S&P's methodology for calculating these
17 ratios was updated in its October 2, 2006 report entitled "Utility Statistical
18 Methodology," which is attached as Schedule MWC-2.

19 **Q. Has the Business Risk Profile score assigned to KCPL by S&P changed from the
20 level used to establish the target ratio levels established in the Stipulation?**

21 A. No. As evidenced in the most recent credit report issued by S&P on KCPL, dated
22 August 1, 2006 (attached as Schedule MWC-3), KCPL's Business Risk Profile remains a

1 “6.” As such, the ratio guidelines established in the 1025 Stipulation are still applicable
2 to KCPL.

3 **Q. How does the CIAC mechanism work?**

4 A. The mechanism results in CIAC being added to KCPL’s cost of service in a rate case
5 when the projected cash flows resulting from KCPL’s Kansas jurisdictional operations, as
6 determined by the KCC, fail to meet or exceed the Kansas jurisdictional portion of the
7 low end of the top third of the BBB range shown in Schedule MWC-1 for the FFO
8 Interest Coverage and FFO as a Percentage of Average Total Debt ratios. The amount of
9 CIAC is the amount needed to achieve that threshold. Any CIAC granted to KCPL is
10 subsequently treated as an offset to rate base, which reduces rates when they are set by
11 the Commission in any future KCPL rate proceedings, beginning with the 2009 rate case.

12 **Q. Did the Commission authorize CIAC in KCPL’s 2006 rate case?**

13 A. The Order in KCPL’s Docket No. 06-KCPE-828-RTS authorized a pre-tax payment on
14 plant in the amount of \$4 million as part of a total rate increase of \$29 million.

15 **Q. From KCPL’s perspective, is cash flow generated through regulated earnings the
16 same as cash flow generated through CIAC?**

17 A. No. The key difference is that, as described in the 1025 Stipulation, retail customers
18 receive a rate base offset beginning with the 2009 rate case for any CIAC authorized.
19 The effect of this is to lower KCPL’s revenue requirement in future rate cases.

20 **Q. How does KCPL view allowed return versus CIAC?**

21 A. KCPL views the availability of CIAC as critical in supporting its efforts to maintain
22 credit quality during a period of very high capital spending. That being said, the CIAC
23 mechanism was not designed as a substitute for fair, traditional cost of service

1 ratemaking. Determination of an appropriate return on equity commensurate with
2 KCPL's risk profile is an essential element of this rate case. In his Direct Testimony in
3 this case, KCPL's witness Dr. Samuel C. Hadaway states well-supported arguments that
4 an 11.25% return on equity is an appropriate level for the Company. Dr. Hadaway's
5 recommended level of return on equity is independent of the existence of the CIAC
6 mechanism. Once a fair level of return has been established, the CIAC mechanism can
7 work as initially contemplated in the 1025 Stipulation, i.e., to provide KCPL with an
8 amount of incremental cash flow needed to attain certain key credit ratio thresholds, *to*
9 *the extent that cash flow provided through rate relief is otherwise insufficient for this*
10 *purpose.*

11 **Q. What is the actual amount of CIAC for which KCPL is filing in this rate case?**

12 A. Based on the various components of KCPL's case, as described in the testimony of
13 numerous witnesses from the Company and experts testifying on the Company's behalf,
14 KCPL estimates that CIAC in the amount of \$12,840,873 above the \$4 million granted in
15 Docket No. 06-KCPE-828-RTS will be needed to achieve the target level FFO / Debt
16 ratios, previously discussed. Schedule MWC-4 (Confidential) contains the supporting
17 calculations for this amount of CIAC.

18 **SECTION 2**

19 **Q. What is the purpose of this section of your testimony?**

20 A. In this section of testimony, I will support two adjustments related to accounts receivable
21 sales fees as referenced in the Summary of Adjustments, attached as Schedule JPW-2 in
22 the Direct Testimony of KCPL witness John P. Weisensee.

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

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

11 **Q. How are the Accounts Receivable sales fees calculated?**

12 A. KCREC pays (i) the weighted average interest rate on the commercial paper issued by the
13 Bank, plus 30 basis points, multiplied by (ii) the average amount of commercial paper
14 outstanding during each calendar month, divided by 360, multiplied by the number of
15 days in a month. KCREC also pays 15 basis points on the average of the difference
16 between the maximum commitment by the Bank and the actual amount of receivables
17 purchased by the Bank.

18 **Q. Why are these adjustments necessary?**

19 A. These adjustments are necessary for two reasons. First, accounts receivables sales fees
20 are recorded on the books of KCREC, not KCPL. Therefore, an adjustment is necessary
21 so that test year fees can be included in KCPL's cost of service. Second, an adjustment is
22 necessary to increase the actual 2006 test year bank fees to projected 2007 expenses to
23 reflect revised assumptions.

1 **Q. How were these adjustment determined?**

2 A. KCPL test year expenses excluded the Bank fees. The first adjustment was determined
3 using actual 2006 commercial paper fees incurred by KCREC. The second adjustment
4 was determined by estimating commercial paper rates for 2007 by month, adding 30 basis
5 points, and applying this total rate to the projected advances under the accounts
6 receivable facility for each month. The advance was estimated to be \$70 million for
7 every month in 2007. The second adjustment was the variance between actual 2006
8 Bank fees and the projected 2007 Bank fees.

9 **Q. What is the amount of the first adjustment?**

10 A. The adjustment for the total 2006 Bank fees is \$3,822,431 and is shown as Adj-9 on the
11 Summary of Adjustments attached to the direct testimony of KCPL witness John P.
12 Weisensee as Schedule JPW-2.

13 **Q. What is the amount of the second adjustment?**

14 A. The adjustment for the incremental increase to projected 2007 Bank fees is \$244,875 and
15 is shown as Adj-54 on the Summary of Adjustments attached to the Direct Testimony of
16 KCPL witness John P. Weisensee as Schedule JPW-2.

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

18 A. Yes.

