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Witness: Michael W. Cline
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Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2010-0355
Date Testimony Prepared: February 28, 2011

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2010-0355

TRUE-UP REBUTTAL TESTIMONY

OF

MICHAEL W. CLINE

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
February 2011**

KCPL Exhibit No. KCPL 110
Date 3/4/11 Reporter JMB
File No. ER-2010-0355

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OF

MICHAEL W. CLINE

Case No. ER-2010-0355

1 **Q: Please state your name and business address.**

2 A: My name is Michael W. Cline. My business address is 1200 Main Street, Kansas City,
3 Missouri, 64105.

4 **Q: Are you the same Michael W. Cline who prefiled direct, rebuttal and true-up direct**
5 **testimony in this matter?**

6 A: Yes.

7 **Q: What is the purpose of your true-up rebuttal testimony?**

8 A: The purpose of my testimony is to respond to comments made by Missouri Public
9 Service Commission Staff ("Staff") witness David Murray in his True-Up Direct
10 Testimony with regard to cost of debt for Kansas City Power & Light Company
11 ("KCP&L" or "the Company") in this proceeding.

12 **Q: Did Mr. Murray change his recommended cost of debt for KCP&L as a result of**
13 **your True-Up Direct Testimony?**

14 A: No. Mr. Murray and the Company are in agreement with respect to a cost of debt of
15 6.825 percent for KCP&L in this case.

16 **Q: With what element(s) of Mr, Murray's testimony do you take issue?**

17 A: Mr. Murray discusses on page 3 of his True-Up direct testimony a long-term debt
18 offering by Great Plains Energy ("GPE") in the amount of \$250 million and a coupon
19 rate of 2.75 percent. The bonds were issued in August 2010, after the updated test year

1 and before the true-up date in this proceeding. This offering was completed by GPE on
2 behalf of KCP&L Greater Missouri Operations (“GMO”) and the entire proceeds were
3 loaned on an intercompany basis from GPE to GMO; therefore, KCP&L’s cost of debt
4 was not impacted by the transaction. Again, though Mr. Murray accepted this treatment
5 for KCP&L in this case, he implies that GPE could have reduced KCP&L’s cost of debt
6 by “assigning” some of the debt to KCP&L rather than completing the offering fully on
7 GMO’s behalf. Citing on page 5 of his True-Up Direct Testimony the “commingling of
8 financing activities [among KCP&L and GMO],” he puts the Commission on notice that
9 Staff may consider using a consolidated cost of debt for ratemaking purposes for KCP&L
10 and GMO in future cases. Mr. Murray also appears to suggest that, but for the impact of
11 GMO on the GPE credit rating, the offering could have been completed at a more
12 attractive rate, providing further support for a reevaluation of Staff’s approach to cost of
13 debt in future cases.

14 **Q: Do you agree with Mr. Murray that KCP&L’s and GMO’s long-term debt**
15 **financing activities are “commingled”?**

16 **A:** No. KCP&L is a registrant with the Securities and Exchange Commission (“SEC”), has
17 its own credit ratings and issues public, registered debt in its own name in the capital
18 markets. GMO’s need for long-term debt in August 2010, the first since the July 2008
19 acquisition by GPE, was met through a bond offering by GPE. The net proceeds received
20 by GPE were loaned in their entirety to GMO on virtually identical terms to the third
21 party parent company debt.

1 **Q: Why did GPE issue the debt on GMO's behalf rather than GMO just issuing debt**
2 **on its own?**

3 A: GPE has made the decision not to establish GMO as an SEC registrant, which therefore
4 means that GMO cannot issue publicly-registered securities in its own name. While other
5 alternatives are available whereby GMO could be the obligor on externally-issued debt
6 (for example, private placement), GPE to date has not found the indicative terms and cost
7 of these alternatives to be as attractive as the structure utilized last August.

8 **Q: What created "GMO's need for long-term debt" that you referenced earlier?**

9 A: GMO's short-term borrowing levels early in the third quarter were approximately 70
10 percent of GMO's \$400 million capacity under its revolving credit facility. Based on
11 cash flow projections, GMO saw little opportunity for a reduction in short-term balances
12 based upon available cash from operations over a reasonable planning horizon; in fact,
13 GMO's cash forecast indicated that its availability under its revolving credit facility
14 would be exhausted by early 2011, absent other actions. As such, a long-term offering to
15 enable GMO to repay short-term debt in the third quarter 2010 was deemed appropriate.

16 **Q: Was a long-term debt offering to repay short-term debt contemplated in the**
17 **projected capital structure and cost of debt GMO requested in Case No. ER-2010-**
18 **0356 ("the 356 Docket")?**

19 A: Yes.

20 **Q: Did KCP&L face similar pressure on its liquidity in this timeframe?**

21 A: No. KCP&L's total revolving credit capacity is \$600 million. KCP&L's short-term debt
22 outstanding during the third quarter of 2010 ranged between 35 percent and 54 percent of
23 its total revolving credit capacity.

1 **Q:** Were there refinancing needs or any other factors at KCP&L that would have
2 warranted issuance of long-term debt at that time?

3 A: No.

4 **Q:** Beginning on page 4, line 8 of his True-Up Direct Testimony, Mr. Murray mentions
5 funding received by KCP&L through the GPE money pool during the third quarter
6 2010, implying that this would have supported allocation by GPE of a portion of the
7 long-term debt offering completed on GMO's behalf. How do you respond?

8 A: The money pool borrowings by KCP&L are irrelevant to this argument, as evidenced by
9 a brief discussion of the operation of the money pool. GMO's short-term borrowings are
10 of a fixed term, typically 30 days in duration. Once those borrowings are made, GMO
11 incurs a cost (a "breakage fee") if it elects to repay the debt before the due date. As such,
12 excess cash generated by GMO on any given day cannot necessarily be used to reduce its
13 short-term debt on a real-time basis. The money pool was established primarily to enable
14 GMO to lend temporary excess cash to the pool, at an "arm's length" rate, and for those
15 funds to be available to KCP&L in lieu of external borrowings for a short period of time,
16 i.e., until GMO needs the cash to be returned to repay short-term debt on a maturity date
17 or for other purposes.

18 **Q:** Are there other elements of Mr. Murray's testimony with which you take issue?

19 A: Yes. Beginning on page 4, line 18 and extending through page 5, line 5, Mr. Murray
20 comments on the impact of the "financially strained GMO operations" on the cost of the
21 debt issued by GPE in August 2010, and states that this debt "could have been issued at
22 an even lower cost" if GPE's credit rating were higher. It is unclear to me why Mr.

1 Murray elected to discuss this in the current KCP&L case rather than in the 356 Docket.

2 Nonetheless, I strongly object to his premise and will respond here.

3 **Q: Why is Mr. Murray's approach not appropriate?**

4 A: Mr. Murray's propensity has been to assert that financing costs incurred by KCP&L,
5 GMO and GPE are higher because of "financially-strained" GMO operations. He used
6 this as a basis to recommend a lower recovery for the cost of GPE's Equity Units in this
7 proceeding. My previous testimony in this case demonstrated that Mr. Murray's
8 arguments were not relevant in that context by providing strong evidence that the cost of
9 Equity Units is a function of the issuer's dividend yield, not the issuer's credit rating. In
10 that testimony, I expressed disagreement with Mr. Murray's assertions regarding the
11 credit impact of GMO but did not elaborate since credit was not relevant to the issue.
12 However, his comments with regard to the Equity Units and again with regard to cost of
13 debt for KCP&L foreshadow an approach to cost of debt that would be inappropriate and
14 not in keeping with the spirit of the Commission's decision in Case No. EM-2007-0374
15 ("the Merger Case") to authorize GPE's acquisition of Aquila, Inc. If the Commission
16 were to move in the direction to which Mr. Murray alludes in future cases, KCP&L and
17 GMO could be prevented from recovering their actual financing costs as long as GMO's
18 credit rating is different from the subjective level Staff determines is correct, whether
19 based on a past credit rating of Aquila or compared to its sister company, KCP&L.
20 KCP&L and GMO would strongly object to adoption of such an approach.

1 **Q: Why would Staff's approach be inconsistent with the spirit of the Commission's**
2 **decision in the Merger Case?**

3 A: The expected credit implications of GPE's acquisition of GMO were well-documented in
4 the Merger Case. The Commission approved the transaction with the expectation and
5 understanding that GMO would be investment grade but that its ratings, at least initially,
6 would be lower than KCP&L's. See Report and Order, Merger Case at pp. 128-38, 242-
7 243, 248-50. These are the exact results that have, in fact, transpired as a result of GPE's
8 effective management of GMO's credit profile (in the midst of the most challenging
9 economic conditions in three generations). GMO is investment grade at both rating
10 agencies and GMO's ratings at S&P and Moody's are exactly the same as they were on
11 the acquisition date. Accordingly, it would be inappropriate for Staff to base its cost of
12 capital recommendations on a credit profile that "was" or "could be." GPE's coupon rate
13 for the August 2010 offering on behalf of GMO was 2.75 percent based on investors'
14 view of its current credit profile and that is the coupon rate GMO is seeking to recover in
15 the 356 Docket. Similarly, KCP&L seeks in this proceeding to recover the actual cost of
16 the debt it has issued (or in one unique circumstance, received funding through a parent
17 company issuance). KCP&L and GMO would strongly oppose, and would ask the
18 Commission to reject, any approach going forward that would deviate from ratemaking
19 based upon recovery of actual long-term debt cost incurred by the Companies.

20 **Q: Is it not true that a hypothetical cost of debt is used for GMO for ratemaking**
21 **purposes at the present time?**

22 A: Yes, that is true. However, that treatment is necessitated by a past commitment by
23 Aquila management and relates only to a single outstanding debt issue. This will no

1 longer be applicable when the debt in question matures in 2012. I discuss this in greater
2 detail in my True-Up Rebuttal Testimony in the 356 Docket.

3 **Q: What final thoughts do you have regarding a potential reevaluation by Staff of its**
4 **approach to cost of debt in future cases?**

5 A: KCP&L and GMO are separate legal entities, do not commingle their respective long-
6 term debt financing activities and will not commingle these activities as long as they
7 remain separate entities. The Companies will therefore oppose any methodology for cost
8 of debt that is inconsistent with the actual cost incurred by the Companies.

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

10 A: Yes, it does.

