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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2009-0090

REBUTTAL TESTIMONY

OF

MICHAEL W. CLINE

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS

Kansas City, Missouri
March 2009

" [redacted] **" Designates "Highly Confidential" Information Has Been Removed. Certain Schedules Attached to This Testimony Also Contain Highly Confidential Information and Have Been Removed Pursuant to 4 CSR 240-2.135.**

REBUTTAL TESTIMONY

OF

MICHAEL W. CLINE

Case No. ER-2009-0090

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 ("Great Plains Energy"), the parent
6 company of KCP&L Greater Missouri Operations Company ("GMO"), as Vice President,
7 Investor Relations and Treasurer.

8 **Q: What are your responsibilities?**

9 A: My responsibilities include financing and investing activities, cash management, bank
10 relations, rating agency relations, financial risk management, and investor relations.

11 **Q: Please describe your education, experience and employment history.**

12 A: I graduated from Bradley University in 1983 with a B.S. in Finance, summa cum laude. I
13 earned an MBA from Illinois State University in 1988. From 1984-1991, I was employed
14 by Caterpillar Inc. in Peoria, Illinois and held a number of finance and treasury positions.
15 From 1992-1993, I was Manager, International Treasury at Sara Lee Corporation in
16 Chicago, Illinois. From 1994-2000, I was employed by Sprint Corporation in Overland
17 Park, Kansas, initially as Manager, Financial Risk Management and then as Director,
18 Capital Markets. During most of 2001, I was Assistant Treasurer, Corporate Finance, at

1 Corning Incorporated in Corning, New York. I joined Great Plains Energy in October
2 2001 as Director, Corporate Finance. I was promoted to Assistant Treasurer in
3 November 2002. During 2004, I was assigned to lead the company's Sarbanes-Oxley
4 Act compliance effort on a full-time basis, though I retained the Assistant Treasurer title
5 during that time. I was promoted to Treasurer in April 2005 and added the title of Chief
6 Risk Officer in July 2005. In February 2008, I was named to my current position as Vice
7 President, Investor Relations and Treasurer.

8 **Q: Have you previously testified in a proceeding at the Missouri Public Service**
9 **Commission or before any other utility regulatory agency?**

10 A: Yes. I have previously testified before the Missouri Public Service Commission ("the
11 Commission") in the Kansas City Power & Light Company ("KCP&L") Regulatory Plan
12 case EO-2005-0329, in KCP&L rate cases ER-2006-0314, ER-2007-0291, and ER-2009-
13 0089, in GMO-L&P Steam's rate case HR-2009-0092 and in the case involving Great
14 Plains Energy's acquisition of Aquila, Inc. ("Aquila"), case EM-2007-0374. I have also
15 submitted testimony to the State Corporation Commission of the State of Kansas for
16 KCP&L's cases filed in that jurisdiction with respect to these matters.

17 **Q: What is the purpose of your Rebuttal Testimony?**

18 A: My testimony is in three sections. In Section 1, I address comments in the Staff's
19 February 13, 2009 Cost of Service Report ("Staff's Report") regarding the impact of the
20 adverse economic and financial market conditions on the cost of debt for utility
21 companies. I also address Staff's recommended capital structure in this case, as well as
22 refute Staff's approach to determining the cost of debt for GMO. In Section 2, I
23 recommend that the Commission reject Staff's imputation of an accounts receivable

1 ("A/R") sales program for GMO, as described on pages 115-116 of Staff's Report. In

2 Section 3, I address various points in the Direct Testimony of Mr. Michael Gorman on

3 behalf of the Office of the Public Counsel with respect to capital structure and the impact

4 of his recommendations for capital structure and cost of capital on GMO's credit metrics

5 and credit rating.

6 **Section 1**

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

8 A: In this section, I address statements in Staff's Report concerning the impact of the

9 adverse economic and financial market conditions on the cost of debt for utility

10 companies.

11 **Q: What assertions does Staff make about the cost of debt for utility companies in the**

12 **midst of the current credit crisis?**

13 A: Staff's Report states the following:

14 ... it appears that the cost of capital for utility companies is returning to levels
15 prior to the credit crisis. Another issue mentioned in the [January 13, 2009 Wall
16 Street Journal article entitled "Bonds a Bright Spot for Utilities in '08"] article is
17 that, although the spreads over U.S. Treasury's [sic] for recent utility bond
18 issuances have been high, much of these high spreads can be attributed at least in
19 part to the extremely low rates on U.S. Treasury bonds. Consequently, while
20 utility bond risk premiums over U.S. Treasury bonds have increased, because
21 yields on U.S. Treasury bonds have decreased dramatically, this doesn't
22 necessarily mean that the overall cost of capital to utilities has increased that
23 much *[Staff Report, page 18]*.

24 **Q: Do you agree with Staff's position?**

25 A: Definitely not. I will leave the discussion of the impacts of the economic and financial

26 market meltdown on utilities' overall cost of capital largely to Dr. Samuel C. Hadaway,

27 GMO's cost of capital witness. However, with respect to the debt capital markets, the

28 current findings of GMO's sister company, KCP&L, as it considers issuance of new

1 long-term debt is a timely and directly relevant indicator of what utility companies generally are experiencing. I can unequivocally say that the cost of new debt for KCP&L is considerably higher than it has been in recent history. This is true notwithstanding the significant decline in U.S. Treasury rates since the second quarter of 2007.

5 Q: **What is your basis for saying that KCP&L's cost of debt has increased?**

6 A: In Great Plains Energy's February 11, 2009 investor conference call and webcast, the Company indicated that KCP&L expected to issue $400 million of long-term debt in 2009. In light of those plans, the Company is closely monitoring market conditions and will continue to do so until the debt offering is completed, including discussions with debt capital markets participants on indicative costs for newly-issued KCP&L debt. These discussions clearly reflect that KCP&L's debt costs have risen significantly since a year ago and since before the crisis.

13 Q: **Where is this illustrated?**

14 A: Schedule MWC-1 (HC) reflects the collective thoughts on KCP&L's current cost of issuing debt on both a secured and unsecured basis for five, 10, and 30 years from three top debt capital markets underwriters: Bank of America, BNP Paribas, and J.P. Morgan. Because KCP&L completed 10-year unsecured debt issues in March 2008 and June 2007, the figures in the 10-year column under the heading "Assuming Senior Unsecured" are the most relevant in assessing how KCP&L's cost of debt has increased.

20 Q: **What is the market's view of the cost of a 10-year senior unsecured debt issue for KCP&L today, and how does that compare with KCP&L's 10-year senior unsecured debt offerings in March 2008 and June 2007?**

1 A: As shown in Schedule MWC-1 (HC), the underwriters estimate that the coupon rate on a
2 new KCP&L 10-year senior unsecured debt offering would be ** **. That rate is
3 ** ** basis points, or nearly ** **, above the rate of 6.375% on KCP&L's $350
4 million 10-year offering completed in March 2008. The rate is also ** ** basis points,
5 or ** **, higher than the rate of 5.85% on KCP&L's $250 million 10-year offering
6 completed in June 2007.

7 **Q: Are the pricing indications for KCP&L in Schedule MWC-1 (HC) based on a**
8 **different credit rating for KCP&L than it had when it completed the 2007 and 2008**
9 **offerings?**

10 A: No. At the time Schedule MWC-1 (HC) was prepared on March 4, 2009, KCP&L's
11 senior unsecured debt rating was unchanged from the time of the 2007 and 2008
12 offerings: A3 at Moody's Investor Service ("Moody's") and BBB at Standard & Poor's
13 ("S&P").

14 **Q: Please summarize your response to Staff's assertion that "the cost of capital is**
15 **returning to levels prior to the credit crisis."**

16 A: Again, I will defer to Dr. Hadaway for an in-depth discussion of the cost of equity, but
17 since Staff chose to couch its comments concerning cost of capital partly by looking at
18 the cost of debt for utility companies, I can say with certainty that their assessment is
19 incorrect. KCP&L's market discovery currently underway is a particularly timely and
20 relevant data point for GMO cost of capital issues. As KCP&L considers issuing new
21 long-term debt, it is receiving frequent input from the debt capital markets that is starkly
22 at odds with Staff's assertion. The cost of new debt for KCP&L has risen considerably
23 compared to a year ago, when difficult market conditions had already existed for a

1 number of months, and much more significantly compared to June 2007, which would be
2 the last month that most market participants would consider "prior to" the credit crisis.
3 For Staff to suggest any semblance of a return to normalcy is to suggest a profound lack
4 of understanding of how difficult and volatile the markets remain and what the
5 implications of such conditions are. Since judgment weighs heavily in the determination
6 of cost of capital and rate of return, the Commission should keep Staff's incorrect
7 assessment of the debt capital markets in mind as it evaluates other areas of subjective
8 judgment incorporated by Staff into its overall cost of capital and rate of return
9 recommendation for GMO.

10 **Q: What capital structure is Staff recommending for GMO in this case?**

11 A: As indicated on page 24 of Staff's Report, Staff is recommending use of the actual GPE
12 capital structure, excluding preferred stock, as of the end of the updated test year in this
13 case, *i.e.*, September 30, 2008. The resulting ratemaking capital structure, according to
14 Staff, consists of 51.03% common stock equity and 48.97% long-term debt.

15 **Q: Does GMO agree with Staff's recommendation?**

16 A: GMO accepts the exclusion of preferred stock. However, as shown below in Table 1,
17 once this exclusion is reflected in GMO's actual capital structure as of September 30,
18 2008, GMO calculates an adjusted common stock equity ratio that is higher than Staff's
19 (51.24% compared to 51.03%, respectively) and a debt ratio that is lower (48.76%
20 compared to 48.97%, respectively). The difference results from a different common
21 equity amount used by Staff. Neither Staff's Report nor Staff's Schedule 12 (incorrectly
22 referenced in Staff's Report as Schedule 8) describes what accounts for this difference.

23

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3 Table 1

GREAT PLAINS ENERGY INCORPORATED
Capitalization
September 30, 2008 (Est.)

($ in 000's)

CAPITAL COMPONENT	AMOUNT	PERCENT
Long-Term Debt (Note 1)	2,510,430	48.76%
Common Equity	2,616,024	
Equity Adj. For All OCI	(22,133)	
Adj. Common Equity	2,638,157	51.24%
	$5,148,587	100.00%

Note 1: Includes amounts classified as current liabilities.
4 Note 2: Excludes preferred stock

5

6 Q: **What cost of debt did GMO request in this proceeding?**

7 A: As shown in the tables on page 6 of Dr. Hadaway's Direct Testimony, Missouri Public
8 Service ("MPS") requested a capital structure that included a cost of debt of 6.83% and
9 St. Joseph Light & Power ("SJLP") and St. Joseph Light & Power Steam ("SJLP Steam")
10 requested a capital structure that included a cost of debt of 7.62%. The schedules that
11 support the weighted average costs of debt are provided in Schedule SCH-4, pages 15-16
12 in Dr. Hadaway's Direct Testimony.

13 Q: **What was the cost of debt provided to Staff as part of the workpapers from the**
14 **September Update?**

15 A: The MPS cost of debt was 6.70% and the SJLP and SJLP Steam cost of debt was 7.76%.
16 The weighted average costs are provided in schedules MWC-2 and MWC-3.

1 **Q: Did Staff agree with GMO's requested cost of debt?**

2 A: No. As reflected on page 28 of the Staff's Report, Staff recommends a GMO cost of debt
3 of 6.75%.

4 **Q: What rationale does Staff provide for recommending a different cost of debt than**
5 **requested by GMO?**

6 A: This is addressed on pages 27 and 28 of the Staff Report, as follows:

7 Aquila's failed non-regulated investments have caused the need for both the
8 company and other parties to make judgments on what the cost of debt might have
9 been if MPS and L&P had been owned by a company with at least an a BBB
10 credit rating. As time has passed and ownership structures have changed, the
11 embedded cost of debt for MPS and L&P has become even less based on reality.

12 As a result of the above, Staff recommends the use of a hypothetical embedded
13 cost of long-term debt for GMO. Staff proposes the use of The Empire District
14 Electric Company's (Empire) embedded cost of long-term debt from its last rate
15 case, Case No. ER-2008-0093 as of true-up date, February 29, 2008. This
16 embedded cost of long-term debt was 6.75 percent. Staff believes the use of
17 Empire's embedded cost of debt is appropriate because the risk profile of Empire
18 and GMO are fairly similar, Empire's operations are predominately regulated
19 operations, most of which are confined to Missouri, and Empire's most recent
20 ratemaking capital structure is similar to that of GMO's parent company, GPE.

21 **Q: Do you agree with Staff's recommendation?**

22 A: No, I do not.

23 **Q: Please explain.**

24 A: Staff's recommendation is to abandon the cost of debt methodology used by GMO in
25 preparing its September 2008 filing -- which, in turn, was consistent with the approach
26 taken by Aquila (now known as GMO) in its last rate case to generate a cost of debt *that*
27 *was accepted by Staff* -- in favor of a new approach that uses a hypothetical cost of debt
28 based solely on Empire's embedded cost of long-term debt. Staff's recommendation
29 would result in a cost of debt for MPS that is five basis points above the updated rate

1 requested by GMO but, more significantly, a cost of debt for SJLP that is 101 basis points
2 below that requested by GMO.

3 Q: **Please briefly describe the methodology used by GMO in determining its requested**
4 **cost of debt in this case.**

5 A: Dr. Hadaway outlined the methodology in his Direct Testimony as follows:

6 The cost of debt for MPS and SJLP was determined based upon the cost of each
7 entity's directly-issued debt, as well as the cost of assigned portions of debt
8 previously issued at the parent-company, i.e., Aquila Inc. level. The amount of
9 such debt assigned to each entity was determined by multiplying the respective
10 projected March 31, 2009 rate bases by the debt percentages shown in the
11 [respective requested capital structures for each entity], then subtracting any
12 directly-issued debt. *[Hadaway Direct Testimony, page 7, lines 13-19]*

13 Q: **What is meant by the "assignment" of debt previously issued at the Aquila parent**
14 **company level to MPS and SJLP?**

15 A: The starting point for the methodology previously established by Aquila, and utilized by
16 GMO in this filing, is the respective rate bases at MPS and SJLP and the debt percentage
17 in their capital structures. That leads to an amount of debt appropriate for each entity.
18 To the extent this amount of debt exceeds debt actually issued by the respective utility,
19 debt previously issued by the parent company is allocated, or "assigned," to each entity,
20 with the oldest such debt allocated first, then the next oldest, and so on.

21 Q: **At what interest rate are the parent company issues assigned?**

22 A: Generally, the issues are assigned at their effective rate, which incorporates the coupon
23 interest rate as well as issuance costs. A notable exception to this is the $500 million
24 Aquila senior notes issue completed in July 2002. Aquila completed this issue in the
25 midst of mounting credit rating and financial pressures brought about by difficulties in its
26 non-regulated business and therefore paid a very high rate of interest (initially 11.875%,

1 subsequently increased to 14.875% following a credit rating downgrade, and reduced to
2 the original 11.875% rate following Aquila's acquisition by Great Plains Energy in July
3 2008. In keeping with Aquila's commitment not to pass along the cost of those failed
4 activities to its Missouri customers, as assignments of that debt have been made in past
5 rate cases, the interest rate used has been based on Aquila's estimate of what the effective
6 rate for the assigned amount would be if the debt were issued on an investment-grade
7 equivalent basis. As such, even though the cost of this debt to Aquila has essentially
8 ranged between roughly 12% and 15%, the cost attributed to MPS has been
9 approximately 5.93% and the cost attributed to SJLP has been approximately 6.47%, as
10 shown in Schedule MWC-4.

11 **Q: Is the methodology that Aquila used in past rate cases, and that GMO used in this**
12 **proceeding, a reasonable approach to determining cost of debt for MPS and SJLP?**

13 A: Yes. The methodology appropriately passes along the cost of debt actually issued by
14 MPS and SJLP. Additional debt appropriate to the respective entities' capital structures
15 has been introduced through the assignment of parent company debt at investment grade
16 equivalent rates. While admittedly still requiring a degree of subjectivity, the
17 methodology is reasonable. Staff appeared to agree with this by accepting the cost of
18 debt for MPS and SJLP in Case No. ER-2007-0004.

19 **Q: Is the Staff correct that using Empire's cost of debt is an "appropriate" proxy for**
20 **the cost of debt for GMO?**

21 A: No. Staff's recommendation appears to imply that regulated utilities operating in the
22 same state will necessarily have the same cost of debt. The factors that dictate an entity's
23 cost of debt go well beyond the areas mentioned by staff and include, among others, the

1 average maturity, the timing and amount of issuance, the terms and conditions of the
2 issuances, the credit profile of the entity at the time of issuance, availability of alternate
3 sources of funding, the entity's market capitalization, and general financial market
4 conditions at the time of issuance. Staff has not attempted to address the comparability of
5 these factors for GMO and Empire.

6 **Q: Please summarize your thoughts on GMO's cost of debt.**

7 A: The cost of debt requested by GMO in this case was developed using a reasonable
8 methodology, the results of which were accepted by Staff in Aquila's last rate case. To
9 set aside this methodology in favor of a hypothetical cost of debt based upon Empire as a
10 proxy is unreasonable and should be rejected by the Commission.

11 **Section 2**

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

13 A: In this section, I recommend that the Commission reject Staff's imputation of an accounts
14 receivable ("A/R") sales program for GMO, as described on pages 115-116 of Staff's
15 Report.

16 **Q: Why does Staff impute an A/R sales program for GMO?**

17 A: Staff indicates that the 2002 termination of an A/R sales program that had been in place
18 at Aquila occurred because of Aquila's financial difficulties. Staff asserts that because an
19 A/R sales program reduces revenue lag days in the Cash Working Capital ("CWC")
20 calculation, the fact that that program was terminated and not subsequently reinstated
21 creates a detriment for GMO's customers. Staff therefore proposes cost of service
22 adjustments in this case, as it also attempted to do in Aquila's last three rate cases, which
23 are based upon the existence of a hypothetical A/R sales program.

1 **Q: Do you agree with Staff's approach?**

2 A: No. In my opinion, Staff's approach is inappropriate for a number of reasons.

3 **Q: Please explain.**

4 A: The first question relates to how broadly Staff has taken this approach with other entities
5 under its purview. A/R sales programs operate similarly in terms of the working capital
6 impact for any firm that uses such a program. As such, according to Staff's logic, it
7 would appear that any regulated utility in Missouri that does not utilize an A/R sales
8 program, regardless of the reason, should have such a program imputed for ratemaking
9 purposes. There are, however, a myriad of factors beyond working capital impact alone
10 that an entity must consider before putting such a program in place, and it is certainly
11 possible that different firms will assess the costs and benefits of a program differently.
12 KCP&L employs an A/R sales program, but I am unsure as to whether that is the case
13 with other Missouri utilities and, if not, whether Staff has handled this issue with those
14 companies similarly to its attempts with Aquila and now GMO.

15 **Q: What other concerns do you have about Staff's approach?**

16 A: Staff incorrectly attempts to make a connection between its imputation of an A/R sales
17 program for GMO and the acquisition of GMO by Great Plains Energy in 2008:

> 18 Based on the Company's past financial problems and the KCP&L
> 19 acquisition (emphasis added), Staff determined an adjustment should be
> 20 made for the bank fees had the program been in place. KCP&L currently
> 21 sells approximately 57% of its account receivables, which include the
> 22 account receivables of GMO and L&P. When calculating an appropriate
> 23 amount for GMO and L&P, Staff used the same percentage based on the
> 24 receivable balance from July 31, 2008 and December 31, 2008 *[Staff*
> 25 *Report, page 116]*.

1 **Q: Why is Staff's assertion incorrect?**

2 A: Contrary to Staff's statement, KCP&L's A/R sales program includes KCP&L's
3 receivables only - GMO's receivables are not included.

4 **Q: Would it even be possible to include GMO's A/R in KCP&L's A/R sales program**
5 **today?**

6 A: No. First, GMO's A/R are already pledged as collateral to support a revolving line of
7 credit and therefore cannot be included in an A/R sales program. Second, we expect that
8 a financial institution would be unwilling to offer a combined structure given the
9 differences between KCP&L and GMO in terms of credit rating, service territory, and
10 other attributes.

11 **Q: What is the status of the line of credit collateralized by GMO's A/R?**

12 A: The line matures in April 2009. GMO is currently in the process of arranging a three-
13 month extension to July 2009, which is also when the KCP&L A/R sales program
14 matures. During the extension period, GMO plans to explore the potential of putting an
15 A/R sales program in place similar to KCP&L's. If GMO elects to do so, the
16 coterminous maturities of the GMO and KCP&L facilities will enable the new A/R sales
17 program for GMO and the renewed program for KCP&L to be completed in parallel,
18 which would be optimal from an administrative and market risk perspective.

19 **Q: Please summarize your thoughts with regard to Staff's imputation of an A/R sales**
20 **program.**

21 A: GMO did not have an A/R sales program in place during the test year and will not have
22 such a program in place by the true-up date in this proceeding. Staff has attempted to
23 support using a hypothetical program for GMO in part by making a connection to

1 KCP&L that does not exist. In addition, Staff has not established the relevance of
2 Aquila's "past financial problems" to GMO's lack of an A/R sales program today, since
3 Staff's logic implies that <u>any</u> entity that does not utilize an A/R sales program, regardless
4 of the reason, should have such a program imputed for purposes of determining cost of
5 service. It is unclear that Staff has taken that approach with other utilities within its
6 purview. Staff's proposal to impute an A/R sales program for GMO in this case lacks
7 merit and should be rejected by the Commission.

8 **Section 3**

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

10 A: In this section, I address various points in the Direct Testimony of Mr. Michael Gorman
11 on behalf of the Office of the Public Counsel with respect to capital structure and the
12 impact of his recommendations for capital structure and cost of capital on GMO's credit
13 metrics and credit rating.

14 **Q: Does Mr. Gorman express concerns about the capital structure proposed by GMO?**

15 A: Yes. In particular, Mr. Gorman indicates that the capital structure proposed in Dr.
16 Hadaway's Direct Testimony is "heavily weighted with common equity" *[Gorman Direct*
17 *Testimony, page 10, line 3]*.

18 **Q: Do you agree with Mr. Gorman's statement?**

19 A: No. The equity ratio recommended by Dr. Hadaway, which was based upon the
20 projected capital structure for Great Plains Energy as of the true-up date, is consistent
21 with the guidelines articulated by S&P for a company with a Financial Risk Profile
22 ("FRP") similar to GMO's, as depicted in Schedule MWC-5. S&P's guidelines are for
23 Total Debt / Capital, or essentially the inverse of the equity ratio, and reflect a range of

1 45% - 60% for a company with an "Aggressive" FRP. GMO's debt ratio as filed by Dr.
2 Hadaway was 45.47%, which would place GMO's proposed capital structure at the
3 strong end of, but still within, the guidelines, even without incorporating the other debt
4 components S&P includes. In addition, S&P's ratios include both short-term debt and
5 off-balance sheet adjustments. Regulatory capital structure includes neither of these
6 components. As such, leverage and equity ratios as calculated for regulatory purposes
7 will almost always be different from how they are determined for rating agency purposes.
8 Such differences can be significant.

9 **Q: Does Mr. Gorman express other reservations about GMO's proposed equity ratio?**

10 A: Yes. On page 10, lines 10-12 of his testimony Mr. Gorman discusses "significant
11 planned equity additions" that are included in GMO's proposed capital structure but
12 "have not yet been made, and may not be made" before the true-up period.

13 **Q: How do you respond?**

14 A: As I indicated earlier, GMO's requested capital structure was based upon Great Plains
15 Energy's projected capital structure as of the true-up date. Mr. Gorman is correct that
16 GMO's requested capital structure included a significant amount of common stock that
17 Great Plains Energy expected to issue prior to the true-up date. To date, it has not done
18 so due to market conditions, SEC-imposed blackout restrictions, and other factors, and
19 there is no assurance Great Plains Energy will issue equity prior to the true-up date. In
20 line with the precedent established in the last two rate cases for GMO's sister company
21 KCP&L, GMO expects the capital structure used in this case will be Great Plains
22 Energy's actual capital structure as of the true-up date.

1 **Q: What capital structure does Mr. Gorman recommend for GMO in this case?**

2 A: Mr. Gorman supports a capital structure for GMO composed of 48.41% common equity
3 and 51.59% debt *[Gorman Direct Testimony, page 11]*. This represents the actual capital
4 structure for GMO based on FERC Form-1 data for the third quarter 2008.

5 **Q: Do you agree with Mr. Gorman's recommended capital structure?**

6 A: No. The Company believes, as described earlier in my discussion of Staff's
7 recommended capital structure, that the use of an actual capital structure as of the
8 September 30 update period is appropriate. However, as described earlier, the Company
9 maintains that the use of the Great Plains Energy capital structure, excluding preferred
10 stock, is appropriate for GMO.

11 **Q: Why is the use of the parent company capital structure appropriate for GMO?**

12 A: The Company believes that the view of capital structure for ratemaking purposes should,
13 with the exception of the exclusion of preferred stock, parallel that of its sister company,
14 KCP&L. The Commission has accepted the use of the parent company capital structure
15 in ratemaking for KCP&L because it avoids the potential for significant deviations
16 between the parent and the regulated subsidiary, e.g., a situation whereby the parent
17 increases leverage and makes a capital contribution to the utility.

18 **Q: Could the reverse also happen, whereby the parent company "over-equitizes"**
19 **compared to the regulated entity?**

20 A: Yes, and that is what Mr. Gorman is arguing is happening here. The key question,
21 however, is whether the parent's capital structure is reasonable given the business and
22 financial risk profile of the regulated utility.. That is true in this case, as I have already
23 established, so Mr. Gorman's concern is unfounded.

1 **Q: Are there additional arguments that support use of the parent company capital**
2 **structure?**
3 A: Yes. Use of the parent capital structure is also appropriate from a credit rating
4 perspective. S&P's ratings methodology is based on the credit profile of the parent
5 company as a foundation, with subsidiary ratings subsequently "notched" higher because
6 of the seniority of bondholder claims. This notching approach is what led to S&P's
7 assignment of a BBB senior unsecured debt rating – identical to KCP&L - to GMO upon
8 the closing of the acquisition by Great Plains Energy. Also, as Mr. Gorman cites on page
9 8, lines 19-23 of his Direct Testimony, Moody's assigned a senior unsecured rating of
10 Baa2 – identical to Great Plains Energy – to GMO based heavily upon guarantees of
11 GMO indebtedness by Great Plains Energy. It is evident that both rating agencies look
12 strongly to the parent company's capital structure in assessing GMO's credit profile.
13 **Q: Mr. Gorman indicates that his proposed capital structure and rate of return for**
14 **GMO will "support its investment grade bond rating and financial integrity." What**
15 **is your reaction to that contention?**
16 A: I disagree. I would characterize Mr. Gorman's discussion of "financial integrity" on
17 pages 42-46 of his testimony and the supporting "Credit Rating Financial Ratios" in his
18 Schedules MPG-21 and MPG-22 as misleading. In calculating his credit metrics, he
19 excludes a number of significant components that would be considered by the rating
20 agencies in considering a stand-alone credit rating for GMO, as I describe below. He
21 also does not provide a proper perspective on the relative weights ascribed by rating
22 agencies to historical, as opposed to forward-looking, metrics in assessing credit ratings.

1 **Q: Please elaborate.**

2 A: The metrics quoted by Mr. Gorman in testimony and calculated in Schedules MPG-21
3 and MPG-22 assume that credit metrics are calculated based solely on regulatory inputs.
4 This is false. In determining FFO Interest coverage, for example, rating agencies will
5 perform the calculation based upon the actual amount of interest GMO pays, whether or
6 not recovered in rates. As reflected in Schedule MWC-6, the annual long-term debt
7 interest paid by GMO is approximately $51 million, or 94%, higher than what Mr.
8 Gorman assumes. This does not even consider (i) interest paid by GMO on its short-term
9 debt, or (ii) imputed interest on debt attributable to off-balance sheet obligations such as
10 leases and power purchase agreements, which are included also in the rating agency
11 metrics. Schedule MWC-6 reflects the calculation of FFO Interest Coverage, using Mr.
12 Gorman's FFO from Schedules MPG-21 and MPG-22 for illustrative purposes only,
13 based on <u>total annualized interest</u> as of September 30, 2008. Inclusion of the non-
14 regulatory interest components lowers the ratio for GMO to 2.4x from Mr. Gorman's
15 combined 3.9x.

16 A similar large discrepancy exists for total debt. Applying Mr. Gorman's total debt ratio
17 to GMO's rate base yields a total combined debt in Schedules MPG-21 and MPG-22 of
18 approximately $778 million, which is $256 million, or 25%, lower than the $1.034 billion
19 of long-term debt that was actually on GMO's books at September 30, 2008 and which
20 would be considered in the rating agencies' calculation of credit metrics. Mr. Gorman's
21 calculations of metrics that involve total debt also do not take into account short-term
22 debt and debt attributed by the rating agencies related to off-balance sheet items such as
23 leases. MWC-6 reflects the calculation of FFO to Debt, again using Mr. Gorman's FFO

1 from Schedules MPG-21 and MPG-22 for illustrative purposes only, based on total debt
2 as of September 30, 2008. Inclusion of the non-regulatory debt components lowers the
3 ratio for GMO to 13.8% from Mr. Gorman's combined 20.4%. Even without a challenge
4 to Mr. Gorman's FFO, adjusting his ratios to a more accurate depiction of the rating
5 agency views of the metrics significantly impacts the results.

6 **Q: Please summarize your thoughts on Mr. Gorman's discussion of "financial**
7 **integrity."**

8 A: Mr. Gorman asserts that his capital structure and recommended rate of return support
9 "BBB" bond ratings for GMO *[Gorman Direct Testimony, page 45, lines 9-10 and page*
10 *46, lines 9-10]*. The credit metric calculations he offers to support this conclusion
11 exclude a number of significant items that, while not included in GMO's regulatory
12 framework, nonetheless are considered in the rating agency determination of metrics.
13 The result is that Mr. Gorman significantly overstates GMO's standalone metrics. He
14 also fails to acknowledge that credit rating agencies base their analysis primarily on
15 forward-looking, as opposed to historical metrics. This means that the impact of
16 regulatory lag on costs is especially important, particularly in an economic environment
17 such as that predicted for GMO in 2009 when customer demand is projected to decline,
18 as described on Great Plains Energy's February 11, 2009 investor conference call and
19 webcast. GMO's current credit rating is a function of the parent company credit rating
20 and is only minimally attributable to its standalone credit metrics. Given all of the above,
21 Mr. Gorman's attempt to link his recommendations to a standalone "BBB" credit rating
22 for GMO is flawed and should be rejected by the Commission.

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

2 A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Aquila, Inc. dba)
KCP&L Greater Missouri Operations Company to) Case No. ER-2009-0090
Modify Its Electric Tariffs to Effectuate a Rate Increase)

AFFIDAVIT OF MICHAEL W. CLINE

STATE OF MISSOURI)
) **ss**
COUNTY OF JACKSON)

Michael W. Cline, being first duly sworn on his oath, states:

1. My name is Michael W. Cline. I work in Kansas City, Missouri, and I am employed by Great Plains Energy, the parent company of Kansas City Power & Light Company as Vice President-Investor Relations and Treasurer.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of KCP&L Greater Missouri Operations Company consisting of twenty (20) pages and Schedule(s) MWC - 1 through MWC - 6, all of which having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Michael W. Cline

Subscribed and sworn before me this 13th day of March 2009.

Notary Public

My commission expires: Feb. 4 2011

" NOTARY SEAL "
Nicole A. Wehry, Notary Public
Jackson County, State of Missouri
My Commission Expires 2/4/2011
Commission Number 07391200

SCHEDULE MWC-1

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ORIGINAL FILED UNDER SEAL

KCP&L - Greater Missouri Operations
Weighted Average Cost of Debt: MPS
September 30, 2008 adjusted for Known & Measurable Changes through March 31, 2009

Assigned Debt	Effective Rate	MO Electric Assigned Debt 3/31/09	Computed Interest on 3/31/09 Assigned Debt	MO Electric Weighted Avg Cost of Debt
30 Yr 8.27%, Due 11/15/21 Effective Rate 8.502%	8.502%	80,850,000	6,873,867	
Sr 7.625%, Due 11/15/09 Effective Rate 7.742%	7.742%	15,133,913	1,171,668	
Wamego 96, Due 3/1/26 Current Effective Rate 2.406%	2.406%	7,300,000	175,638	
Environ Improve, Due 5/1/28 Current Effective Rate 4.123%	4.123%	5,000,000	206,150	
Sanwa Bank Loan 6.99%, Due 12/9/09 Effective Rate 7.02%	7.020%	1,094,353	76,824	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 5.35% (10/01/04)	5.350%	108,063,961	5,781,422	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.05% (7/15/04)	6.050%	66,171,000	4,003,346	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.474% (6/26/06)	6.474%	101,965,118	6,601,222	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 5.848% (12/29/06)	5.848%	25,300,318	1,479,563	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.404% (6/15/07)	6.404%	1,498,277	95,950	
Sr 7.95% (downgrade 9.95%), Due 2/1/11 Effective Rate 8.01%	8.010%	87,623,060	7,018,607	
UCFC Sr 7.75%, Due 6/15/11 Effective Rate 8.487%	8.487%	0	0	
Total		**$ 500,000,000**	**$ 33,484,255**	**6.697%**

KCP&L - Greater Missouri Operations
Weighted Average Cost of Debt: SJLP
September 30, 2008 adjusted for Known & Measurable Changes Through March 31, 2009

Assigned Debt	Effective Rate	SJLP Assigned Debt 3/31/09	Computed Interest on 3/31/09 Assigned Debt	SJLP Weighted Avg Cost of Debt
Poll Cntrl Bonds 5.85%, Due 2/1/13 Effective Rate 6.991%	6.991%	5,600,000	391,496	
20 Yr MTN 7.16%, Due 11/29/13 Effective Rate 7.573%	7.573%	6,000,000	454,380	
30 Yr MTN 7.17%, Due 12/1/23 Effective Rate 7.584%	7.584%	7,000,000	530,880	
30 Yr MTN 7.33%, Due 11/30/23 Effective Rate 7.753%	7.753%	3,000,000	232,590	
Sr 7.625%, Due 11/15/09 Effective Rate 7.742%	7.742%	53,355,087	4,130,751	
Sr 7.95% (downgrade 9.95%), Due 2/1/11 Effective Rate 8.01%	8.010%	19,661,000	1,574,846	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.474% (6/26/06)	6.474%	33,544,913	2,171,698	
UCFC Sr 7.75%, Due 6/15/11 Effective Rate 8.487%	8.487%	27,610,000	2,343,261	
Sub Total		155,771,000	11,829,901	
9.44% FMB, Due 2/1/2021 Effective Rate 9.487%	9.487%	14,625,000	1,387,474	
Total		**$ 170,396,000**	**$ 13,217,375**	**7.757%**

KCP&L - Greater Missouri Operations
Weighted Average Assgined Cost of $500 Million of 11.875% Senior Notes: MPS
September 30, 2008 Adjusted for Known and Measurable Changes Through March 31, 2009

Assigned Debt	Effective Rate	MO Electric Assigned Debt 3/31/09	Computed Interest on 3/31/09 Assigned Debt	MO Electric Weighted Avg Cost of Debt
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 5.35% (10/01/04)	5.350%	108,063,961	5,781,422	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.05% (7/15/04)	6.050%	66,171,000	4,003,346	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.474% (6/26/06)	6.474%	101,965,118	6,601,222	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 5.848% (12/29/06)	5.848%	25,300,318	1,479,563	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.404% (6/15/07)	6.404%	1,498,277	95,950	
Total		**$ 302,998,674**	**$ 17,961,501**	**5.928%**

KCP&L - Greater Missouri Operations
Weighted Average Assgined Cost of $500 Million of 11.875% Senior Notes: SJLP
September 30, 2008 Adjusted for Known and Measurable Changes Through March 31, 2009

Assigned Debt	Effective Rate	SJLP Assigned Debt 3/31/09	Computed Interest on 3/31/09 Assigned Debt	SJLP Weighted Avg Cost of Debt
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.474% (6/26/06)	6.474%	33,544,913	2,171,698	
Total		**$ 33,544,913**	**$ 2,171,698**	**6.474%**

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November 30, 2007

U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix

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U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix

The electric, gas, and water utility ratings ranking lists published today by Standard & Poor's U.S. Utilities & Infrastructure Ratings practice are categorized under the business risk/financial risk matrix used by the Corporate Ratings group. This is designed to present our rating conclusions in a clear and standardized manner across all corporate sectors. Incorporating utility ratings into a shared framework to communicate the fundamental credit analysis of a company furthers the goals of transparency and comparability in the ratings process. Table 1 shows the matrix.

Table 1

Business Risk/Financial Risk

	Financial Risk Profile				
Business Risk Profile	**Minimal**	**Modest**	**Intermediate**	**Aggressive**	**Highly leveraged**
Excellent	AAA	AA	A	BBB	BB
Strong	AA	A	A-	BBB-	BB-
Satisfactory	A	BBB+	BBB	BB+	B+
Weak	BBB	BBB-	BB+	BB-	B
Vulnerable	BB	B+	B+	B	B-

The utilities rating methodology remains unchanged, and the use of the corporate risk matrix has not resulted in any changes to ratings or outlooks. The same five factors that we analyzed to produce a business risk score in the familiar 10-point scale are used in determining whether a utility possesses an "Excellent," "Strong," "Satisfactory," "Weak," or "Vulnerable" business risk profile:

- Regulation,
- Markets,
- Operations,
- Competitiveness, and
- Management.

Regulated utilities and holding companies that are utility-focused virtually always fall in the upper range ("Excellent" or "Strong") of business risk profiles. The defining characteristics of most utilities--a legally defined service territory generally free of significant competition, the provision of an essential or near-essential service, and the presence of regulators that have an abiding interest in supporting a healthy utility financial profile--underpin the business risk profiles of the electric, gas, and water utilities.

As the matrix concisely illustrates, the business risk profile loosely determines the level of financial risk appropriate for any given rating. Financial risk is analyzed both qualitatively and quantitatively, mainly with financial ratios and other metrics that are calculated after various analytical adjustments are performed on financial statements prepared under GAAP. Financial risk is assessed for utilities using, in part, the indicative ratio ranges in table 2.

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Table 2

Financial Risk Indicative Ratios - U.S. Utilities

(Fully adjusted, historically demonstrated, and expected to consistently continue)

	Cash flow		Debt leverage
	(FFO/debt) (%)	(FFO/interest) (x)	(Total debt/capital) (%)
Modest	40 - 60	4.0 - 6.0	25 - 40
Intermediate	25 - 45	3.0 - 4.5	35 - 50
Aggressive	10 - 30	2.0 - 3.5	45 - 60
Highly leveraged	Below 15	2.5 or less	Over 50

The indicative ranges for utilities differ somewhat from the guidelines used for their unregulated counterparts because of several factors that distinguish the financial policy and profile of regulated entities. Utilities tend to finance with long-maturity capital and fixed rates. Financial performance is typically more uniform over time, avoiding the volatility of unregulated industrial entities. Also, utilities fare comparatively well in many of the less-quantitative aspects of financial risk. Financial flexibility is generally quite robust, given good access to capital, ample short-term liquidity, and the like. Utilities that exhibit such favorable credit characteristics will often see ratings based on the more accommodative end of the indicative ratio ranges, especially when the company's business risk profile is solidly within its category. Conversely, a utility that follows an atypical financial policy or manages its balance sheet less conservatively, or falls along the lower end of its business risk designation, would have to demonstrate an ability to achieve financial metrics along the more stringent end of the ratio ranges to reach a given rating.

Note that even after we assign a company a business risk and financial risk, the committee does not arrive by rote at a rating based on the matrix. The matrix is a guide--it is not intended to convey precision in the ratings process or reduce the decision to plotting intersections on a graph. Many small positives and negatives that affect credit quality can lead a committee to a different conclusion than what is indicated in the matrix. Most outcomes will fall within one notch on either side of the indicated rating. Larger exceptions for utilities would typically involve the influence of related unregulated entities or extraordinary disruptions in the regulatory environment.

We will use the matrix, the ranking list, and individual company reports to communicate the relative position of a company within its business risk peer group and the other factors that produce the ratings.

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Credit Rating Financial Ratios

Line*		MPS*	SJLP*	Gorman Combined	Total GMO Actual Rating Agency View	GMO Reference
1	Rate Base	$1,202,225,058	$ 305,034,038	$1,507,259,096		
6	Funds from Operations	$ 127,443,088	$ 31,323,703	$ 158,766,791	$ 158,766,791	Sum of line 6 from MPG-21 and MPG-22
8	Interest Expense	$ 42,364,515	$ 11,992,205	$ 54,356,720	$ 105,813,882	GPE cost of capital schedule as of 9/30/08
	Interest on Short-Term Debt				$ 850,000	Line 11b * 5% effective rate at 9/30/08
	Interest on Off Bal Sheet Items Attributed as Debt**				$ 8,876,231	(Sum of lines 11c - 11f)*8.8%
8a	**Total Interest Expense**			**$ 54,356,720**	**$ 115,540,113**	
9	FFO Plus Interest	$ 169,807,603	$ 43,315,908	$ 213,123,511	$ 274,306,904	Line 6 + Line 8a
10	FFO Interest Coverage	4.0	3.6	**3.9**	**2.4**	Line 9 / Line 8a
11	Total Debt Ratio	51.59%	51.59%			
11a	Total Long-term Debt	$ 620,227,907	$ 157,367,060	$ 777,594,968	$ 1,033,697,200	GPE cost of capital schedule as of 9/30/08
11b	Short-term Debt				$ 17,000,000	GPE Form 10-Q for 9/30/08 page 36
	Debt attributed to off-balance sheet items**					
11c	Present value of operating leases				$ 18,064,038	GMO financials given to agencies Feb 09
11d	Present value of power purchase agreements				$ 51,946,721	GMO financials given to agencies Feb 09
11e	Tax-effected PostRetirement Benefit Obligations				$ 23,279,100	GMO financials given to agencies Feb 09
11f	Tax-effected Asset Retirement Obligations				$ 7,576,400	GMO financials given to agencies Feb 09
11g	Total Debt			**$ 777,594,968**	**$ 1,151,563,459**	Sum of lines 11a - 11f
12	FFO to Total Debt	20.5%	19.9%	**20.4%**	**13.8%**	Line 6 / Line 11g

* Line references for these columns correspond to lines from Mr. Gorman's schedules MPG-21 and MPG-22

**Off balance sheet items reflect information reported to the rating agencies in February 2009; estimates as of 9/30/08 were not available