Exhibit No.:	
Issue:	Finance
Witness:	Michael W. Cline
Type of Exhibit:	Surrebuttal Testimony
Sponsoring Party:	KCP&L Greater Missouri Operations Company
Case No.:	ER-2009-0090
Date Testimony Prepared:	April 9, 2009

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2009-0090

SURREBUTTAL TESTIMONY

OF

MICHAEL W. CLINE

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City, Missouri
April 2009

SURREBUTTAL TESTIMONY

OF

MICHAEL W. CLINE

Case No. ER-2009-0090

Q: Please state your name and business address.

A: My name is Michael W. Cline. My business address is 1201 Walnut, Kansas City, Missouri 64106.

Q: Are you the same Michael W. Cline who submitted Rebuttal Testimony in this proceeding?

A: Yes.

Q: What is the purpose of your Surrebuttal Testimony?

A: My testimony is in two sections. In Section 1, I respond to the Rebuttal Testimony of Missouri Public Service Commission Staff ("Staff") witness David Murray with respect to the cost of debt to be applied to KCP&L Greater Missouri Operations Company ("GMO" or the "Company") for ratemaking purposes in this case. In Section 2, I address comments from the Rebuttal Testimony of Michael Gorman on behalf of the Office of the Public Counsel ("OPC") with respect to St. Joseph Light & Power's ("SJLP's") cost of debt.

Section 1

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

A: In this section, I respond to the Rebuttal Testimony of Staff witness David Murray with respect to the cost of debt to be applied to GMO for ratemaking purposes in this case.

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

A: As shown in the tables on page 6 of Company witness Dr. Samuel C. Hadaway's Direct Testimony, Missouri Public Service ("MPS") requested a capital structure that included a cost of debt of 6.83% and SJLP and SJLP Steam requested a capital structure that included a cost of debt of 7.62%. The schedules that support the weighted average costs of debt are provided in Schedule SCH-4, pages 15-16 in Dr. Hadaway's Direct Testimony.

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

A: The MPS cost of debt was 6.70% and the SJLP and SJLP Steam cost of debt was 7.76%. The weighted average costs were provided in schedules MWC-2 and MWC-3 to my Rebuttal Testimony.

Q: Did Mr. Murray agree with GMO's requested cost of debt?

A: No. As reflected on page 28 of Staff's February 13, 2009 Cost of Service Report ("Staff Report"), in which Mr. Murray was the Staff expert on cost of capital and capital structure matters, Mr. Murray recommended a GMO cost of debt of 6.75%.

Q: What rationale did Mr. Murray provide for recommending a different cost of debt than requested by GMO?

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

> Aquila's failed non-regulated investments have caused the need for both the company and other parties to make judgments on what the cost of debt might have been if MPS and L&P had been owned by a company with at least a BBB credit rating. As time has passed and ownership structures have changed, the embedded cost of debt for MPS and L&P has become even less based on reality.
>
> As a result of the above, Staff recommends the use of a hypothetical embedded cost of long-term debt for GMO. Staff proposes the use of The Empire District Electric Company's (Empire) embedded cost of long-term debt from its last rate case, Case No. ER-2008-0093 as of true-up date, February 29, 2008. This embedded cost of long-term debt was 6.75 percent. Staff believes the use of

> Empire's embedded cost of debt is appropriate because the risk profile of Empire and GMO are fairly similar, Empire's operations are predominately regulated operations, most of which are confined to Missouri, and Empire's most recent ratemaking capital structure is similar to that of GMO's parent company, GPE.

Q: Does Mr. Murray expand upon this rationale in his Rebuttal Testimony?

A: Yes. Mr. Murray restates his position that the use of Empire's embedded cost of debt is "appropriate" because "Empire is predominately (sic) a Missouri regulated electric utility exposed to many of the same risks as the GMO properties" *[Murray Surrebuttal Testimony, page 23, lines 10-11]*. He also indicates that such an approach is preferable to the methodology used to determine cost of debt by GMO in this proceeding and by Aquila in previous rate cases because "Staff does not have confidence in this process" *[Id., page 22, line 19]*.

Q: Does Staff's position with respect to the cost of debt in Aquila's rate case ER-2007-0004 corroborate Mr. Murray's statement about Staff's "lack of confidence" in the methodology for determination of GMO's cost of debt in the current proceeding?

A: No. In rate case ER-2007-0004, Aquila used the same approach to determine its cost of debt that GMO used in this proceeding. Staff accepted Aquila's requested cost of debt in that case.

Q: Did the Commission express any reservations about the process Aquila used to determine its cost of debt in its rate cases ER-2007-2004, ER-2005-0436, and ER-2004-0034?

A: No. The cost of debt used in ER-2007-0004 was Aquila's requested cost of debt, which was accepted by Staff. The 2004 and 2005 cases were settled and there was no indication of any objection by the Commission to Aquila's methodology, which is consistent with GMO's approach in this proceeding.

Q: Do you agree with Staff's recommendation with respect to GMO's cost of debt in this proceeding?

A: No, I do not.

Q: What is the basis of your disagreement?

A: Staff's recommendation is to abandon the cost of debt methodology used by GMO in preparing its September 2008 filing -- which, in turn, was consistent with the approach taken by Aquila (now known as GMO) in its last rate case to generate a cost of debt *that was accepted by Staff* -- in favor of a new approach that uses a hypothetical cost of debt based solely on Empire's embedded cost of long-term debt. Staff's recommendation would result in a cost of debt for MPS that is five basis points above the updated rate requested by GMO but, more significantly, a cost of debt for SJLP that is 101 basis points below that requested by GMO.

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

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

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

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

A: The starting point for the methodology previously established by Aquila, and utilized by GMO in this filing, is the respective rate bases at MPS and SJLP and the debt percentage in their capital structures. That leads to an amount of debt appropriate for each entity.

To the extent this amount of debt exceeds debt actually issued by the respective utility, debt previously issued by the parent company is allocated, or "assigned," to each entity, with the oldest such debt allocated first, then the next oldest, and so on.

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

A: Generally, the issues are assigned at their effective rate, which incorporates the coupon interest rate as well as issuance costs. A notable exception to this is the $500 million Aquila senior notes issue completed in July 2002. Aquila completed this issue in the midst of mounting credit rating and financial pressures brought about by difficulties in its non-regulated business and therefore paid a very high rate of interest (initially 11.875%, subsequently increased to 14.875% following a credit rating downgrade, and reduced to the original 11.875% rate following Aquila's acquisition by Great Plains Energy in July 2008). In keeping with Aquila's commitment not to pass along the cost of those failed activities to its Missouri customers, as assignments of that debt have been made in past rate cases, the interest rate used has been based on Aquila's estimate of what the effective rate for the assigned amount would be if the debt were issued on an investment-grade equivalent basis. As such, even though the cost of this debt to Aquila has essentially ranged between roughly 12% and 15%, the cost attributed to MPS has been approximately 5.93% and, as shown in Schedule MWC-4 to my Rebuttal Testimony, the cost attributed to SJLP has been approximately 6.47%.

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

A: Yes. The methodology appropriately passes along the cost of debt actually issued by MPS and SJLP. Additional debt appropriate to the respective entities' capital structures has been introduced through the assignment of parent company debt at investment grade equivalent rates. While still requiring the use of judgment, the methodology is reasonable. Staff appeared to agree with this by accepting the cost of debt for MPS and SJLP in Case No. ER-2007-0004 and, as mentioned earlier, the Commission has not indicated any objection to the methodology in Aquila's last three rate cases.

Q: Notwithstanding Staff's concurrence with the cost of debt developed by Aquila in Case No. ER-2007-0004, why does Mr. Murray now indicate the Staff lacks confidence in the methodology you have outlined?

A: Mr. Murray states the following in his testimony:

> First, Aquila based these assigned debt costs on BBB- debt yields obtained from Bloomberg. Because Aquila had a BBB credit rating before it encountered financial difficulties due to its failed non-regulated investments, Staff believes this would be the most appropriate benchmark. Second, Aquila used spot yields to determine the cost of debt to assign to L&P and MPS. Staff believes it would be better to smooth these yields by taking an average for the month. Finally, Staff is not sure how many debt issuances comprise the BBB- debt yields. If there are relatively few BBB- debt issuances comprising these debt yields, then a few debt issuances may skew these yields *[Murray Rebuttal Testimony, page 22, line 21 to page 23, line 5]*.

Q: How do you respond?

A: The Company has been consistent in the use of this debt assignment methodology in its last three rate cases and Mr. Murray's testimony is the first time these specific objections have been raised. The use of a BBB- credit rating for this purpose is consistent with the commitment initially made by Aquila management not to pass along to its Missouri customers the impact of Aquila's credit rating falling below investment grade as a result of its non-regulated activities. The Company has not evaluated the impact of the other two concerns raised by Mr. Murray but does not disagree with them conceptually. These, however, fall into the category of minor potential refinements to the methodology and do not represent a basis for throwing it out entirely.

Q: Is Mr. Murray correct that using Empire's cost of debt is an "appropriate" proxy for the cost of debt for GMO?

A: No. Mr. Murray's recommendation appears to imply that regulated utilities operating in the same state will necessarily have the same cost of debt. The factors that dictate an entity's cost of debt go well beyond the areas mentioned by staff and include, among others, the average maturity, the timing and amount of issuance, the terms and conditions of the issuances, the credit profile of the entity at the time of issuance, availability of alternate sources of funding, the entity's market capitalization, and general financial market conditions at the time of issuance. Mr. Murray has not supported his recommendation by attempting to address the comparability of these factors for GMO and Empire.

Q: Please summarize your thoughts on Mr. Murray's position with respect to GMO's cost of debt.

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

Section 2

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

A: In this section, I address comments from the Rebuttal Testimony of Michael Gorman on behalf of the Office of the Public Counsel with respect to SJLP's cost of debt.

Q: What are Mr. Gorman's assertions with respect to SJLP's cost of debt?

A: Mr. Gorman indicates that SJLP's requested cost of debt is significantly higher than other Missouri public utilities and market and industry costs *[Gorman Rebuttal Testimony, page 13, lines 7-10]*. He goes on to state that "refinancing [SJLP's debt] is critical to allow SJLP's customers to benefit from lower capital market costs" *[Id., page 14, lines 8-9]*. He concludes that SJLP's embedded cost of debt should be set at the same level as MPS.

Q: Do you agree with Mr. Gorman that SJLP's embedded cost of debt is higher than other Missouri utilities and market and industry costs?

A: It is not clear to what Mr. Gorman is referring with respect to "market and industry costs" so I withhold opinion on that particular comment. I have not independently confirmed the debt costs listed in Table 4 of his Rebuttal Testimony for AmerenUE and Empire but I accept his assessment that SJLP's debt cost is higher than other Missouri utilities.

Q: To what do you attribute SJLP's higher cost?

A: As I described in my response to Mr. Murray, the mere fact that utilities operate in the same state does not portend an equivalent cost of debt for each. SJLP's higher debt cost is attributable to the fact that SJLP issued its long-term debt in the early 1990s at interest rates well above 7% (including one First Mortgage Bond at 9.44%). Schedule MWC-7 separates SJLP's cost of debt as reflected in Schedule MWC-3 of my Rebuttal Testimony into the cost attributable to debt issued directly by SJLP and that attributable to the assignment of parent company debt pursuant to the methodology I described earlier. As shown in Schedule MWC-7, the cost of the $36.2 million of long-term debt directly issued by SJLP and still outstanding is approximately 8.27%.

Q: Has the issuance of that debt by SJLP ever been deemed imprudent?

A: No.

Q: What is the amount and the cost of the parent company debt assigned to SJLP using the methodology described earlier?

A: As shown in Schedule MWC-7, assigned debt for SJLP totals $134.2 million at a rate of 7.62%.

Q: What impact has the assignment of parent company debt had on SJLP's embedded cost of debt?

A: It has reduced the cost by 51 basis points, i.e., the difference between SJLP's cost of 8.27% for the debt it issued directly and its overall embedded cost of debt at 7.76%.

Q: Does Mr. Gorman express any reservations about, or disagreement with, the assignment methodology used by the Company?

A: No, he does not.

Q: Why hasn't the Company refinanced its debt to lower its costs, as Mr. Gorman suggests?

A: Mr. Gorman's assertion that "refinancing is critical to allow SJLP's customers to benefit from lower capital market costs" *[Gorman Direct Testimony, page 14, lines 8-9]* would be workable only to the extent that the Company would be able to call its debt at no or little premium. Such is not the case with SJLP's debt, where (a) three of the five direct debt issues and one of the four assigned parent issues are non-callable; and (b) one of the direct debt issues and three of the assigned parent debt issues have onerous "make whole" call provisions that render refinancing economically unattractive. The lone remaining direct debt issue, which is callable at a price of 100.5% of par value, carries a coupon rate of 5.85% and therefore would not be an attractive candidate to call.

Q: What embedded debt cost does Mr. Gorman ultimately recommend for SJLP?

A: Mr. Gorman recommends using an embedded cost of debt of 6.83% for SJLP, which is equivalent to the cost of debt requested by MPS in this proceeding (subsequently revised to 6.70% in the September Update, as discussed earlier). He provides no support for this recommendation.

Q: Please summarize your thoughts regarding Mr. Gorman's position with respect to SJLP's cost of debt.

A: The cost of debt requested by SJLP in this case includes debt directly issued by the Company, the prudency of which has never been challenged, and parent company debt assigned using the methodology described earlier, to which Mr. Gorman expresses no objections. Further, Mr. Gorman's view is incorrect that SJLP has opportunities to refinance its debt and lower its effective cost. Mr. Gorman's recommendation to use the MPS cost of debt as a proxy for SJLP in this proceeding is unsubstantiated, lacks merit, and should be rejected by the Commission.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of KCP&L Greater)
Missouri Operations Company to Modify Its) Case No. ER-2009-0090
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 KCP&L Greater Missouri Operations Company.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of KCP&L Greater Missouri Operations Company consisting of ten (10) pages and Schedule~~(s)~~ MWC-7 ~~through~~ ______, 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
Michael W. Cline

Subscribed and sworn before me this 9th day of ~~March~~ April 2009.

Nicole A. Wehry
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

Aquila Missouri
Weighted Average Cost of Debt: SJLP
September 30, 2008, Adjusted for Known & Measurable Changes Through March 31, 2009

SJLP Issued Debt	Effective Rate	SJLP Electric Assigned Debt 3/31/09	Computed Interest on 9/30/08 Assigned Debt	SJLP Electric 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		
9.44% FMB, Due 2/1/2021 Effective Rate 9.487%	9.487%	14,625,000	1,387,474		Debt on SJMOE books - assumes 100% Electric
Sub Total		36,225,000	2,996,820	8.273%	
Assigned Debt					
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		134,171,000	10,220,555	7.618%	
Total		**$ 170,396,000**	**$ 13,217,375**	**7.757%**	