

Exhibit No.:
Issue: Cost of Capital
Witness: Michael W. Cline
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2006-0314
Date Testimony Prepared: October 6, 2006

**MISSOURI PUBLIC SERVICE COMMISSION
CASE NO.: ER-2006-0314**

FILED³

NOV 13 2006

SURREBUTTAL TESTIMONY

Missouri Public
Service Commission

OF

MICHAEL W. CLINE

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

Kansas City, Missouri
October 2006

KCP Exhibit No. 25
Case No(s) ER-2006-0314
Date 10-16-06 Rptr RF

SURREBUTTAL TESTIMONY

OF

MICHAEL W. CLINE

Case No. ER-2006-0314

1 **I. Introduction**

2 **Q. Please state your name and affiliation.**

3 **A. My name is Michael W. Cline. I previously filed Direct and Rebuttal Testimony**
4 **on behalf of Kansas City Power & Light Company ("KCPL" or the "Company")**
5 **in this proceeding.**

6 **Q. What is the purpose of your surrebuttal testimony?**

7 **A. The purposes of my surrebuttal testimony are as follows: (1) To respond to the**
8 **rebuttal testimony filed on September 8, 2006 by Missouri Public Service**
9 **Commission Staff witness Matthew J. Barnes with respect to the relationship**
10 **between rating agency viewpoints and the Company's construction risk profile;**
11 **(2) To respond to the rebuttal testimony filed on September 8, 2006 by**
12 **Richard A. Baudino on behalf of the Office of the Public Counsel with respect to**
13 **the extent to which the amortization mechanism reduces the Company's**
14 **construction risk; and (3) To respond to the rebuttal testimony filed on**
15 **September 8, 2006 by Office of the Public Counsel witness**
16 **Russell W. Trippensee with respect to the proper risk factor to be applied to the**
17 **Company's long-term purchase power contracts.**

18 **Q. Please summarize your comments on Mr. Barnes' rebuttal testimony.**

1 A. In his rebuttal testimony, Mr. Barnes disputes the recommendation in the Direct
2 Testimony of Company witness Dr. Samuel C. Hadaway that a 50 basis point
3 increase in the Company's return on equity ("ROE") is warranted because of the
4 Company's significantly higher construction risk compared to the comparable
5 group. Dr. Hadaway's Surrebuttal Testimony addresses Mr. Barnes' objections,
6 but there is one area of Mr. Barnes' testimony related to rating agency sentiment
7 where additional rebuttal by the Company is necessary.

8 Q. To what area of Mr. Barnes' testimony are you referring?

9 A. In his testimony (page 7, lines 12-15), Mr. Barnes, in response to a question as to
10 whether any risk-reducing mechanisms are in place in the Stipulation and
11 Agreement in Case No. EO-2005-0329, references the "amortization mechanism
12 that allows for additional cash flow to meet certain credit metrics intended to
13 allow the Company the opportunity to maintain an investment grade credit rating
14 during the construction phase." He goes on to cite reports from
15 Standard & Poor's ("S&P") and Moody's that were complimentary of the
16 mechanism. He then concludes at page 8, lines 21-24:

17 "Based on these two reports it is apparent that the two credit rating
18 agencies responded positively to the Stipulation and Agreement and that any risk
19 associated with construction should be mitigated by the use of amortization that
20 allows for additional cash flow to the Company and the opportunity to maintain
21 an investment grade credit rating."
22

23 Based on this conclusion, Mr. Barnes recommends that the Commission ignore
24 Dr. Hadaway's recommendation that KCPL's ROE be increased by 50 basis
25 points due to construction risk.

1 **Q. With what part of Mr. Barnes' testimony do you take issue?**

2 **A.**Mr. Barnes is correct that (1) the amortization mechanism is a means of risk
3 reduction to KCPL during the construction period; and (2) S&P's and Moody's
4 have responded favorably to that mechanism. However, Mr. Barnes uses these
5 premises to categorically disregard Dr. Hadaway's recommendation for an ROE
6 premium based upon increased construction risk. This is incorrect because it fails
7 to recognize (1) the full range of risks to the Company posed by the construction
8 program and the fact that the amortization mechanism provides help only in the
9 area of *credit risk*; and (2) the fact that, despite the rating agencies' favorable
10 responses to the amortization mechanism, neither agency has been willing to view
11 it as eliminating KCPL's relatively higher risk, as evidenced by the agencies'
12 failure to take formal action with respect to the Company's credit ratings and, in
13 S&P's case, the Company's Business Risk Profile since the Stipulation and
14 Agreement was filed in 2005.

15 **Q. What risk does the Amortization mechanism address?**

16 **A.**In my Rebuttal Testimony filed in this proceeding, I indicated that the
17 amortization mechanism is a means of addressing *credit risk* and is therefore
18 focused on bondholders and creditors. It does not, however, mitigate or eliminate
19 other risks to the Company that are critical to *equity investors*, including cost
20 increases, delays, labor shortages, new regulations, and financing, to name but a
21 few. The importance of recognizing the relative risk that this project's scale
22 represents to KCPL, as demonstrated by Dr. Hadaway in his Direct Testimony in
23 this proceeding, is absolutely critical in terms of KCPL's ability to attract equity

1 capital needed to finance construction over the next few years. In competitive
2 capital markets, if investors can get the same rate of return from other utilities
3 facing little or no current construction risk, they have no incentive to provide
4 equity capital to companies like KCPL who need such capital to finance more
5 risky construction projects. The amortization mechanism does not address the
6 concerns of this constituency. KCPL's investors must be compensated for the
7 risks they bear. In this regard, Mr. Barnes' rejection of the Company's requested
8 risk adjustment is unreasonable.

9 **Q. What is your issue with Mr. Barnes' conclusions concerning the rating**
10 **agencies' reaction to the amortization mechanism?**

11 A. While there is no doubt that S&P's and Moody's have responded favorably to the
12 mechanism, Mr. Barnes errs in using this as a basis to reject an ROE increase
13 based on relative construction risk. As stated earlier, though the amortization
14 mechanism is designed to address bondholder and creditor risk, the existence of
15 the mechanism in and of itself has not, to date, resulted in any formal changes to
16 the Company's credit ratings or, in the case of S&P, the Business Risk Profile it
17 assigns to KCPL. Said another way, the rating agencies still recognize that the
18 Company faces a number of risks in completing its construction program and,
19 though taking a positive view of the amortization mechanism, the agencies clearly
20 do not share Mr. Barnes' view that it alone is sufficient to address the full scale of
21 relative risks to the Company. This was evident in a July 2006 conference call
22 with parties to the Company's case in both Missouri and Kansas during which
23 S&P indicated that, while they had been encouraged with the tone of regulatory

1 support and focus on credit quality that had pervaded the development of the
2 Regulatory Plan, they would be watching the outcome of the current case for
3 concrete evidence of that continued support as they re-evaluate the Company's
4 Business Risk Profile and its credit ratings.

5 **Q. Please summarize your comments on Mr. Baudino's rebuttal testimony.**

6 A. In his testimony beginning on page 9, line 12, Mr. Baudino asserts that the
7 Commission should reject Dr. Hadaway's recommended 50 basis point ROE
8 adder for construction risk. Mr. Baudino bases his assertion partially on
9 ("Discounted Cash Flow") DCF issues, which Dr. Hadaway addresses in his
10 Surrebuttal Testimony. Like Mr. Barnes, Mr. Baudino also supports rejecting the
11 adder on the basis that the amortization mechanism in the Stipulation and
12 Agreement is sufficient on its own to mitigate KCPL's risk during the
13 construction program. Although Mr. Baudino indicates, on page 11, line 4,
14 "there are several factors that mitigate risk for the Company," he actually
15 discusses only the amortization mechanism. The points I outlined earlier to refute
16 Mr. Barnes' erroneous conclusions on how the amortization mechanism reduces
17 KCPL's overall construction risk are equally applicable to Mr. Baudino.

18 **Q. Please summarize your comments on Mr. Trippensee's rebuttal testimony.**

19 A. In his testimony beginning on page 3, line 19 and concluding on page 5, line 12,
20 Mr. Trippensee takes the position that a risk factor of 10% should be applied to
21 the Company's long-term purchase power contracts to determine the level of debt
22 attributable to such contracts for credit metric calculation purposes. His basis for
23 this is captured in the following passage (beginning on page 4, line 16):

1 "It is the Public Counsel's belief that the lowest risk factor available
2 within the rating agency methodology should be utilized to determine the debt
3 equivalent value of each off-balance sheet obligation included in the calculation
4 of the amortization. KCPL is a regulated entity providing service to Missourians
5 as a monopoly provider of electric service. Any risk associated with a loss of
6 market share for the services provided, loss of revenue streams, or this
7 Commission's obligation to provide KCPL with an opportunity to earn a
8 reasonable rate of return (i.e., all expense supported by revenue including a
9 reasonable return) is minimal."
10

11 **Q. What is your issue with Mr. Trippensee's position?**

12 A. In our responses to Staff data request nos. 0444 and 0510, the Company has
13 indicated that Standard & Poor's applies a risk factor of 50% to KCPL's long-
14 term purchased power contracts when calculating the Company's credit metrics.
15 Given that fact, and the fact that the very purpose of the amortization mechanism
16 is to ensure that the Company achieves targeted levels for S&P-published credit
17 metrics, the Company believes Mr. Trippensee's position is without merit. If the
18 Commission were to adopt his recommendation, amortization would be
19 determined using a lower level of debt than the level of debt actually used by S&P
20 in determining the Company's credit ratios. This, in turn, would result in the
21 Company failing to meet the thresholds that S&P has established. Mr. Trippensee
22 may have a fundamental disagreement with the logic S&P uses to determine the
23 Company's risk factor (S&P's May 2003 white paper on this topic was part of our
24 response to Staff data request no. 0510), but S&P's position must be accepted as a
25 given in light of what the amortization mechanism is designed to accomplish.

26 **Q. Does this conclude your surrebuttal testimony?**

27 A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of Kansas City)
Power & Light Company to Modify Its Tariff to)
Begin the Implementation of Its Regulatory Plan)

Case No. ER-2006-0314

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 Incorporated and Kansas City Power & Light Company as Treasurer and Chief Risk Officer.

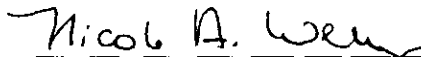
2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Kansas City Power & Light Company consisting of six (6) pages, all of which having been prepared in written form for introduction into evidence in the above-captioned docket.

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 6th day of October 2006.



Notary Public

My commission expires: Feb. 4, 2007

NICOLE A. WEHRY
Notary Public - Notary Seal
STATE OF MISSOURI
Jackson County
My Commission Expires: Feb. 4, 2007