

Exhibit No.:
Issue: Financial Modeling
Additional Amortizations
Accounts Receivable Sales Fees
Witness: Michael W. Cline
Type of Exhibit: Direct Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2007-____
Date Testimony Prepared: January 31, 2007

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2007-____

DIRECT TESTIMONY

OF

MICHAEL W. CLINE

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
January 2007**

**Certain Schedules Attached To This Testimony Designated (“HC”)
Have Been Removed
Pursuant To 4 CSR 240-2.135**

DIRECT TESTIMONY

OF

MICHAEL W. CLINE

Case No. EO-2007-

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"), 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.**

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

1 2001 as Director, Corporate Finance. I was promoted to Assistant Treasurer in
2 November 2002. During 2004, I was assigned to lead the company's Sarbanes-Oxley
3 Act compliance effort on a full-time basis, though I retained the Assistant Treasurer title
4 during that time. I was promoted to Treasurer in April 2005 and added the title of Chief
5 Risk Officer in July 2005.

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

8 A: Yes. In 2006, I provided Direct, Rebuttal, and Surrebuttal testimony into KCPL's
9 Missouri rate case ER-2006-0314 and also testified before the Missouri Public Service
10 Commission related to the aforementioned docket. Also in 2006, I provided Direct and
11 Rebuttal testimony in KCPL's Kansas rate case 06-KCPE-828-RTS. In 2005, I testified
12 before the Missouri Public Service Commission and submitted testimony to the Kansas
13 Corporation Commission concerning KCPL's Regulatory Plan.

14 **Q: What is the purpose of your testimony?**

15 A: My testimony is in two sections. In Section 1, I will do the following: (1) Review the
16 conceptual rationale for, and methodology for determining, Additional Amortizations to
17 maintain KCPL's financial ratios as outlined in the 2005 Regulatory Plan Stipulation and
18 Agreement in Case No. EO-2005-0329; (2) Review the amount of Additional
19 Amortizations authorized by the Commission in its Report and Order in case ER-2006-
20 0314 dated December 21, 2006; (3) Describe the impacts to KCPL of achieving targeted
21 credit metrics through earnings compared to Additional Amortizations; and (4) Describe
22 the amount of Additional Amortizations that KCPL is requesting in this case. In Section

1 2, I will support adjustments related to accounts receivable sales fees as included in
2 Schedule JPW-2 attached to the Direct Testimony of KCPL witness John P. Weisensee.

3 **SECTION 1**

4 **Q: The Regulatory Plan Stipulation and Agreement approved by the Commission in**
5 **August 2005 in Case No. EO-2005-0329 (“Stipulation”) discussed Additional**
6 **Amortizations to maintain financial ratios. Please explain the significance of these**
7 **amortizations and the maintenance of financial ratios for KCPL.**

8 A: The Signatory Parties to the Stipulation agreed that it is imperative that KCPL maintain
9 its debt at an investment grade rating during the implementation period of its
10 Comprehensive Energy Plan (the “Plan”). For its part, KCPL acknowledged its
11 responsibility and commitment to take prudent and reasonable actions to maintain its
12 investment grade rating during this period. The non-KCPL Signatory Parties, in turn,
13 agreed to support the “Additional Amortizations to Maintain Financial Ratios,” (the
14 “Additional Amortizations”) as defined in the Stipulation and related appendices, in
15 KCPL general rate cases filed prior to June 1, 2010. The Signatory Parties agreed that
16 the Additional Amortizations would be an element in any KCPL rate case only when the
17 Missouri jurisdictional revenue requirement in that case fails to satisfy the financial ratios
18 shown in Appendix E of the Stipulation and Agreement through the application of the
19 process illustrated in Appendix F of the Stipulation.

20 **Q: Why is it important for KCPL to maintain investment grade ratings during the**
21 **implementation of the Plan?**

22 A: Maintaining high credit quality at KCPL is vital to debt and equity investors, banks,
23 rating agencies, and ratepayers for three primary reasons. First, KCPL and its parent,

1 Great Plains Energy, will rely extensively on the debt and equity capital markets for
2 financing over the next several years. Total capital expenditures (including Plan-related
3 expenditures and “normal course” capital expenditures) over the 2007-2011 period are
4 expected to exceed \$2.5 billion. Approximately 45% of this amount will need to be
5 raised through issuances of debt by KCPL and equity by Great Plains Energy. Investors
6 will need to have confidence in KCPL’s credit strength and financial wherewithal to feel
7 comfortable making this capital available to KCPL and Great Plains Energy on attractive
8 terms, particularly given competing opportunities for deployment of capital. Second, in
9 addition to new funding required for the Regulatory Plan, KCPL will have a significant
10 amount of debt subject to refinancing during the period of the Plan. KCPL has \$225
11 million of senior notes maturing in March 2007. Further, KCPL has \$257 million of tax-
12 exempt debt that is either subject to remarketing during the Regulatory Plan period or is
13 in a weekly or monthly “auction” mode and essentially refinanced at those intervals.
14 KCPL’s ability to refinance its debt efficiently, effectively, and on favorable terms will
15 be heavily dependent on bondholder and rating agency views of KCPL’s
16 creditworthiness. Finally, the strong financial profile required for an investment grade
17 rating benefits ratepayers by enabling KCPL to (a) attract the capital needed to make
18 infrastructure investments; (b) reduce its interest costs; (c) meet its obligations in a timely
19 fashion; (d) attract and retain a high-quality workforce; and (e) invest in the communities
20 it serves.

21 **Q: What is the purpose of the Additional Amortizations?**

22 A: The 2005 Regulatory Plan Stipulation identified three credit ratios deemed most
23 important to the credit rating agency Standard & Poor’s (“S&P”) in determining a

1 utility's credit quality. These three ratios are: (i) Total Debt to Total Capitalization; (ii)
2 Funds from Operations ("FFO") Interest Coverage; and (iii) FFO as a Percentage of
3 Average Total Debt. The fundamental purpose of the Additional Amortization is to
4 provide a means by which KCPL may achieve an amount of FFO sufficient to sustain
5 levels of ratios (ii) and (iii), above, that are consistent with the low end of the top third of
6 the range for BBB-rated utility companies with an equivalent Business Risk Profile to
7 KCPL, per S&P's guidelines.

8 **Q: Does S&P publish these guidelines?**

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

13 **Q: Has the Business Risk Profile score assigned to KCPL by S&P changed from the**
14 **level used to establish the target ratio levels established in the Stipulation and**
15 **Agreement?**

16 A: No. As evidenced in the most recent credit report issued by S&P on KCPL, dated August
17 1, 2006 (attached as Schedule MWC-3), KCPL's Business Risk Profile remains a "6."
18 As such, the ratio guidelines established in the Stipulation are still applicable to KCPL.

19 **Q: How does the Additional Amortizations mechanism work?**

20 A: The mechanism results in an Additional Amortizations amount being added to KCPL's
21 cost of service in a rate case when the projected cash flows resulting from KCPL's
22 Missouri jurisdictional operations, as determined by the MPSC, fail to meet or exceed the
23 Missouri jurisdictional portion of the low end of the top third of the BBB range shown in

1 Schedule MWC-1 for the FFO Interest Coverage and FFO as a Percentage of Average
2 Total Debt ratios. The amount of Additional Amortizations is the amount needed to
3 achieve that threshold. Any Additional Amortizations granted to KCPL are subsequently
4 treated as an offset to rate base, which reduces rates when they are set by the Commission
5 in the next general rate case.

6 **Q: Did the Commission authorize Additional Amortizations in KCPL's 2006 rate case?**

7 A: Yes. The Report and Order in KCPL's Case No. ER-2006-0314 authorized Additional
8 Amortizations in the amount of \$21.7 million as part of a total rate increase of \$50.6
9 million. The calculation of the Additional Amortizations authorized in that case is shown
10 in the attached Schedule MWC-4.

11 **Q: From KCPL's perspective, is cash flow generated through regulated earnings the
12 same as cash flow generated through Additional Amortizations?**

13 A: No. The key difference is that, as described in the 2005 Regulatory Plan Stipulation,
14 ratepayers receive a rate base offset beginning in the next rate case for any Additional
15 Amortizations authorized. The effect of this is to lower KCPL's revenue requirement in
16 subsequent rate cases.

17 **Q: How does KCPL view allowed return versus Additional Amortizations?**

18 A: KCPL views the availability of Additional Amortizations as critical in supporting our
19 efforts to maintain credit quality during a period of very high capital spending. That
20 being said, the amortization mechanism was not designed as a substitute for fair,
21 traditional cost of service ratemaking. Determination of an appropriate return on equity
22 commensurate with KCPL's risk profile is an essential element of this rate case. In his
23 Direct Testimony in this case, KCPL's witness Dr. Samuel C. Hadaway supports an

1 11.25% return on equity as an appropriate level for the Company. Dr. Hadaway's
2 recommended level of return on equity is independent of the existence of the Additional
3 Amortizations mechanism. Once a fair level of return has been established, the
4 Additional Amortizations mechanism can work as initially contemplated in the
5 Stipulation, i.e., to provide KCPL with an amount of incremental cash flow needed to
6 attain certain key credit ratio thresholds, *to the extent that cash flow provided through*
7 *rate relief is otherwise insufficient for this purpose.*

8 **Q: What is the actual amount of Additional Amortizations for which KCPL is filing in**
9 **this rate case?**

10 A: Based on the various components of KCPL's case, as described in the testimony of
11 numerous witnesses from the Company and experts testifying on the Company's behalf,
12 KCPL estimates that Additional Amortizations in the amount of \$9,284,389 above the
13 \$21.7 million granted in Case No. ER-2006-0314, will be needed to achieve the level of
14 FFO / Debt published in S&P's guidelines, as previously discussed on page 5. Schedule
15 MWC-5 contains the supporting calculations for this amount of Additional
16 Amortizations.

17 SECTION 2

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

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

1 **Q: Briefly explain how the sale of KCPL's accounts receivable is structured.**

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

12 **Q: How are the Accounts Receivable sales fees calculated?**

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

19 **Q: Why are these adjustments necessary?**

20 A: These adjustments are necessary for two reasons. First, accounts receivable sales fees are
21 recorded on the books of KCREC, not KCPL. Therefore, an adjustment is necessary so
22 that test year fees can be included in KCPL's cost of service. Second, an adjustment is

1 necessary to increase the actual 2006 test year bank fees to projected 2007 expenses to
2 reflect revised assumptions.

3 **Q: How were these adjustment determined?**

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

11 **Q: What is the amount of the first adjustment?**

12 A: The adjustment for the total 2006 bank fees is \$3,822,420 and is shown as Adj-9 on the
13 Summary of Adjustments attached to the direct testimony of KCPL witness John P.
14 Weisensee as Schedule JPW-2.

15 **Q: What is the amount of the second adjustment?**

16 A: The adjustment for the incremental increase to projected 2007 bank fees is \$244,886 and
17 is shown as Adj-54 on the Summary of Adjustments attached to the Direct Testimony of
18 KCPL witness John P. Weisensee as Schedule JPW-2.

19 **Q: Does this conclude your testimony?**

20 A: Yes.

