

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**

**SURREBUTTAL TESTIMONY  
OF  
MICHAEL W. CLINE  
ON BEHALF OF  
KANSAS CITY POWER & LIGHT COMPANY**

**Kansas City, Missouri  
October 2006**

**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**

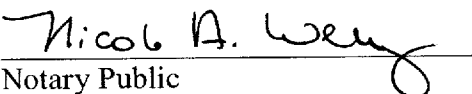
**STATE OF MISSOURI** )  
 ) ss  
**COUNTY OF JACKSON** )

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 6<sup>th</sup> 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