THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company and Westar Energy, Inc. for Approval of the Acquisition of Westar Energy, Inc. by Great Plains Energy Incorporated.	))))))	Docket No. 16-KCPE-593-ACQ

JOINT APPLICANTS' REPLY BRIEF

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I. INTRODUCTION

The record in this matter demonstrates that the proposed acquisition of Westar Energy, Inc. ("Westar") by Great Plains Energy, Incorporated ("GPE"), the parent company of Kansas City Power & Light Company ("KCP&L") (GPE, KCP&L and Westar collectively referred to herein as the "Joint Applicants" and the proposed acquisition as the "Transaction") will promote the public interest. The acquisition will generate substantial efficiencies and savings for utility customers that cannot be achieved by either KCP&L or Westar on a standalone basis or through any other plausible course of action. Indeed, as the record reflects, although merits of such a combination have long been obvious to both KCP&L and Westar and has been tried before, it has finally met the necessary conditions to get it accomplished. Contrary to the posturing and duplicative arguments of certain parties opposing the Transaction, the record establishes that the Transaction will generate long-term benefits for Kansas customers of both utilities while maintaining the utilities' financial integrity and ability to serve the public interest effectively and efficiently. The record also shows that numerous key stakeholders, elected officials and business organizations support the Transaction and believe that it will promote the public interest. *See* Caisley Rebuttal, Schedule CAC-3. Notably, not a single elected official, civic group or business organization has voiced opposition to the Transaction. The Joint Applicants have demonstrated that the Transaction, subject to the conditions set out in Schedule DRI-3 of Mr. Ives' rebuttal testimony (hereafter "DRI-3"), promotes the public interest, meets the requirements of the Commission's Merger Standards and should be approved.

In this Reply Brief, the Joint Applicants will address the main arguments made and repeated by parties in opposition to the Transaction. For the convenience of the Commission, this brief has been organized using the topic headings utilized at the evidentiary hearings. The failure to address any argument in opposition to the Transaction in this brief does not indicate agreement or acquiescence.

II. EXECUTIVE SUMMARY

The proposed Transaction meets the requirements of the Commission's Merger Standards. It will promote the public interest and should therefore be approved. The record demonstrates that the combination and joint operation of KCP&L and Westar under common ownership within the GPE holding company structure will generate savings and benefits for customers that cannot be achieved by Westar or KCP&L on a standalone basis. Over the long term, the combination of GPE and Westar will make each utility stronger – better able to provide high quality, reliable, safe, even more efficient and sufficient electric service. And, while there may be differing views about the precise levels of future savings and the desired level of proof, or the exact timing of their reflection in rates, the record strongly supports the conclusion, and there can be no serious question, that the Transaction will reduce the rate of increase in customer rates over the near- and long-term. Even CURB witness Crane has stated that the Joint Applicants' estimates of savings from the Transaction appear reasonable. *See* Crane Direct at p. 47.

The record shows that both KCP&L and Westar will remain financially strong, investment-grade utilities after the Transaction. And, even though GPE has received a one notch downgrade by one of the ratings agencies, as previously discussed at hearing as likely, GPE remains rated as investment-grade credit in its own right, with no expected degradation of the Westar or KCP&L credit ratings. The strong investment grade utility ratings and the investment grade holding company rating are conducive to GPE being able to support the Transaction financing with the ability to begin reducing its acquisition debt in the near future. The Transaction financing plan is balanced, employing approximately equal amounts of debt and equity. All of the required new financing, all of which has already been successfully raised or committed, will be used to purchase Westar stock from individual Westar shareholders; none of the Transaction financing will be used to finance utility operations at KCP&L and Westar or invest in facilities that serve utility customers. The utilities will continue to be financed by their capital structures in a manner consistent with industry norms and consistent with their remaining very solid investment grade credit. Consequently, each of the utility operating companies' capital structures should be used as the basis for ratemaking in the future, as Joint Applicants' have demonstrated is consistently done for operating utilities of holding companies by regulatory commissions across the country. Conversely, were the Commission to attempt to make rates based on the consolidated capital structure, including the holding company acquisition debt, it is not likely the Transaction could be completed and the transaction benefits produced.

While numerous parties oppose the merger for various reasons and make many of the same or similar arguments, the repetition of the same arguments by multiple parties does not make them deserving of more weight, true, reasonable, or supportive of the public interest. It also should be noted that most of the intervenors in this case intervened to pursue their private individual interests and as such those intervenors' positions indicate their focus on their specific interests, not the long-term effect of the Transaction on the totality of the public interest. As such, none of those intervenors represents the broader public interest that the Commission is charged to protect.

III. THE PUBLIC INTEREST (INCLUDING TRANSACTION OVERVIEW, BUYER/SELLER RATIONALE, KANSAS MERGER STANDARDS AND FUTURE REGULATORY IMPACT)

A. Rationale

The record in this matter strongly supports the strategic basis for the merger – that the combination of two well-performing, familiar (both to each other and to the Commission itself), KCC-jurisdictional utilities, operating jointly and under common control will generate efficiencies that will save customers money. In an era of flat or declining electric sales, in which higher costs necessarily result in higher rates, aging infrastructure and consolidation in the industry, *see* Ruelle Direct at pp. 8-10, bringing KCP&L and Westar together will contain rates and help ensure local control of the utilities and a focus on the needs of Kansas and Kansas electric utility customers. *See* Ruelle Direct at pp. 14-15. And, while the Transaction will undoubtedly produce significant long-term benefits for customers and require only the continuation of longstanding, familiar and widely accepted Commission ratemaking practices to effect those savings for customers, the Transaction has also been structured to place virtually all of the risk on GPE shareholders. *See* Tr. Vol. 1, Ruelle, p. 264.

B. Applicability of the KCC Merger Standards

The Commission has established Merger Standards to judge applications such as the one under consideration in this docket. In this docket, the Commission announced its intention to follow those standards.[1] From past participation in several of the cases in which the Merger Standards were developed, the Joint Applicants are intimately familiar with the Merger Standards, their development and past application by the Commission. The Joint Applicants followed the standards, and previous Commission decisions in applications such as the one under consideration in this docket, in designing their proposal and in presenting it to the Commission. The Transaction meets the requirements of the Merger Standards as they have been developed and appropriately applied over the years.

The Merger Standards themselves are a list of considerations the Commission uses to review and evaluate proposed transactions and by their very nature incorporate the Commission's practices in reviewing and approving past applications. Consequently, they can

[1] Docket No. 16-KCPE-593-ACQ, *Order on Merger Standards* (August 9, 2016).

only be understood and properly applied based on the context of underlying cases in which they were developed and applied over the past two and one-half decades. Therefore, to better understand the standards, the Joint Applicants reviewed both the standards and the cases in which they were developed – the acquisition of Kansas Gas and Electric Company by The Kansas Power and Light Company (the "1991 Merger Order) and the proposed acquisition of Kansas City Power & Light Company by Western Resources, Inc. (the "1999 Merger Order") and subsequently applied in each merger case having come before the Commission. *See* Proctor Rebuttal, *generally*.

Staff suggests that the Joint Applicants have changed their position that the Transaction and their filing in this case conform to the requirements of the Merger Standard. *See* Staff Brief at p. 23. Nothing could be further from the truth. Rather, the Joint Applicants conducted an in-depth review of the cases in which the Merger Standards have been developed and applied and presented the results of that review in Mr. Proctor's testimony. Mr. Proctor's review of the precedent makes clear that certain portions of the Merger Standards – most notably Merger Standards (a)(ii) and (a)(iv) – are not applicable in a transaction such as the current case in which recovery of the acquisition premium in rates is not sought because Merger Standards (a)(ii) and (a)(iv) have been used to determine the amount of acquisition premium that would be allowed rate recovery. This conclusion is dictated by logic as well, since Merger Standards (a)(ii) and (a)(iv) assess the purchase price and acquisition premium in terms of the effect of the transaction on customers and when, as is the case in this Transaction, no rate recovery of the acquisition premium is requested, there is no effect on customers. However, contrary to assertions of both Staff and KEPCo, Joint Applicants have not argued that either the purchase price or acquisition premium is irrelevant to the Commission's review under the Merger Standards. Rather, as Mr.

Proctor stated in his rebuttal testimony, in a case such as this, Merger Standard (a)(i) – which addresses the financial condition of the post-Transaction entities – provides the vehicle for review of effect of the purchase price and acquisition premium. *See* Proctor Direct at pp. 18-19. The conclusion that certain provisions of the Merger Standards do not apply in the unique circumstances of this case does not indicate a deviation from the standard any more than Staff's conclusion that the acquisition of Empire District Electric Company passed the Merger Standards despite the lack of significant synergies or operating cost savings as a result of the Transaction.[2] It is clear, therefore, that Joint Applicants have adhered to the Merger Standards as they have been applied by the Commission in previous cases.

The record in this case demonstrates that the Transaction is in the public interest as evaluated under the Merger Standards. As will be discussed in further detail in this brief, the Transaction will generate substantial savings that would not exist absent the merger, the purchase price, when evaluated in proper context, is in line with prices and premiums paid in transactions approved by this and other regulatory commissions, the Transaction will generate long-term benefits for customers while shielding utility customers from financial risks associated with holding company financing, and the Transaction will advance public safety, environmental stewardship, economic development and other interests while ensuring that rates for electric service remain just and reasonable.

Based on Staff witness Scott Hempling's review of the Proxy Statement filed in connection with the Transaction, Staff asserts that obtaining the highest purchase price – with no regard for customer benefit – was Westar's motivation for entering the Transaction, Staff Brief,

[2] *See Re Joint Application of The Empire District Electric Company, et al.*, Order Granting Joint Motion to Approve the Unanimous Settlement Agreement and Approval of the Joint Application, at ¶¶ 34, 38 (December 22, 2016).

at 30, contrary to explicit statements to the contrary in that very Proxy Statement. Ruelle Rebuttal, at pp. 20-21. However, Mr. Hempling's interpretation of the Proxy was colored by his failure to recognize the purpose of the document. As Mr. Reed testified, it is not surprising that the Proxy focuses on the value of the Transaction to shareholders. Reed Rebuttal at p. 30. As he explained:

> A proxy statement is a ***letter to shareholders*** asking for their vote on an issue that requires shareholder approval; the proxy statement focuses on how the shareholder will be affected by the proposed action. . . . Consequently, ***by their very nature, both focus on benefits to shareholders*** whose votes are being solicited and whose interests are the objects of protections.

Id. (***emphasis added***).

Mr. Hempling's one-sided view of the GPE Proxy was further undercut during his cross-examination through the introduction of the proxy, *see* Joint Applicants' Exhibit 5, that was issued in support of the acquisition of Empire District Electric Company by Algonquin Power and Utilities – a transaction recently approved by the Commission. As in the GPE Proxy, the Empire Proxy contains a section entitled "Background of the Merger" which discusses the process used to arrive at a price for Empire. That section of the Empire Proxy is strikingly similar to the "Background of the Merger" section of the GPE Proxy– with the exception that, unlike the GPE Proxy which mentions customer impacts of the Transaction numerous times, the Empire Proxy contains no indication that Empire's board gave any consideration to impacts of the acquisition by Algonquin on customers. *See* Joint Applicants' Exhibit 5; Ruelle Rebuttal, pp. 20-21.

In its brief, Staff contends that it applied the Merger Standards "as reaffirmed in the Commission's August 9, 2016 Order on Merger Standards . . . ." *See* Staff Brief at ¶ 67. In making this assertion, Staff contends that its witness Scott Hempling merely "provides areas in which the Commission may articulate guidance on future mergers in light of the "new merger paradigm" he envisions. *Id.* Staff's characterization of Mr. Hempling testimony – suggesting that it did not provide a basis for diverging from the Commission's historic approach – directly contradicts Mr. Hempling's testimony in which he asserted that the Commission's Merger Standards suffer a "gap" that his approach would eliminate. *See, e.g.*, Hempling Direct, at p. 11; Tr. Vol 2, Hempling, at p. 511; Joint Applicants' Exhibit 8. In fact, Staff's case relied heavily on Mr. Hempling's unorthodox theories and musings which, by his own admission, have never been accepted by any other regulatory Commission. *See* Tr. Vol. 2, Hempling, at pp. 511-12; Joint Applicants' Exhibits 8 and 9. And by Mr. Hempling's own assessment, were the Commission to adopt his approach, the Commission would likely suffer a "reputational hit" from being perceived as changing its policies. *See* Tr. Vol. 2, Hempling, at p. 494; Joint Applicants' Exhibit 4.

Contrary to the suggestion in Staff's brief that Mr. Hempling's testimony was merely forward-looking and did not provide analysis of the Transaction, Mr. Hempling himself testified that his testimony addressed the Transaction's compliance with Merger Standards (a)(ii), (a)(iii), (a)(iv), (a)(v), (d) and (g). *See* Hempling Direct at p. 8. Moreover, by his own admission, Mr. Hempling's testimony applied the standards differently than the Commission has in the past (*See* Joint Applicants' Exhibit 4, Tr. Vol. 2, Hempling, at p. 494), and "did not feel particularly bound by anything other than the statute and the Commission's general criteria that it puts in its guidance document."[3] And the fact that Mr. Hempling would apply the Merger Standards

[3] Thus, Mr. Hempling testified that he did not feel particularly constrained by the Merger Standards. As he put it, when he read prior merger decisions of the Commission: ". . . other than a list of criteria that are in the Commission's merger guidelines, I, I saw an openness because of the public interest standard to articulate what guidance would be for the Commission, ***so I did not feel particularly bound by anything other than the statute and***

differently than the Commission's past practice was no surprise to Staff, even after Staff failed to offer new suggested standards upon the Commission's earlier invitation for parties to do so. As Mr. Hempling testified:

> Q. (By Mr. Bregman): Prior to the filing of your testimony in this case, did you discuss with the Staff that you were going to apply the Merger Standards differently than the Commission Staff's practice?
>
> A. (By Mr. Hempling): I think that's why they called me. My recollection is that the first contact was a phone call from Mr. Gatewood who said he'd read my testimony in the Central Louisiana case and that the Staff was interested in discussing the principles that articulated in that prefiled testimony, so ***the notion that I was going to present ideas that the Commission had not seen before and adopted before was central to the relationship that Staff chose to enter into with me***.

See Tr. Vol. 2, Hempling, at p. 495 (***emphasis added***). The impact of Mr. Hempling's deviation from the Commission's past application of the Merger Standards is evident throughout Staff's testimony and brief. Thus, Staff witnesses adopted Mr. Hempling's unconventional view that the "control premium" portion[4] of the acquisition premium ought to be allocated to customers and should somehow be used to confer the equivalent of an ownership interest to customers in the Transaction. *See* Grady Direct at pp. 8, 67. Staff relied on his mischaracterization of the acquisition premium, a gain on the shareholders' sale of their shares, as analogous to a gain on the sale of a utility asset previously in rate base. *See* Grady Direct at pp. 81-84. Echoing Mr. Hempling's unsupported testimony that but for alleged conflicts between utility management and customers, Westar should have been willing to merge with no

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the Commission's general criteria that it puts in its guidance document." *See* Tr. Vol. 2, Hempling, at p. 491 (***emphasis added***).

[4] The Joint Applicants have found no cases in which the Commission has used the concept of "control premium" in any previous electric utility merger proceeding.

premium being paid (*see* Hempling Direct at p. 29, and n. 59), and despite Mr. Hempling's admission that he is unaware of any utility merger having been being effectuated without a premium. *See* Tr. Vol 2, Hempling, at p. 517; Joint Applicants Exhibit 13. Staff erroneously argued in its brief that Westar should have been willing to enter into a transaction with any premium no matter how small. *See* Tr. Vol 2, Hempling, at p. 517; Joint Applicants Exhibit 13. Finally, based on Mr. Hempling's testimony (*See*, Hempling Direct at pp. 87-99), Staff rejected the Joint Applicants' quantification of benefits despite the fact that it was developed using precisely the same methods that have been accepted in prior cases.[5] In fact, Staff rejected the Joint Applicants' savings estimates in part because of an alleged lack of "commitments" to the savings by the Joint Applicants despite Mr. Hempling's admission "that the Commission has not required commitments to savings as a prerequisite for counting savings" in past cases. *See* Hempling Direct at p. 94.

C. <u>Satisfaction of the KCC Merger Standards</u>

Had Staff followed an approach in line with past practice under the Merger Standards rather than one based on "ideas that the Commission had not seen before and adopted before," (*See* Tr. Vol. 2, Hempling, at p. 495) Staff would have concluded that the Transaction promotes the public interest and should be approved.

As the Joint Applicants pointed out in their filing and testimony, the approach to sharing of savings between customers and shareholder is simple and self-implementing. Realized savings will be returned to customers through the normal ratemaking process. Between rate cases, which by virtue of savings produced by the Transaction will be less frequent and of

[5] Unlike Staff, CURB witness Andrea Crane stated that she was "persuaded that the Company's testimony and financial modeling of savings estimates are reasonably quantified . . . at this point in the merger process." Crane Direct, at p. 47.

smaller magnitude than absent the Transaction, the Joint Applicants will retain savings only temporarily through regulatory lag. There will be no need to track savings or amortize the acquisition premium. GPE will bear all risk associated with financing the Transaction.

In contrast to the simple, direct approach proposed by the Joint Applicants, Walmart – alone among the parties to this case – proposes a mechanism to track savings and implement a rider that would credit all savings above "approved transition costs" to customers through 2020. *See* Walmart Brief at pp. 2-3. Walmart's proposal should be rejected. Setting aside for a moment the difficulty of tracking savings, it must be noted that Walmart's proposal is a one-sided arrangement that would immediately recognize savings from the Transaction and flow them to customers even as the utilities absorb increases in costs across their operations.

Additionally, the introduction of an administratively complex requirement that the Joint Applicants track and Staff audit merger savings is precisely the type of inefficient and unduly burdensome exercise that caused the Joint Applicants to develop a more efficient approach that maintains its incentive to aggressively pursue savings and then pass them on to customers within a clearly delineated time frame. While tracking mechanisms have been used in the past, the result was a time-consuming and controversial process that dragged on for years. *See* Ruelle Direct at p. 26. Staff witness McClanahan agreed that Staff has shied away from the tracking of merger savings due to this complexity. Tr. Vol. 2, McClanahan, at pp. 468-469. Moreover, the implementation of a rider to track and direct all savings to customers between rate cases would eliminate any benefit of the merger to GPE shareholders and unfairly redirect cash flows that would otherwise be used to support the financing related to the Transaction. *See* Bryant Rebuttal at p. 21. The creation of a rider designed to give merger savings that are generated between rate cases to customers would be *inconsistent* with past Commission orders that have uniformly allowed merging companies to retain savings between rate cases to offset transaction costs. *See, e.g.*, 1999 Merger Order, at ¶ 31.

D. <u>Merger Standard (d) – "Whether the proposed transaction will preserve the jurisdiction of the KCC and the capacity of the KCC to effectively regulate and audit public utility operations in the state."</u>

Contrary to assertions by Staff and the Kansas City, Kansas Board of Public Utilities ("BPU"), the Transaction will not affect the Commission's ability to regulate and audit KCP&L and Westar.

BPU incorrectly argues that the Transaction will affect the Commission's ability to regulate KCP&L and Westar due to concerns over the impacts on the financial condition of GPE. *See* BPU Brief at pp. 16-29. Staff and other intervenors, make this argument also. They are wrong.

First, the Transaction will not change the status of KCP&L or Westar as KCC-jurisdictional utilities in any way. Both will continue to be pervasively regulated by the Commission under Chapter 66 of the Kansas Statutes. Their relationship with GPE will be subject to the Kansas Holding Company Act, K.S.A. 66-1401, *et seq*. The Commission has broad authority under the Kansas Holding Company Act and Chapter 66 generally to prevent any potential financial distress at GPE from negatively affecting Kansas utility customers. These facts are entirely unchanged by the merger. History shows the prior willingness and ability of the Commission to do so. *See* Ruelle Direct at pp. 25-27.

Second, while both Westar and KCP&L will continue to be capitalized as they are today and continue to enjoy their strong investment grade ratings, GPE will also be financially sound after the Transaction and will take steps to delever, and reduce its financial risk post-Transaction. As the record shows, after the Transaction, GPE is also expected to continue to have investment-grade ratings from both major rating agencies. Bryant Rebuttal at p. 7. In fact, the debt issuance for the Transaction was successfully completed on March 6, 2017 and GPE maintained its investment-grade rating despite having issued all of the required debt financing for the Transaction. Additionally, GPE will be able to substantially reduce its debt in the first five years following the Transaction. Mr. Bryant stated:

> …the Transaction-related net free cash flows are projected to be nearly $500 million in the first full five years following closing of the Transaction and will enable GPE to reduce its debt by just over 11%. This is accomplished while maintaining balanced capital structures at Westar and KCP&L.

See Bryant Rebuttal at p. 21.

While the actual amount that is paid down in the first five years may end up being different from the amount Mr. Bryant identified, and the sources may be different than he assumed at the time of hearing, the evidence establishes that there will be cash flows from which substantial debt reduction will occur.

Third, the Joint Applicants have agreed to a comprehensive set of commitments concerning the relationship between the utility operating companies and GPE that are set out in their Proffered Merger Commitments and Conditions in Schedule DRI-3. Because of the commitments being made by the Joint Applicants, all of the transactions between the utility operating companies and GPE will be transparent and auditable by the Commission. The ring-fencing provisions proposed by the Joint Applicants are extensive and will effectively insulate the utility operating companies from any financial difficulties that GPE might encounter. Tr. Vol. 3, Reed, at pp. 568-69. Ring-fencing is more specifically addressed in Section IV.C. of this Reply Brief.

The arguments of Staff and intervenors that this Transaction will negatively impact the Commission's ability to regulate are all based on the premise that the Commission will not appropriately and assertively exercise its power and authority to protect utility customers. This is not true, is contrary to how the Commission has acted historically and it is certainly within the Commission's power to make sure it does not happen.

IV. FINANCIAL ISSUES (INCLUDING CAPITAL STRUCTURE, TREATMENT OF GAIN ON SALE, ACQUISITION PREMIUM, REASONABLENESS OF PURCHASE PRICE, AND FINANCIAL IMPACTS ON UTILITIES, GPE AND SHAREHOLDERS)

A. Effect of the Merger on the Financial Condition of the Companies

1. Staff

a. Impact of the Purchase Price on GPE, KCP&L and Westar.

Staff argues that the price of this Transaction causes undue financial risk for GPE and its subsidiaries. *See* Staff Brief at p. 32. Staff refers to select statements made at hearing by Mr. Ruelle about GPE's size and his early perceptions regarding GPE's potential ability to finance the Transaction which were made long before GPE was able to present an effective plan to do so, and Mr. Bryant's candid comment that the Transaction is a stretch for GPE, implying such statements are somehow proof of GPE's inability to accomplish the financing steps necessary to close and support the Transaction. *See* Staff Brief at pp. 32-33. On the contrary, by the time of hearing, GPE had already completed the equity portion of the financing, and on March 6, 2017, GPE completed the debt portion, obtaining terms for the debt even more favorable than those used as inputs to its financial modeling.[6] To be clear, sophisticated investors who make their living evaluating potential investments and their associated risks voted a resounding "yes," as both debt and equity transactions were substantially oversubscribed, meaning, both equity and debt investors sought more of the offered securities than GPE needed to sell to effect the Transaction. And so long as the Commission adopts reasonable and fair regulatory policies that are consistent with past practices – something Joint Applicants relied

[6] Joint Applicants' Motion to Reopen the Record, filed March 8, 2017.

upon in evaluating their ability to accomplish the Transaction – then GPE can successfully meet its future obligations to its creditors and shareholders and reducing its acquisition debt in a reasonable time, while ensuring the ability of its subsidiary utilities to provide sufficient and efficient service to customers.

Joint Applicants have not claimed that there is no link between GPE and its subsidiaries. That is why the ring-fencing conditions proposed in DRI-3 are appropriate. They will protect utility customers from risks associated with GPE's Transaction debt. It is not necessary, as Staff argues, to unlink credit ratings in order to adequately protect customers. *See* Staff Brief at p. 42. Staff's position is extreme and inconsistent with how utility transactions are reviewed and approved by other commissions. *See* Reed Rebuttal at pp. 11, 97. Staff would cause the Transaction to fail by insisting upon a separation of the Companies that does not need to occur. Staff alleges that, "[t]rue ring-fencing that allows the utilities to become financially autonomous and insulated from holding company financial risk would result in unlinked credit ratings." *See* Staff Brief at p. 42. To support this assertion, Staff cites only to the testimony of its own witness, Mr. Gatewood, and the prefiled direct testimony of KEPCo witness, Dr. David Dismukes. However, the testimony of Dr. Dismukes to which Staff cites does not assert that true ring-fencing results in unlinked credit ratings, as Staff represents in its Brief. It also is not addressing the ring-fencing measures set out in Schedule DRI-3, as those were proposed later in Joint Applicants' rebuttal testimony. It bears noting, however, that the conditions contained in Schedule DRI-3 were developed using Dr. Dismukes' proposals from his direct testimony. *See* Ives Rebuttal at p. 41.

b. <u>Credit Ratings.</u>

Staff speculates that, absent the Transaction, Westar would likely be on the verge of receiving the benefits of higher debt ratings and lower interest costs prior to the announcement of this transaction. Staff then further surmises that such benefit has been sacrificed in favor of the financial risk taken on by GPE in order to meet Westar's demand for a larger and larger premium, without any guarantee of customer benefits. *See* Staff Brief at p. 39. Staff provides no evidence to support its speculation and conclusion. The rating agencies have clear means of expressing their intent related to future sentiments, with a tool called a "credit watch." A "positive credit watch" would signal a likely upgrade in the near future. But Staff's Exhibit 6, which is the June 2, 2016 Moody's Report, says Westar's outlook is "stable", which means no expected change – up or down. Westar had no positive credit watch prior to the Transaction.

Staff cites to Mr. Hevert's testimony at hearing as if it supports Staff's claim that there will be negative ratings pressure at the utility. *See* Footnote 171 of Staff Brief at p. 40. However, a review of the cited portion of the transcript shows that Mr. Hevert specifically stated, "I also would not conclude from this that Moody's is saying but for the transaction it would be upgraded, it being Westar." *See* Tr. Vol. 4, Hevert, at p. 853. Obviously, this is not testimony supporting Staff's claim that Westar was on the verge of receiving a credit upgrade, and any arguments made by Staff based upon such an assertion should be disregarded by the Commission.

Staff also argues that the Moody's report did not contemplate insulating ring-fencing conditions. *See* Staff Brief at p. 40. It is true the initial written report did not mention all of the financial conditions set out in Schedule DRI-3 because those conditions were not yet part of the anticipated structure. However, Staff is fully aware that GPE discussed the ring-fencing conditions as proposed in Schedule DRI-3 with Moody's and confirmed that the addition of those conditions in this case would not result in a downgrade. *See* Tr. Vol. 3, Bryant, at p. 742.

Further, Staff states that Mr. Bassham testified at hearing that the financial commitments Joint Applicants support in this proceeding "do not classify as the type of ring-fencing contemplated by Moody's opinion," which Staff then interprets as meaning the ring-fencing proposed by Joint Applicants is "not the type of ring-fencing protections that would provide true separation and insulation for Westar from GPE's financial risks".[7] That is not at all what Mr. Bassham said.

Mr. Bassham was being questioned about Appendix A of BPU Exhibit 4, which is the May 12, 2016 letter from Moody's. Appendix A lists the assumptions used in the assessment, and Mr. Bassham was asked about the one that states "[n]o ring-fencing type provisions are introduced that would significantly limit the upstream dividend capabilities of Westar or the Great Plans utilities". *See* Tr. Vol. 1, Bassham, at pp. 111-112. Staff's "restatement" of Mr. Bassham's answer is incorrect. His testimony is not the equivalent of saying the proposed ring-fencing conditions would not provide true separation and insulation for the financial risks. Staff goes beyond taking liberties in its interpretation of Mr. Bassham's testimony, to the point of completely misrepresenting what was said. *See* Tr. Vol. 1, Bassham, at p. 111-113. Staff's Brief also fails to make clear that Mr. Bassham was being questioned about Moody's May 12, 2016 letter, which did not address the extensive ring-fencing conditions contained in Schedule DRI-3.

In fact, the Schedule DRI-3 financial conditions do restrict the companies' ability to pay dividends. Condition 14.v. states that the utility shall not pay a common dividend without Commission approval if its affiliation with GPE or any other GPE affiliate causes its rating to be

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[7] *See* Staff Brief, p. 40 states – "Notably, Joint Applicants stated at the hearing that the financial commitments they support in this proceeding do not classify as the type of ring-fencing contemplated by Moody's opinion; ***in other words,*** not the type of ring-fencing protections that would provide true separation and insulation for Westar from GPE's financial risks." (***emphasis added***)

downgraded to below BBB- or Baa3. *See* Schedule DRI-3 at p. 7. This is in addition to the Commission's already existing statutory authority to restrict dividends.[8]

Similarly, Staff cites to the testimony of Mr. Bryant to support its assertion that the ring-fencing proposed by Joint Applicants is "not the type of ring-fencing protections that would provide true separation and insulation for Westar from GPE's financial risks." Mr. Bryant's actual testimony cited to by Staff reads as follows:

> Q: (By Staff Counsel) Earlier I had asked Mr. Reed, and he deferred to you, so I will ask you, the Joint Applicants have represented that they have vetted the ring fencing conditions as proposed in rebuttal with the credit rating agencies, is that correct?
>
> A: (Mr. Bryant) That's correct.
>
> Q: And the response that Mr. Reed represented was that the credit agencies were fine with that?
>
> A: Correct.
>
> Q: It would not bring about a downgrade, is that correct?
>
> A: It wouldn't create a negative credit event.

See Tr. Vol.3, Bryant, at p. 742.

Clearly, this testimony does not support the argument Staff is putting forth. The agency's statement that the ring-fencing conditions would not create a negative credit event does not equate to them finding that the conditions do not provide true separation and insulation for Westar from GPE's financial status. In fact, Staff's argument is directly contrary to the testimony and evidence presented in the case. The ring-fencing conditions contained in Schedule

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[8] *See* K.S.A. 66-1214.

DRI-3 are extensive, effective and consistent with conditions adopted by other commissions across the country in similar utility company transactions. *See* Reed Rebuttal at pp. 11, 97.

Staff's use of the credit rating agencies' reports involves pulling snippets out and presenting them individually and out of context as proof of whatever calamity Staff is claiming could happen. Staff ignores the positive analyses in those same reports supportive of the Transaction. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 35, 81. Staff also fails to recognize that financial conditions and plans at a company are fluid and will change, sometimes daily, as economic, market and industry conditions change. Management must plan accordingly and respond as necessary. It is unrealistic for Staff to expect otherwise, and it is unreasonable to insinuate that changes in one underlying assumption or factor considered by the ratings agencies would impact the overall opinion without impacting other underlying considerations in the analysis. For example, the Moody's report assumed a 4.5% coupon on the $4.4 billion of Transaction debt,[9] but the actual percentage resulting from the issuance came in at a weighted average interest rate of 3.68%.[10] This extremely positive change – representing $36 million per year in interest savings – in an underlying assumption[11] would impact various aspects of the rating agencies' analysis, something ignored by Staff when it points out a difference in one factor underlying an analysis while assuming the remaining factors, and the analyst's subjective considerations, remain unchanged.

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9 *See* Tr. Vol. 5. Gatewood, p. 1165 – Mr. Gatewood reviews the assumptions in the Moody report.

10 *See* Joint Applicants' Motion to Reopen the Record, p. 2.

11 The difference between 3.68% and 4.5% in interest expense on $4.4 billion is approximately $36 million a year. Over the weighted average maturity of 12.1 years, that is reduced interest expense of approximately $437 million. Additionally, the favorable terms extended to GPE by creditors, and the fact that the order book finished approximately 5.8x times oversubscribed with nearly $25 billion of orders from numerous recognizable, high quality participants, would also be expected to positively impact the rating agencies' analyses. (*See* Joint Applicants' Motion to Reopen the Record, p. 2.)

The credit agency reports must be considered in their entirety. Most important is their overall conclusions reached after balancing the risks with the benefits of the Transaction. Moody's and S&P both concluded the Transaction would not result in a credit downgrade for KCP&L or Westar, and S&P determined there would be no downgrade at GPE, as well.

c. Debt Reduction Plans.

Staff argues that GPE has no written plan to reduce debt so the new $4.3 billion in debt is likely permanent.[12] Staff seems to assume that, absent a written debt reduction plan, no debt reduction will occur. On the contrary, as Mr. Bryant explained, he works on such a plan every day. *See* Tr. Vol. 3, Bryant, at pp. 772-773. A "plan" to reduce debt must consider and evaluate facts and market conditions, all of which are constantly changing. Staff's expectation of a written, static "plan" reflects the fact that Staff has no practical experience in executing the financial operations of a company like GPE; it does not prove there is some shortcoming in GPE's business plans. Mr. Bryant explained the sources of cash flow available to GPE for meeting its obligations, including significant cost savings related to the acquisition, reductions in overall dividend payments, conversion of preferred stock to common after three years, and the use of non-regulated net operating loss carry-forwards. *See* Bryant Direct at pp. 15-17; Bryant Supplemental at p. 7. In rebuttal testimony, Mr. Bryant responded more specifically to Staff's concern by demonstrating how Transaction-related net free cash-flows could use to reduce

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[12] *See* Staff Brief, pp. 35-36.

In ¶ 93, Staff makes the statement that the Commission should not give any weight to Joint Applicants' assertion that it has the ability to pay down transaction-related debt within three-to-five years, citing to the testimony of Mr. Robert Hevert to support their assertion. Footnote 154 of Staff's Brief states, "[F]or additional discussion of the permanent nature of GPE's new debt, see Tr. Vol. 4, pp. 893-895." This testimony at hearing of Mr. Hevert does not, in any way, support Staff's arguments regarding GPE's ability to pay-down debt or Staff's claim the debt should be considered permanent. In fact, Mr. Hevert's testimony on cross-examination cited by Staff affirms Mr. Bryant's testimony that the Company does not need a written plan to deleverage, that he expects the Company would deleverage, and his belief that it is not proper to assume the debt will be permanent as Staff has speculated.

Transaction debt by 11% in the first full five years following the closing of the Transaction. *See* Bryant Rebuttal at pp. 20-23. Even though there will also be dividends from GPE's other utility subsidiaries as well, through this specific illustration, Mr. Bryant focused solely on Westar by including in his projections an amount representing dividends from only Westar from 2018 through 2022, and an amount representing retained merger-savings. *See* Bryant Rebuttal at p. 22. In response to Mr. Bryant's testimony on projected net Transaction-related cash-flows for paying down debt, Staff attempted to undermine his projections by showing there were some discrepancies in the amounts included in Mr. Bryant's example and earlier representations presented to the ratings agencies regarding dividend payments and growth. *See* Tr. Vol. 3, Bryant, at pp. 724, 730. Staff proposed hypotheticals resulting in negative Transaction-related net cash flows. *See* Tr. Vol. 3, Bryant, at pp. 726-736. Staff did not consider that some of Mr. Bryant's assumptions could also turn out to be different than what was presented, in a way that increases the cash flow available to pay debt. For example, the substantially lower interest rate actually paid for the Transaction-related debt issued March 6, 2017, the extension of the estimated average maturity from seven (7) years to over twelve (12) years, and the positive cash settlement from the interest rate hedges that allowed for a reduction of $100 million in total long-term debt versus amounts originally anticipated.

Ultimately, Staff argues that the only analysis put on the record by Joint Applicants that addresses GPE's ability to pay down its Transaction-related debt in the years following the Transaction shows only a small portion of the debt will be retired. *See* Staff Brief at p. 35. Joint Applicants do not agree that paying down $400-500 million of debt over just the initial five-year period is a "small portion".

While Staff never questions GPE's ability to *support* Transaction financing, given its obvious ability to do so as reinforced by the rating agencies, Staff has chosen to narrow-mindedly only argue that there will be insufficient cash flow to *pay off* the first debt maturity obligation of $750 million in year three following the close of the Transaction. *Id.* Contrary to this narrow view and based upon the projections of Mr. Bryant, a major portion of this debt can indeed be paid down before it matures in 2020, leaving an amount that will need to be refinanced. However, refinancing a lower amount of debt is positive for GPE's credit profile and is a routine occurrence for companies such as GPE and the prospect should not cause the Commission concern for two primary reasons. First, only GPE and its shareholders will be at risk for future refinancing of Transaction debt. The Commission has control in that regard, and can adopt the proposed ring-fencing conditions contained in Schedule DRI-3 to assist it in ensuring customer rates are not impacted by this risk.

Second, Staff fails to cite to any evidence in the record for its assertion that "expert financial and economic forecasters lending to credit rating agencies' opinion, logic [*sic*] suggests that interest rates will likely go up." Even if it were true, the timing of future interest rate increases is unknown and cannot be assumed to be prior to the maturity of GPE's first Transaction-related portion of debt. And, even so, it would only impact GPE's ability to pay down debt with no intervenor suggesting any impact on GPE's ability to support the debt and existing credit ratings. No weight should be placed on Staff's argument for these reasons.

Staff repeatedly expresses its postulations that the combination of GPE Transaction debt and uncertainty about debt reduction and future refinancing of such debt results in the likelihood of credit rating downgrades at GPE and the utility subsidiaries. *See* Staff Brief at pp. 34, 38. Operating a business – including a regulated utility business – does not mandate paralysis to avoid all risks. It requires the company's leadership team to act prudently and to actively and appropriately engage in risk-management so that the benefits of transactions such as this one can be achieved for customers and shareholders while limiting the risk to the appropriate party. *See* Tr. Vol. 1, Ruelle, at pp. 263-264. Joint Applicants have done this by structuring the Transaction so that Goodwill will be kept only on GPE's books, by not requesting recovery of AP in future revenue requirements, and by proposing the ring fencing conditions in Schedule DRI-3 designed to protect customers from any costs associated with risks more appropriately borne by shareholders.

Without providing a citation to the record, Staff asserts that "it is the presence of captive ratepayers that makes the capital markets willing to finance this Transaction to begin with." *See* Staff Brief at p. 34. This statement is unfounded and untrue. It dramatically over-simplifies the extensive research and analyses done by creditors prior to extending debt to utility companies, and their holding company parents and it assumes the Commission will fail to exercise its broad powers to meet its obligation to set future rates that are just and reasonable. The Commission has not displayed such bashfulness or dereliction of duty in the past, and neither Joint Applicants nor their creditors expect that to happen in the future. *See* Tr. Vol. 1, Ruelle, at pp. 265-66.

2. Intervenors

Kansas Industrial Consumers ("KIC") speculate that the credit ratings of the subsidiary utilities "could" be restrained by the lower credit rating of GPE, which presents the "potential" for a higher cost of capital at the subsidiary level, which could lead to "potentially higher electric rates." *See* KIC Brief at p. 13. KIC argues that GPE fails to give appropriate weight to the fact that a potential downgrade of GPE could restrain the credit ratings of subsidiary utilities.[13] GPE fully acknowledged in testimony and at hearing that its subsidiaries' credit ratings were linked to GPE's rating. However, the evidence showed that the financing of the Transaction is not expected to result in a downgrade to the utility companies' ratings, and, in fact, there was no such downgrade in response to GPE's issuance of the Transaction debt on March 6, 2017.[14]

KIC's conjecture that the Transaction could lead to higher electric rates fails to consider the fact that Joint Applicants have made commitments to ensure this cannot occur and ignores the benefit of merger savings that will inure to customers. Commitment 14 of Schedule DRI-3 specifically states that, in the event KCP&L or Westar receive a downgrade to below BBB- or Baa3, they will, among other obligations, (1) provide the Commission with documentation detailing how the impacted utility would not request from Kansas customers any higher capital costs incurred due to the downgrade, and (2) stop common dividend payments from the impacted utility until the credit rating had been restored unless the Commission would order otherwise. Commitment 15 of Schedule DRI-3 prohibits KCP&L and Westar from seeking an increase to their cost of capital as a result of the Transaction or their ongoing affiliation with GPE, and requires them to document in future rate cases that any increases in their cost of capital were not related to the affiliation with GPE or changes in their risk profiles related to the Transaction. Commitments 22, 23 and 24 of that schedule provide that the utilities' fuel, purchased power costs, retail rates and future ROEs should not be adversely impacted as a result of the Transaction.

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[13] KIC makes a vague reference to the impact of the Transaction on future potential credit upgrades at the utility companies, but does not go so far as to argue there was evidence such upgrades had any likelihood of occurring absent the Transaction. (*See* KIC Brief, pp. 12-13.)

[14] Notice of the actual terms of the March 6, 2017 Transaction debt issuance was provided to the Commission in Joint Applicants' Motion to Reopen the Record filed March 8, 2017.

When the record is considered in its entirety, it clearly does not support KIC's claim that the Transaction could "potentially" result in higher electric rates.

3. Other Intervenors

CURB's arguments on Merger Standard (a)(i) are essentially the same as Staff's and have been refuted above. *See* CURB Brief at pp. 7-15. Like Staff, CURB believes the purchase price is too high, even though it is the result of an open auction process, it has been analyzed and supported by Goldman Sachs and Guggenheim, and GPE's shareholders have found it to be not just reasonable, but advantageous.[15] CURB is not better positioned than these interested parties to judge the purchase price, and any concerns CURB expresses regarding the financial impact of the Transaction debt on GPE can be fully and effectively addressed through the proposed ring-fencing conditions in Schedule DRI-3.

Finally, CURB argues that the fact Staff, CURB and all intervenors oppose the Transaction makes it obvious the proposed Transaction will result in harm to all ratepayers. *See* CURB Brief at p. 13. First, all intervenors did not oppose the Transaction as Staff did; with CURB mirroring Staff's actions throughout the case. Some intervenors opposed it "as filed", which is exceedingly common in acquisition proceedings before the Commission. Some recommended approval if conditions were imposed that served their individual parochial

[15] Also like Staff, CURB misrepresents the meaning of statements contained in the record of the docket. For example, CURB alleges an inconsistency in Joint Applicants' Initial Post-Hearing Brief between the following two statements contained in the Brief - "[c]redit agencies have examined this risk and concluded that it will have no negative effect on the credit ratings of either Westar or KCP&L …," and "[e]ven though there is but a slim chance that Transaction debt held by GPE would negatively impact the credit ratings of KCP&L and Westar …" (CURB Brief, pp. 11-12.) These comments are not inconsistent as they focus on two different aspects of the credit ratings issue. The credit rating agencies have said the Transaction will not have a negative effect on the utilities' credit ratings and, in fact, there has been none in response to the equity and debt issued by GPE to finance the Transaction. The second comment focuses on the potential for a negative impact on the utilities in the future as a result of their link to GPE. Joint Applicants acknowledge that potential exists, but it will be adequately addressed by the proposed ring-fencing measures. (*See* Joint Applicants' Initial Post-Hearing Brief, p. 37.)

interest[16], and some recommended approval as long as more general, public interest types of conditions were adopted.[17] Second, if support for a particular outcome by multiple parties can be considered evidence that makes one party's position on a disputed issue "obvious", then the unanimously positive testimony presented by the many community leaders and other interested parties attending the public hearing in this case would also render it "obvious" that the Transaction is beneficial to all customers.

BPU's and KEPCo's arguments about the impact of the Transaction on the utility companies have been addressed in response to the parties above.

B. Capital Structure

As Joint Applicants' witness Reed testified, the ring-fencing conditions set out at Schedule DRI-3 to Mr. Ives' testimony:

> are absolutely right down the middle of the fairway in terms of industry norms. They are not going to be viewed by the rating agencies as extreme, but they are effective. ***They are in fact beyond what was required in other financial distress situations to effectively isolate the utility and maintain them at strong investment grade***.

Id. (***emphasis added***). The other parties to this docket have presented no witness with the experience and expertise close to matching that of Mr. Reed in merger and acquisition transactions in the utility industry. Perhaps that explains why their briefs make limited mention of Mr. Reed's testimony endorsing the sufficiency and appropriateness of the Joint Applicants' ring-fencing commitments.

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[16] The Municipal Group argues that the Commission should order Westar to give its generation formula rate customers an early termination option on their existing wholesale contracts. This would benefit the Municipal Group, BPU and Sunflower/MidKansas at the expense of other Westar customers. (*See* Municipal Group Brief, p. 2).

[17] *See* Steve Chriss Direct at pp. 5-6; *See* Maximilian Chang Direct at pp. 5-6; *See* Michael Gorman Direct at pp. 5-6.

It also bears noting that, at hearing, Staff took the position that the low discount rate used by GPE's Transaction advisors indicate that investors expect to earn much less than the utilities' authorized regulatory rates of return. Mr. Hevert explained the overwhelming fallacy of that assertion, as fully addressed in Joint Applicants' Initial Post-Hearing Brief. Staff did not respond on this point in its Brief, and the Commission should consider such failure to respond as an abandonment of Staff's argument on that issue.

1. Staff

Staff's arguments rely on the fundamentally erroneous premise that customers' rates are *excessive* unless they are based upon the purported least cost capital structure, which Staff claims post-Transaction will be the higher leveraged consolidated capital structure of GPE -- assuming, of course, that one ignores the erroneous mismatch between capital structure and risk-related capital cost described by Mr. Hevert. *See* Staff Brief at p. 43. Joint Applicants have fully addressed the fallacy of this position in their Initial Post-Hearing Brief and will not repeat those arguments here. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 40-56. Because Staff's premise is fatally flawed, its arguments in reliance on that premise must be rejected. This encompasses Staff's allegations that the purchase price is excessive, the rates of the utility will exceed actual costs, and that such purported excess is the basis for what GPE committed to pay as the AP. *See* Staff Brief at p. 43.

a. <u>Capital Structure versus Ring-Fencing</u>

Staff argues that Joint Applicants' intent to use cash flows made possible because of the availability of low-cost debt to finance the Transaction somehow harms customers because "operating savings are not the same as capital cost savings produced by financial engineering. The latter comes with real costs, risk, and detriment to the public interest." *Id.* First, it is important that Staff's continued effort to conflate the ring-fencing issue with the capital structure issue not be allowed to confuse and color the analysis of these clearly distinct issues. The risks of higher debt at the parent company are appropriately addressed through ring-fencing conditions. It is not appropriate, or justifiable by financial theory, to address these costs and risk by adopting hypothetical capital structures for setting KCP&L and Westar's utility rates (such as GPE's post-Transaction capital structure which will *not* represent capital used *to fund utility assets and operations*). Staff's approach does not protect customers from the costs or risks of the Transaction; to the contrary, it *increases* those costs and risk, causing a detriment to the public interest.

In determining how to *protect customers* from the cost and risks of the Transaction, the Commission needs to consider the ring-fencing conditions put forth by the parties. These conditions, in combination with the Commission's existing broad statutory power and authority will ensure utility customers get the benefits of this Transaction without bearing the risks that are more appropriately assumed by GPE's shareholders.

In determining the *appropriate capital structure policy* to adopt for purposes of future rate cases, the Commission should remain consistent with its well-established practice of using a capital structure that reflects the capital used to finance the assets and operations of the utility companies. Westar and KCP&L have and will continue to have their own separate capital structures and debt. Their capital structures presently represent the capital used to finance their assets and operations, and that will not change as a result of this Transaction. In the recent past, and because of special conditions, it was acceptable to use either GPE's consolidated capital structure or KCP&L's capital structure only because they were essentially the same or because such financing was for utility operations. That special condition will no longer be the case post-Transaction, so it will no longer be appropriate to use the GPE consolidated capital structure in setting KCP&L's or Westar's rates. GPE's capital structure post-Transaction will no longer reflect the capital that supports utility assets and operations.

b. Just and Reasonable Rates

Staff contends that GPE's consolidated capital structure must be recognized in the ratemaking process for the utilities' rates to remain just and reasonable. *See* Staff Brief at p. 46. While Kansas law requires the Commission set rates that are just and reasonable[18], it does not support Staff's argument that a holding company's consolidated capital structure must be recognized in rates in order to meet this standard. While Staff presents this argument as one based on Kansas law, Staff fails to provide any legal authority that actually supports its position.

First, Staff argues that Joint Applicants' position on capital structure will result in KCP&L's and Westar's customers paying for "a more expensive capital structure than GPE is using to capitalize the consolidated company". *See* Staff Brief at p. 46. Staff's careful selection of words here is telling. The relevant consideration is how *KCP&L and Westar* are capitalized; not how the consolidated company is capitalized. Staff sidesteps the critical issues - that KCP&L and Westar will be capitalized the same post-Transaction as they are now, that the $4.3 billion of debt is unquestionably being used exclusively to finance GPE's acquisition of Westar shares, not utility assets or operations, and that Joint Applicants' position on capital structure has absolutely no impact on KCP&L's or Westar's post-Transaction rates as compared to their present rates.[19]

Staff's other arguments are equally flawed and unhelpful to their cause:

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[18] K.S.A. 66-101b

[19] *See* Joint Applicants' Exhibit 19.

- Staff argues that a holding company can engage in manipulation of the capital structures of the utilities by simply issuing debt and using the proceeds to make an equity infusion to the subsidiary. Staff asserts that this would allow the holding company to assign to the utility a capital structure that does not necessarily reflect the capitalization of the holding company. *See* Staff Brief at p. 47. Again, it is the capitalization of the *utility's* assets and operations that is relevant; not the holding company's. And there is nothing "simple" about the type of manipulation Staff describes, as such attempts at manipulation would be readily apparent and easily adjusted for in future rate cases *if* they were to occur, but which will not. *See* Tr. Vol. 5, Gatewood, p. 1133. Add to this the fact that GPE has never done this in the past although it could have as Staff suggested. This is especially true where the utility companies are maintained as separate entities with separate, individual debt of their own – like Westar and KCP&L have and will continue to have. Staff's concern in this regard is more relevant to situations where the utility is an operating division of the parent and capital is actually "assigned" by the parent to its various operating divisions, such as is the case with Atmos Energy, Kansas Gas Service, and the former Aquila companies.
- Staff asserts that "Staff nearly always relies on the purported lowest cost capital structure between a wholly-owned subsidiary utility and its parent company ... this approach is reasonable because it recognizes the reality of the parent company's absolute control over the subsidiary." *See* Staff Brief at p. 48. Staff also claims this approach removes a parent company's incentive to overleverage its capital structure. As explained in detail in the Joint Applicants' Initial Post-

Hearing Brief, Staff's past positions (and Commission decisions) on capital structure reflect an attempt to identify the structure that represents the actual capital used to fund the utility as opposed to just seeking the purported lowest-cost capital structure. Staff asserts that the Commission's decisions on capital structure have been "much more nuanced" than the two guiding principles expressed by Mr. Hevert of (1) matching the assets used to provide utility service, and (2) assessing the reasonableness of the capital structure of the utility by reference to industry practice. *See* Staff Brief at p. 49. However, Staff cites to Commission precedent that is consistent with Joint Applicants position, not Staff's:

- In the Blue Valley case,[20] the Commission was determining the appropriate amount to be paid to Blue Valley out of the Kansas Universal Service Fund ("KUSF"). The KUSF is a subsidy fund that all telecommunications and local exchange companies in Kansas pay into and assess against their customers. Blue Valley is a member-owned cooperative, presenting with a capital structure of 77.52% equity and 22.48% debt. Because Blue Valley had a high equity capital structure, Staff recommended a hypothetical capital structure of 60% equity and 40% debt be used to establish Blue Valley's KUSF payment to avoid a situation where all contributors to the KUSF, regardless of their service provider, would pay for Blue Valley's equity, instead of the cooperative's

[20] Docket No. 02-BLVT-377-AUD, Order issued October 10, 2002 ("02-377 Docket" and "02-377 Order", respectively).

members/owners. The hypothetical capital structure recommended by Staff was based upon the average of a proxy group of five telephone companies.[21] The Commission found that, since Blue Valley's actual capital structure was atypical relative to the publicly traded proxy companies used in Staff's analysis, the Commission could adopt a reasonable debt to equity ratio for calculating rate of return.[22] The Commission agreed with Staff that other Kansas customers should not subsidize Blue Valley's members, accepting Staff's recommended 60/40 capital structure.[23] The Commission's decision and analysis in Blue Valley is consistent with Joint Applicants' position in this case, not Staff's.

- In Wheat State Telephone Company[24], the utility's capital structure was 100% equity, which was completely out of line with standard utility capital structure of around 50% equity and 50% debt. *See* Tr. Vol. 4, Hevert, at p. 934. There were also concerns in that case about ratepayers subsidizing unregulated affiliate operations.[25] Staff and the company agreed that it would not be appropriate to use Wheat State's actual capital structure for regulatory purposes. The company proposed a hypothetical capital structure of 40% debt and 60% equity, while Staff recommended using the actual capital structure of the parent company, which was

[21] 02-377 Order, pp. 6-7, ¶¶ 15, 16.

[22] 02-377 Order, p. 8, ¶ 20.

[23] 02-377 Order, p. 9, ¶ 21.

[24] Docket No. 03-WHST-503-AUD, Order issued September 29, 2003 ("03-503 Docket" and "03-503 Order", respectively.)

[25] 03-503 Order, pp. 9, 10, ¶¶ 22, 23.

87.77% debt and 12.23% equity. Staff argued that the *actual* capital structure should be utilized unless it is clearly inappropriate. In adopting the actual parent company capital structure and rejecting use of the hypothetical one proposed by the company, the Commission stated,

> The Commission has indicated in other dockets that an ROE analysis needs to be specific to the particular utility.[26]
>
> This proceeding presents the Commission for the first time with testimony and evidence concerning a wholly owned subsidiary ***which does not have an appropriate capital structure for ratemaking purposes,*** but whose ***assets are collateral for the loans of a parent company*** with a high debt capital structure."[27]

And referring to use of the company's proposed use of a hypothetical capital structure, the order stated:

> Instead of paying the costs necessary for efficient and sufficient service ..., the customers would be paying the costs of equity ***that does not exist*** and ***the utility*** would receive a return in excess of its legitimate regulatory needs.[28]

In the present case, KCP&L's and Westar's capital structures will be appropriate for ratemaking purposes, and neither will have assets used as collateral for parent company loans because of the commitments made in DRI-3. The equity portion in each utility's capital structure actually exists, now and after the Transaction, and *the utilities* will only receive revenues

[26] 03-503 Order, p. 13, ¶32.

[27] 03-503 Order, p. 12, ¶29 (***emphasis added***).

[28] 03-503 Order, p. 12, ¶30 (***emphasis added***).

based upon *the utilities'* legitimate needs.[29] The 03-503 Order supports Joint Applicants' position in this case, not Staff's.[30]

- In the Haviland Telephone Company case,[31] the utility's actual capital structure was 87.9% debt and 12.10% equity, which is what Staff recommended be used to set rates. Haviland requested a hypothetical capital structure of 50% equity and 50% debt. Haviland had no holding company parent, and therefore, no consolidated capital structure to consider. In recommending use of the actual, highly leverage capital structure of the utility, Staff emphasized that "management has chosen to finance the telephone operations through a large amount of debt, and that Haviland has paid a significant amount of its equity out as dividends."[32] For the same underlying policy reasons as stated in the 03-503 Order, the Commission held the actual capital structure of the utility (Haviland) should be used.[33] Again, the 03-664 Order supports Joint Applicants' position in this case, not Staff's.

[29] It is also important to note that in the 03-503 Order, once the Commission decided to use the parent company's highly leverage capital structure to set the subsidiary utility company's rates, the Commission held that a premium on the ROE was warranted for the additional risks associated with the high amount of debt. (03-503 Order, p. 13, ¶ 33.) Staff's analysis had resulted in an ROE of 11.5%, but Staff proposed a 2.5% premium on top of that (14%) to recognize the increased risk related to the higher debt. The Commission increased Staff's proposed ROE from 14% to 18% to adequately account for the more highly leveraged capital structure. (03-503 Order, p. 14, ¶ 33.)

[30] Staff incorrectly asserts that the Commission "explicitly endorsed Staff's least-cost 'asymmetrical' approach to capital structure." (*See* Staff Brief, p. 50, footnote 207, citing to ¶ 28 of the 03-503 Order.) Paragraph 28 of the 03-503 Order does not do what Staff claims.

[31] Docket No. 03-HVDT-664-RTS, Order issued November 7, 2003 ("03-664 Docket" and "03-664 Order", respectively).

[32] 03-644 Order, p. 6, ¶ 16.

[33] 03-664 Order, p.p. 6-7, ¶ 17.

- In the Aquila case cited by Staff,[34] the Commission made clear it was adopting a consolidated capital structure for the Kansas operating division of Aquila (WPK) based upon the evidence presented in that proceeding, which included:

  - WPK was not a separate entity from Aquila. It was an operating division of Aquila and its capital structure was allocated to it by Aquila.[35]
  - The manner in which Aquila allocated capital structure to WPK was inequitable to ratepayers. The equity ratio allocated was greater than Aquila's actual equity ratio.[36]
  - There was "no easy solution for a company so intricately entwined in its parent's financial affairs.[37]
  - Aquila had suffered financially because of its unregulated business.

  The Commission concluded that "[g]iven the evidence presented in this proceeding", it was very difficult to wholly treat WPK as a stand-alone company.[38] None of the same facts relied upon in 04-1065 exist in the GPE/Westar/KCP&L structure and relationship.

The Commission also recognized in the 04-1065 Order that its power to make and apply policy concerning the appropriate balance between the rates utility customers pay and the returns

[34] Docket No. 04-AQLE-1065-RTS, Order on Reconsideration issued March 14, 2005 ("04-1065 Docket" and "04-1065 Order", respectively.)

[35] 04-1065 Order, p. 6, ¶ 14.

[36] 04-1065 Order, p. 6, ¶ 14.

[37] 04-1065 Order, p. 7, ¶ 16.

[38] 04-1065 Order, p. 6, ¶ 14.

on capital utility investors receive is limited by constitutional protections, citing to *Kansas Gas and Electric v. State Corporation Commission*, 239 Kan. 483 (1986), which endorsed the *Hope and Bluefield* standards. As explained by Mr. Hevert (*See* Hevert Rebuttal at p. 6), and referenced in Joint Applicants' Initial Post-Hearing Brief (*See* Joint Applicants' Initial Post-Hearing Brief at p. 47), Staff's position on capital structure in this case violates the *Hope and Bluefield* standards. Within these constitutional parameters, Joint Applicants have not argued the Commission lacks authority to establish a fair capital structure for rate-setting, including the ability to reject an unreasonable utility capital structure or adopt a consolidated or otherwise hypothetical structure that more fairly represents the capital used to fund the utility's operations and assets. The Kansas case law cited by Staff in its Brief makes this clear. *See* Staff Brief at pp. 53-55. However, there must be substantial competent evidence to support the Commission's decision, and simply stating that the purported "least-cost" capital structure is to be used falls woefully short of this evidentiary and analytical standard.[39]

Staff represents these previous Commission orders as adopting a policy of imposing a "least-cost" capital structure in setting rates. That is not what the Commission did in these dockets. In each case, the Commission evaluated the circumstances and facts specific to the utility company - namely, what capital funded the utility's operations and assets, the utility's actual capital structure, its parent's consolidated capital structure if it had a parent, how its capital structure compared to industry standards, impacts of unregulated operations on the

[39] Even Staff's own quote from *SW Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 82 (1963), indicates a regulatory body might question a situation "where a parent holding company maintains a high debt ratio in its capital structure while its operating subsidiary's debt is practically nil." *See* Staff Brief, p.53. Obviously, this does not describe the situation that will exist as a result of this Transaction. GPE will not be artificially maintaining a high debt ratio, nor will KCP&L or Westar have practically no debt. GPE will have increased debt directly tied to its investment in Westar, and the utility companies will have the same level of debt and equity as they do now – close to 50/50, the industry norm.

regulated utility's financial condition, and whether there appeared to be some inter-company manipulation involved resulting in a higher equity component in the utility company's capital structure. As Staff states in its Brief, when the Commission adopted a consolidated company capital structure in previous dockets it was "to avoid a shareholder windfall at the ratepayers' expense." *See* Staff Brief at p. 51. Staff has failed to show that, in this case, using the utilities' capital structure would result in a shareholder windfall at ratepayers' expense. Quite the opposite is true; use of KCP&L and Westar's utility-specific capital structures will allow customers to enjoy the benefits of having 100% of the merger savings flow through to their rates in each post-Transaction rate case, while the risks of making that happen fall on shareholders.

Staff asserts that "Joint Applicants cite no Kansas case law on capital structure in their legal brief and virtually no Commission decisions specific to capital structure", indicating these omissions, as perceived by Staff, are "not surprising as the law is quite problematic for the Joint Applicants on this issue." *See* Staff Brief at pp. 54-55. This comment is factually incorrect. Staff's assertion that Joint Applicants did not address Kansas case law is meaningless because, as stated above, Joint Applicants have not questioned the Commission's power to adopt a hypothetical capital structure under appropriate circumstances, so it was wholly unnecessary for Joint Applicants to devote pages of their Initial Post-Hearing Brief to evaluating case law on this issue. Staff incorrectly accuses Joint Applicants of failing to cite case law, while at the same time stating in its Brief that the arguments of Mr. Hevert "are the same arguments rejected by the Commission and Kansas appellate courts in the rulings cited above." *See* Staff Brief at p. 56. Staff then fails to explain how any of the case law it has cited rejected the arguments of Mr. Hevert. If any party has failed to properly address case law here, it is Staff.

And Staff's assertion that Joint Applicants cited no Commission decisions is factually incorrect. Joint Applicants' Initial Post-Hearing Brief states the following:

> Staff assures the Commission that the position it is taking in this case is consistent with its position in past Commission dockets. Staff's representation is not supported by the record in those previous dockets. Mr. Gatewood has historically relied upon, and argued in favor of, the same position Joint Applicants present in this case – that the cost of capital should reflect the capital sources use to fund the utility's assets and operations. ***Hevert Rebuttal, pp. 10-14.*** Although that analysis may have resulted in the Commission using a consolidated capital structure in some past cases, that is not the same as the Commission adopting a policy of using the consolidated capital structure as represented by Staff in this case.

See Joint Applicants' Initial Post-Hearing Brief at Footnote 18, p. 44. ***(Emphasis added)***. On pages 10-14 of Mr. Hevert's rebuttal, he analyzes no fewer than ten past Commission decisions on capital structure, explaining how those decisions are consistent with the Joint Applicants' position in this case and inconsistent with Staff's.

The standards, guidelines and policy goals stated in previous Commission Order regarding the appropriate capital structure to use for a utility company in setting rates are consistent with the policy Joint Applicants are requesting the Commission affirm in this case for future Westar and KCP&L rate cases. Staff is mistaken if it believes these Commission orders are consistent with the position Staff has taken in this case.[40]

[4040] Staff now argues in its Brief that it is not promoting a policy of adopting the capital structure that will result in the lowest rates. (*See* Staff Brief, p. 54.) That is directly in conflict with Staff's statement on page 61 of its Brief referring to "Staff's lowest-cost capital structure policy" and Mr. Gatewood's direct testimony that says,

> "In situations where we set rates for a utility that is a wholly owned subsidiary, we carefully review the capitalization of the subsidiary, as well as the capitalization of the parent company. For the purpose of determining the weighted average cost of capital or allowed rate of return, ***we will rely on the capitalization that results in the lowest weighted average cost of capital.*** Thus, ***if the parent company exhibits a higher debt ratio than the subsidiary, we will use the parent company's capital ratios to calculate the revenue requirement***." (Gatewood Direct, pp. 40-41, ***emphasis added***.)

c. Staff's Response to Robert Hevert's Analyses

Staff incorrectly asserts that Mr. Hevert's analysis is based on an assumption that the Transaction debt is only being used to pay for the acquisition premium and not to support utility services or assets. *See* Staff Brief at p. 56. Staff misstates Mr. Hevert's position. Mr. Hevert was responding to Staff's assertion that the acquisition debt is being acquired to "recapitalize" the operating utilities. As he stated, that is not the case. As Mr. Hevert stated, the acquisition debt is "supporting the acquisition of Westar, that is, financing the purchase of Westar shares from individual Westar shareholders. Neither Westar's nor KCP&L's capital structure will change as a result of the debt issuance." Hevert Rebuttal at p. 17. All of the funds raised to effect the Transaction will be paid to Westar shareholders for their shares; none will go to Westar itself. Bassham Direct at p. 3. ("GPE has agreed to pay approximately $8.6 billion ***to acquire the stock of Westar*** . . . ." (***emphasis added***)); Proctor Rebuttal at p. 33 (". . . the cash and other proceeds of this Transaction will go to Westar's shareholders ***Neither Westar, KCP&L nor GPE will receive cash, or any other consideration from the Transaction . . .*"** (***emphasis added***)). Since none of the funds will be paid to the operating utilities, none of the funds will be available to support investments by the operating utilities in their assets or operations.

In this case, there is no basis to argue that GPE's consolidated capital structure after the Transaction supports utility operations. All of the capital currently being raised by GPE will go to purchase Westar's stock from its current shareholders, including a premium necessary to entice shareholders to sell their shares to allow the Transaction to occur. Accordingly, none of that capital will go to fund Westar or KCP&L utility assets. Proctor Rebuttal at p. 33. As Mr. Bryant testified, absent the Transaction, GPE would not be raising any capital at this time. *See* Tr. Vol. 3, Bryant, at p. 749. Because GPE's Transaction debt does not support utility operations, using GPE's consolidated capital structure which contains it as the basis for setting rates solely because it may result in a purported "lowest cost" capital structure available would be arbitrary and inappropriate. To be clear, the issue before the Commission, as is always the case, is use of the appropriate capital structure, the one that supports the utility's assets and operations. As Mr. Ives testified, to discuss the issue as consolidated versus stand-alone capital structure is too narrow. The intent, and the Commission's practice, is to utilize a capital structure to provide returns consistent with the risks faced by the investor in funding the utility's assets and operations. *See* Hevert Rebuttal at pp. 10-14. The effects of the Transaction on the consolidated GPE capital structure necessitate the Commission rely on the logic and rationale of using the operating company's capital structure as supported by the Joint Applicants.

Staff argues that Mr. Hevert's position - that the capital structure should match the assets used to provide utility service - ignores the fundamental basis of cost-based ratemaking that requires the Commission examine the company's capital structure to identify the sources of its capital. *See* Staff Brief at p. 57. Staff cites to *Moundridge Telephone Company v. Kansas Corporation Commission,* 361 P.3d 523 (Kan. Ct. App. 2015) to support this assertion, [41] but the *Moundridge* decision does not support Staff's position in this case. Moundridge does not hold that *an investor's* source of capital must be taken into consideration in determining the appropriate rate of return for a subsidiary utility company owned by the investor. *Moundridge* is

[41] *Moundridge* is an unpublished decision, improperly cited by Staff in violation of Supreme Court Rule 7.04, which provides that an unpublished opinion "(A) is not favored for citation and may be cited only if the opinion: (i) has persuasive value with respect to the material issue not addressed in a published opinion of a Kansas appellate court; and (ii) would assist the court in disposition of the issue; and (C) must be attached to any document, pleading, or brief that cites the opinion." First, *Moundridge* does not address a material issue not addressed by a published appellate opinion, which is why it is unpublished. The quote set out in Staff's Brief is a general explanation of how rate of return is calculated in setting utility rates and can be found in many published Kansas decisions. Second, the cite to *Moundridge* does not assist the Commission in deciding the matter at issue as it does not address the matter at issue – whether it is appropriate to use a capital structure that reflects the source of funds used by *a parent company* to purchase its investment in the utility. Finally, Staff failed to attach the document to its Brief. Staff also failed to provide an appropriate cite identifying the location in the decision where the quote contained in Staff's Brief could be found.

an appeal of a Commission decision that adopted a hypothetical capital structure of 60% equity and 40% debt for a telephone company because its actual capital structure was 95.34% equity and 4.66% debt. The Commission based the 60/40 capital structure on a more typical industry standard represented by two other telephone companies in Kansas. *Moundridge* provides a general review of the Commission's rate-setting process, including the unremarkable quote included in Staff's Brief. *Moundridge* also recognizes that issues in ratemaking arise when a utility's actual capital structure is unbalanced,[42] (*Moundridge* at p. 13), and that hypothetical capital structures may be appropriate when a utility company's actual structure is unbalanced – something not applicable to Westar's and KCP&L's post-Transaction capital structures of 53/47 and 49/51, respectively. (*Moundridge* at 13.)

It is perplexing that Staff can argue the importance of examining the source of the funds used by an investor to purchase its investment in a utility company, while acknowledging on the record that it neither knows nor cares how Westar's present shareholders funded their investment. *See* Tr. Vol. 5, Gatewood, p. 1147. Staff tries to convince the Commission that this aspect of its analysis should be different simply because Westar's future shareholder (GPE) will own all of its stock, whereas present shareholders do not exercise that level of control. *See* Staff Brief at p. 58. Staff's unsupported assertions in this regard do not begin to overcome the reasoned logic of Mr. Hevert or his analysis of economic theory and regulatory precedent on this issue. *See* Tr. Vol. 4, Hevert, p. 924.

Staff also argues that Mr. Hevert is incorrect in stating that a capital structure's reasonableness should be assessed by reference to industry practice. *See* Staff Brief at p. 58. Staff's position on this is confusing, since Staff acknowledges that this is "an important

[42] As would be the GPE 41% equity, 59% debt capital structure post-Transaction.

benchmark" (*See* Staff Brief at p. 58), and past Commission decisions cited in Staff's own Brief relied upon this benchmark, sometimes to the apparent exclusion of any other considerations.[43]

Mr. Hevert evaluated past Commission decisions and identifies two common principles guiding the Commission's decisions in those dockets regarding the appropriate capital structure to use for setting rates. He explains that the capital structure should match the assets used to provide utility service, and that the reasonableness of a capital structure should be assessed by reference to industry practice. *See* Hevert Rebuttal at p. 14. Staff seems to disagree with Mr. Hevert's position, while also agreeing that these are guiding principles. *See* Staff Brief at pp. 56-59. Staff's attempt to deviate from the Commission's past practices and policies does not undermine the accuracy and validity of Mr. Hevert's analysis of past Commission decisions.

Staff also misrepresents Mr. Hevert's testimony regarding the risk undertaken by GPE versus risk taken by regulated utility companies like KCP&L and Westar. *See* Staff Brief at p. 59. Mr. Hevert explained the differences in risk undertaken by investing holding companies as compared to appropriate risk taking by a regulated utility company. *See* Tr. Vol. 4, Hevert, pp. 882-85. They are not the same. It is also misleading for Staff to reinterpret Mr. Hevert's testimony discussing differences between different types of holding companies as somehow supporting Staff's claim that GPE faces the same risks as its subsidiary utility companies. Statements from Staff such as "the ratings agencies obviously agree that GPE's new capital structure is suboptimal and carries excessive and unnecessary risk" (*See* Staff Brief at p. 59), and "GPE seems to be admitting that its own capital structure is too risky for a standalone electric utility" (*Id.)* offer no meaningful guidance, as they do not provide the Commission with sound

[43] *See* Docket No. 02-BLVT-377-AUD.

economic and regulatory theory and policy, which is what is needed in deciding the capital structure issue presented in this case.

2. Intervenors

KIC represents that Joint Applicants have requested the Commission find in this docket that the capital structure of the utility companies must always be used in future rate cases, and that such a finding would be "bad policy" and would be unlawful. *See* KIC Brief at pp. 15, 19. KIC misrepresents Joint Applicants' position in this regard, and incorrectly argues that using the utilities' capital structure to set future rates yields an annual revenue increase of $130 million. *See* KIC Brief at pp. 16-17.

Joint Applicants have consistently recognized that this Commission cannot "bind" a future Commission by declaring in this case what capital structure will be used to set rates in all future rate cases for Westar and KCP&L. However, the Commission can indicate in this case what it considers to be the appropriate standard in adopting a capital structure based upon the facts surrounding this Transaction and the conditions that will exist for the entities post-Transaction. That is what Joint Applicants have asked the Commission to do so that they can determine whether it is feasible to go forward with the acquisition in light of the risks posed by the Commission's policy determination. If the Commission decides in this case that Joint Applicants' position on capital structure is correct, it would be reasonable to expect future Commissions to honor that finding so long as the facts and reasoning continue to apply. However, Joint Applicants understand that Kansas law allows a future Commission to decide the issue differently provided it explains the basis for the change, and bases the change on substantial competent evidence in the record. Joint Applicants have not demanded a "blanket condition to always use the subsidiary utility capital structure," as represented by KIC. *See* KIC Brief at p. 19.

KIC also misleads the Commission with its assertion that Joint Applicants' position on capital structure yields electric rates for the subsidiary electric utilities that are $130 million more per year. *See* KIC Brief at pp. 16-17. KIC is referring to the analysis performed by Staff witness, Mr. Gatewood, comparing post-Transaction revenue requirements for Westar and KCP&L using their utility capital structures versus using a consolidated capital structure.[44] KIC fails to recognize that this comparison is irrelevant since the Transaction will not occur if the consolidated capital structure were to be adopted. Staff acknowledged this to be true during cross-examination at hearing (Tr. Vol. 6, Gatewood, pp. 1138-39); KIC chooses to ignore it.

Joint Applicants have provided a thorough analysis showing that, under the circumstances in this case, future rates are most appropriately set using the individual utility companies' capital structures. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 39-56. Consistent with Joint Applicants' position, KIC recognizes that the appropriate rate of return should reflect the "risks" associated with the investment, as opposed to the source of funds used by the investor to purchase the investment.[45] KIC's ultimate recommendation, however, is in conflict with its own statement.

CURB's arguments on capital structure are the same as Staff's and have already been fully refuted in response to Staff and in Joint Applicants' Initial Post-Hearing Brief. CURB asserts that rates should be set based upon the 41% equity 59% debt capital structure of GPE or

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[44] *See* Gatewood Direct, p. 37, Tr. Vol. 5, p. 1138. This issue is fully addressed in Joint Applicants' Initial Post-Hearing Brief, pp. 50-51.

[45] *See* KIC Brief, p. 16. KIC also includes in its Brief assertions about risk and financing for non-utility activities and differences between equity levels of utility subsidiaries, indicating these circumstances would support using a different capital structure of some type. (*See* KIC Brief, p. 17) The position being advocated for which KIC presents this information is unclear and there are no cites to the record to clarify the point or substantiate the claims.

else it "will result in ratepayers paying rate of return in excess of what is actually required." *See* CURB Brief at p. 20. However, "what is required" is determined by looking at the return an investor would require to invest in Westar; it is not determined by looking at how much it cost an investor to finance its purchase in Westar's stock. *See* Hevert Rebuttal, p. 19. CURB ignores this inescapable reality. CURB also ignores the fact that, without the Transaction, there is no $4.3 billion of low-cost debt to bring GPE's capital structure to the 41/59 ratio, and therefore, no reduction in the utilities' cost of service or rates absent the Transaction. *See* Tr. Vol. 5, Gatewood, p. 1129. CURB, Staff and other intervenors can espouse circular arguments that superficially argue for lower rates for customers, but what they are actually doing is arguing a position that results in customers *losing* the chance to obtain lower rates. Joint Applicants and the Commission must address reality. To obtain lower costs and lower rates for customers, the Transaction must occur; for the Transaction to occur, the parent company capital structure cannot be imputed to the utility companies.

CURB is wrong when it says, "the leveraged financing is being used to buy Westar utility assets." *See* CURB Brief at p. 20. It is being used to buy Westar's stock from Westar stockholders. Westar's assets and operations are financed by their existing levels of equity and debt, which will not change after the ownership of Westar's stock changes. *See* Hevert Rebuttal at p. 18. The fact that GPE will control the utility companies as the sole stockholder does not change this analysis. GPE's control of Westar is properly monitored through the ring-fencing conditions proposed in Schedule DRI-3 and the Commission's already existing power and authority. CURB's reliance upon GPE's "control" in this regard indicates CURB is concerned about GPE's ability to manipulate Westar's capital structure in the future so as to increase its revenue requirement. If this happens (and GPE assures the Commission it will not as undue capital structure manipulation has never happened in the past), such behavior would create a paper trail easily identified in future Commission audits so that appropriate adjustments can be taken at that time to protect customers. The fact that GPE will have control of Westar *does not* support using GPE's capital structure to set rates when that capital structure does not reflect the capital used to fund the assets and operations of the utility.

If Joint Applicants had used a financial model for the Transaction that took into account the possibility of regulators using a consolidated capital structure as CURB argues should have been done (*See* CURB Brief at pp. 21-22, citing to Gatewood Direct at pp. 28-29), then the model would also have needed to include the AP in the utilities' revenue requirement,[46] and higher component costs of that capital – debt and equity – reflective of the greater financing risk at the holding company than exists at the utility. *See* Tr. Vol. 4, Hevert, pp. 926-27. This inconvenient fact is glossed over by CURB, but cannot be ignored. It is irresponsible to argue that customers should receive 100% of the Transaction's financial benefits (lower cost of service from merger savings + the parent's low-cost debt and higher leveraged capital structure), while leaving the risks and costs associated with those benefits entirely upon the parent company. Joint Applicants did not model a scenario where GPE's capital structure was used to set utility rates because (1) it was not requesting any portion of the AP be included in rates; (2) its proposed method was simpler and consistent with the Commission's movement away from recovering AP from customers in rates based upon an estimated level of merger savings; (3) GPE's post-Transaction capital structure would not accurately represent the funds used to finance the utilities' assets and operations; (4) its position on the appropriate capital structure to

[46] *See* Proctor Rebuttal, pp. 20-21. And, as already addressed in the Initial Post-Hearing Brief, when a change in made in one assumption in these analyses it impacts other factors. It is not meaningful to change one assumption and assume everything else stays exactly the same. (*See* Joint Applicants' Initial Post-Hearing Brief, pp. 148-49)

use in setting future utility rates is consistent with Commission policy and precedent; and both GPE's CEO and CFO testified that GPE would not be able to effect the Transaction under such a scenario.

BPU's arguments on ring fencing have been fully addressed in Joint Applicants' response to the other parties. However, BPU, more so than other intervenors, makes an issue of the fact that Joint Applicants did not present the capital structure issue in their Application. *See* BPU Brief at pp. 17. Joint Applicants need to address the inaccurate assumptions and factual assertion relied upon by BPU for its arguments in this regard.

First, BPU states that Joint Applicants should have addressed in the Application their position on capital structure because it "relies on the Commission changing the methodology it currently employs to set KCP&L's rates." This is incorrect, and in making this assertion, BPU completely disregards the evidence in the record wherein Mr. Hevert reviewed in detail the guiding facts and policy relied upon by the Commission in past cases in setting capital structure, including KCP&L's. *See* Hevert Rebuttal at pp. 10-14. Mr. Hevert explained that, while the analysis of these facts and policies resulted in the Commission adopting a consolidated capital structure for KCP&L in recent rate cases, that was because, in that particular case, the consolidated capital structure also met the Commission's underlying guidelines and was essentially the same as KCP&L's utility-specific capital structure. *See* Joint Applicants' Initial Post-Hearing Brief at p.40. BPU misses this important distinction.[47]

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[47] BPU also misses this distinction as regards MPSC and FERC employing consolidated capital structure in setting KCP&L's rates. Like the KCC, these regulatory jurisdictions do not have a policy of using consolidated capital structure, even though their underlying policies and guidelines have resulted in the use of such in recent cases. As Mr. Ives explained at hearing, with the change in the consolidated capital structure for GPE as a result of this Transaction, GPE's consolidated capital structure will no longer be appropriate for KCP&L, and the Company will be filing at FERC an application to modify the capital structure upon which its FERC rates are based. GPE has no reason to believe that application will be unsuccessful in light of FERC's actual, underlying standards used to determine an appropriate capital structure. (*See* Joint Applicants' Initial Post-Hearing Brief, p. 53, footnote 23)

Second, Joint Applicants did not "fail to raise this concern with the Commission". *See* BPU Brief at p. 18. Joint Applicants did not anticipate capital structure being an issue until Staff made it one after the Application had been filed. Staff described it as "a threshold issue" (*See* BPU Brief at pp. 17-18) because Staff has chosen to take a position that is not consistent with Commission precedent and would cause the Transaction to fail. Staff's actions in this case have lifted the capital structure issue to the 'make-it or break-it' status it now holds in this case. That was not anticipated at the time the Application was prepared.

C. Ring-Fencing

1. Staff

Staff acknowledges that using ring-fencing to shield customers from parent company financial risk is not an unreasonable solution, but insists that this case is so unique that ring-fencing cannot insulate Westar and KCP&L's customers from the financial impacts to GPE of this Transaction. *See* Staff Brief at p. 59. Staff's position rests on Staff's premise that the only "true ring-fencing" is one that totally separates the companies involved. *See* Staff Brief at p. 83. Staff is its own only authority for its definition of "true ring-fencing". Staff's definition and premises are wrong, making Staff's conclusions wrong.[48]

Staff does the Commission a disservice when it claims the testimony of Mr. Reed regarding the ring-fencing imposed in the Enron and Oncor cases shows that the ring-fencing provisions in Schedule DRI-3 are somehow not effective because they are not the same as Enron's and Oncor's. Staff states that Joint Applicants "tout [the Enron and Oncor] provisions, implying that similar protections exits [*sic*] relative to GPE/Westar or GPE/KCP&L; however

[48] Joint Applicants have already fully addressed Staff's misguided attempt to use capital structure to discourage a parent company from taking advantage of low-cost debt to create benefits for its customers and shareholders and will not repeat those arguments here. (*See* Joint Applicants' Initial Post-Hearing Brief, pp. 47-51)

Mr. Reed testified that the commitments in Schedule DRI-3 are not as extensive as the elements of Oncor's Ring-Fence." *See* Staff Brief at p. 83-84. The testimony of Mr. Reed Staff cites to does not discuss the Enron case, but it very clearly explains that the situation at Oncor was dramatically different from the one in this case. The actual exchange with Staff counsel was so different from what Staff has represented that Joint Applicants believe it is important to set it out for the Commission:

> Q: [Staff counsel] And as you noted to CURB counsel, this ring fence as it exists today protected Oncor Electric Delivery Company from the financial distress of Energy Future Holdings company, correct?
>
> A: [Mr. Reed] Yes. To be clear the distress existed when the transaction was closed. As I said, EFH, the ultimate parent, was six notches below investment grade when they acquired TXU. So you started with the parent company being in a very, very deep hole. So the Commission imposed I would say at that point – well, you probably saw. I was the witnesses that created these ring fencing conditions for Oncor. I know them pretty well. I recommended these to the Commission because I felt it was important to protect the utility from what was ***a parent company headed pretty clearly towards bankruptcy***. So yes, ***under that extreme circumstance*** where you started with the parent that was six notches below investment grade, strict ring fencing was important.
>
> Q: And as you insinuate to CURB counsel, these types of conditions are not necessary in our proceeding today, is that correct?
>
> A: Certainly not to this extent, that's correct. Many of the points on this Page 3 [of Staff Exhibit 1- a summary of certain ring fencing terms imposed on Oncor] are in Mr. Ives' proposed ring fencing, but not all of them.

See Tr. Vol. 3, Reed, at pp. 560-561 (***emphasis added***).

The ring-fencing proposed in Schedule DRI-3 is not "heavily-caveated", as Staff claims. *See* Staff Brief at p. 60. It was developed using conditions successfully adopted and implemented in many other jurisdictions, relying heavily upon the recommendations in this case of KEPCo witness, Dr. Dismukes, and the terms negotiated by interested parties to the Transaction in the Missouri proceeding.[49] What Staff deems to be "caveats" are terms designed to conform to the specific Transaction at issue in this case while ensuring the Commission and its Staff has all information needed in a timely way to allow them to exercise their power to make sure customers are not negatively impacted by the Transaction.

Staff's comment, "[b]ecause customers will be exposed to risks associated with GPE's debt, they must also benefit from the lower cost of that financing" (*See* Staff Brief at pp. 60, 85), reflects Staff's continued conflation of these two separate issues; effective ring-fencing and appropriate capital structure. This only serves to confuse matters, leaving Staff chasing its tail, arguing "*GPE will be financially devastated by the Transaction; that devastation will impact KCP&L and Westar; ring-fencing won't protect customers; since ring-fencing won't work, it's necessary to adopt a double-leverage adjustment to give customers the benefits of GPE's higher debt; lowering rates to reflect the double-leverage adjustment increases the financial devastation on GPE; etc.*" Ultimately Staff must conclude that it is describing a death-spiral, causing Staff to reaffirm its opposition to the Transaction just should not be approved to begin with.[50] It is Staff's inability to consider the ring-fencing conditions after staking out a position that it has steadfastly adhered to since the merger was announced – that it opposed the merger – that led Staff to this conclusion; not the Transaction itself.

Staff incorrectly argues that Schedule DRI-3 contains reactive reporting mechanisms meaningful only after financial harm has occurred. *See* Staff Brief at p. 66. The financial status and events at GPE, KCP&L and Westar will be transparent to the Commission and Staff, with

[49] *See* Ives Rebuttal, pp. 41-42. Joint Applicants offered similar conditions in the FERC docket on the Transaction.

[50] *See* Staff Brief, p. 65 – Staff recognizes that using the consolidated capital structure to set rates could further imperil the financial standing of the consolidated company. This is a dilemma of Staff's own making.

timely notices and on-going reporting. Condition 14 of Schedule DRI-3 referred to by Staff addresses what will be done if a downgrade occurs, but this is not the only Condition in Schedule DRI-3. Other Conditions address what will be done prior to such an event occurring, if it ever were to occur. And the use of words such as “intend” and “plan” in the Conditions reflects nothing nefarious; the language only recognizes that future events could impact how the Conditions in this case are implemented. Joint Applicants attempt to avoid making hard promises as if future conditions would have no potential impact on their implementation. These words in no way restrict the Commission’s ability to enforce the ring-fencing Conditions agreed to, including a determination that some modification may – or may not – be appropriate in the future.

It is also misleading for Staff to assert that Moody’s did not regard the provisions proposed by Joint Applicants to be ring-fencing because of the statement in Moody’s May 12, 2016 letter that says “no ring-fencing type provisions are introduced that would significantly limit the upstream dividend capability of the Westar or Great Plains utility” and Moody’s later confirmation to GPE that the Schedule DRI-3 commitments were “not a credit negative event”. *See* Staff Brief at p. 67. Ring-fencing conditions do not have to significantly limit upstream dividend capability or be a credit negative to constitute real and effective ring-fencing. Only Staff views these excessive requirements as necessary for “true ring-fencing”, and the credibility of Staff on this point was heavily undermined during cross-examination of Mr. Gatewood at hearing. *See* Tr. Vol. 5, Gatewood, pp. 1125 – 1161.

Staff asserts that the ring-fencing proposed by Joint Applicants ignores the risks and costs to ratepayers caused by the Transaction when an actual credit downgrade does not occur, and some undefined “unquantifiable” risks. *See* Staff Brief at pp. 67-68. As for the “unquantifiable” risks, Joint Applicants are not sure how any entity could adequately respond to such a vague category of fears. Reasonably foreseeable risks and costs are addressed by Schedule DRI-3, and that should be the Commission's focus. As for costs that might occur caused by the Transaction even if a credit downgrade does not occur, Schedule DRI-3 does address that category. Conditions 20, 22, 23, 24, 25 and 26 specifically provide that customers will not bear such costs in their rates. Staff's example of the Iatan 2 case, Docket No. 10-KCPE-415-RTS ("10-415 Docket"), relies upon an inaccurate assessment of facts contained in Mr. Grady's testimony in that docket, but ultimately, the higher-cost securities Staff references were excluded from KCP&L's rates because the Commission found them to be related to Aquila's unregulated operations.[51] In other words, the Commission was fully capable of identifying costs it believed were related to the Aquila acquisition but did not flow from a credit downgrade, and exclude them from KCP&L's rates. This completely undermines Staff's argument and supports Joint Applicants' position that the ring-fencing measures and Commission's existing power and authority will protect customers.

Staff also abuses the record in this case by testifying in its Brief about Staff's recall and understanding of issues adjudicated in the 10-415 Docket.[52] Joint Applicants dispute Staff's representation of events in that case, but will not belabor the record in this case, by engaging in

[51] Staff also uses the Iatan 2 case to insinuate that Mr. Bassham's assurances are not always reliable. (*See* Staff Brief, p. 77) KCP&L explained in the Iatan 2 case why it did not view the Equity Units at issue as related to the Aquila Transaction, and thus, appropriate for inclusion in rates. Staff disagreed and the Commission found in favor of Staff's position. A disagreement between the parties does not constitute evidence that one of those parties failed to "keep his word".

[52] *See* Staff Brief, p. 77 – 79. Some of Staff's elaboration on what it views transpired in the 10-415 Docket is not expressed in the record of the 10-415 Docket. Certainly, some of these opinions of Staff in these earlier dockets was contested by Joint Applicants, but there is no benefit in rearguing those issues in this case. Additionally, Staff's Brief fails to explain where the dockets and testimony cited in this section of its Brief are admitted into the record of this case. It was not in the portion of the transcript to which Staff's cites (*See* Tr. Vol. 1, p 146.)

further argument over it. Paragraphs 177 through 183 of Staff's Brief should be disregarded in its entirety by the Commission in its deliberations in this docket.

Staff's statement that "[t]horough and adequate ring-fencing might protect Westar from being milked by GPE; but it does not protect Westar from being undernourished by GPE" is creative and colorful from a literary perspective, but it is unproductive from the perspective of achieving a workable resolution in this case that obtains for customers the benefits of the Transaction while providing them with adequate protection from risks more appropriately borne by the parent company's shareholders. Staff's comment illustrates the negative attitude Staff has displayed towards this Transaction from its inception.

All of Staff's reasons for believing ring-fencing will not work in this case are based upon Staff's continued assumption that the Commission will not exercise its authority to protect ratepayers. Joint Applicants do not share Staff's despair or cynicism in this regard.

2. Kansas Electric Power Cooperative, Inc. ("KEPCo")

KEPCo was the only party to this docket other than Joint Applicants to make a serious effort at identifying appropriate ring fencing provisions to adopt for the Transaction. *See* Dismukes Direct at Exhibit DED-2. Joint Applicants used Dr. Dismukes' matrix of ring-fencing recommendations in developing Schedule DRI-3. In many instances, his provisions were adopted as proposed, while others required some modification. KEPCo argues that Dr. Dismuke's provisions should be adopted, as presented.[53] Joint Applicants do not agree. While many are acceptable, and the form of others have value, some of his terms are excessive under the circumstances of this case, result in redundant, costly regulatory proceedings, impose

[53] *See* KEPCo Brief, pp. 54, 72. KEPCo modified DRI-3 to incorporate KEPCo's ring fencing provisions into it as proposed by Dr. Dismukes. (*See* KEPCo's Brief, Appendix C.)

unnecessary caps, will restrict the Commission's flexibility in the future, and will negatively impact the ability of the Transaction to proceed.

KEPCo argues that the ring-fencing conditions proposed in Schedule DRI-3 will not protect the utility companies "if post-acquisition GPE is unable to timely deleverage the holding company within the timeframes that financial investors, analysts, and the ratings agencies expect because merger synergy savings do not materialize as estimated." *See* KEPCo Brief at p. 53. First, it bears noting that the ratings agencies have not established a timeline for GPE to deleverage. While GPE will indeed pay down Transaction debt over time (See Bryant Rebuttal at pp.21-24, Joint Applicants' Initial Post-Hearing Brief, p. 12), the ratings agencies' do not require a "deleveraging schedule", but rather, rely upon their knowledge of the company in concluding that GPE has the capacity to adequately pay down its debt.[54] Similarly, there is no debt pay-down schedule adopted by investors or analysts that establishes a timeline as referred to by KEPCo, and cites to no support for this statement in its Brief.[55]

KEPCo believes that certain terms and language used in Schedule DRI-3 are not definitive enough to ensure customers are insulated from the Transaction-related debt at GPE. *See* KEPCo Brief at pp. 56, 72. Schedule DRI-3 imposes certain conditions "unless otherwise approved by the KCC", or "unless otherwise authorized by the Commission" and KEPCo does not believe the Conditions should allow for future modifications, even if the Commission

[54] KEPCo does not provide support for its assumption that the ratings agencies have some time frame for deleveraging the Transaction. Joint Applicants refer the Commission to the S&P report of May 18, 2016, to see what they generally considered the ability of the Company to deleverage in giving their opinion that no downgrade would occur for GPE.

[55] KEPCo also recommends Joint Applicants file within 30 days after an Order in this case approving the Transaction a written plan to deleverage the holding company (*See* KEPCo Brief, Appendix C, p. 9.) This is unnecessary. However, a requirement in the Commission's Order that an informational report be filed in 30 days would not cause the Transaction to fail. If this requirement in included in the Order, the details of the report should be left to Joint Applicants, rather than listing specific potential elements as Dr. Dismukes does in his recommendation.

reviews and approves them. *See* KEPCo Brief at pp. 72-73. Joint Applicants disagree. Changes in circumstances may dictate that it is in the best interests of all stakeholders to make modifications or allow waivers of certain conditions in the future. While such requests would not be made lightly by Joint Applicants, and certainly the Commission would not grant them unless convinced they are in the public interest, this type of reservation is appropriate. Although KEPCo states its belief that these "out" clauses somehow transfer the burden of proof away from Joint Applicants, that is not the case.

Regarding Dr. Dismukes' Commitment No. 1 (*See* Dismukes Direct at Exhibit DED-2, p.1; KEPCo Brief at p. 73-74.), in Schedule DRI-3 and the testimony in this case, Joint Applicants fully accept the obligation to maintain the utilities' financial integrity and independence in all respects and to exercise management prudence in matters relating to dividends, capital investments and other financial actions. Joint Applicants incorporated provisions a, b, and c under Dr. Dismukes' Commitment No. 1 into Schedule DRI-3. However, to the extent Commitment 1 indicates that Joint Applicants promise to keep Westar's and KCP&L's credit ratings at investment grade, the Companies do not have the power to control the credit ratings issued by S&P or Moody's. *See* Tr. Vol. 4, Ives p.1078. The modifications made to this provision were not intended to water-down Joint Applicants' commitment to separation[56] and financial integrity, but only to remove what was perceived as a promise Joint Applicants lack the power to control.

KEPCo also modifies Schedule DRI-3 to remove language that would enable Joint Applicants to seek recovery of the AP in rates in future rate cases if certain conditions occur.

[56] Joint Applicants did not include Dr. Dismukes Commitment No. 2 because they do not believe it is necessarily in the best interests of their customers to refrain from operating the Companies under one name in the future.

See KEPCo Brief, p. 74; Appendix C, p. 11, Conditions 20 and 21. As Joint Applicants have already explained in detail, the reservation expressed regarding AP recovery in rates is necessary for the possibility that a party might attempt to argue, as they have in this docket, that the utility companies' rates should be based on a capital structure that contains the Transaction-related debt and does not reflect the sources of capital used to fund the utilities' assets and their operations.[57] The reservation is unlikely to be triggered in future cases if the Commission affirms the capital structure policy Joint Applicants identify in this case, but the commitment to not include the AP asset in rates is tied to the ability to use cash flow created by GPE's low-cost debt to pay the debt incurred for the AP. Joint Applicants cannot be expected to lock themselves in on one side of the issue (no recovery of AP in rates) while leaving themselves exposed to the other half of the equation (the potential that Transaction-related debt would be used to set future rates).

KEPCo asserts that the reservation in Condition 16 would cause the Commission to "accept an open-ended condition that could result in the Commission being faced with creative impairment arguments in future rates cases." *See* KEPCo Brief at p. 76. KEPCo cites to the rebuttal testimony of Mr. Ives saying, should impairment of the goodwill occur potentially impacting the utilities, rates will be adjusted as needed to remove the impact of the impairment unless caused by KCC Order."[58] Joint Applicants have made clear that their expectation is for the Commission to treat them in the future consistent with how other utility companies are regulated, applying standard regulatory practices. If that is what the Commission does, this

[57] *See* Joint Applicants' Initial Post-Hearing Brief, pp.54-56. KEPCo incorrectly asserts that the reservation goes beyond a situation involving a future request to include Transaction-related debt in KCP&L's or Westar's revenue requirements to set utility rates, citing to a data request response. (*See* KEPCo Brief, p. 75) DRI-3 Condition does not include a situation where capital cost increases occur from an impairment that results from a KCC order, beyond the situation addressed in Joint Applicants Initial Post-Hearing Brief. KEPCo states that in his direct testimony, "Dr. Dismukes noted the same qualification in GPE's commitment", but DRI-3 did not exist at the time Dr. Dismukes filed his direct testimony.

[58] KEPCo also cites to testimony of Mr. Busser, but his testimony addresses the same situation as Mr. Ives.

reservation is meaningless and only the reservation in Condition 20 is relevant. This hardly constitutes a loop-hole that exposes the Commission to a vast array of impairment arguments in the future.

Joint Applicants' ability to request recovery of a portion of the AP in future rates is extremely limited in scope: another party must attempt to disturb the symmetry between the obligation to pay for the AP asset and use of the capital structure that reflects the debt incurred to purchase the AP. The symmetry must be maintained for rates to be just and reasonable and for GPE's investors to have an opportunity to recover a reasonable return on their investment. The Commission controls that symmetry; Condition 20 simply ensures that Joint Applicants are not foreclosed in the future from requesting the symmetry be honored. The manner in which Joint Applicants have presented Condition 20 in DRI-3 is reasonable and fair and should not be modified as KEPCo suggests.

Finally, KEPCo recommends the Commission require Joint Applicants to obtain KCC approval before selling, leasing, renting or otherwise conveying (outside routine business practices), any of their assets. *See* KEPCo Brief, Appendix C at p. 3. Kansas law does not place this condition on utility companies and Joint Applicants do not believe it is necessary or advisable. The Commission will have advance notice of GPE's plans for its generating assets (i.e., plant retirements, major environmental retrofits, plant additions, etc.) through GPE's Integrated Resource Plan ("IRP") and can take action if concerns arise in any particular instance.[59] But requiring the Commission to evaluate and approve, in advance, every such transaction will unnecessarily consume Commission and Company resources. While it is

[59] Kansas does not require an IRP, but GPE provides to Commission Staff a copy of its IRP each time it is submitted to the MPSC.

sometimes advantageous to the regulated utility to know in advance whether the Commission will view an asset transaction as prudent, and there are statutes allowing a utility to obtain a Commission decision on some investments in advance,[60] generally the Kansas Commission reviews such transaction in the course of rate cases to determine whether they were prudent and whether adjustments to rates flowing from the circumstances of the sale may be appropriate. *See* Tr. Vol. 7, Glass, pp. 1626-28. The regulatory structure in place is adequate in this area and further resource commitments from the Commission as recommended by KEPCo in this regard are not necessary.

3. Intervenors

KMEA/KMU/City of Independence ("Municipal Group") acknowledge that Joint Applicants accepted and incorporated into Schedule DRI-3 the ring-fencing protections proposed by their witness, Mr. Joseph Herz, except for two of his suggestions. *See* Municipal Group Brief at p. 1. They argue these two ring-fencing commitments included in the MPSC docket were not included in Schedule DRI-3, and should be adopted by the Commission in its Order in this case. *See* Municipal Group Brief at p. 2. Specifically, they want Joint Applicants to provide to the Commission, for a period of two years, any reports or presentations made to the GPE Board of Directors regarding efficiencies, and to provide twice annually a report on the dollar value of the efficiencies attained as a result of the Transaction. The Municipal Group argues that these requirements would address their suggestion that Joint Applicants "[P]rovide mechanisms for the quantification, monitoring, allocation, and verification of savings resulting from the Transaction in order to safeguard against the inequitable allocation of savings by GPE." *Id.*

[60] *See* K.S.A. 66-1239 – the Commission's preapproval statute.

The two supplemental provisions the Municipal Group proposes will not "safeguard against the inequitable allocation of savings" because it will not provide information to the Commission regarding the *allocation* of savings among GPE's affiliate companies. It will only identify the level of overall achieved savings, which is information the Commission will already have available to it through its audit process in future rate cases. As for the "allocation" of the savings, the argument of the Municipal Group reflects a misunderstanding of how the savings will flow through to customers. Merger savings will not be quantified and then divvied up among the utility subsidiaries; the flow-through will occur naturally as part of the allocation process used for expenses, as will be set out in the Cost Allocation Manual to be discussed with Commission Staff and filed with the Commission pursuant to Commitment 34 of Schedule DRI-3. Thus, the Municipal Group's request is misguided and unnecessary.

That said, if the Commission decides to impose the two additional reporting recommendations of the Municipal Group, Joint Applicants advise the Commission that such action would not threaten the viability of the Transaction.

Sunflower and Mid-Kansas argue the Commission should require that the boards of directors for Westar, KCP&L and GPE be made up of different board members and none should be comprised by a majority of management. *See* Sunflower Brief at p. 4, ¶¶ 11, 12. Sunflower rejects the testimony of Joint Applicants' expert witness, Mr. John Reed, wherein Mr. Reed explained the independent nature of a board member who serves on the boards of both GPE and its utility subsidiaries due to the fiduciary responsibilities held in each separate role. When asked at hearing by Commissioner Albrecht what assurances there were that the boards of the utilities would act independently, Mr. Reed explained that there would be separate boards, and that because they are separate corporations, and because the directors of each corporation have duties partially to that corporation and to the parent, it means that they do have slightly different duties when they are on the board of Westar or KCP&L versus when they are serving on the board of GPE. *See* Tr. Vol. 5, Reed, at pp. 1095-97. He said a common approach corporations generally use for this kind of structure actually has the subsidiary boards comprised of directors that are employees of the parent, making them a "fully captive board". *See* Tr. Vol. 5, Reed, at p. 1096. He explained that, in this case, the public company, GPE, actually has a majority independent board, so the majority of its members meet the NYSE definition for independence. Their independence is also reflected in the GPE committee structure, where key committees such as the Audit Committee are required to be headed up by independent directors. He concluded that,

> This proposal by GPE actually goes quite a bit further in terms of governance ... So my view as to what GPE has put forth here is actually a large step and beyond what is traditional in the industry. It is traditional to use captive boards, captive directors. Here they are using what's called a mirror board, but it's still a separate corporation, a separate board and understanding the shared responsibilities they have to that corporation and to the parent.

See Tr. Vol. 5, Reed, at p. 1096-97.

Mr. Reed's testimony was based upon decades of experience gleaned from his involvement in numerous mergers across the country. *See* Reed Rebuttal at pp. 1-3; Reed Exhibit JJR-1. Even so, Sunflower asserts that the independence described by Mr. Reed is "highly idealistic", and that the ability of a dual board member to make independent decisions in the best interest of the entity for which the decision is being made is "highly improbable". *See* Sunflower Brief at p. 4, ¶ 11. Of all the parties to this docket, Joint Applicants would expect Sunflower and Mid-Kansas to know, first-hand, that such independence is achievable. The Sunflower board of directors is identical to the Mid-Kansas board of directors, and even though Sunflower's interests are not always aligned with those of Mid-Kansas, we presume their dual board members effectively carry out their fiduciary duties to each separate organization without compromising one company's interests for the benefit of the other. Further, the boards of both Sunflower and Mid-Kansas are comprised entirely of individuals who work *in management* for the distribution cooperatives that own the two entities. Sunflower and Mid-Kansas do not explain why Mr. Reed's testimony is accurate in their case, but "highly idealistic" and "highly improbable" in the case of Joint Applicants.

CURB does not present any substantive arguments or authorities different from those of Staff and the other intervenors, so they have been addressed in Joint Applicants' response above and will not be repeated. However, CURB does make accusations against Joint Applicants in its Brief that are not substantiated by the record and cannot be allowed to stand unchallenged.

CURB argues that Joint Applicants attempt to smear the other parties by blaming them for Joint Applicants' failure to provide adequate ring-fencing provisions. *See* CURB Brief at p. 27. This could not be any further from the facts of what actually happened in this docket. During the course of the hearing, it was clear the Commissioners were struggling with identifying where the line was between adopting adequate ring-fencing and taking actions that would terminate the Transaction. Joint Applicants explained that the balance the Commissioners were seeking is usually negotiated in the settlement process, resulting in all parties obtaining the strongest position for the interest they represent while still maintaining the viability of the Transaction. In contrast in this case, Joint Applicants had to unilaterally present a matrix of financial conditions in rebuttal. Knowing the facts of what had occurred between the parties regarding ring-fencing was important so that the Commission could understand that Schedule DRI-3 represented a strong set of protections even though it had to be presented by Joint Applicants in rebuttal. Staff determined early-on that there were no ring-fencing conditions Staff would find acceptable,[61] and so indicated by taking a non-negotiable threshold position that consolidated capital structure had to be used to set future utility company rates. *See* Tr. Vol. 5, Gatewood, at p. 1161. Staff knew this position ensured a comprehensive set of conditions like the one in Schedule DRI-3 could not be worked out among the parties. That meant Joint Applicants had to, in essence, 'negotiate with itself' to work out a proposal that considered the concerns of the parties expressed in their prefiled direct testimony, incorporating the conditions offered by Dr. Dismukes, while still allowing the Transaction to move forward. Joint Applicants' only avenue to do this was by presenting in its rebuttal testimony the comprehensive package resulting from that effort.

When Mr. Gatewood testified during cross-examination that, had Joint Applicants provided Staff with "definitive well-documented mechanisms rating agencies have agreed to separate the operating utility risk from the parent company risk … that would be very strong evidence for Staff to go down a different path," (*See* Tr. Vol. 5, Gatewood at p. 1158) and that "ring fencing didn't really come up until rebuttal testimony (*Id.*)," it became even more critical to explain what had really happened so as to support the credibility of the package contained in Schedule DRI-3. Mr. Gatewood's testimony at hearing erroneously represented events in a way that undermined the veracity of Schedule DRI-3. Contrary to his representations, Joint Applicants *had* presented Staff with such ring-fencing mechanisms, in writing, in an effort to work out a package of conditions. *See* Tr. Vol. 5 Gatewood, pp. 1159-60 Staff expressed no

[61] *See* Tr. Vol. 5, Gatewood, p. 1158 – Mr. Gatewood testified, "Frankly, when we knew capitalization was going to be a central issue. I discussed with my boss and my boss' boss whether we wanted to I guess try to fix this transaction with ring fencing and our conclusion was we couldn't do it." CURB follows suit - "CURB does not believe that any type of ring-fencing provisions can eliminate the risks associated with this transaction." (*See* CURB Brief, p. 28.)

interest in such discussion given their view of the capital structure issue and did not engage further.

Unlike CURB's accusations in its Brief, Joint Applicants representations are contained in the record of this docket and reflect a thoughtful, professional approach to a situation resulting from Staff taking a position that was impossible for Joint Applicants to agree to and was not open to negotiations.

BPU's arguments on ring-fencing have been fully addressed in response to the other parties. However, there are a few arguments made by BPU that require additional response. As a preliminary matter, Joint Applicants want to set the record straight that they have not expressed a "repeated complaint that they were deprived the opportunity to proffer negotiated ring-fencing conditions." *See* BPU Brief at p. 28. Joint Applicants' testimony and arguments in this regard address and explain why the Commission – without the benefit of a negotiated agreement from the parties – is having to do its own balancing of the adequate level of ring-fencing protections that do not go so far as to cause the Transaction to fail.

BPU also represents that the Conditions "surfaced in their current form only in rebuttal testimony, thus evading responsive testimony and much meaningful cross-examination."[62] This is not accurate for a number of reasons. First, a set of conditions similar to Schedule DRI-3 were presented to Staff and CURB in November, 2016, so they "surfaced" long before they were filed in Mr. Ives' rebuttal testimony. *See* Tr. Vol. 5, Gatewood, p. 1161. Because Staff rejected further discussions outright, Joint Applicants did not pursue further discussions that would have involved the other intervenors. However, Staff and CURB were well aware of the types of

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[62] *See* BPU Brief, p. 21. BPU also refers derogatorily to "Joint Applicants' latterly discovered interests in ring-fencing". (*See* BPU Brief, p. 22.) This ignores that Joint Applicants proposed ring fencing in their Application filed June 28, 2016, evidencing their interest in the area since the beginning of this case. (*See* Ives Direct, p. 22-24.)

provisions being suggested by Joint Applicants almost two months prior to Schedule DRI-3 being filed in rebuttal. BPU states that “Joint Applicants never approached the BPU to negotiate or even discuss ring-fencing provisions prior to filing their rebuttal testimony” (*See* BPU Brief at p. 28), but BPU made no overtures to Joint Applicants to discuss potential ring-fencing, either. This was an opportunity available to BPU from the time it entered the case in August, 2016, but BPU chose not to take any affirmative action to explore ring-fencing with Joint Applicants prior to the time Joint Applicants filed their rebuttal testimony.

Second, the great majority of the Conditions in Schedule DRI-3 are contained in the direct testimony of KEPCo witness, Dr. Dismukes, filed on December 16, 2016. BPU chose not to file cross-answering testimony to Dr. Dismukes as allowed for under the procedural schedule in this docket, thus missing its opportunity to provide input and suggest changes as early as mid-December of last year.

Finally, BPU’s argument implies there is some level of due process missing as a result of the fact that Schedule DRI-3 was in Joint Applicants’ rebuttal testimony. However, BPU did not file a prehearing motion requesting the opportunity to file surrebuttal on this issue, nor did BPU ask that Mr. Ives’ Schedule DRI-3 be stricken as inappropriate rebuttal testimony, even though BPU did file such a motion against other rebuttal testimony of Joint Applicants.[63] Schedule DRI-3 is appropriate rebuttal that is responsive to the concerns of the parties expressed in their direct cases and their criticisms of the ring-fencing provisions proposed in Joint Applicants direct case. It was filed on January 9, 2017, in accordance with the schedule adopted by the Commission – a schedule BPU never objected to on the record – giving BPU three weeks to

[63] Joint Motion to Strike and for Sanctions Against Joint Applicants, filed January 11, 2017, denied by the Commission on January 26, 2017.

prepare its cross-examination. If BPU believes its cross-examination in this area was not "meaningful", the fault cannot be laid at the feet of the Commission or Joint Applicants.

BPU asserts, "Joint Applicants have made it clear that any variation of the commitments in Schedule DRI-3 would cause this Transaction to be 'infeasible', making it difficult to understand how any negotiations would have been fruitful." (*See* BPU Brief, pp. 28-29.) To support its claim that Joint Applicants have said any variation would make the Transaction "infeasible", BPU cites to page 66 of Joint Applicants' Initial Post-Hearing Brief. BPU misstates Joint Applicants' Initial Post-Hearing Brief, which very clearly says "if the KCC imposes additional conditions on Joint Applicants beyond those contained in Schedule DRI-3, ***there is the possibility*** that one or some of those additional conditions ***could*** result in making the Transaction infeasible." (***Emphasis added***). Mr. Ives' entire point was that negotiations would have allowed the parties to arrive at the balance the Commission now must seek without the benefit of the give-and-take inherent in negotiations and the surety that arises from their ultimate results: identifying adequate ring-fencing terms that do not go so far as to terminate the Transaction they are trying to address.

BPU also objects to Condition 10 of Schedule DRI-3 because it would allow KCP&L's and Westar's capital structures to climb to 65% debt/35% equity, citing to Mr. Ruelle's testimony that says utilities should be financed at about 50/50. *See* BPU Brief at pp. 22-23. But BPU accepts Staff's position that the 41% equity, 59% debt capital structure of GPE should be used to set utility rates even though that ratio is clearly not consistent with the 50/50 capital structure for which a responsible utility strives to achieve and maintain.

BPU also asserts that Condition 10 cannot be reconciled with Condition 18 because the former allows the utility companies' debt to increase to 65% of its capital structure, while the latter says rates will be set using an actual utility-specific capital structure with no less than 45% and no more than 53% equity. *See* BPU Brief at p. 24. There is no inconsistency between these provisions. Condition 10 sets the outer bounds for the utility companies' capital structures, whereas Condition 18 provides the parameters for setting rates. If KCP&L or Westar's equity in its actual capital structure goes outside of the 45-53% range, it would not violate Condition 10, but the Commission can rely upon Condition 18 to impose an adjustment in setting rates. The Conditions address two different issues. BPU's speculation about future problems concerning these two Conditions is unwarranted. *See* BPU Brief at pp. 24-25.

BPU presents other scenarios, speculating about future situations that might arise under the Schedule DRI-3 Conditions, but Joint Applicants believe the Commission knows it has the power necessary to analyze, interpret, apply and enforce the Conditions adequately, so further response to these concerns is not necessary.

D. <u>Reasonableness of Purchase Price</u>

4. Staff

Staff purports that the purchase price in the Transaction is "too high", in contrast to the opinions of Goldman Sachs, Guggenheim, GPE's shareholders, GPE's management, and the testimony of experts in the field, including Mr. Robert Hevert and Mr. John Reed. *See* Staff Brief at pp. 28-29. It is unnecessary for Staff to second-guess the amount of the purchase price, as such a determination is not required by the Merger Standards, especially when Joint Applicants have not requested a portion of the AP be included in future revenue requirements set for the utility companies. However, that said, the evidence in the case establishes that the negotiated price is fair and reasonable.

First, Joint Applicants have explained why an analysis of the reasonableness of the purchase price under Merger Standards (a)(ii) and (a)(iv) are only relevant if the Company is requesting recovery of the AP in future revenue requirements. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 96-98. Joint Applicants' position in this regard is consistent with how the Commission has developed and applied this Merger Standard in past dockets; Staff's position is not. Staff takes issue with Joint Applicants saying the Staff has suggested merger savings must equal or exceed the acquisition premium, commenting that the Companies' assertion does not cite to the record and is not an accurate reflection of Staff's position on the issue.[64] Staff represents its actual position as being that the merger savings only supports less than fifteen percent of the acquisition premium, and therefore, clearly does not justify the payment of the acquisition premium, stating its position that the acquisition premium is not reasonable in light of demonstrated savings. *See* Staff Brief at p. 96. Perhaps this is just semantics, but if Staff is now agreeing that the level of merger savings does not need to justify the level of the acquisition premium, then Joint Applicants have no disagreement with Staff in that regard.

Second, Staff is incorrect in its assertion that Merger Standard (a)(i) involves an analysis of whether the purchase price is too high a price to pay for the equity of Westar. As Joint Applicants witness Proctor stated, "the Commission's concern for the purchase price should only be related to an inquiry concerning the impact of the price on the post-merger entity's financial health." Comparing and evaluating the financial condition of the newly created entity as

[64] Mr. Grady evaluated the reasonableness of the purchase price on behalf of Staff using methodologies intended to estimate the net present value of after-tax expected savings. He states, "[t]he resulting NPV of after-tax expected savings I arrived at in this calculation is $685.15 million. Using this Commission-approved methodology, this would represent ***the largest possible AP over book value that the Joint Applicants could support based on the expected savings levels that they have identified***." (Grady Direct, p. 45, *emphasis added*.) Mr. Grady's testimony very clearly takes the position that the acquisition premium in the purchase price should be directly related to the savings from the Transaction. (*See* Grady Direct at pp. 45-52.)

compared to the financial condition of the stand-alone entities if the Transaction does not occur does not require Staff to make its own determination of whether the purchase price established in the open marketplace was reasonable. It only involves a comparison and analysis of the entities' financial condition assuming the purchase price is paid; no separate judgment by Staff of the price itself is indicated by Merger Standard (a)(i).

Finally, Joint Applicants have fully established that the price is reasonable and consistent with other similar recent transactions. *See* Joint Applicants' Initial Post-Hearing Brief at p. 71. The price was the result of an auction process, and is supported by the fairness opinions of Goldman and Guggenheim, and the comparative analysis performed by Mr. Hevert. (*Id.*) Staff's analyses in support of its assertion that the price was too high was fraught with errors and cannot be relied upon to overcome the arms-length nature of the Transaction and the opinions of professionals in the industry.[65]

5. Other Intervenors

CURB reiterates the same arguments made by Staff. CURB also asserts that the 1991 and 1999 Merger Standards should be analyzed based on "how they are actually written in the Commission's Order on Merger Standards. *See* CURB Brief at p. 30. Apparently CURB believes the Merger Standards should be applied without considering how they have been interpreted and applied by the Commission in past dockets. The fallacy of this argument is apparent.

CURB's continues with its irrational assertions by arguing that "the Joint Applicants did not ask for a modification of Commission Merger Standard (a)(ii)[66] and (a)(iv), so the analysis

[65] Mr. Hevert explained these errors, as summarized in Joint Applicants' Initial Post-Hearing Brief, pp. 71-76.

[66] Mr. Proctor addressed Merger Standards (a)(ii) and (a)(iv). Reference in CURB's Brief to (a)(iii) appears to be an error.

that Mr. Proctor provides is based on language and a standard that has not been approved by the Commission in this docket." *See* CURB Brief at p. 30. Joint Applicants are not asking for a modification of any Merger Standard. Mr. Proctor's testimony reviews past Commission decisions to show how the Standards have been applied in the past and, as such, it makes no sense to say his analysis is based on language and a standard that has not been approved *in this docket.*

BPU's arguments regarding the undisturbed stock price of Westar (*See* BPU Brief at pp. 29). have been fully addressed in Joint Applicants' Initial Post-Hearing Brief and will not be reiterated here. It is interesting, however, that BPU concludes the "Commission should credit Westar and Guggenheim as the more knowledgeable and credible sources on the unaffected stock price," while at the same time arguing that the purchase price found to be reasonable by Goldman Sachs and GPE's sophisticated investors should not be given the same deference. *See* BPU Brief at pp. 31-39.

V. SAVINGS AND INTEGRATION

A. <u>Merger Standard (a)(iii): "(a) The effect of the transaction on consumers, including: (iii) Whether ratepayer benefits resulting from the transaction can be quantified."</u>

Joint Applicants have addressed in their Initial Post-Hearing Brief many of the criticisms noted in the Staff and intervenors briefs with regard to the development and veracity of the efficiencies levels and Integration Project efforts. For the sake of brevity, Joint Applicants will attempt to respond only to the items not already discussed in the Initial Post-Hearing Brief, or, if necessary, offer brief comment for items previously addressed. One such brief comment being that Parties criticize the auction-process timeline under which the efficiencies were developed. *See* BPU Brief at p. 61. This criticism implies inappropriateness to the auction process employed, and disregards the current trend in auction-style bids. As noted, the auction process is becoming increasingly more prevalent and the associated timeline for evaluation does not change the nature of the work performed in analyzing the likely efficiencies resulting from a winning bid. *See* Joint Applicants' Initial Post-Hearing Brief at p. 89. While the parties may have preferred that a more historic, non-auction style bid process be utilized, that is not the situation with which GPE was presented.

1. Response to KEPCo

KEPCo argues that Joint Applicants' erroneously assume efficiencies will continue in perpetuity (*See* KEPCo Brief at p. 27) but in fact such assumption is not in error. As noted by Mr. Flaherty, efficiencies studies are conducted with the understanding that they are a snapshot of a point in time, and the information being captured is the situation as it exists at that time. *See* Tr. Vol. 5, Flaherty, pp. 1319-1320. So, for example, if a position is lost as a result of a transaction, the savings attributable to that reduction sets a new baseline of costs and as such, the reductions do continue in perpetuity. *See* Tr. Vol. 5, Flaherty, p. 1318. Additional future costs could occur from business changes like mandates, growth or operating requirements, but these costs would not be merger related and it would be inappropriate to attempt to assume potential future costs unrelated to the merger would offset merger savings – the merger savings are separate and perpetual, while new costs are unique and are not known at this time. *Id.*

KEPCo next argues that the efficiencies presented by Joint Applicants are unreliable because at the time Enovation was asked to perform an efficiencies study in April 2017, GPE identified minimum efficiencies targets of $50 million, $100 million, and $150 million for 2018, 2019, and 2020, respectively. *See* KEPCo Brief at p. 30. KEPCo's argument infers that these minimum efficiencies targets were somehow included in Mr. Kemp's modeling, which is simply not true. As explained, the minimum efficiencies targets were numbers identified by GPE management as thresholds in making a determination on whether to make a bid for Westar; they were not inputs into Mr. Kemp's model for the purpose of calculating the efficiencies estimates. *See* Kemp Rebuttal at p. 9.

KEPCo also argues that the efficiencies are unsupported because they are subjective in nature. *See* KEPCO Brief at p. 30. Efficiencies estimates can never be fully objective because the events to which they are related have yet to occur – this has been recognized by the KCC and other commissions as a necessary perspective when considering merger savings. Efficiencies estimates are a look at what is expected to happen in the future, not what has happened in the past. As noted in Joint Applicants' Initial Post-Hearing Brief, the efficiencies estimates were developed collaboratively between GPE management and Enovation, and embody the knowledge base of the industry experts involved. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 83-86. As such, the efficiencies estimates are based on informed judgment as opposed to an arbitrary subjective opinion as KEPCo would have the Commission believe.

KEPCo next attempts to pit Joint Applicant witnesses Messrs. Kemp and Flaherty against one another. *See* KEPCo Brief at pp. 33-34. KEPCo argues that Mr. Flaherty's discussion at hearing cautioning the use of macro level costs savings such as FERC accounts is an attack on Mr. Kemp's methodology in assisting GPE with the development of the efficiencies estimates. Such is not the case. Mr. Flaherty does not suggest that Mr. Kemp's approach is invalid, but rather notes that when using macro level costs categories caution should be employed and cost types are usually the most relevant indicator of actual savings realized. Mr. Flaherty's testimony notes that this macro level discussion is not an issue with regard to the Administrative & General cost portions of Mr. Kemp's study, which is where most merger savings tend to occur and his analyses of cost level changes supports. *See* Tr. Vol. 5, Flaherty, at p. 1318. Mr. Flaherty's analysis of the GPE efficiencies estimates both included and excluded Generation costs savings contained in the efficiencies estimates, and showed that even when Generation costs savings data was excluded, the efficiencies estimates were still within the reasonable range of comparable transactions. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 93-94. This fact reinforces the validity and reasonableness of the GPE efficiencies estimates.

KEPCo's attempt to undermine Mr. Kemp by virtue of Mr. Flaherty fails because it disregards the fact that regardless of the individual methodologies preferred and employed by Messrs. Kemp and Flaherty the result is the same – this Transaction will result in significant benefits. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 93-95. Messrs. Kemp and Flaherty have each created their own transaction databases derived from their respective experiences with these types of transactions, which are vast and undisputed. *See* Schedule WJK-1; Schedule TJF-1. Each utilized their respective databases in preparing their work on behalf of GPE, and each reach the same conclusion. That two such renowned experts can employ different analyses with regard to the efficiencies and come to the same conclusion only serves to amplify the validity of the efficiencies levels, not call them into question as suggested by KEPCo.

KEPCo then criticizes Mr. Flaherty's analysis at hearing with regard to Dr. Kirsch's testimony alleging that a large number of the mergers contained in Mr. Kemp's database failed to achieve their anticipated efficiencies estimates. *See* KEPCo Brief at p. 34. Dr. Kirsch argued in prefiled testimony that because costs increases were noted in the merger transactions contained in Mr. Kemp's database that this means that the mergers failed to achieve their projected efficiencies estimates.[67] KEPCo argued that "[f]or Mr. Flaherty's criticism [of Dr. Kirsch] to be valid, one must accept that the 60% of the 25 mergers shown…that failed to meet their cost

[67] *See* Kirsch Direct, pp. 31-35. It should be noted that Mr. Kemp refuted Dr. Kirsch's criticisms in rebuttal testimony. *See*, Kemp Rebuttal, pp. 50-51.

savings targets…had ‘other ***costs*** over a broader database’ systematically ***higher than forecast***…” (***emphasis added***), and that “merging utilities systematically ***underestimate post-merger costs*** and overestimate merger cost savings.” *See* KEPCo Brief at p. 34 (***emphasis added***). The inherent problem with KEPCo’s argument and Dr. Kirsch’s conclusion that many of the noted mergers failed to achieve their efficiencies estimates is that KEPCo is attempting to evaluate the achievement of efficiencies by looking at total costs. Stated differently, KEPCo is attempting to use data from Mr. Kemp’s database of comparative changes in total costs to criticize the conclusions that Mr. Flaherty draws from his database of specific areas of realized efficiencies. Mr. Flaherty’s data on the achievement of efficiencies from mergers are more granular, and reflect the performance of utilities in achieving specific savings, *e.g.*, insurance, benefits, supply chain, etc., rather than generation, transmission, or distribution, around their merger integration programs. Mr. Flaherty’s critique of Dr. Kirsch stands on his own, very well informed expertise from working with scores of merging utilities before and after their transactions, something that Dr. Kirsch has not been involved with. Post-merger costs of future operations are not estimated for the purposes of determining efficiencies estimates. Rather, discrete, merger driven cost savings categories, like those above, are estimated, therefore, KEPCo’s arguments and conclusion are flawed.

KEPCo seeks to further its argument that merging utilities fail to achieve projected efficiencies estimates by discussing the Boston Consulting Group (BCG) study cited by Dr. Kirsch. *See* KEPCo Brief at p. 35. KEPCo accuses Mr. Flaherty of leveling two baseless criticisms against Dr. Kirsch for his use of the BCG study, the first being that the study is conducted at a macro-level that does not account for savings at the category level, and the second being that Dr. Kirsch selectively used only portions of the BCG study. *See* KEPCo Brief at p. 36.

KEPCo alleges that in response to questioning on the BCG study at hearing Mr. Flaherty "twice dissembled and did not answer the questions." *Id.* This statement is inaccurate. Mr. Flaherty explained that his criticism with Dr. Kirsch's use of Figure 1 from the BCG study is that the Figure purports to show what was actually realized in terms of cost savings, but the source for the Figure is derived from FERC Form 1data, which only captures total functional costs and does not contain the level of detail necessary to make such a calculation. *See* Tr. Vol. 5, Flaherty, at pp. 1323-1325. Mr. Flaherty further noted that as depicted in Dr. Kirsch's testimony the Figure 1 from the BCG study did not identify the source of the data, and had Mr. Flaherty not been aware of the data source for Figure 1, he would have assumed, based on Dr. Kirsch's depiction of the study, that BCG had insight as to what was actually realized. Tr. Vol. 5, Flaherty, at 1325 However, because of Mr. Flaherty's familiarity with the study he took exception with Dr. Kirsch use of Figure 1 because Mr. Flaherty disagrees that merger specific savings can be derived from FERC Form 1 data, which is exactly what BCG did. Tr. Vol. 5, Flaherty, at 1324. FERC data may contain the actual merger savings realized, but it also contains all other cost level changes that are unrelated to the merger. With regard to Dr. Kirsch's selective use of the study, his testimony conveniently ignores that the BCG report nonetheless states "[i]n fact, The Boston Consulting Group estimates that a typical utility merger offers 18 to 33 percent in savings[,]"[68] which belies Dr. Kirsch assertion that merging utilities fail to achieve projected efficiencies estimates.

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[68] The link to the BCG study was provided on p. 33, footnote 55 of Dr. Kirsch's Direct Testimony. The quoted reference can be found by following the link and clicking on the "The Drivers of Utility Consolidation" heading. https://www.bcgperspectives.com/content/articles/energy_environment_mergers_aquisitions_utility_m_and_a/#chapter1.

2. Response to BPU

BPU finds fault in the efficiencies presented by Joint Applicants, but the evidence shows that the approaches employed by GPE in establishing and evaluating the efficiencies were consistent with both industry and Commission practice (*See* Joint Applicants' Initial Post-Hearing Brief at pp. 84, 86, 89), unlike the approach espoused by BPU. While BPU argues for perfect information, real time business decisions must be made using the best information available, which is what GPE did in developing its efficiencies estimates. Ironically, BPU cites to the Commission's Merger Standards arguing that Joint Applicants have failed to satisfy the Standards (*See* BPU Brief at pp. 61-62), while at the same time recommending the Commission deviate from its historic practice with regard to application of those Standards.[69] BPU continues to argue for the application of the Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines ("DOJ Horizontal Merger Guidelines") (*See* BPU Brief at pp. 66-67), when the Commission has never required such application (*See* Tr. Vol. 4, Steffen, p. 810), arguably because they were developed for use by the federal government in antitrust investigations (*See* Tr. Vol. 4, Steffen, p. 811), and as such do not contemplate, nor were they ever intended for, use in State regulatory proceedings. *See* Flaherty Rebuttal at p. 49; Kemp Rebuttal at p. 14). While it is unclear at times which application of the DOJ Guidelines BPU champions, the one published by the DOJ or the version proffered by BPU witness Mr. Steffen, what is clear is that the Commission has never applied these standards previously, and Mr. Steffen's use of them has not been adopted in a State commission proceeding. *See* Tr. Vol. 4, Steffen, at p. 809-810.

[69] In addition to the use of standards from the Department of Justice Horizontal, the Securities and Exchange Commission, and Financial Accounting Standards Board, Mr. Steffen criticizes Joint Applicants for having failed to conduct an analysis of the purchase of Westar involving a buyer other than GPE. The Commission has never required such an evaluation. (*See* Tr. Vol. 4, Steffen, p. 815)

BPU dedicates several pages of its brief arguing that Mr. Kemp's inclusion of Generation related efficiencies was inappropriate.[70] *See* BPU Brief at pp. 64-71. As noted in Joint Applicant's Initial Post-Hearing Brief, Mr. Kemp conducted his analysis consistent with the approach in the Aquila acquisition, and included costs that were directly created or enabled by the Transaction, and could not be realized in the normal course of business as separate companies, including benefits that could demonstrably be achieved at significantly greater speed or lower risk. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 84-85. Based on these guidelines, Mr. Kemp included Generation related efficiencies. In the event the Commission approves the Transaction, it is logical that GPE will be able to operate the separate generation fleets of Westar and KCP&L in a manner that is more efficient than what the two companies can do today. While the exact nature of the retirements cannot be known until a post-close IRP can be conducted, it is reasonable to expect there will be Generation efficiencies.

It is not uncommon for experts to argue about efficiencies (*See* Joint Applicants' Initial Post-Hearing Brief at p. 95), and in fact, a review of the rebuttal testimonies of Messrs. Kemp, Flaherty, and Busser highlight some of the calculation and assumption errors made by the various Staff and Intervenor efficiencies witnesses on a variety of issues. However, if the Commission is concerned about the issues raised with regard to the inclusion of Generation-related efficiencies, they can rest assured that even absent the inclusion of those efficiencies; this

[70] BPU, citing to Mr. Noblet's rebuttal testimony, also argues that $214.1 million of T&D CapEx savings is not related to the Transaction because of Mr. Noblet's statement that the "…$214.1 million of the…T&D…has been determined as not needed by SPP…" However, BPU ignores the preceding sentence from Mr. Noblet that says "…we anticipate that by reviewing the new combined priorities between the Westar and KCP&L territories, some projects will be able to be deferred, delayed, and a few even might be accelerated". BPU's emphasis on one sentence of Mr. Noblet's discussion disregards the fact that there were efficiencies identified as a result of the "new combined priorities between Westar and KCP&L territories[.]" To the extent efficiencies were identified due to reprioritization of projects resulting from the Transaction, those were appropriately included in Mr. Kemp's efficiencies estimates.

Transaction is still favorable as compared to the other industry transactions in recent years. Based on Mr. Flaherty's analysis of Mr. Kemp's efficiencies study, even when all Generation related efficiencies are removed, the initial level of position reductions, and the level of O&M reductions are within the reasonable range. *See* Joint Applicants' Initial Post-Hearing Brief at pp. 93-94).

The motivation behind BPU's criticisms of Joint Applicants' efficiencies and the processes employed in the development and verification of the efficiencies calls into question the credibility of the BPU testimony offered. BPU engaged a savings expert, Mr. Steffen, who utilizes an efficiencies evaluation methodology that results in no merger-related savings being found, not only in this case, but also in the only other case cited by BPU for support of Mr. Steffen's methodology. *See* Tr. Vol. 4, Steffen, p. 811; Exhibit JA-18. BPU's argument that Joint Applicants could have filed their case at a later date when the Integration Project was further along (BPU Brief at p. 73) necessarily implies that the timing of the filing would have made a difference in BPU's analysis, but that is simply not the case. Mr. Steffen's methodology identified no efficiencies related to this Transaction, so the timing of the filing argument espoused by BPU is irrelevant. That this Transaction involving contiguous utilities results in zero merger related savings is contrary to the Commission's past findings,[71] and defies logic, unless one considers the underlying interests at play.

As noted by BPU witness Mr. Krajewski, within SPP, BPU is connected to two zonal areas – Westar's and KCP&L's. *See* Krajewski Direct, p. 18. Under the SPP rules, BPU has the ability to select the most advantageous of the zonal rates to which it is connected, which happens to be the KCP&L rate. *See* Krajewski Direct at p. 19. If the Commission approves the

[71] 1999 Merger Order.

Transaction, BPU theorizes that GPE could combine the transmission operations of KCP&L, GMO, and Westar, thereby eliminating the currently favorable KCP&L zonal rate that BPU selectively uses. Krajewski Direct at pp. 19-21. The impact on BPU of this theoretical combination of the zones arguably does not present if a company other than GPE purchases Westar. Therein lies the crux of the matter. While BPU's assumptions with regard to the combination of GPE transmission zones are admittedly conjectural (Krajewski Direct at p. 19), and assume the status quo with regard to all other transmission operations within SPP indefinitely, this potential impact calls to light the driving force behind BPU's opposition to this Transaction and offers insight into the use of an expert witness whose methodologies are designed to categorize traditional merger-related efficiencies as generic so as to produce a result indicating a lack of merger-related efficiencies. BPU seeks to retain the advantages it presently has with the zonal rates and is willing to help scuttle the Transaction and its benefits to the public generally to achieve its individual goals.

Next, BPU criticizes Joint Applicants for not including in rebuttal testimony an update on the efficiencies levels (*See* BPU Brief at p. 74), but fails to mention that it was a joint signatory to a *Joint Motion to Strike and for Sanctions Against Joint Applicants* (Motion to Strike) filed in this proceeding on January 11, 2017. In the Motion to Strike, the signatories argued to strike portions of the efficiencies testimonies of Messrs. Kemp, Busser and Flaherty in part because the testimonies were an attempt to "augment savings estimates with new information from Integration Teams[.]" Motion to Strike, at 6, ¶ 17. Now, in its brief, BPU argues that Joint Applicants should have included even more information in rebuttal testimony than that which BPU sought to have stricken from the record on January 11th. It is clear from these conflicting arguments that regardless of Joint Applicants' actions, BPU was and is determined to find fault to support its position for denial of the Transaction.

3. Response to Staff

Staff argues that Joint Applicants' use of Mr. Flaherty as a witness put Staff in a position that it was "unable to rebut on the record" information provided by Mr. Flaherty in rebuttal testimony, and that Mr. Busser's reference to a December 20, 2016 Steering Committee report containing the latest details on the efficiencies "is not in the record, so any references to updated efficiencies should be rejected as procedurally improper." Staff Brief at p. 89. These arguments are without merit. First, with regard to Mr. Flaherty, the notion that an applicant has no right in rebuttal testimony to address arguments raised by Staff and intervenors in their respective direct testimonies is contrary to Kansas law,[72] and is an issue that was argued in this case before the Commission on January 24, 2017 in relation the Motion to Strike referenced above in response to BPU. Staff could have filed a motion for leave to file surrebuttal testimony in the event it felt responding to Mr. Flaherty in written form was imperative. However, it instead chose to file the Motion to Strike and attack Mr. Flaherty's rebuttal testimony as improper. In deciding the matter, the Commission denied the Motion to Strike, necessarily finding Mr. Flaherty's testimony to be proper rebuttal testimony.[73]

Second, Mr. Flaherty testified at hearing and, in fact, Staff, cross-examined him. That Staff elected not to avail itself of the opportunity at hearing to explore with Mr. Flaherty his assumptions and conclusions was Staff's choice. For Staff to now argue that it was denied the opportunity to refute Mr. Flaherty is inaccurate.

[72] Joint Applicants' *Response to Joint Motion to Strike and for Sanctions Against Joint Applicants*, pp. 2-4, filed Jan. 20, 2017.

[73] Order on Prehearing Motions, p. 12, ¶ D, Jan. 26, 2017.

Finally with regard to Mr. Flaherty, the procedural schedule in this matter was in place for many months and Staff was well aware of it. It is not uncommon for a witness in a proceeding to first present rebuttal testimony in response to another party or parties' direct testimony, and Staff's suggestions to the contrary are meritless.

With regard to Mr. Busser's reference to the December 20, 2016 Steering Committee report, that information was provided to the parties through discovery so there is nothing procedurally improper about Mr. Busser's reference to the report. Tr. Vol. 5, Busser, at 1222. As a reminder, in Direct testimony Staff argued that Joint Applicants' should not be allowed to provide in rebuttal testimony any information with regard to the efficiencies levels (Diggs Direct at p. 29), so in an attempt to satisfy Staff, Joint Applicants did not include the referenced report and supporting documents in Mr. Busser's Rebuttal testimony. However, as noted, the information was provided to the parties through discovery, and Staff could have cross-examined Mr. Busser with regard to the data response, yet it chose not to. The Commission should find this curious. Mr. Busser took the stand knowing that the Steering Committee report and supporting documents were not contained in his Rebuttal testimony due to Staff's comments in its Direct Testimony. Mr. Busser also knew that the parties had the information in their possession by virtue of the data response. Mr. Busser was prepared to discuss those documents at hearing upon questioning by the parties, and in fact noted on the stand his heightened confidence in the efficiencies levels, yet Staff did not question Mr. Busser with regard to those documents. Why? If the documents did not purport to support Mr. Busser's assertions, Joint Applicants have every belief that Staff would have used them to impugn Mr. Busser's credibility.

Next, like KEPCo, Staff argues that the minimum efficiencies targets identified by GPE management somehow influenced the efficiencies estimates calculated in Mr. Kemp's model.

Staff Brief at p. 90. As noted previously in response to KEPCo, these efficiencies targets were not inputs in Mr. Kemp's model and as such could not have compromised the results.

Staff further argues that it is Joint Applicants' burden to show that GPE management's provisioning of efficiencies targets to the Efficiencies Team did not influence the resulting study in light of Staff's allegations that it did, and that [t]he fact that Mr. Kemp was provided any 'targets' at all is enough to cast doubt on the credibility of his analysis." Staff Brief at p. 90. This argument is perplexing. Joint Applicants understand that an applicant before the Commission has the burden of proving its case. But once a party alleges an inaccuracy with regard to the information provided, <u>that</u> party has a burden to prove why its assertion should be accepted. In this instance, Joint Applicants noted that Ms. Diggs allegations regarding biases were not supported by logical explanation or evidence to show that the provisioning of the minimum efficiencies targets did in fact cause bias. *See* Joint Applicants' Initial Post-Hearing Brief at p. 86. Joint Applicants further noted, as stated above, that the minimum efficiencies targets were reference points, not values utilized in the calculation of the efficiencies estimates. The mere allegation by Ms. Diggs is not enough to <u>prove</u> the existence of an underlying bias that the Joint Applicants must then "disprove". Staff still offers no evidence or logical explanation for their statement, other than to cite the testimony of Ms. Diggs that Joint Applicants already noted was illogical.

Staff next argues that Joint Applicants' representations that the Aquila efficiencies were greater than initially estimated and that the efficiencies for this Transaction are within the range of similar industry transactions is misleading. *See* Staff Brief at p. 91. Joint Applicants respectfully disagree. Staff's analysis is overly simplistic and ignores that the initial estimates of non-fuel O&M savings from February 2007 were significantly lower than the final estimates from November 2007, indicating that savings opportunities typically expand as you drill deeper, and the fact that the initial savings estimates did not include interest savings on Aquila's debt or CapEx savings in the Supply Chain area. As noted by Mr. Kemp, both of these savings elements turned out to be substantial, and are not reflected in the non-fuel O&M savings, which is a narrower measure. *See* Kemp Rebuttal at p. 92.

Also, as noted by Mr. Ives at hearing,

> Part of our integration process, the same as we did with the Aquila transaction, is that we will – we will track savings from our perspective on kind of a major project basis as identified by the teams so that we can get comfortable that we have delivered the types of savings that we've told our commissions and our Board and our shareholders that we can deliver, so we will have our tracking mechanism.

See Tr. Vol. 4, Ives, at p. 1048. Mr. Ives' reference to the tracking of the Aquila efficiencies is consistent with Mr. Flaherty's discussion regarding the need to track efficiencies on a more granular level so that the realized efficiencies are not masked by costs increases at the larger FERC account level. Staff's argument that the Aquila efficiencies were less than expected suffers from the analytical flaw identified by Mr. Flaherty, and as discussed above in response to KEPCo – Staff is attempting to evaluate the achievement of efficiencies by looking at total costs post-merger, which is inappropriate.

Staff also attacks Mr. Kemp with regard to various Generation related items, citing to Mr. Drabinski for support. *See* Staff Brief at p. 93. However, Staff fails to note that Joint Applicants refuted Mr. Drabinski's testimony on several points. Mr. Drabinski's model regarding post-closure O&M did not include all non-fuel O&M, and as such it was inaccurate. *See* Kemp Rebuttal at pp. 20-21. Mr. Drabinski confirmed this error at hearing. *See* Tr. Vol. 6, Drabinski, at p. 1424. Mr. Drabinski's conclusions that there will be little improvement in the average heat rate of the generation fleet is inaccurate because of his use of the incorrect heat rate.

See Kemp Rebuttal at pp. 21-22. With regard to decommissioning and dismantlement costs, Mr. Drabinski's analysis gave no consideration to salvage of equipment, sale or reuse of the site, or the fact that mothballing is a viable option. *See* Kemp Rebuttal at pp. 24-25. He also erroneously assumes the same D&D cost for all plants regardless of size and type, which disregards the significant cost associated with items such as coal handling equipment, slag-contaminated metal, ash storage remediation, to name a few. *See* Kemp Rebuttal at p. 24. This results in a significant overstatement of costs. *See* Kemp Rebuttal at p. 24. Therefore, Staff's reliance on their witness to criticize Mr. Kemp's plant retirement efficiencies as lacking reliability is inappropriate. As noted in response to KEPCo, when it comes to merger-related efficiencies, experts will disagree, but even when all Generation efficiencies are removed, which Joint Applicants believe would be inappropriate, the Transaction still falls within a reasonable range as compared to other such transactions.

Staff next argues that with respect to Transmission and Distribution that the efficiencies identified are inappropriate because the costs associated with Westar's proposed but Commission rejected EDGR program were not included. *See* Staff Brief at p. 93. Mr. Kemp addressed this issue in rebuttal and noted that because the Commission did not adopt the EDGR program, the costs associated with the program were not included in the Westar budget used to set the baseline in establishing the efficiencies estimates. *See* Kemp Rebuttal at pp. 47-48. Mr. Kemp also noted that GPE would approach cost-reductions in the T&D and Customer Service areas in such a way so as to ensure that reliability and customer satisfaction are not negatively affected. *See* Kemp Rebuttal at p. 48.

Staff then turns its attention to Supply Chain efficiencies and again relies upon Mr. Drabinski to argue that these efficiencies could be achieved without the merger. *See* Staff

Brief at p. 94. Again, Joint Applicants fully refuted Mr. Drabinski, demonstrating Mr. Drabinski's lack of understanding regarding procurement consortia. *See* Kemp Rebuttal at pp. 26-34. Staff did not challenge Mr. Kemp regarding his testimony rebutting Mr. Drabinski on Supply Chain efficiencies.[74]

With regard to Shared Services, Staff argues that the headcount reductions identified by Joint Applicants are unsupported. *See* Staff Brief at p. 94. Joint Applicants disagree and note that Staff's arguments on this issue were rebutted by Mr. Kemp. First, as noted by Mr. Kemp, GPE used a general assumption in the bid estimates that the cost to achieve per FTE reduction would be 50% of the annual loaded labor cost per FTE for that budget line. *See* Kemp Rebuttal at p. 42. Mr. Kemp explained that GPE views this as a conservative assumption, and at the upper end of what its costs to achieve could be. *See* Kemp Rebuttal at p. 43. Mr. Kemp went on to explain that 50% of the loaded labor cost is close to the average severance payments that GPE assumed in the bid process for the combined Westar and GPE workforces, and that the actual average cost per FTE is expected to be lower, since a large proportion of the FTE reductions (25% or more) will be accomplished without severance payments. *Id.* GPE will use attrition, relocation, and redeployment instead of severance payments wherever possible, as explained by Mr. Bassham. *See* Bassham Direct at p. 8. Therefore, the weighted average costs to achieve will roll in the lower cost attrition, relocation and redeployment options, as well as the severance payment option.

Second, while Joint Applicants acknowledge that in calculating the FTE reductions for 2017, GPE should have used 50% of the loaded labor cost per FTE for the full year 2017, as opposed to the half year 2017, the understatement of costs to achieve is not material. Kemp

[74] Joint Applicants also refuted BPU witness Dr. Lesser pp. 34-40 with regard to Supply Chain efficiencies.

Rebuttal at p. 43. Therefore, Staff's conclusion that GPE's Shared Services efficiencies are unsupported is erroneous.

4. Kansas Industrial Customers

To the extent that KIC argues that the efficiencies estimates have not been demonstrated, Joint Applicants have already addressed the adequacy of the efficiencies estimates and Integration efforts in the Initial Post-Hearing Brief and above in response to other parties, and will not restate those arguments here.

KIC's essential argument with regard to efficiencies is that Joint Applicants have failed to show that the Transaction will lower rates and that there is uncertainty with regard to the timing of when the efficiencies flowing back to customers.

First, KIC to misapplies the public interest consideration of the Commission's analysis for merger transactions. The public interest consideration does not require a transaction to result in a line item reduction on a customers' bill such as the cash payments to customers and bill credits proposed by KIC. *See* KIC Brief, at p. 19-20. Second, Joint Applicants have been very clear that the efficiencies of this Transaction will flow back to customers through the normal regulatory process, and that this transaction will result in future rates lower than they would otherwise be without the Transaction. *See* Tr. Vol. 4, Ives, at p. 1049, Tr. Vol. 5, Ives, at pp. 1228-29. KIC's arguments attempt to characterize the post-close regulatory plan as a nefarious scheme to keep savings from customers, however, any efficiencies realized necessarily offsets other costs incurred by the utility, and as such, regardless of the timing of future rate cases, customers will get the benefit of those efficiencies.

At hearing KIC spent much time discussing evidence it introduced at hearing in an attempt to show that the rates paid by KIC members are higher than in surrounding areas, but failed to establish a foundation that simply comparing rates was relevant. Obviously many factors go into rate comparisons and one exhibit purporting to show average rates for customers may not capture the true costs to customers. *See* Tr. Vol. 4, Ives, at 1051. For example, Joint Applicants have already made environmental compliance investments whereas other utilities reflected in KIC's exhibit may not have. Joint Applicants do not accept the premise that the evidence presented by KIC provides a holistic view of customer bill impacts. Joint Applicants do, however, find KIC's objection to the Transaction curious because it appears to be counterintuitive to KIC's argument that its members' 'rates' are high as compared to other areas of the country. An ability to ensure that future rate increases will be less than otherwise experienced by KIC members is exactly what this Transaction offers, as noted by Mr. Ives at hearing in response to questioning by KIC, yet KIC argues against it. Tr. Vol. 4, Ives, at 1057-58.

5. Sunflower

In questioning the efficiencies estimates Sunflower argues that no efficiencies from the Transaction can occur because "the realization of savings by one public utility due to something another public utility made possible is impossible without one set of rate payors [*sic*] subsidizing the rate payors [*sic*] of another public utility."[75] This argument indicates a lack of understanding on the part of Sunflower as to how these companies will be operated in the future. As noted in response to the Municipal Group in Section IV above, the Commission will approve a CAM that will ensure that all efficiencies and costs are properly allocated to the appropriate company.

As noted above and in Joint Applicants' Initial Post-Hearing Brief, when it comes to efficiencies estimates experts will disagree with regard to methodologies employed and values derived, and the briefs of the parties in this matter demonstrate such. *See* Joint Applicants'

[75] *See* Sunflower Brief, p. 4. Sunflower offers no citation to any authority

Initial Post-Hearing Brief at p. 95. Joint Applicants commented in the Initial Post-Hearing Brief that the Commission has previously found that the combination of Westar and KCP&L is beneficial to Kansas customers, and nothing about the underlying principles of that finding has changed. *See* Joint Applicants' Initial Post-Hearing Brief at p. 95. No party challenged these statements. This Transaction will result in hundreds of millions of dollars of savings flowing to customers, mitigating cost increases, and thereby resulting in lower future rates than what will otherwise occur without the Transaction, and as such the Commission should approve the Transaction. *See* Joint Applicants' Initial Post-Hearing Brief at p. 95.

B. <u>Merger Standard (a)(iv): "(a) The effect of the transaction on consumers, including: (iv) Whether there are operational synergies that justify payment of a premium in excess of book value."</u>

As is discussed in the immediately preceding section, the Transaction will generate substantial, quantifiable benefits for customers. As GPE witness Bryant testified, the net present value of anticipated merger savings are approximately $4.3 billion. *See* Bryant Supplemental Direct at p. 6. Admittedly, as pointed out by Mr. Bryant, *id*. at p. 7, and by BPU in its brief, BPU Brief at p. 45, the net present value of the anticipated savings from the Transaction is less than the anticipated acquisition premium. However, contrary to BPU's suggestion and as GPE's witnesses have pointed out, *id*., Ives Supplemental Direct at p. 11, there is no requirement under Merger Standard (a)(iv) that anticipated savings exceed the acquisition premium. As Mr. Ives testified: "In fact, when the Commission first established its Merger Standards, it approved a transaction where the acquisition premium exceeded the net present value of anticipated savings." Ives Supplemental Direct at p. 11. And, as Mr. Proctor testified, "…this Commission has never denied a merger application on the basis of the merger savings being less than the acquisition premium." *See* Tr. Vol. 2, Proctor, p. 362.

In any event, as Joint Applicants witness Jim Proctor testified, Merger Standard (a)(iv) was developed and used to determine what portion of the acquisition premium may be recovered in rates. *Id*. It is not applicable where, as here, the applicants are not seeking to recover any portion of the acquisition premium in rates. CURB and KEPCo have suggested that Mr. Proctor's testimony on this matter is inappropriate and should be disregarded. *See* CURB Brief at pp. 30-31, KEPCo Brief at 12-20. In essence, both suggest that Mr. Proctor and the Joint Applicants are seeking a modification to the standard rather than applying it as required by the Commission's Order on Merger Standards. Both, however, miss the point of Mr. Proctor's testimony.

As Mr. Proctor testified, the Merger Standards were developed through a case process. *See* Tr. Vol. 2, Proctor, at p. 361. As a result, it is not possible to really understand the merger standards just by reading them as the Commission published them in its Order on Merger Standards. *Id*. The only way to understand the standards is to review – as Mr. Proctor did – the manner in which they have been applied in previous mergers. *Id*. Having established its approach to mergers – in this case with regard to judging whether there are sufficient synergies to justify payment of the acquisition premium – the Commission is required to follow its precedent or provide a reasoned explanation for failing to do so. *See, e.g., Western Resources, Inc. v. KCC*, 30 Kan. App. 2d 348, syl. ¶ 7 (2002) ("Where the Kansas Corporation Commission rules in a manner inconsistent with a previous decision, the law requires that the commission explain its change in position.") By announcing that it would follow and apply the Merger Standards that it had developed in prior cases, the Commission effectively adopted and republished more than the mere words of the standards, it adopted and republished the history through which the standards were developed. Mr. Proctor's testimony accurately and appropriately explained that history to assist the Commission in its proper application of the Standards.

KEPCo suggests that Mr. Proctor is attempting to modify the Commission's standard by requiring the insertion of words that are not there. *See* KEPCo Brief at pp. 13-14. KEPCo is incorrect on at least two grounds. First, as was discussed above, Mr. Proctor's testimony accurately recounts the manner in which the Commission has applied the Merger Standards. As he testified, the Commission has never decided whether to approve a transaction based on a comparison of anticipated savings to the acquisition premium. Rather, it has used the quantification of anticipated savings to place a cap on the recovery of transaction-related costs. Rejecting the Transaction on the ground that anticipated savings are less than the acquisition premium would violate – not follow – the Commission's precedent.

Second, as Mr. Proctor testified, Merger Standard (a)(ii) (and (a)(iv) for that matter) are used to assess "the effect on consumers" of the acquisition premium and the purchase price. Tr. Vol. 2, Proctor, at p. 360. Where, as here, the acquisition premium is not to be reflected in rates, it can have no effect on consumers. *Id*. That is not to say that the Commission should not consider the size of the premium or the purchase price. Rather, the Commission should consider those items under Merger Standard (a)(i) that deals with the financial condition of the newly created entity as compared to the financial conditions of the standalone entities. As is discussed in Section IV.A. above, the Transaction meets that standard.

VI. QUALITY OF SERVICE AND PUBLIC SAFETY

A. <u>Service Quality Standards</u>

The Commission should adopt the service quality standards proposed by Joint Applicants through the Rebuttal Testimony of Kevin Noblet. *See* Noblet Rebuttal at pp. 16-32; Schedules KTN-1 through KTN-4. Joint Applicants have proposed standards that ensure the Transaction will not result in degradation of service reliability or responsiveness; such proposed standards are consistent with the Commission's long-standing practice. Staff and CURB are the only two parties that discuss service quality standards in their post-hearing briefs. However, neither party offers any substantive basis to support their suggestion that Joint Applicants' proposed service quality standards are insufficient. In fact, Staff does not even acknowledge that Joint Applicants have proposed service quality standards and instead simply repeats the discussion of such standards from Mr. Gile's testimony without any mention of Joint Applicants' proposal. *See* Staff Brief at ¶¶ 230-238.

Both Staff and CURB argue – without any authority – that the service quality standards set by the Commission should require improvement from existing performance levels. *See* Staff Brief at ¶ 230; CURB Brief at ¶ 85. Staff goes so far as to suggest that the word "promote" when used in K.S.A. 66-131 (an acquisition should "promote" the public convenience and necessity) means that service levels must improve as a result of the acquisition. Staff offers no legal authority, Commission precedent, or other support for its assertion. In fact, even Staff witness Gile has admitted that no prior Commission orders had required improved performance to avoid penalties when establishing service quality standards. Tr. Vol. 6, Gile, pp. 1485-1486; *see also* Ives Rebuttal at p. 39 (Joint Applicants could find no prior transaction-related order of the Commission requiring improved service quality as a condition of a merger or acquisition). The settlement Staff agreed to in the recently approved Liberty/Empire transaction did not require improvement in service quality.[76] Staff is applying a different definition of "promote" in

[76] *See* Order Granting Joint Motion to Approve the Unanimous Settlement Agreement and Approval of the Joint Application, Docket No. 16-EPDE-410-ACQ, ¶ 50 (Dec. 22, 2016) ("Liberty/Empire Order ") ("maintenance" of quality of service is sufficient to meet Commission merger standard); Exhibit A, ¶ 50 (Empire's reliability statistics cannot fall below the 2013-2015 average).

this case and fails to justify – or even discuss – its departure from Commission precedent in its Post-Hearing Brief.

Staff continues to insist that service quality standards be set to require improvement despite Mr. Gile's admission that service level objectives must be assessed in light of the cost necessary to attain and support them and his admission that Staff has not assessed the cost necessary to attain improvement in service levels. Tr. Vol. 6, Gile, pp. 1486-1496. In its Post-Hearing Brief, Staff provides no response to this concern and instead simply repeats Mr. Gile's recommendations, which were admittedly developed without any consideration of cost.

Staff also argues that the Commission should defer consideration of the details of the service quality standards and require the parties to develop a plan using Staff's conceptual outline after the Commission approves the Transaction. *See* Staff Brief at ¶ 238. Staff completely disregards the testimony of Mr. Noblet that it would be more appropriate for the Commission to address this issue as part of the current proceeding given that Joint Applicants' proposal includes all of the provisions necessary for a Commission decision on service quality standards. Noblet Rebuttal at pp. 10-11. As Joint Applicants indicated in their Initial Post-Hearing Brief, it would be completely unreasonable for the Commission to issue an order regarding the proposed Transaction and leave uncertainty regarding service quality standards and potential penalties that – even under Joint Applicants' proposal – could range up to $12.328 million annually. Without certainty on such a significant issue, it would be impossible for Joint Applicants to fully evaluate the impact of the Commission's order and make a decision regarding how to proceed in a manner best for all stakeholders – including customers and shareholders of both companies.

CURB argues that the three consecutive year penalty provisions proposed by Joint Applicants are not long enough and suggests – for the first time in its Post-Hearing Brief – that the penalty provisions for the service quality standards should be in place for 10 years. CURB provides no details about how the 10-year timeframe would work – whether Joint Applicants would be required to go for 10 years in a row without incurring any penalty or whether it would be a simple 10-year timeframe. CURB provides no support whatsoever for its 10-year recommendation, which was not part of CURB's original recommendations regarding quality of service standards provided in Ms. Harden's Direct Testimony. Ms. Harden's original recommendation was that the standards and penalty provisions should be similar to the standards approved for the Liberty/Empire transaction, which include a three consecutive year term for penalties,[77] and Joint Applicants' proposal was consistent with that recommendation. Harden Direct at p. 8. Now, in its Post-Hearing Brief, CURB deviates from that recommendation without any support or justification and goes on to suggest that Joint Applicants' proposal – which was based on Ms. Harden's recommendations – shows a lack of confidence in the ability to maintain service quality. CURB completely disregards Joint Applicants' explanation that the minimum three-year penalty timeframe was designed to match up with the time period when Joint Applicants will be striving to achieve savings. The minimum three-year time frame for penalties is also consistent with the service quality standards approved in the Liberty/Empire transaction, the Aquila acquisition, and the One Gas reorganization, all of which included penalty timeframes of three years or less.[78] Additionally, both KCP&L and Westar already – and will continue to – submit performance metric reporting that will allow the Commission and

[77] *See* Liberty/Empire Order, Exhibit A.

[78] *See* Liberty/Empire Order, Exhibit A; Joint Motion and Settlement Agreement ("Aquila S&A"), filed Feb. 28, 2008, Attachments 1, 2 and 3; Order Approving Unanimous Settlement Agreement, Docket No. 14-KGSG-100-MIS, Schedule 1 (Dec. 19, 2013) ("One Gas S&A").

its Staff to monitor performance even after the penalty period expires. Accordingly, Joint Applicants ask that the Commission adopt the quality of service standards explained in Mr. Noblet's rebuttal testimony.

B. <u>Merger Standard (h) – "What impact, if any, the Transaction has on public safety."</u>

There is no basis to conclude that the Transaction will have any impact on public safety. In their post-hearing briefs, Staff and CURB express vague and unsupported concerns that the reduction in full-time employees (FTEs) as a result of the merger or the reduction in other spending could lead to reliability and/or safety impacts. *See* Staff Brief at ¶ 231; CURB Brief at ¶ 83. They completely ignore the testimony of Kevin Noblet and the Joint Applicants' Initial Post-Hearing Brief that explain why there is not an automatic connection between Joint Applicants' plans to achieve savings and reliability or safety. Instead of addressing the specific information provided by Mr. Noblet and discussed in Joint Applicants' Initial Post-Hearing Brief, Staff and CURB simply repeat, without further discussion, the assertions made in their direct testimony.

Staff lists areas where Joint Applicants plan to make reductions in spending or FTEs and asserts, without further discussion, that the planned reductions could impact reliability. *See* Staff Brief at ¶¶ 234-236. For example, Staff claims that Joint Applicants will reduce spending on vegetation management which could lead to exposure to greater storm damage. Staff fails to address Joint Applicants' explanation that savings to be achieved in vegetation management will not reduce the amount of tree trimming that occurs and, instead, will be achieved through efficiencies in how the vegetation management program is staffed, managed and executed. Noblet Rebuttal at p. 36. Similarly, Staff claims that Joint Applicants' plans to reduce FTEs in transmission and delivery could reduce reliability. Staff again ignores Joint Applicants' explanation that the majority of capital expenditure reductions in the transmission and distribution area will come from re-prioritization and realignment of transmission capital and not from a reduction in capital expenditures related to distribution system reliability. Noblet Rebuttal at p. 36.

Staff also suggests that Joint Applicants plan to close generating units in order to achieve savings but have not studied the impact of the plant closures on stability or reliability. *See* Staff Brief at ¶ 233. This assertion is completely inconsistent with the evidence in the record, which demonstrates that the impact of plant closures was analyzed by KCP&L and studied by the Southwest Power Pool and no adverse reliability impacts were noted in the assessments. *See* Ives Rebuttal at p. 56; Exhibit SC-7. Staff's assertion also ignores Joint Applicants' commitment to conduct a full Integrated Resource Planning (IRP) process before shutting down any generating units, including a review of any reliability impacts. As Mr. Ives explained, Westar and KCP&L will study the impacts of any plant closings and addressing any related transmission reliability concerns is always part of any plan to retire units. Ives Rebuttal at pp. 53-54. "If a plant is determined to be necessary to maintain transmission system reliability, it will not be retired until mitigation measures are in place." Ives Rebuttal at p. 54.

Finally, Staff and CURB suggest that GPE may be under pressure to contain costs and could therefore "potentially" reduce spending for customer service and reliability. *See* Staff Brief at ¶ 237; CURB Brief at ¶ 83. Staff and CURB offer no support for this assertion, which is pure speculation. Additionally, Joint Applicants have offered quality of service standards, with significant penalty provisions, that will ensure that the merger has no such impact on customer service or reliability.

VII. ENVIRONMENTAL IMPACTS, ECONOMIC IMPACTS, COMPETITIVE IMPACTS, AND TRANSMISSION AND WHOLESALE RATES

A. <u>Merger Standard (a)(v) – "The effect of the proposed transaction on the existing competition."</u>

The Transaction will not have any significant effect on existing competition because, in Kansas, only one electric utility is permitted to serve retail customers in a specific geographical area. CURB is the only party that discusses the effect of the Transaction on competition in its post-hearing brief. CURB simply repeats the claim made by CURB witness Crane in her direct testimony that eliminating one independent entity through the merger could affect the progress of future technological developments or development of new power sources because there will be one less independent entity to provide a different perspective on such developments. *See* CURB Brief at ¶ 63. Ms. Crane actually agrees with Joint Applicants that there will be no short-term impact on competition because there is no competition for service territories in Kansas. Crane Direct at pp. 50-51. Her suggestion that elimination of an independent entity could affect development of technologies or new power sources in the future is really just speculation. She provides no support for this conclusion in her direct testimony and no examples of other mergers that caused such impacts to occur. This type of conjecture provides no basis for the Commission to conclude that the Transaction would have a negative impact on competition.

B. <u>Merger Standard (b) – "The effect of the transaction on the environment."</u>

There has been no evidence presented that the Transaction will have a negative effect on the environment. In fact, the evidence suggests that the Transaction will likely have a positive impact on the environment. The only issues raised in the parties' post-hearing briefs regarding the impact of the Transaction on the environment relate to requests that the Commission require Joint Applicants to commit to increase their wind investments, increase energy efficiency offerings, and maintain existing or develop new tariff offerings in the future. No party suggests that the Transaction itself will have a detrimental impact on the environment – instead, the parties speculate about how tariffs might change in the future or how GPE will invest in generation in the future. Specifically, Sierra Club asks that the Commission require Joint Applicants to add more wind to their system and commit to more energy efficiency programs. *See* Sierra Club Brief at p. 10. Walmart asks the Commission to require a stakeholder process to develop new renewable tariff offerings similar to Westar's existing Wind Generation Tariff. *See* Walmart Brief at Section II. CURB suggests that Joint Applicants be required to maintain Westar's inclining block rate structure for summer months. *See* CURB Brief at ¶ 68. None of these conditions are necessary for the Transaction to promote the public interest under the merger standards and all are better addressed either in future rate cases or through GPE's IRP process. Not surprisingly, for the most part this is another area where private party intervenors seek to expand application of the merger standards to advance their private party interests.

First, there is no requirement that Joint Applicants prove the Transaction have a positive impact on the environment and such a requirement has not been applied by the Commission or Staff in the recent mergers approved by the Commission. *See, e.g.,* Liberty/Empire Order, ¶ 40 (Commission found that the Liberty/Empire transaction would not "negatively impact the environment"). Additionally, none of the Commission's merger standards impose a requirement that the Transaction result in more investment in wind, new energy efficiency programs, or in the maintenance or creation of other environmental programs or tariffs and none of the parties identify any precedent that would support imposition of such a requirement. The merger standard related to environmental impacts simply directs the Commission to look at any impacts of the proposed Transaction on the environment.

Second, Joint Applicants' current practices with respect to wind investment and energy efficiency support a conclusion that the Transaction will have a positive impact on the environment. Joint Applicants have consistently confirmed their commitment to wind energy and indicated that after the Transaction closes, "more than 45% of the combined company's retail energy demand will be met through emission free resources." *See* Caisley Rebuttal at p. 14. Sierra Club misrepresents the evidence provided by Joint Applicants when it suggests that GPE's wind investment is substantially less than Westar's and that GPE is not committed to investing in wind. Mr. Heidtbrink testified that KCP&L has

> 149 MW (nameplate) of wind generating capacity located in Spearville, Kansas, and almost 600 MW of wind generating capacity under contract located in Kansas. KCP&L has an additional 120 MW of wind generating capacity that is expected to begin operation at the end of 2016 and 180 MW that is expected to begin operation before the end of 2017 located in Missouri.

See Heidtbrink Direct at p. 4. Sierra Club seems to have selectively chosen which data requests it entered into the record at hearing, *See* Tr. Vol. 6, at 1351, omitting the data request response provided by KCP&L that directly contradicts its statement that Westar has significantly more wind capacity than GPE. KCP&L's response to Sierra Club Data Request No. 2-5, attached hereto (originally designated as Confidential, but being filed publically here in light of the Commission's ruling on confidentiality issues), shows that in 2015, 24% of GPE's retail sales were made using wind energy compared to 32% for Westar. Sierra Club ignores the data it was provided during discovery in order to make factually inaccurate assertions. Given the significant level of investment in wind generation both GPE and Westar currently have, there is no basis for Sierra Club's claims that GPE's commitment to wind generation is somehow lacking or will be lacking after close of the Transaction.

Similarly, GPE has confirmed through its actions its commitment to energy efficiency. Sierra Club acknowledges GPE's success with energy efficiency programs in Missouri but argues that neither GPE nor Westar are pursuing energy efficiency in Kansas. Sierra Club completely disregards the fact that KCP&L currently has on file a proposal to expand its energy efficiency offerings in Kansas and implement a full suite of energy efficiency programs for customers in Kansas. *See* Caisley Rebuttal at pp. 14-15. GPE has committed – both to the Commission and to its customers – that it will make a similar filing for Westar once the Transaction is complete. *See* Caisley Rebuttal at pp. 8, 14-15.

There is also no basis for Walmart's request that the Commission require a stakeholder process to develop renewable tariff offerings or CURB's concern that Joint Applicants might alter Westar's inclining block rate structure sometime in the future. Both arguments are based on speculation about what tariff changes Westar and KCP&L might or might not propose in the future and neither is relevant to the question of what impact the merger itself has on the environment. Instead, they are issues that are more appropriately addressed during the operating utilities' general rate cases in the future. *See* Ives Rebuttal at p. 63.

Finally, Sierra Club argues that the Commission should require GPE to perform an IRP, including an analysis of early retirement of fossil fuel plants, prior to approval of the Transaction. *See* Sierra Club Brief at p. 11. Sierra Club seems to imply that conducting an IRP as part of a merger application is standard practice but cites no authority for such a conclusion. As Mr. Ives explained, the IRP is a multi-month process that "requires detailed input from several experts within the Companies…We expect that the first integrated (KCP&L/GMO/Westar) study will take longer than usual as new models will need to be developed and results will require a more rigorous review than in the case of an update to a prior IRP study." *See* Ives Rebuttal at p. 58.

Thus, it would be unreasonable for the Commission to require GPE to complete this process prior to obtaining Commission approval of the Transaction.

Additionally, antitrust requirements would impose restrictions on Joint Applicants' ability to share certain information that would be necessary to complete a full IRP study prior to close of the Transaction. Exchanging competitively sensitive information between merging parties, particularly disaggregated, forward-looking information, can violate the Hart-Scott-Rodino Act of 1976, as amended, as well as Section 1 of the Sherman Act.[79] [80] The exchange of competitively sensitive information between entities not party to a merger can also violate Section 1 of the Sherman Act.[81] The IRP process utilized by GPE involves a detailed review of a large number of factors, including fuel costs, purchased power costs, and off-system sales revenues, *see* Ives Rebuttal, at 53-54, all of which would likely be considered competitive market information that affects the companies' bids into the SPP Integrated Market.

GPE has a "long history of conducting IRP studies that evaluate the appropriate long-term resource plans for retail customers." *See* Ives Rebuttal at p. 59. GPE has demonstrated its ability to conduct reasonable IRP studies and make decisions regarding resource planning that are in the best interests of its customers, after consideration of all relevant factors including environmental impacts. *See* Ives Rebuttal at p. 53. Joint Applicants have committed to including Westar in its IRP process after the Transaction closes and there is no reason to doubt that GPE will continue to act reasonably and make resource planning decisions on behalf of the

[79] Complaint, *United States v. Computer Associates International, Inc*., Civil Action No. 1:01CV02062 (April 23, 2002) (citing the exchange of "competitively sensitive business information" as a violation of the HSR Act, the case resulted in a fine of $638,0000).

[80] The civil penalty for violations of the HSR Act is currently $40,654 per day (inflation adjusted annually). Violations of Section 1 of the Sherman Act can include criminal fines of up to $1 million for individuals and $100 million or more for corporations.

[81] *United States v. Container Corp. of America*, 393 U.S. 333 (1969) (exchange of pricing information unlawful).

combined organization that are in the best interests of customers based on a consideration of all relevant factors. There is no need to require completion of an IRP prior to approval of or closing of the Transaction, and as noted, no practical way the Joint Applicants could complete such an IRP prior to approval.

C. **<u>Merger Standard (c) – "Whether the proposed transaction will be beneficial on an overall basis to state and local economies and to communities in the area served by the resulting public utility operations in the state."</u>**

The proposed Transaction will be beneficial to state and local economies and to the communities served by Westar and KCP&L. The efficiencies created by the Transaction will result in energy costs that are less expensive for customers than they would be absent the merger and lower energy costs will have a positive economic impact for Kansas. *See* Bassham Direct at p. 13; Ives Direct at p. 11; Tr. Vol. 1, Bassham at p. 92. The economic benefits provided by the Transaction will be enhanced even further because the Transaction retains local control over the two largest utilities in Kansas and because of the commitments GPE has made to the state and local communities. *See* Ives Direct, pp. 11-12; Ives Rebuttal, p. 28; Caisley Rebuttal, p. 3. Neither Staff nor CURB – or any other intervenor – has acknowledged the value of retaining local control of Westar or the very real possibility that Westar could have been acquired by an out-of-state or out-of-country entity, which would have resulted in a loss of local control over the largest electric utility in Kansas as well as a movement of jobs out of the state.

Staff and CURB provide only a very cursory discussion of the question of economic impact in their post-hearing briefs. Staff essentially repeats the arguments made in Dr. Glass's direct testimony without any discussion of the issues raised in Joint Applicants' Initial Post-Hearing Brief, where it was established that Dr. Glass's analysis was faulty. *See* Staff Brief at ¶¶ 239-249. CURB simply states that the economic impact of the Transaction is unknown because there is no guarantee of savings but we know there will be a decrease in jobs. *See* CURB Brief at ¶¶ 69-71. However, as Joint Applicants explained in their Initial Post-Hearing Brief, there are a number of other considerations relevant to the question of economic impact, all of which have been ignored by both Staff and CURB. For example, Staff and CURB do not take into consideration the economic benefit associated with lower rates that will occur from the Transaction and the fact that the money saved from lower rates "will become available as a pool of discretionary cash for business or residential spending in other areas." Caisley Rebuttal at p. 11. Staff also completely ignores the fact that GPE plans to achieve the majority of the job reductions through attrition and the evidence that demonstrates GPE is well on its way to achieving this goal. *See* Tr. Vol. 1, Bassham, at pp. 95-96; Tr. Vol. 1, Ruelle, at pp. 266-267. And neither Staff nor CURB recognize that there will be significant economic benefits for Kansas from the payment to Kansas based Westar shareholders for their Westar stock and the capital gains taxes that will be paid to the state as a result. *See* Ruelle Direct at pp. 31-32. Staff's and CURB's analyses of the economic impact of the Transaction are incomplete and fail to demonstrate that the Transaction will have a negative economic impact.

Moreover, Staff's and CURB's myopic focus on the fact that the Transaction will result in a decrease in total jobs is inconsistent with Commission precedent, which recognizes that the goal should always be to create a more efficient utility, even if the result is a decrease in total jobs. As Joint Applicants discussed in their Initial Post-Hearing Brief, in the Commission proceeding related to the merger between KPL and KGE, Staff raised concerns about employment level reductions as a result of the proposed merger very similar to those raised in this docket. In response, the Applicants explained that "the creation of jobs in Kansas should not be achieved through an inefficient utility infrastructure." 1991 Merger Order, p. 95. The Commission, when concluding that the proposal would have a positive economic impact, agreed with the Applicants and stated that it "believes the policy of this State is that utilities should always strive to increase efficiency in providing safe, reliable utility service. Where synergies are available in the overlapping service territories, the Commission believes Applicants should act to capture those savings." Id. Staff's and CURB's viewpoint implies that Kansas would be better off if utilities "employed many more people, older and less efficient generation plants continued to operate, and utility bills were much higher." Caisley Rebuttal at p. 9; *see also* Tr. Vol. 1, Bassham, p. 133.

Rather than address the Commission precedent on this issue in their post-hearing briefs or explain why the Commission should deviate from that precedent in this current case, Staff and CURB simply repeat the arguments from their direct testimony and ignore the relevant precedent on this issue. Staff and CURB do not dispute that slowing the pace of rate increases will benefit the economy and is something that the Commission, Staff, CURB and all customers have been pushing for, especially recently. *See* Bassham Rebuttal at pp. 18-19. GPE has been clear that this Transaction will slow the pace of rate increases but, in order to achieve that goal, the Transaction will also result in fewer jobs. However, GPE plans to achieve the required reductions in a manner that is the best possible for employees and Kansas communities, making this an opportune time to move forward and create more efficient operating utilities in Kansas.

D. Merger Standard (f) – "Whether the transaction maximizes the use of Kansas energy resources."

The Transaction maximizes the use of Kansas energy resources. As Joint Applicants discussed in their Initial Post-Hearing Brief, both Westar and KCP&L have, without the Transaction, already committed to significant quantities of native Kansas energy resources, predominantly wind energy and the combined company will be in a better position to take further advantage of those resources in the future. Ives Direct at p. 13; Bassham Direct at pp. 13-14.

The only parties that addressed the impact of the Transaction on Kansas energy resources in their post-hearing briefs were CURB and Sierra Club and they made the same arguments they made with respect to Merger Standard (b), the effect of the transaction on the environment, which were addressed above.

Ultimately, application of this merger standard comes down to the fact that "KCP&L has a robust integrated resource planning ("IRP") process that evaluates the Company's generating resource needs going forward" and has committed to expand this process to Westar post-Transaction. *See* Ives Rebuttal at pp. 35-36. If the IRP process determines that a Kansas generating plant should be closed, this would reflect the most efficient use of resources. *Id.* The Commission's Merger Standards review whether a transaction maximizes the use of Kansas energy resources but certainly do not "promote continued use of resources that result in greater cost to Kansas customers." *Id.*

E. Merger Standard (g) – "Whether the transaction will reduce the possibility of economic waste."

Staff and CURB repeat arguments from their direct testimony regarding economic waste without responding to or even acknowledging Joint Applicants' explanation that the primary objective of the Transaction is to create efficiencies. The savings – and resulting rates lower than would be possible without the Transaction – are an economic efficiency and reduce the possibility of economic waste. *See* Ives Direct at p. 14; Tr. Vol. 7, Glass, at pp. 1621-1622; Bassham Direct at p. 13; Reed Rebuttal at pp. 58-59.

Staff reiterates its concern that the retirement of the Lawrence Energy Center ("LEC") would be inefficient, based on an analysis done by Dr. Glass of SPP dispatch of generating units. Staff Brief at ¶¶ 255-256. Staff does not respond to the concern raised by Joint Applicants that their very narrow analysis on this issue does not consider anything other than unit dispatch within the SPP IM. *See* Tr. Vol. 7, Glass, at p. 1621. Yet, Dr. Glass has admitted that other aspects of the Transaction could have an impact on economic efficiency – he agreed that "if rates would be lower with the merger than without that would be an economic efficiency" and that it would be an economic efficiency "if the combined companies can serve customers with fewer employees over time." *See* Tr. Vol. 7, Glass, at pp. 1621-1622. The Transaction is designed to achieve efficiencies in the operation of GPE's operating utilities and an increase in operational efficiencies means a reduction in economic waste. *See* Hall Rebuttal at pp. 16-20.

Staff's concern about "premature" closing of LEC is mitigated by the fact that, as discussed above, GPE has committed to complete an IRP by July 2017 for all of its operating utilities and has indicated no final decisions regarding plant closures will be made until after the IRP is completed. *See* Ives Rebuttal at p. 57. GPE's IRP process is very thorough and evaluates many factors, including "the impact on future capacity needs, fuel costs, purchased power costs, off-system sales revenues, capital costs, environmental retrofits, environmental regulations compliance, and other factors pertinent to retail revenue requirement impacts," Ives Rebuttal at pp. 53-54, unlike Staff's evaluation which only considered one factor. The IRP process is designed to determine the "most effective use of resources," Ives Rebuttal at p. 36, and as a result should produce the most economically efficient use of GPE's combined resources, reducing the possibility of economic waste. Staff recognizes GPE's plan to utilize the IRP process prior to any plant closings but accuses Joint Applicants of "hiding the ball" by claiming savings related to plant closures in their savings estimates but also indicating that no final plans have been made for plant closures. As discussed above, it was reasonable for Joint Applicants to assume that they will be able to achieve a certain amount of savings through plant retirements, despite the fact that the IRP cannot be completed and specific plant closings confirmed until after the Transaction closes. Consequently, the Commission should find that the Transaction decreases the possibility of economic waste by creating more efficient utilities.

F. **<u>The Commission should not consider the effect of the Transaction on transmission or wholesale rates or on wholesale or transmission competition in this docket because those issues are jurisdictional to FERC.</u>**

Several parties –BPU, KMEA, and KPP – continue to discuss FERC-jurisdictional issues in their post-hearing briefs. These parties still fail to acknowledge that the issues they raise regarding FERC-regulated wholesale power contracts, transmission formula rates (TFR), and transmission zones fall within FERC's jurisdiction and should not be considered as part of this proceeding. BPU suggests that the impact of the Transaction on Westar's and KCP&L's FERC-regulated TFRs is relevant in this proceeding because retail customers are affected by changes to the TFRs through the transmission delivery charge (TDC) they pay as part of their retail bill. *See* BPU Brief at pp. 74-75. However, K.S.A. 66-1237, which enables use of the TDC to collect transmission-related charges from retail customers, clearly indicates that a utility's transmission revenue requirement is determined by FERC and that this Commission must conclusively deem that revenue requirement to be prudent for purposes of establishing the TDC.[82] As a result, any question regarding the impact of the proposed Transaction on the utilities' TFRs and the resulting impact on their TDCs is a FERC-jurisdictional question.

BPU's suggestion that a change in capital costs that occurs as a result of the Transaction could simply flow through the TDC without review is unfounded. Joint Applicants have filed an application for approval of the Transaction with FERC and have made hold harmless

[82] K.S.A. 66-1237 provides, in part: "All transmission-related costs incurred by an electric utility and resulting from any order of a regulatory authority having legal jurisdiction over transmission matters, including orders setting rates on a subject-to-refund basis, shall be conclusively presumed prudent for purposes of the transmission delivery charge and an electric utility may change its transmission delivery charge whenever there is a change in transmission-related costs resulting from such an order."

commitments as part of that proceeding that will hold transmission and wholesale power and wholesale distribution service customers with cost-based rates harmless from the rate effects of the Transaction. Ives Rebuttal at p. 70; Answer to Comments and Protests of Great Plains Energy Incorporated and Westar Energy, Inc., Docket No. EC16-146 (Oct. 11, 2016). These commitments would prevent a change in capital costs caused by the Transaction from flowing through the TFR and, therefore, from flowing through the TDC. KCBPU and the other parties all have ample opportunity to participate in the review of any impact of the Transaction on the TFR – by intervening in the pending docket at FERC in which FERC is reviewing the proposed Transaction and its impact on wholesale and transmission rates, by asking data requests and participating in the review process when Westar and/or KCP&L updates rates under their TFRs, and – if necessary – filing a complaint with FERC if they believe Westar or KCP&L have flowed improper costs through their TFRs. There is no legal basis, however, for this Commission to assert jurisdiction over the impact of the Transaction on FERC-jurisdictional rates and tariffs. *See Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966, 106 S. Ct. 2349, 2357, 90 L. Ed. 2d 943 (U.S. 1986) ("FERC clearly has exclusive jurisdiction" over the rates to be charged to interstate wholesale customers); *Kansas Indus. Consumers Grp., Inc. v. State Corp. Comm'n of State of Kan.*, 36 Kan. App. 2d 83, 101 (2006) ("FERC has jurisdiction to address rates for the transmission of electrical power and interstate sales of electrical power").

BPU argues that it and its retail customers could potentially be impacted if Joint Applicants were to consolidate Westar's and KCP&L's transmission zones in the SPP. *See* BPU Brief at p. 76. However, as Joint Applicants explained in their Initial Post-Hearing Brief, Joint Applicants are not seeking to consolidate the KCP&L and Westar (or any other) transmission zones in connection with the Transaction. *See* Ives Rebuttal at p. 68. The Commission should reject BPU's request to address a concern related to a proposal – consolidation of Westar and KCP&L transmission zones in SPP – that has not been made. Moreover, if Joint Applicants wanted to consolidate transmission zones, the KCC is not the right forum for such a request; they would have to get approval of the consolidation by going through the SPP process for tariff changes and then filing an application with FERC under section 205 of the Federal Power Act. Joint Applicants have not made such an application. Ives Rebuttal at p. 68. However, if they were to make such a proposal in the future, BPU and any other interested parties would have the opportunity to participate in the SPP stakeholder process and to participate in the FERC docket, expressing any concerns they have about consolidation at that time. BPU also implies that Joint Applicants may have a financial incentive to move to consolidate transmission zones quickly. BPU offers no support for this assumption, which is inaccurate. Consolidation of transmission zones might shift allocation of Westar's and KCP&L's transmission revenue requirements among transmission customers but would have no impact on the total transmission revenue requirement collected by GPE's operating utilities, which is determined through the formulas contained in Westar's and KCP&L's TFRs. There is no need or legal basis for the Commission to address the issue of consolidation of transmission zones in this proceeding.

In their post-hearing briefs, the Municipal Group and KPP present several other FERC-jurisdictional matters for consideration by this Commission. For example, KMEA argues that the Commission should order Westar to give its generation formula rate (GFR) customers an early termination option.[83] *See* Municipal Group Brief at p. 2. The Municipal Group provides no real explanation of why such a termination option should be given. Even so, the terms of

[83] Giving the Commission a glance at what these parties' real interests were in getting involved in this docket, as opposed to protecting the public interest.

Westar's GFR contracts are clearly jurisdictional to FERC and this Commission would have no authority to order an early termination option. KPP argues that the Commission should make rulings regarding the continued classification of Westar's 34.5 kV system as transmission, the consent requirements under KPP's wholesale purchase power agreement (PPA),[84] and the energy management agreement Westar has with Dogwood. *See* KPP Brief at pp. 5-9. KPP contends in its post-hearing brief that Joint Applicants have failed to respond to its requests (*See* KPP Brief at ¶ 13), completely ignoring Joint Applicants' discussion in rebuttal testimony and their Initial Post-Hearing Brief explaining that the issues raised by KPP are not within this Commission's jurisdiction. As a result, the Commission should not consider the claims by parties about the impacts of the Transaction on FERC-jurisdictional matters when making its decision in this docket.

VIII. CONCLUSION

The acquisition of Westar by GPE promotes the public interest. This is a result that has been a long-time in the making. Both Westar and KCP&L have seen the merit in such a combination for many years but the conditions necessary for the Transaction to move forward have not been present until now. Despite Staff's and the other intervenors' duplicative and erroneous assertions to the contrary, the record clearly establishes that the Transaction meets the requirements of the Commission's Merger Standards as stated in the 1991 and 1999 Merger Orders and applied in cases thereafter. Although certain parties might argue over the precise amount of savings that will be achieved, there is no doubt that the Transaction – a combination

[84] KPP argues that Westar should have obtained KPP's consent to the Transaction because its PPA contains restrictions on assignment of the PPA to another entity if that entity's creditworthiness is not equal to or higher than Westar's. KPP's argument is misplaced because the Transaction will not result in the assignment of the PPA – or any other contract – by Westar to GPE or KCP&L. Westar will remain a separate legal entity and will continue to be the party to its agreements, including its PPA with KPP. *See* Bassham Direct at p. 4.

of two successful, adjacent utilities – will achieve substantial efficiencies and savings and will reduce the rate of increase in customer rates over the long-term. If this Transaction does not meet the Commission's Merger Standards, it is likely that no other merger or acquisition would ever satisfy those standards.

This Transaction ensures that control of the two largest electric utilities in Kansas is retained locally and that the executives responsible for the utilities are located in Kansas or within only a few miles of the state border. The Transaction also retains a majority of Westar's employees in Kansas. Staff and intervenors have failed to even acknowledge the very real possibility of the alternative, which would have been the acquisition of Westar or KCP&L by an out-of-state or out-of-country entity, where the executives running the utility and many of the employees would be located outside of Kansas and possibly even out of the country.

The Transaction has been structured in a way that gives all the savings to customers through the normal ratemaking process and insulates customers from all of the risks associated with financing the Transaction and achieving those savings. GPE has already demonstrated that it can obtain the financing necessary to execute the Transaction while retaining an investment grade rating, even after its recent and expected one-notch downgrade, and without any credit rating impact to Westar or KCP&L.

At stake if the Commission does not approve this Transaction is the loss of an opportunity that will provide billions of dollars in savings for customers and is strongly supported by numerous elected officials, civic organizations, business groups and, significantly, Kansas communities, including those served by Westar. This is an opportunity that has been in the making for over 30 years and one that may not come around ever again. Joint Applicants ask that the Commission seize the opportunity to provide significant benefits to customers and the

State of Kansas and approve the proposed Transaction subject to the conditions and commitments proposed by Joint Applicants in Schedule DRI-3 to Mr. Ives' rebuttal testimony.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that on the 20th day of March, 2017, I electronically filed via the Kansas Corporation Commission's Electronic Filing System, a true and correct copy of the above and foregoing with a copy emailed to all parties of record.

Robert J. Hack
Robert J. Hack

KCPL KS
Case Name: 2016 Westar Acquisition
Case Number: 16-KCPE-593-ACQ

Response to Zmijewski Dan Interrogatories - Sierra Club_20161201
Date of Response:

Question:2-5

Please refer to pg. 14 of the Direct Testimony of Terry Bassham where he states: "That amount of wind energy, is equivalent to almost one-third of the total energy use by our customers. When coupled with nuclear power, the ratio of emission-free energy to retail energy use is more than 45% once all of the wind facilities currently under contract are placed in service."

Please provide all bases for the aforementioned quoted text, including all supporting analyses, calculations, data, documents, and workpapers. Please identify all wind facilities under contract, but not in service, including year anticipated in service, unit capacity, and location.

RESPONSE: (do not edit or delete this line or anything above this)

Response Provided By:

The attachments to this response are considered CONFIDENTIAL as they contain marketing analyses or other market-specific information relating to services offered in competition with others.

Wind energy and CO_2 emission-free energy with respect to retail sales - see attached workbook QSierra Club_2-5_CONF_GPE and Westar Emission Free Resources:

KCP&L and GMO wind facilities under contract but not in-service – see attached workbook “QSierra Club_2-5_CONF_Wind Under Construction.xls”

Laura Becker, Manager, Resource Planning

Attachments:
QSierra Club_2-5_CONF_GPE and Westar Emission Free Resources.xls
QSierra Club_2-5_CONF_Wind Under Construction.xls
SierraClub2-5_Verification.pdf

** CONFIDENTIAL **

KCP&L		
	MW	MWh
Cimarron*	131.1	549,732
Spearville-1*	100.5	299,674
Spearville-2*	48	159,669
Spearville-3*	100.8	405,494
Waverly**	200	806,000
Slate Creek**	150	604,000
Osborn**	120	484,000
Rock Creek**	180	725,000
Hydro PPA*	61.5	399,316
Wolf Creek*	549	4,056,184

* 2015 Actual ** Estimated

GMO		
	MW	MWh
Gray*	60.0	143,000
Ensign*	98.9	418,000
Osborn**	80	322,000
Rock Creek**	120	484,000
Greenwood Solar**	3	4,700
SJLP Landfill Gas*	1.6	12,447

* 2015 Actual ** Estimated

Westar		
	MW	MWh
Central Plains**	99	289,342
Flat Ridge**	50	135,622
Flat Ridge**	50	138,343
Meridian Way**	96	282,902
Ironwood**	168	598,672
Post Rock**	201	795,956
Cedar Bluff**	199	739,019
Kay Wind**	199	754,139
Ninnescah**	200	818,464
Kingman**	103	409,495
Western Plains**	280	1,182,546
Wolf Creek*	549	4,056,184
Rolling Meadows LFG**	6	46,355

* 2015 Actual ** 2017 Budget

KCP&L/GMO - Wind Only	
Wind Generation	5,417,716
Retail (MWh)^	22,668,684
% of Retail Sales from Emission-Free Resources	**24%**

^ 2015 FERC 1

GPE- All emission-free resources	
CO_2-free Generation	9,873,216
Retail (MWh)^	22,668,684
% of Retail Sales from Emission-Free Resources	**44%**

^ 2015 FERC 1

Westar - Wind Only	
Wind Generation	6,144,500
Retail (MWh)^	19,449,878
% of Retail Sales from Emission-Free Resources	**32%**

^ 2015 FERC 1

Westar - All emission-free resources	
CO_2-free Generation	10,247,039
Retail (MWh)^	19,449,878
% of Retail Sales from Emission-Free Resources	**53%**

^ 2015 FERC 1

KCP&L/GMO + Westar - Wind Only	
Wind Generation	11,562,216
Retail (MWh)	42,118,562
% of Retail Sales from Emission-Free Resources	**27%**

GPE + Westar	
CO_2-free Generation	20,120,255
Retail (MWh)	42,118,562
% of Retail Sales from Emission-Free Resources	**48%**

** Confidential **

Name	Location	Commercial Operation Date	Fuel Source	Capacity (MW)	Renewable Purchase Power	Capacity Factor*	PPA Expiration Date
Rock Creek	Atchison County, MO	Dec 31, 2017*	Wind	300	Yes	46%	Dec 30, 2037
Osborn	DeKalb County, MO	Dec 31, 2016*	Wind	200	Yes	45%	Dec 30, 2036

* Expected