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BEFORE THE STATE CORPORATION COMMISSION

OF THE STATE OF KANSAS

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DIRECT TESTIMONY

OF

ANTHONY D. SOMMA

WESTAR ENERGY

DOCKET NO. 12-WSEE-112-RTS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Anthony D. Somma, 818 South Kansas Avenue, Topeka, Kansas 66612.

Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?

A. Westar Energy, Inc. (Westar), Senior Vice President, Chief Financial Officer and Treasurer.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I hold a B.B.A. in accounting from Bellevue University and an M.B.A. from the University of Nebraska at Omaha. I passed the certified public accountant exam and I'm a member of the American Institute of Certified Public Accountants, the Association of Financial Professionals and Financial Executives International. I have worked in the utility industry for 18 years. I began my career at Aquila Energy in 1988, where I held various accounting and corporate development positions. I joined what is now Westar Energy in 1994 in corporate development. I then left in 1999 to serve in various senior financial positions at Protection One, Inc. including Chief Financial Officer and Senior Vice President Finance and Administration. I then rejoined Westar as Executive Director, Financial and Strategic Planning in generation and marketing in 2004. In 2006, I was named Treasurer, and in 2009, I became Vice President and Treasurer. I held that position until August 1, when I became Senior Vice President, Chief Financial Officer and Treasurer.

II. PURPOSE AND OUTLINE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. A significant expense associated with providing electric service is payroll and benefits. One of those benefits is pension expense. Even though we have already undertaken many of the pension reforms that some are just now addressing, our pension expense is nonetheless increasing. Mr. Banning will demonstrate that the design of our employee benefits, including pension benefits, is at or below the market median in comparison to Westar's peers. My testimony will show the increase in Westar's pension expense is based upon reasonable assumptions and prudent risk management practices. The increase is driven almost entirely by an exogenous event outside of Westar's control, namely the financial crisis of 2008

Although pension funding and accounting are complex issues, I am hopeful that my testimony will provide confidence to the Commission and other parties who participate in this proceeding in the merits of what we are doing, why we have taken the actions we have, and that the results with respect to pension expenses are reasonable.

I am also sponsoring Westar's capital structure, cost of debt, cost of preferred equity, and overall rate of return found in Section 7 of the Minimum Filing Requirements (MFRs). Mr. Ruelle will sponsor our cost of equity capital.

Q. PLEASE OUTLINE THE PRINCIPAL SECTIONS OR TOPICS COVERED IN YOUR TESTIMONY.

A. My testimony provides the following:

1. A summary of how Westar manages the costs and risks of the pension plan, which is an extension of our approach to management philosophy generally;
2. A discussion of the details of the current regulatory construct, including why it ensures that customers will only pay reasonable pension expense and that pension expense recovered in rates will in fact be used to fund the pension plan, and a description of Westar's discipline with regard to

funding practices, both past and present, relative to amounts that have been reflected in utility rates;

3. An explanation of current pension cost, incorporating the associated expense level drivers and a review showing what has caused the change in the amount requested to be recovered in rates – namely the financial crisis which caused a decline in the stock and bond markets – and how Westar is managing the volatility of pension cost. Specifically, I will address asset returns for the pension plan, asset allocation, and how the unusually low interest rate environment caused by the financial crisis has contributed to the increase in pension cost;
4. The basis for determining Westar's capital structure, including the proportions of debt, preferred equity, and common equity capital as a percent of Westar's overall capitalization;
5. The calculations of Westar's cost of debt and preferred equity; and
6. My calculation of an overall weighted cost of capital to be applied to rate base.

Q. YOU REFER TO BOTH PENSION EXPENSE AND PENSION COST. CAN YOU EXPLAIN THE DIFFERENCE BETWEEN THE TWO?

A. Pension cost refers to the actuarially-determined total cost to the Company to maintain its qualified pension plan for the year. Pension expense is equal to total pension cost less the amount of pension cost related to labor allocated to capital projects. It is the pension expense that is included in our cost of service as an expense item. The balance of pension cost is already reflected as part of rate base. Everything else being equal, as pension cost increases, so does pension expense.

III. WESTAR'S MANAGEMENT AND FUNDING OF THE PENSION PLAN

Q. PLEASE DESCRIBE HOW WESTAR MANAGES THE PENSION PLAN.

A. Westar manages the plan by utilizing the same management philosophy generally that we utilize for the rest our business; namely, adhering to certain core tenets:

1) Avoid over confidence and recognize that it is <u>impossible to predict the future</u>. Whether dealing with commodity prices, the stock market, or demand for electricity, one realizes and is humbled by how unpredictable the future can be.

2) Recognize our limited ability to predict the future and <u>embrace uncertainty</u> rather than assume it won't have any negative impact on our customers or our company.

3) <u>Place a high value on optionality and flexibility</u> in managing our business and operations. This holds true for major

construction projects, how we finance our business, how we meet customers' demand for energy, and how we go about managing our pension plan. This approach allows us to make course corrections, if needed, and adapt to the changing landscape, thereby allowing us to ameliorate many of the uncertainties and volatility that can negatively affect our customers or Westar.

4) Be <u>transparent and open</u> with our customers, regulators, employees, and shareholders so inaccurate conclusions about our actions are avoided. We believe firmly that transparency and openness give us the opportunity to hear from our stakeholders along the way and enhance the quality of our decision making.

Q. WHO IS CHARGED WITH MANAGING THE PENSION PLAN?

A. As with other aspects of our business, we seek to apply best practices to governance, including pension governance. In this instance, Westar's Chief Executive Officer (CEO) appoints a committee of officers, representing various disciplines within the Company, to the Investment and Benefits Committee (Committee), which I chair. The Committee is delegated authority from the CEO to manage the investment and administrative practices of the pension plan in accordance with the company's obligations under Employee Retirement Income Security Act (ERISA).

Q. HOW OFTEN DOES THE COMMITTEE MEET?

A. The Committee has regularly scheduled quarterly meetings. However, when matters need to be addressed between meetings – for instance, making tactical or strategic shifts in the plan assets – the Committee will meet more frequently.

Q. TYPICALLY, WITH RESPECT TO THE PENSION PLAN, WHAT TYPE OF BUSINESS DOES THE COMMITTEE ADDRESS IN ITS MEETINGS?

A. The Committee develops the strategic asset allocation for the plan. It makes the decisions about how much to invest in various asset classes, including the amount invested in a particular type of investment, such as stocks or bonds. The Committee hires professional managers for each asset class, and those managers, not the Committee, make individual choices about which individual investments (e.g., which stocks or bonds) to buy or sell. The Committee typically reviews the performance of the plan assets versus industry benchmarks as well as changes in overall capital market conditions to ensure the plan is on target to satisfy its obligations. We also monitor the financial and administrative health of the plan by reviewing the plan's funded status and regularly confirming the plan is being administered in accordance with the applicable regulations.

Q. DOES THE COMMITTEE RECEIVE ANY HELP AND OR ADVICE TO MANAGE THE PLAN?

A. Yes. We have expert consultants who update the Committee on capital market conditions and make recommendations to the Committee on asset allocations, fund managers, and prudent ways to minimize cost yet still meet obligations of the plan, as well as other matters of interest to the Committee in performing its oversight duties. Additionally, the Committee receives help from professional actuaries as well as outside legal counsel who specialize in the application of the ERISA.

Q. DOES THE COMMITTEE RECEIVE ANY OTHER HELP?

A. Yes, the Committee also receives support from the human resources, finance, accounting, and legal departments at Westar.

Q. DO MEMBERS OF THE COMMITTEE RECEIVE ANY TRAINING?

A. Yes, members receive periodic training from outside consultants and counsel.

Q. WHAT CONSIDERATIONS AFFECT FUNDING OF THE PENSION PLAN?

A. Under the Pension Protection Act, plan assets must equal at least 80% of plan liabilities in order to avoid restrictions. As a result, Westar has a practice of funding plan assets, at a minimum, to a level equal to 80% of the plan liabilities. Historically, Westar has made all legally required minimum contributions.

Q. HOW DOES WESTAR'S FUNDING HISTORY COMPARE TO THE PENSION AMOUNT INCLUDED IN ITS UTILITY RATES OVER TIME?

A. In Westar's case, not only have we funded the plan with at least the full amount collected in rates, we have actually funded significantly in excess of what customers have paid for in their base utility rates. Table 1 below shows, going back more than 10 years, that Westar has contributed far more to its plan than it has recovered in rates. Specifically, from 1998 through the end of 2011, Westar will have contributed a cumulative $157 million to the plan as compared to just $46 million reflected as pension expense in rates over the same period.

TABLE 1
(Dollars in thousands)

	Pension Amount in Base Rates	Cumulative	Actual Pension Contribution	Cumulative	Funding in Excess of (Less than) Amount In Base Rates	Cumulative
1998	$ 6,900	$ 6,900	$ -	$ -	$ (6,900)	$ (6,900)
1999	6,900	13,800	-	-	(6,900)	(13,800)
2000	6,900	20,700	-	-	(6,900)	(20,700)
2001	6,900	27,600	-	-	(6,900)	(27,600)
2002	(6,033)	21,567	-	-	6,033	(21,567)
2003	(12,500)	9,067	-	-	12,500	(9,067)
2004	(12,500)	(3,433)	-	-	12,500	3,433
2005	4,300	867	-	-	(4,300)	(867)
2006	4,300	5,167	20,750	20,750	16,450	15,583
2007	4,300	9,467	11,800	32,550	7,500	23,083
2008	4,300	13,767	15,000	47,550	10,700	33,783
2009	10,674	24,441	37,304	84,854	26,630	60,413
2010	10,674	35,115	22,400	107,254	11,726	72,139
2011	10,674	45,789	50,000	157,254	39,326	111,465

Q. WHY IS IT IMPORTANT THAT UTILITIES FUND THEIR PENSION PLANS?

A. In addition to avoiding the restrictions mentioned earlier, pension funding serves to reduce future pension expense. Therefore, it is in customers' interests to see that utilities contribute to their plans consistent with pension expense recovered in utility rates. If utilities did not contribute such funds to their pension plans, future pension expense would be higher than necessary. Intuitively, it just doesn't make sense to put off today what can later become an unmanageable challenge down the road. We don't think that would be a responsible way to manage any aspect of our business.

IV. CURRENT REGULATORY FRAMEWORK

Q. WHAT IS THE CURRENT REGULATORY FRAMEWORK APPLICABLE TO WESTAR'S PENSION PLAN?

A. On September 11, 2009, the Commission issued an order approving Westar's Application for Accounting Authority Order (AAO) in Docket No. 10-WSEE-135-ACT regarding rate recovery of pension expense. The AAO authorized Westar's implementation of two trackers, described below, and provides customers the assurance that they will not pay pension expense in excess of the amount Westar actually uses to fund the plan. Mr. Rohlfs discusses the pension trackers authorized by the AAO in greater detail in his testimony.

Q. UNDER THE AAO, WHAT HAPPENS IF THE AMOUNT OF CURRENT YEAR EXPENSE IS GREATER THAN WHAT IS CURRENTLY BEING REFLECTED IN RATES?

A. If current year pension expense is greater than what's reflected in rates, the excess amount is deferred on the balance sheet as a regulatory asset eligible for future recovery, which the AAO refers to as "Tracker 1."

Q. HOW DOES WESTAR RECOVER THE EXCESS AMOUNT?

A. Westar can only recover the excess in a rate case. According to the Commission order, the excess will be amortized over a period not to exceed five years following the rate case. Westar is seeking recovery of this deferral in the current rate case filing. Mr. Armstrong addresses this recovery request.

Q. HOW DO THE PROVISIONS OF THE AAO ENSURE THAT WESTAR WILL ACTUALLY CONTRIBUTE THE AMOUNT OF PENSION EXPENSE RECOVERED IN RATES TO THE PLAN?

A. Per the AAO, Westar will only be entitled to utilize Tracker 1 if it contributes to its plan an amount equal to or greater than the current year pension expense.

Q. WHAT HAPPENS IF WESTAR CONTRIBUTES AN AMOUNT THAT IS GREATER THAN CURRENT YEAR PENSION COST?

A. The excess, which is referred to as "Tracker 2," is also deferred on the balance sheet, although Westar's ability to recover this is far less certain.

Q. HOW MIGHT WESTAR RECOVER TRACKER 2 EXCESS CONTRIBUTIONS?

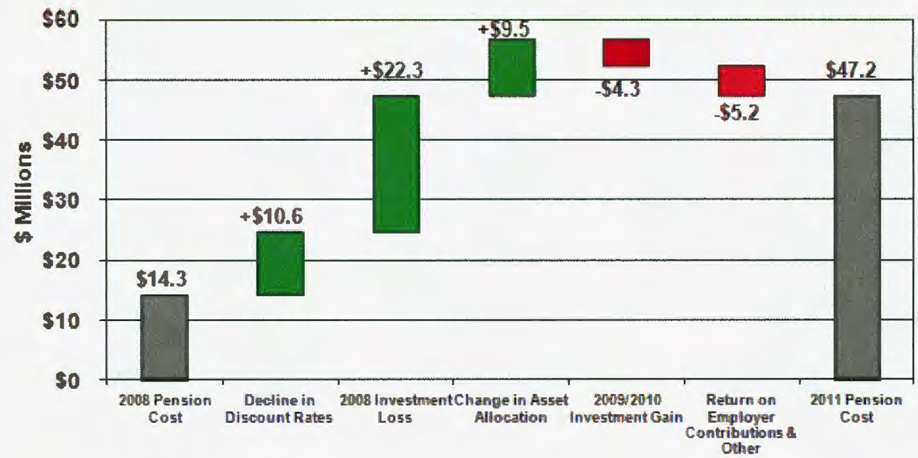
A. The AAO provides that Tracker 2 allows Westar to establish a "piggybank," to track contributions made to the pension plan in excess of pension cost. Excess contributions may be applied in future years to satisfy Staff's recommended minimum funding level." AAO, ¶ 11. And that can only happen if Westar's required cash contribution to the pension fund is less than its pension expense for the year. According to actuarial projections, this is unlikely over the next 10 to 15 years.

V. CHANGE IN PENSION COST

Q. PLEASE DESCRIBE WESTAR'S RECENT PENSION COST EXPERIENCE.

A. Pension cost has been gradually increasing over the past several years, due primarily to the financial crisis that resulted in significant investment losses across all asset categories, followed by low discount rates for quantifying pension liabilities. Figure 1 below shows the various factors that have had an impact on pension cost since 2008.

FIGURE 1



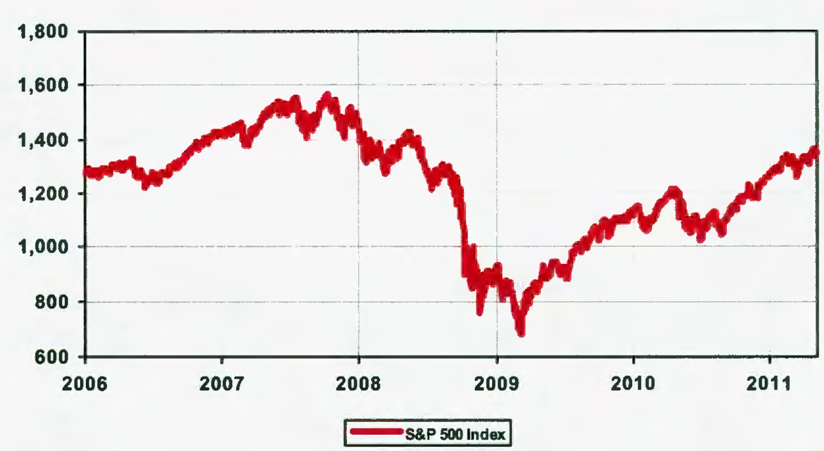
As you can see from Figure 1, the market events of 2008, lower discount rates and poor asset returns – items outside of Westar's, or anyone's control – combine to make up the vast majority of the increase in pension cost. The single biggest driver of the increase in pension cost is the 2008 investment loss, which increased annual pension cost by $22.3 million from 2008 to 2011.

Like many, Westar has also reduced our stakeholders' risk by reducing our equity exposure and allocating more to fixed income. While this change reduced the expected volatility of our investment returns, it also reduced expected returns. This resulted in an increase in pension cost as shown in Figure 1. This increase is offset by investment gains in 2009 and 2010 along with earnings on the significant cash contributions Westar has made to the plan to improve its funded status. I discuss each of these items in more detail later in my testimony.

Q. HOW SIGNIFICANT WERE THE ASSET LOSSES IN 2008?

A. Figure 2 below shows how the S&P 500, an index generally indicative of equity returns, has performed since 2006. For 2008, the S&P 500 went from 1,468 at the beginning of the year to 903 at the end – a drop of 38%.

FIGURE 2



Because of their long investment horizons, most plans, including Westar's, have significant investments in equities. As a consequence, Westar experienced similar losses in its investment in equities. These losses, however, were offset by the benefits of diversification which included non-equity investments. For 2008, Westar's assets were down 31%, representing a decline of $146 million, but less than the 38% drop experienced by the S&P 500.

Q. HOW HAS WESTAR ATTEMPTED TO MINIMIZE THE IMPACT OF THE 2008 MARKET EVENT ON PENSION COST?

A. Because investment performance is volatile and is a key driver of pension cost, Westar uses a four-year asset smoothing mechanism to: (1) reduce the year-to-year volatility of pension cost, and (2) allow time for a recovery in the market to offset some of the impact of recent investment gains or losses.

Figure 3 below compares the annual pension cost for 2009 through 2011 to the amount that would have been incurred had Westar not used the smoothing mechanism described above.

FIGURE 3

As shown in Figure 3, the cost recognized in 2009 and 2010 was significantly reduced by the asset smoothing because recognition of a portion of the large investment loss from 2008 was deferred into 2011 and 2012. This feature makes the use of asset smoothing very common among pension plan sponsors. Since the impact of the 2008 investment loss is being phased in through the use of asset smoothing, pension cost is expected to increase until the full impact of the losses has been reflected in 2012, muted of course by subsequent investment gains that are also being smoothed in over time.

Q. HOW HAS WESTAR'S INVESTMENT EXPERIENCE BEEN SINCE 2008?

A. The investment returns for the plan were 26% in 2009 and 8% in 2010, compared to the actuarial expected gains of 8.25% for each of those years. The asset gains generated from this favorable performance, however, have not been enough to offset the loss experienced in 2008.[1] Since these favorable asset gains are also smoothed over a four-year period, they should help stabilize pension cost after 2012 once the 2008 losses have been fully phased-in.

Q. PLEASE SUMMARIZE THE PROCESS USED FOR SETTING ACTUARIAL ASSUMPTIONS THAT IMPACT PENSION COST.

A. Westar is responsible for the selecting the following key assumptions used to determine pension cost based on guidance from the Financial Accounting Standards Board (FASB).

Discount rate

FASB Reference	ASC 715-30-35-44
Relevant Guidance	• Based on high quality corporate bond yields • Duration should match the expected cash flows payable from the plan
Westar's Approach	• Construct a yield curve based on the yields on over 500 high-quality, non-callable corporate bonds at the measurement date • Discount plan's cash flows using the yield curve to derive single point discount rate matching the plan's payout structure

Expected Return on Assets

FASB Reference	ASC 715-30-35-47
Relevant Guidance	• Long-term assumption • Based on target allocation • Consideration should be given to rates available for reinvestment

[1] Note that a 45% return is needed to recoup a 31% loss from the prior year as shown in the following example: A 31% loss on a $100 investment results in a remaining investment of $69. To get back to $100, a $31 gain in the following year is needed which equates to a 45% return on $69 ($31/$69).

Westar's Approach	• Actuary sets its global capital market model assumptions based on expected outlook for returns and volatility by asset class • Portfolio simulator projects investment return for each asset class over the next 10 years under 1,000 different economic scenarios • Westar's target asset allocation is applied to the returns to generate a range of potential outcomes for Westar's specific investments • Westar's assumption generally targets a 50% probability of being above or below the given assumption

Westar's actuary assists in the assumption selection process, particularly by providing relevant data used for assessment in the selection. The independent auditors of the plan also review the actuarial assumptions to determine whether they are reasonable. Even though Westar selects the assumptions, the reasonableness of those assumptions is independently reviewed by the auditors and actuaries.

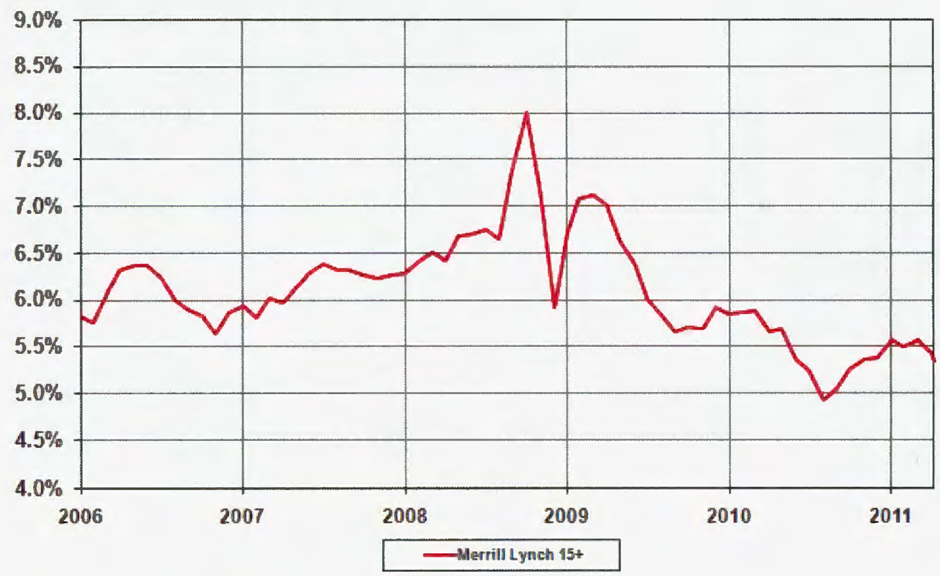
Q. HOW IS IT THAT LOW INTEREST RATES AFFECT PENSION COST?

A. Pension cost is determined in large part by using a present value calculation to discount future liabilities to the present. The discount rate is largely a function of interest rates akin to what might be earned on a pool of high quality corporate bonds. As that rate declines, it increases the present value of the future liabilities. This change is amortized into expense over the future average service life of plan participants.

Q. HOW HAVE DISCOUNT RATES CHANGED SINCE 2008?

A. Figure 4 below shows a history of the Merrill Lynch 15+ index (a common benchmark for pension discount rates) since 2006.

FIGURE 4



Clearly there has been a sharp decline since 2008. Lower discount rates result in a higher present value of pension liability, which leads to higher pension cost and funding requirements.

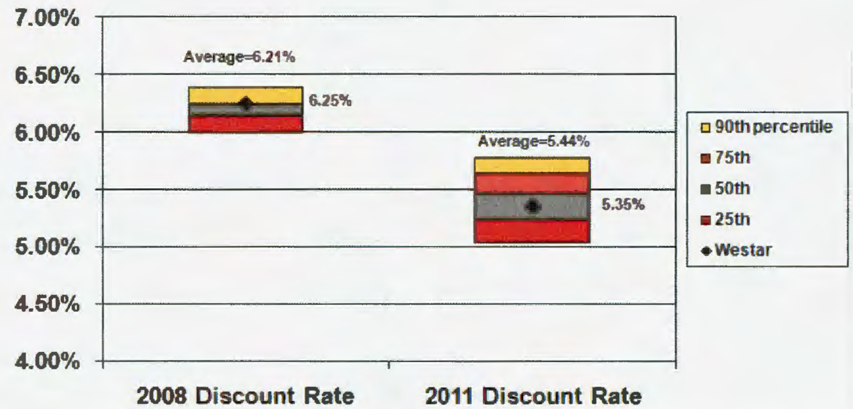
Q. HOW MUCH DOES A DECREASE IN THE DISCOUNT RATE INCREASE THE PLAN LIABILITIES?

A. A 100 basis point decrease in the discount rate (going from 7% to 6% as an example), would increase the liabilities of the plan by approximately $100 million.

Q. HOW DOES THE DISCOUNT RATE FOR WESTAR COMPARE TO OTHER ORGANIZATIONS WITH THE SAME MEASUREMENT DATE?

A. We are right down the middle of the fairway. Figure 5 below shows how the assumption for Westar compares to the assumptions for a compilation of approximately 300 other large company plan sponsors tracked by our actuary, both in 2008 and 2011.

FIGURE 5



Q. WHAT IS THE SIGNIFICANCE OF THE EXPECTED RETURN ON ASSETS ASSUMPTION?

A. One component of the annual pension cost is a credit to reflect expected investment returns on plan assets for the next year. This amount is determined by applying the expected return on assets assumption to the plan assets and by reflecting the smoothing of prior years' investment gains and losses as appropriate.

Q. HOW HAS THE EXPECTED RETURN ON ASSETS ASSUMPTION CHANGED SINCE 2008?

A. The assumed expected return on assets was reduced from 8.5% in 2008 to 6.5% today. This decrease was due to a combination of changes in the portfolio's asset allocation and changes in long-term expectations for returns. This decrease was expected and logical based on the plan assets being subject to less risk exposure after the reallocation.

Table 2 below shows the results from the actuary's portfolio simulator, which is described in the chart on page 18 above, with Westar's asset allocation as of December 31, 2010. The simulator results support the 6.5% assumption used by Westar because the 6.5% assumption is consistent with the simulator results for the 50th percentile – the median or midpoint – for all return periods.

TABLE 2

Projected Portfolio Return	*Mean*	*10th percentile*	*25th percentile*	*50th percentile*	*75th percentile*	*90th percentile*
1 year	7.07	-6.8	-0.5	6.7	14.2	21.5
5 years	6.34	1.8	3.9	6.3	8.8	10.8
10 years	6.43	3.9	5.1	6.4	7.8	8.9
15 years	6.51	4.8	5.6	6.5	7.4	8.4
20 years	6.59	5.0	5.7	6.6	7.4	8.3

Q. HOW DO YOU EVALUATE WHETHER OR NOT THE INVESTMENT ALLOCATION OF THE PLAN SHOULD BE CHANGED?

A. Consistent with how we manage the rest of our business, we periodically reevaluate whether the investment allocation for the pension plan is appropriate and in the best interests of our stakeholders. The market events since 2008 revealed to us – and to many other plan sponsors – that the level of risk exposure to changes in both investments and corporate bond yields was greater than had been previously assumed. In addition, our plan is maturing with an increasing proportion of the obligations attributable to participants who have retired and are currently receiving benefits or are near retirement and will soon be receiving benefits.

Q. WHY IS WESTAR'S PENSION PLAN MATURING?

A. Westar's plan is maturing because the percentage of the total plan obligations attributable to retirees is much higher today than it was 10 years ago. It is becoming more common to think about active member obligations and retiree member obligations differently when determining the plan's overall risk appetite when setting the asset allocation. Active members have a longer expected life with very uncertain cash flows, suggesting a higher level of risk tolerance. By contrast, retiree obligations are much more "defined" in that the annual annuity payment for these individuals is known. They also have a shorter time horizon – suggesting a lower level of risk tolerance. As a result, as the plan "matures," the plan sponsor – Westar in this case – should reduce its risk tolerance and increase its allocation to fixed income, which we have done.

Q. HOW HAS WESTAR ADJUSTED THE PLAN ALLOCATION TO ACCOUNT FOR THESE ISSUES?

A. We made changes to the investment allocation to reduce these risks by adopting a "liability driven investment" strategy that better matches plan assets with plan liabilities. This strategy reduces the effect that changes in discount rates have on pension cost. Specifically, Westar has reduced its allocation to equity investments, increased its allocation to fixed income, and restructured its fixed income portfolio into longer duration maturities to better match the plan's liability profile. We made these changes to reduce year-over-year volatility of asset returns and to help mitigate the likelihood of large swings in pension cost which could affect utility rates. We believe making these changes was in the best interests of our customers, plan participants, and the Company.

Q. PLEASE SUMMARIZE YOUR PENSION COST COMMENTS.

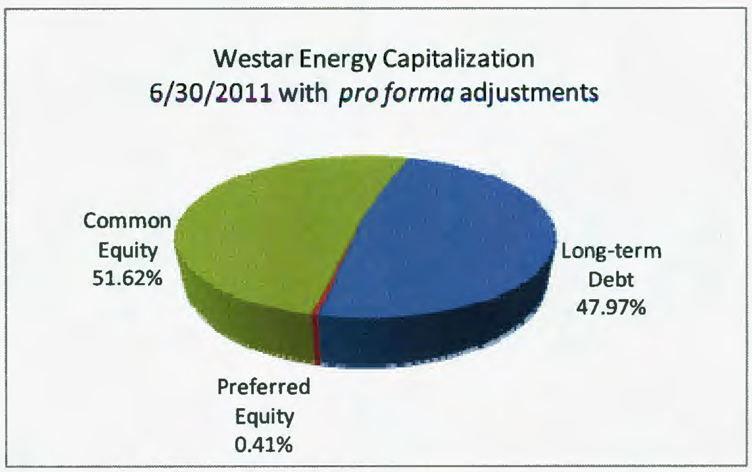
A. Pension cost has increased as a result of investment losses and lower discount rates stemming from the financial crisis. Westar's results are not extraordinary; they are consistent with what has occurred in the broader capital markets. The actuarial assumptions used by Westar to determine pension cost are reasonable, both in how they were selected and the rates that were chosen, particularly when compared to market practices generally. In addition, the asset smoothing methodology used by Westar spreads the impact of asset gains and losses into the future, which reduces volatility that customers might otherwise experience. Unfortunately, the market recovery we experienced during 2009 and 2010, while significant, has not yet been enough to offset the poor experience from 2008.

VI. WESTAR'S BOOK CAPITALIZATION

Q. PLEASE SUMMARIZE YOUR TESTIMONY WITH RESPECT TO CAPITAL STRUCTURE.

A. Westar's proposed capital structure is comprised of three components of investor-supplied capital: common equity, debt and a small amount of preferred equity.

FIGURE 6



Westar's capital structure is based on the actual amounts recorded on Westar's audited books and records and, consistent with long-standing Commission practice and the FERC Uniform System of Accounts, updated through our last quarterly financial statements including *pro forma* adjustments. We would also expect that the Commission, consistent with its prior practice, would ask that these figures be further updated for facts known closer to the hearing date, yet sufficiently early as to be available for audit by Staff and other parties.

Q. HOW DID YOU DETERMINE THE AMOUNTS AND PERCENTAGES OF THE THREE TYPES OF INVESTOR-SUPPLIED CAPITAL: DEBT, PREFERRED EQUITY AND COMMON EQUITY?

A. I used the respective amounts on Westar's audited books and records as of March 31, 2011, updating them to reflect amounts included in our financial statements as of June 30, 2011. I then adjusted the figures for known and measurable changes beyond June 30, 2011. The Commission Staff typically updates these amounts through a date closer to the evidentiary hearing as part of the discovery process. This would provide the most recent capital cost information and would still allow adequate time for the Staff and other intervenors to validate the figures. This would also be consistent with the Commission's reasonable and long-standing practice of using the most recent available capitalization and capital cost data in setting rates. An illustration of this can be found in Westar's last rate case when the Commission adopted post-test year adjustments for capital structure two months following the filing of the rate application, but early enough to permit full discovery and validation.

Q. PLEASE DESCRIBE ANY *PRO FORMA* ADJUSTMENTS TO WESTAR'S CAPITAL STRUCTURE IN THIS FILING.

A. The first adjustment updated the test year ending March 31, 2011 capital structure to reflect the most current quarter ending balances as of June 30, 2011. I then made a series of *pro forma* adjustments (outlined in Section 7-A) related to equity sold during 2010, through a series of forward equity transactions, but not yet reflected on Westar's balance sheet as of June 30, 2011.

Q. PLEASE DESCRIBE A FORWARD EQUITY TRANSACTION.

A. A forward equity transaction offers the flexibility of pricing equity at a specific point in time and not settling the transaction until a future contractual date when the cash is needed. Essentially, when we priced these equity transactions, the investment banks borrowed shares from our large institutional shareholders and sold the borrowed shares to new shareholders. The banks will hold the proceeds from these sales until Westar sends them a notice that it needs the cash and would like to settle the transaction(s). Upon settlement, Westar will issue new shares to the banks; the banks will then deliver the funds to us. Contemporaneously, the banks will repay the borrowed shares to the large investors from whom they originally borrowed them.

Westar has already begun settling these forward equity transactions, and anticipates settling the rest of these transactions over the next couple of months. Because the equity was priced during 2010, and Westar has a contractual obligation to settle these transactions, we deemed it appropriate to include the recently settled and the remaining unsettled transactions in our capital structure.

Q. IS THIS CONSISTENT WITH THE COMMISSION'S STANDARD PRACTICE FOR RECOGNIZING THIS TYPE OF TRANSACTION IN RATES?

A. Yes. In 2007, Westar entered into a forward equity transaction and settled a portion of that transaction in 2008. The Commission allowed Westar to include this equity adjustment in our last rate case, which used 2007 as the test year.

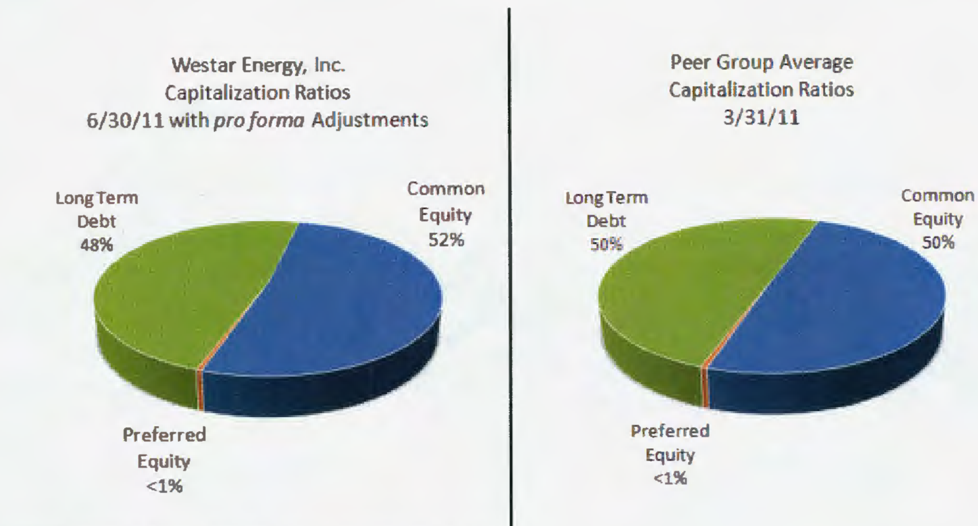
Q. WHAT IS THE AMOUNT OF THIS ADJUSTMENT?

A. As reflected in Schedule 7-A, the *pro forma* adjustment to Westar's common equity balance resulted in an increase of $222,997,561.

Q. HOW DOES YOUR OVERALL CAPITALIZATION COMPARE TO THAT OF YOUR PEERS?

A. Figure 7 below shows that Westar's capitalization is similar to the average of the proxy group selected to estimate the cost of equity in Mr. Ruelle's direct testimony. Westar and other utilities with businesses similar to ours typically operate within a fairly narrow band of capitalization ratios. This balance is an important element in providing assurance that utilities will be able to make the long-term, capital-intensive investments needed to provide reliable utility service, while at the same time, incorporating enough lower-cost debt capital to keep utility rates reasonable.

FIGURE 7



Source: Westar's financials / Bloomberg accessed June 8, 2011

VII. THE COSTS OF WESTAR'S DEBT AND PREFERRED EQUITY

Q. HOW DOES ONE ESTABLISH THE COST OF DEBT AND THE COST OF PREFERRED EQUITY FOR RATEMAKING?

A. Long-standing regulatory precedent is to use the actual underlying contractual obligations for these securities: the cost the Company actually incurs.

Q. WHAT IS WESTAR'S COST OF DEBT?

A. Westar's cost of debt is 6.6509%, as shown on Schedule 7-C. This figure reflects the weighted average contractual interest cost on Westar's various series of outstanding bonds, as well as the amortization of applicable premiums, discounts, issuance costs and refinancing costs.

Q. WHAT IS WESTAR'S COST OF PREFERRED EQUITY AND HOW IS IT DETERMINED?

A. The cost of preferred equity is determined by simply confirming and calculating the embedded contractual cost. Westar's cost of preferred equity is 4.5529%, as shown on Schedule 7-E.

VIII. WEIGHTED COST OF CAPITAL (I.E., RETURN ON RATE BASE)

Q. WHAT IS WESTAR'S OVERALL COST OF CAPITAL OR RATE OF RETURN REQUESTED IN THIS FILING?

A. The cost of capital included in the overall cost of service should be the weighted costs of debt, preferred equity and common equity. As supported in Mr. Ruelle's direct testimony, Westar's recommended return on equity is 10.6000%. These component costs multiplied by the respective capitalization ratios result in a weighted cost of capital of 8.6809% on Schedule 7-A and illustrated below:

TABLE 3

Return on Rate Base (as filed)				
		A	B	C
		Percent of Capitalization	Component Cost	Weighted Avg. Cost
1	Debt	47.9662%	6.6509%	3.1902%
2	Preferred Equity	0.4121%	4.5529%	0.0188%
3	Common Equity	51.6218%	10.6000%	5.4719%
4	**Totals**	**100.0000%**		**8.6809%**

Q. WILL YOU SUMMARIZE YOUR TESTIMONY REGARDING WESTAR'S OVERALL RATE OF RETURN?

A. The capital structure included in Westar's Application is based on its actual capital structure, adjusted for customary known and measurable changes consistent with prior practice before the Commission. Moreover, this capital structure is consistent with industry practice.

The cost of debt and preferred stock are also calculated in accordance with prior practice before the Commission and reflect Westar's actual cost.

The weighted average cost of capital is the mathematical result of the above elements, plus the recommended ROE sponsored by Mr. Ruelle.

Q. THANK YOU.