**BEFORE 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

POST-HEARING BRIEF OF COMMISSION STAFF

TABLE OF CONTENTS

The Staff of the State Corporation Commission of the State of Kansas ("Staff" and "Commission," respectively) submits its Post-Hearing Brief regarding the Joint Application of Great Plains Energy, Incorporated (GPE), Kansas City Power & Light Company (KCP&L), and Westar Energy, Inc. (Westar) (collectively, "Joint Applicants") for approval of the acquisition of Westar by GPE.

I. BACKGROUND

A. Interventions

1. On June 29, 2016, the Citizen's Utility Ratepayer Board (CURB) filed its intervention citing its authority to represent residential and small commercial ratepayers and to function as an official intervenor in cases filed with the state corporation commission.[1] On July 14, 2016, the Commission granted CURB's intervention in this docket.[2]

2. On June 30, 2016, the Kansas Electric Power Cooperative, Inc. (KEPCo) filed its intervention , claiming its members will or may be bound by any Commission order or activity in this proceeding because: (1) KEPCo co-owns the Wolf Creek Generating Station with KCP&L and Westar; (2) KEPCo co-owns Iatan Generation Station Unit 2 with KCP&L; and (3) KEPCo is dependent on Westar's generation fleet and transmission system for its power supply.[3] On August 2, 2016, the Commission granted KEPCo's intervention in this docket and also consolidated with KPP.[4]

3. On July 1, 2016, Spirit AeroSystems filed its intervention citing this Docket may affect Westar' s current or future rates, and terms and conditions of service to them, giving them a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy

[1] Petition to Intervene and Motion for Protective Order and Discovery Order, (June 29, 2016).
[2] Order Designating Prehearing Officers; Granting Intervention to CURB; and Protective and Discovery Order, ¶ 6, (July 14, 2016).
[3] Petition of Kansas Electric Power Cooperative, Inc. to Intervene (June 30, 2016).
[4] Order Granting Intervention to Kansas Electric Cooperative, Inc. and Kansas Power Pool, ¶ 5, (Aug. 2, 2016).

issues that may be addressed, considered, and determined by the Commission.[5] On July 14, 2016, the Commission granted Spirit AeroSystems intervention in this docket and also consolidated Spirit Aerosystems, Inc.; the Goodyear Tire & Rubber Co.; Coffeyville Resources Refining & Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC.[6]

4. On July 1, 2016, Goodyear Tire filed its intervention citing this Docket may affect Westar' s current or future rates, and terms and conditions of service to them, giving them a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy issues that may be addressed, considered, and determined by the Commission.[7] On July 14, 2016, the Commission granted Goodyear Tire's intervention in this docket and also consolidated Spirit Aerosystems, Inc.; Coffeyville Resources Refining & Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC.[8]

5. On July 1, 2016, Coffeyville Resources Refining filed its intervention citing this Docket may affect Westar' s current or future rates, and terms and conditions of service to them, giving them a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy issues that may be addressed, considered, and determined by the Commission.[9] On July 14, 2016, the Commission granted Coffeyville Resources Refining and also consolidated Spirit Aerosystems, Goodyear Tire, Cargill, Inc., and CCPS Transportation.[10]

6. On July 6, 2016, CCPS Transportation filed its intervention citing this Docket may affect Westar' s current or future rates, and terms and conditions of service to them, giving

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[5] Petition to Intervene of Spirit AeroSystems, Inc., (July 1, 2016).
[6] Order Granting Intervention to Spirit Aero Systems; The Goodyear Tire & Rubber Co.; Coffeyville Resources Refining and Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC, ¶ 5-6 (July 14, 2016).
[7] Petition to Intervene of The Goodyear Tire & Rubber Company, (July 1, 2016).
[8] Order Granting Intervention to Spirit Aero Systems; The Goodyear Tire & Rubber Co.; Coffeyville Resources Refining and Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC, ¶¶ 5-6 (July 14, 2016).
[9] Petition to Intervene of Coffeyville Resources Refining & Marketing, LLC, (July 1, 2016).
[10] Order Granting Intervention to Spirit Aero Systems; The Goodyear Tire & Rubber Co.; Coffeyville Resources Refining and Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC, ¶¶ 5-6 (July 14, 2016).

them a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy issues that may be addressed, considered, and determined by the Commission.[11] On July 14, 2016, the Commission granted CCPS Transportation's intervention and consolidated Spirit Aerosystems, GoodYear Tire, Coffeyville Resources Refining, and Cargill, Inc.[12]

7. On July 6, 2014, Cargill, Inc. filed its intervention citing Docket may affect Westar' s current or future rates, and terms and conditions of service to them, giving them a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy issues that may be addressed, considered, and determined by the Commission.[13] On July 14, 2016, the Commission granted Cargill, Inc.'s intervention and consolidated Spirit Aerosystems, GoodYear Tire, Coffeyville Resources Refining, and CCPS Transportation.[14]

8. On July 7, 2016, International Brotherhood of Electric Workers, Local 304 filed its intervention claiming its members will or may be bound by any Commission order or activity in this proceeding because: (1) IBEW 304 is a signatory to a collective-bargaining agreement with Westar, governing the terms and conditions of the employment for approximately 1,200 bargaining unit employees, including, but not limited to, wages, health care benefits and retirement benefits; (2) As the exclusive bargaining representative, IBEW 304 has a legal duty to its members, concerns over possible labor dislocations, and an interest in mitigating any potential resulting harm; and (3) IBEW's ability to negotiate terms and conditions of employment is

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[11] Petition to Intervene of CCPS Transportation, LLC, (July 6, 2016).
[12] Order Granting Intervention to Spirit Aero Systems; The Goodyear Tire & Rubber Co.; Coffeyville Resources Refining and Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC, ¶¶ 5-6, (July 14, 2016).
[13] Petition to Intervene of Cargill, Incorporated, (July 6, 2014).
[14] Order Granting Intervention to Spirit Aero Systems; The Goodyear Tire & Rubber Co.; Coffeyville Resources Refining and Marketing, LLC; Cargill, Inc.; and CCPS Transportation, LLC, ¶¶ 5-6 (July 14, 2016).

directly linked to the financial viability of the proposed acquisition.[15] On August 2, 2016, the Commission granted International Brotherhood of Electric Workers, Local 304 its intervention.[16]

9. On July 13, 2016, Kroger filed its intervention states, as one of Westar's largest commercial customers, the terms and conditions of its electric service could be substantially affected by this Docket. With approximately 85 accounts in Westar's service territory, Kroger purchases more than 150 million kWh of electricity from the Company annually.[17] On August 2, 2016, the Commission granted Kroger's intervention.[18]

10. On July 15, 2016, KPP filed its intervention citing its members will or may be bound by any Commission order or activity in this proceeding because: (1) KPP has a Purchase Power Agreement with Westar for 59 megawatts of power from the Jeffrey Energy Center; and (2) KPP's power supply is dependent upon Westar's transmission system for delivery to its members.[19] On August 2, the Commission granted KPP's intervention and consolidated with KEPCo.[20]

11. On July 27, 2016, Sunflower & Mid-Kansas filed its intervention citing a contractual relationship with Westar to purchase up to 8% of the energy output produced by Westar's Jeffrey Energy Center. Sunflower and Mid-Kansas also each pay transmission charges for power across Westar's transmission grid.[21] On August 9, 2016, the Commission granted Sunflower and Mid-Kansas's intervention and consolidated with KPP's intervention.[22]

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[15] Petition to Intervene, (July 7, 2016).
[16] Order Granting Intervention to IBEW, Local Union 225 and IBEW, Local Union 1523, ¶ 4 (Aug. 2, 2016).
[17] Kroger Co's Petition to Intervene, (July 13, 2016).
[18] Order on Petition to Intervene and Motion for Admission Pro Hac Vice, ¶ 5 (Aug. 2, 2016).
[19] Petition of the Kansas Power Pool (KPP) A Municipal Energy Agency to Intervene (July 15, 2016).
[20] Order Granting Intervention to Kansas Electric Cooperative, Inc. and the Kansas Power Pool, ¶ 5, (Aug. 2, 2016).
[21] Petition to Intervene (July 27, 2016).
[22] Order Granting Sunflower Electric Power Corporation and Mid-Kansas Electric Company, LLC's Petition to Intervene, ¶¶ 4-5 (Aug. 9, 2016).

12. On August 3, 2016, International Brotherhood of Electric Workers, Local 225 filed its intervention citing its members will or may be bound by any Commission order in this proceeding because: (1) IBEW 225 is a signatory to a collective-bargaining agreement with Wolf Creek Nuclear Operating Company governing the terms and conditions of the employment for approximately 400 bargaining unit employees, including, but not limited to, wages, health care benefits and retirement benefits; (2) as the exclusive bargaining representative, IBEW 225 has a legal duty to represent its members; and (3) IBEW's ability to negotiate terms and conditions of employment is directly linked to the financial viability of the proposed acquisition.[23] On August 16, 2016, the Commission granted and consolidated with IBEW 304, 1523, 412, 1465, and 1613.[24]

13. On August, 3, 2016, International Brotherhood of Electrical Workers, Local 1523 filed its intervention citing its members will be affected by any Commission order or activity in this proceeding7 because: (1) IBEW 1523 is a signatory to a collective-bargaining agreement with Westar which sets forth the terms and conditions of the employment for approximately 1,200 bargaining unit employees, including, but not limited to, wages, health care benefits and retirement benefits; (2) IBEW 1523 has specific jurisdiction over bargaining unit employees in the Wichita area and has a duty to represent those employees; and (3) IBEW 1523 has direct knowledge of Westar's workforce and has a legal duty to be concerned with the possibility of labor dislocations that may be particularly harmful to local communities, or the state generally, and whether measures can be taken to mitigate the harm.[25] On August 16, 2016, the Commission granted and consolidated with IBEW 304, 1523, 412, 1465, and 1613.[26]

[23] Petition to Intervene (Aug. 3, 2016).
[24] Order Granting Intervention to IBEW, Local Union 225 and IBEW, Local Union 1523, ¶¶ 5-6 (Aug. 16, 2016).
[25] Petition to Intervene (Aug. 3, 2016).
[26] Order Granting Intervention to IBEW, Local Union 225 and IBEW, Local Union 1523, ¶¶ 5-6 (Aug. 16, 2016).

14. On August 4, 2016, Occidental Chemical Corporation filed its intervention citing its status as the largest user of electricity in the State of Kansas and Occidental is a Westar customer.[27] On August 16, 2016, the Commission granted the intervention.[28]

15. On August 4, 2016, Midwest Energy filed its intervention citing filed a Petition to Intervene, stating it is a long-standing large volume customer of Westar and purchases support services related to its participation in the SPP Integrated Market.[29] On August 16, 2016, the Commission granted intervention and the Commission found it appropriate to condition Midwest's intervention on requiring them to combine their activities with Sunflower, Mid-Kansas, and the KPP.[30]

16. On August 4, 2016, Brightergy filed its intervention explaining it provides energy efficiency, management and generation solutions for public and private entities in both KCP&L's and Westar's service territories. Specifically, Brightergy claims it will be directly and substantially impacted by the Commission's decision in this Docket because "energy solutions, including on-site solar generation, efficiency, and energy management, are heavily shaped by a utility's individual polices and tariffs.[31] On September 15, 2016, the Commission denied the intervention.[32] On October 27, 2016, the Commission granted the intervention and the Commission found it appropriate to limit Brightergy's intervention to the issues identified in its Petition, tariffs for parallel generation and net metering. Brightergy's intervention was limited to engaging in discovery and filing motions and briefs on the issues of tariffs for parallel generation

[27] Petition to Intervene of Occidental Chemical Corporation (Aug. 4, 2016).
[28] Order Granting Intervention to Occidental Chemical Corporation,¶¶4-6 (Aug. 16, 2016).
[29] Petition to Intervene of Midwest Energy, Inc. (Aug. 4, 2016).
[30] Order Granting Intervention to Midwest Energy, Inc., ¶¶4-5 (Aug. 16, 2016).
[31] Petition to Intervene (Aug. 4, 2016).
[32] Order Denying Brightergy’s Petition to Intervene (Aug. 4, 2016).

and net metering. However, in the interest of the orderly and prompt conduct of the proceeding, Brightergy was not permitted to actively participate in the evidentiary hearing.[33]

17. On August 5, 2016, Kansas Municipal Energy Agency filed its intervention stated its business is the planning, financing and constructing of projects for the purchase, sale, generation and transmission of electricity for its municipal members. KMEA asserted its members will or may be affected by any Commission order or activity in this Docket because many of its "members do business with, and/or are interconnected with transmission systems owned by KCP&L or Westar" and it participates in the Southwest Power Pool Regional Transmission Organization (SPP), whose operations extend into Kansas and are affected by KCP&L and Westar.[34] On September 15, 2016, the Commission grants intervention and the Commission found it appropriate to condition the intervention of KMEA, Independence, and KMU on requiring them to combine their activities in this Docket, including their presentations of evidence, argument, cross-examination, discovery, and other participation in the proceedings. Since the parties are similarly situated as municipalities and are represented by the same counsel, the Commission found it appropriate to condition their intervention on requiring them to combine their activities in the docket.[35]

18. On August 5, 2016, City of Independence, Missouri filed an intervention citing its customers will or may be affected by any Commission order or activity in this Docket because its "electric system is interconnected with KCP&L's system" and it also participates in SPP, whose operations extend into Kansas and are significantly affected by KCP&L and Westar.[36] On September 15, 2016, the Commission granted intervention and the Commission found it

[33] Order Granting Brightergy's Motion to Reconsider, ¶8 (Oct. 27, 2016).
[34] Petition of Kansas Municipal Energy Utilities to Intervene (Aug. 5, 2016).
[35] Order Granting Intervention to Kansas Municipal Energy Agency, City of Independence, Missouri, and Kansas Municipal Utilities, ¶6 (Sept. 15,2016).
[36] Petition of the City of Independence, Missouri to Intervene (Aug. 5, 2016).

appropriate to condition the intervention of KMEA, Independence, and KMU on requiring them to combine their activities in this Docket, including their presentations of evidence, argument, cross-examination, discovery, and other participation in the proceedings. Since the parties are similarly situated as municipalities and are represented by the same counsel, the Commission found it appropriate to condition the large industrial intervenors' intervention on requiring them to combine their activities in the docket.[37]

19. On August 5, 2016, Kansas Municipal Utilities filed its intervention KMU claims its members will or may be affected by any Commission order or activity in this proceeding because: (1) it participates in the SPP, and by virtue of the participation in SPP by Westar and KCP&L, SPP operations extend into Kansas and are significantly affected by KCP&L and Westar; and (2) many of its members have various contracts with KCP&L and/or Westar and are interconnected with transmission systems owned by KCP&L and Westar.[38] On September 15, 2016, the Commission granted intervention and the Commission found it appropriate to condition the intervention of KMEA, Independence, and KMU on requiring them to combine their activities in this Docket, including their presentations of evidence, argument, cross-examination, discovery, and other participation in the proceedings. Since the parties are similarly situated as municipalities and are represented by the same counsel, the Commission found it appropriate to condition the large industrial intervenors' intervention on requiring them to combine their activities in the docket.[39]

20. On August 18, 2016, Walmart filed its intervention stating as one of the twenty largest customers of Westar and KCP&L, this Docket may affect Westar's and KCP&L's rates,

[37] Order Granting Intervention to Kansas Municipal Energy Agency, City of Independence, Missouri, and Kansas Municipal Utilities, ¶ 6 (Sept. 15, 2016).
[38] Petition of Kansas Municipal Utilities to Intervene (Aug. 5, 2016).
[39] Order Granting Intervention to Kansas Municipal Energy Agency, City of Independence, Missouri, and Kansas Municipal Utilities, ¶6 (Sept. 15, 2016).

and terms and conditions of service to the company. Walmart claims it "has a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy issues that may be addressed, considered and determined by the Commission in this docket.[40] On September 15, 2016, the Commission granted Walmart's intervention and the Commission found it appropriate to condition the intervention of Walmart on requiring it to combine its activities in this Docket with the Kroger Company, including their presentations of evidence, argument, cross examination, discovery, and other participation in the proceedings.[41]

21. On August 19, 2016, KCK BPU filed its intervention stating it "is a non-profit, municipally owned electric power and energy company which supplies electric power and energy to more than 64,000 residential, commercial and industrial customers." The BPU further stated it is interconnected with both KCP&L and Westar, and is a Southwest Power Pool (SPP) customer in both the Westar and KCP&L transmission zones.[42] On September 15, 2016, the Commission granted intervention and the Commission found it appropriate to condition the intervention of the BPU on requiring them to combine their activities in this Docket with Kansas Municipal Energy Agency (KMEA), Kansas Municipal Utilities (KMU), and the City of Independence, Missouri (Independence), including their presentations of evidence, argument, cross-examination, discovery, and other participation in the proceedings.[43]

22. On August 18, 2016, the International Brotherhood of Electrical Workers, Locals 412, 1464, and 1613 filed its intervention stating they are legally obligated to represent their 1,720 members who are employed by KCP&L and reside in Kansas and Missouri because those individuals and their local communities will be affected by any Commission order or activity in

[40] Petition to Intervene (Aug. 18, 2016).
[41] Order Granting the Petition to Intervene of Walmart Stores, Inc. ¶¶ 4-5 (Sept. 15, 2016).
[42] Petition to Intervene (Aug. 19, 2016).
[43] Order Granting Intervention to Kansas City, Kansas Board of Public Utilities, ¶4 (Sept. 15, 2016).

this proceeding. The Locals further declared they have "direct knowledge of KCP&L's workforce and have a legal duty to be concerned with the possibility of labor dislocations ... and whether measures can be taken to mitigate the harm done …"[44] On September 15, 2016, the Commission granted intervention and the Commission found it appropriate to condition the intervention of the Locals on requiring them to combine their activities in this Docket with IBEW Local Unions No. 225, 304, and 1523, including their presentations of evidence, argument, cross-examination, discovery, and other participation in the proceedings.[45]

23. On October 12, 2016, the Missouri Joint Municipal Electric Utility commission filed its intervention asserting three grounds for intervention: (1) its 11.76% ownership interest in the Iatan 2 Generating Plant (Iatan 2) could be affected by this Docket; (2) several of its members use transmission service from KCP&L and KCP&L's GMO systems, and may be impacted by cost shifts from the acquisition; and (3) many of its members participate in the Southwest Power Pool Regional Transmission Organization (SPP), which extends into Missouri and includes KCP&L as a participating utility. Because of KCP&L's involvement in SPP, MJMEUC alleged that SPP, and therefore MJMEUC's members, may be affected by the acquisition.[46] On October 24, 2016, the Joint Applicants filed an objection to MJMEUC's petition to intervene arguing that MJMEUC fails to meet the requirements of K.A.R. 82-1-225.[47] First, Joint Applicants argued that MJMEUC's legal interest in the Iatan 2 will not be substantially affected by this proceeding.[48] The Joint Applicants also argued MJMEUC's statements regarding transmission service are "conclusory and general statements" and the

[44] Petition to Intervene (Aug. 18, 2016).
[45] Order Granting Intervention to IBEW, Local Unions No. 412, 1464, and 1613, ¶¶ 5-6 (Sept. 15, 2016).
[46] Petition of the Missouri Joint Municipal Electric Utility Commission, (Oct. 12, 2016).
[47] Objection of Joint Applicants to the Petition to Intervene of the Missouri Joint Municipal Electric Utility Commission (Oct. 24, 2016).
[48] *Id.* at ¶ 4.

Federal Energy Regulatory Commission (FERC) is the proper forum to address transmission service issues.[49] On November 29, 2016, the Commission found that KEPCo, with only a 3.53% interest in the Iatan 2, was granted intervention earlier in this Docket, with no protest by the Joint Applicants. MJMEUC has similar interests as KEPCo as a co-owner of the Iatan 2. Because KEPCo's ownership interest in the Iatan 2 justified intervention, the Commission likewise deemed MJMEUC's ownership interest in the Iatan 2 sufficient under K.A.R. 82-1-225 to intervene in this Docket. The Commission agreed with KCP&L that FERC is the better venue to address MJMEUC's concerns over transmission services it receives in Missouri from KCP&L. Therefore, the Commission limited MJMEUC's intervention only to its ownership interest in the Iatan 2 and found it appropriate to condition the intervention of MJMEUC on requiring it to combine its activities in this Docket with KEPCo, including their presentations of evidence, argument, cross-examination, discovery, and other participation in the proceedings.[50]

24. On October 21, 2016, Sierra Club filed its intervention arguing because some of its Kansas members are KCP&L and Westar customers, the proposed merger may substantially affect utility services purchased and rates of its members. Sierra Club claims an interest in analyzing two Merger Standards: the transaction's effects on the environment and whether it maximizes the use of Kansas energy resources.[51] On November 29, 2016, the Commission found the Sierra Club has a sufficient legal interest to intervene on two issues. Accordingly, the Commission found the Sierra Club has met the requirements of K.A.R. 82-1-225 and K.S.A. 77-

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[49] *Id.* at ¶ 5.
[50] Order Granting Limited Intervention to Missouri Joint Municipal Electric Utilities Commission, ¶¶4-8 (Nov. 29, 2016).
[51] Sierra Club Petition to Intervene (Oct. 21, 2016).

521, and should be granted intervention, limited to "the effect of the transaction on the environment" and "whether the transaction maximizes the use of Kansas energy resources."[52]

25. On December 1, 2016, HollyFrontier El Dorado Refining filed its intervention stating HollyFrontier is a petroleum refining business, with substantial business operations in the area of El Dorado, Kansas. HollyFrontier claims as one of Westar's largest, direct retail electric customers, it has a substantial, direct financial interest in all of the costs of service, rate design, tariffs, and policy issues in this Docket.[53] On December 15, 2016, the Commission granted HollyFrontier's intervention combined with other large industrial customers already intervened, and reclassified the group as intervenors through KIC.[54]

26. On December 2, 2016, KIC filed an Application for Intervention on behalf of commercial, business, industrial, and not-for-profit and educational entities that purchase large volumes of electric energy and natural gas for their operations and activities. Specifically, KIC explained Occidental Chemical Corporation; CCPS Transportation, LLC; Spirit AeroSystems, Inc.; The Goodyear Tire & Rubber Company; Coffeyville Resources Refining & Marketing, LLC; Cargill Incorporated; and HollyFrontier would participate through the KIC. The first six of those entities had already been granted intervention, and were consolidated into the Large Industrial Consumers Group.[55] On December 15, 2016, the Commission granted its intervention and stated since the Commission has already granted intervention to the Large Industrial Consumer Group, the Commission believes no prejudice would result in reclassifying them as intervenors through KIC.[56]

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[52] Order Granting Limited Intervention to the Sierra Club, ¶7 (Nov. 29, 2016).
[53] Petition to Intervene of HollyFrontier El Dorado Refining LLC (Dec. 1, 2016).
[54] Order Granting Intervention to HollyFrontier El Dorado Refining, Inc. and Recognizing the Kansas Industrial Consumers Group, Inc., ¶7 (Dec. 15, 2016).
[55] Application for Intervention (Dec. 2, 2016).
[56] Order Granting Intervention to HollyFrontier El Dorado Refining, Inc. and Recognizing the Kansas Industrial Consumers Group, Inc. ¶7 (Dec. 15, 2016).

B. Pre-Filed Testimony

27. On June 28, 2016, concurrent with the filing of their Joint Application, the Joint Applicants filed the pre-filed direct testimony of the following witnesses: Terry Bassham, President and Chief Executive Officer of KCP&L and GPE; Mark Ruelle, President and Chief Executive Officer of Westar; Kevin Bryant, Chief Financial Officer of KCP&L; Scott Heidtbrink, Executive Vice President and Chief Operating Officer for KCP&L; Steven Busser, Vice President – Risk Management and Controller for GPE; Charles Caisley, Vice President – Marketing and Public Affairs for GPE; Darrin Ives, Vice President – Regulatory Affairs for KCP&L; and William Kemp, Senior Managing Director of Enovation Partners, LLC.

28. On November 2, 2016, Joint Applicants filed a Motion for Leave to File Supplemental Direct Testimony and Petition for Reconsideration of Order Addressing Joint Applicants' Verified Responses on the Commissions (*sic*) Merger Standards (Motion and PFR).[57] The Joint Applicants' Motion and PFR contained Joint Applicants' proffered supplemental testimony as attachments. The proffered supplemental direct testimony purported to address deficiencies in response to the Commissions October 18, 2016 Order Addressing Joint Applicants' Verified Responses on the Commission's Merger Standards.

29. On December 16, 2016, Staff filed the direct testimony of the following witnesses: Jeffrey McClanahan, Director, Utilities Division; Justin Grady, Chief of Accounting and Financial Analysis; Dr. Robert Glass, Chief of Economics and Rates; Adam Gatewood, Managing Financial Analyst; Casey Gile, Energy Engineer; Scott Hempling, President, Scott Hempling, Attorney at Law LLC; Walter Drabinski, Vantage Energy Consulting LLC; and Ann Diggs, Ann Diggs, CPA.

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[57] Motion for Leave to File Supplemental Direct Testimony and Petition for Reconsideration of Order Addressing Joint Applicants' Verified Responses on the Commissions (sic) Merger Standards (Nov. 2, 2016).

30. On December 16, 2016, the CURB filed the direct testimony of Andrea Crane, President of The Columbia Group, Inc., and Stacey Harden, independent consultant.

31. On December 16, 2016, KEPCo filed the direct testimony of the following witnesses: Dr. David E. Dismukes, Ph.D., Consulting Economist with the Acadian Consulting Group; Dr. Laurence D. Kirsch, PhD., Senior Consultant with Christensen Associates Energy Consulting, LLC; and Mark F. Doljac, Director of Rates and Regulation for KEPCo, on behalf of combined intervenors KEPCo and KPP.

32. On December 16, 2016, KPP filed the direct testimony of Larry Holloway, Assistant General Manager – Operations, of KPP on behalf of combined intervenors KEPCo and KPP.

33. On December 16, 2016, IBEW Local 1523 filed the direct testimony of the following witnesses: Raymond Rogers, Business Manager for IBEW Local 225; John Garretson, Business Manager/Financial Secretary for IBEW Local 304, and Duane Nordick, Business Manager for IBEW Local 1523, on behalf of combined intervenors IBEW Local 225, IBEW Local 304, IBEW Local 1523, IBEW Local 412, IBEW Local 1465, and IBEW Local 1613.

34. On December 16, 2016, Sunflower & Mid-Kansas filed the direct testimony of James Brungardt, Manager of Regulatory Relations, on behalf of combined intervenors Sunflower/Mid-Kansas, and Midwest Energy.

35. On December 16, 2016, Walmart filed the direct testimony of Steve W. Chriss, Director, Energy and Strategy Analysis, on behalf of combined intervenors Walmart and Kroeger Company.

36. On December 16, 2016 KCK BPU filed the direct testimony of John Krajewski, P.E., President of JK Energy Consulting, LLC; Jonathan A. Lesser, President of Continental

Economics, Inc.; and Boris J. Steffen, CPA, ASA, ABV, CDBV, CGMA, Director and Southeast Leader of the Financial Investigations and Dispute Advisory Services practice of RSM US LLP, on behalf of combined intervenors KCK BPU, KMEA, KMU, and Independence.

37. On December 16, 2016, KMEA, KMU, and Independence filed the direct testimony of Joseph A. Herz, Vice President of Sawvel and Associates on behalf of combined intervenors KCK BPU, KMEA, KMU, and Independence.

38. On December 16, 2016, the Sierra Club filed the direct testimony of Maximilian Chang, Principal Associate with Synapse Energy Economics.

39. On December 16, 2016, KIC filed the direct testimony of Michael P. Gorman, Managing Principal with Brubaker & Associates, Inc. on behalf of KIC and the combined large industrial customers.

40. On December 22, 2016, Brightergy filed the cross answering testimony of Jessica Oakley, Vice President of Client Solutions.

41. On January 9, 2017, Joint Applicants filed the rebuttal testimony of the following witnesses: Terry Bassham, President and Chief Executive Officer of KCP&L and GPE; Mark Ruelle, President and Chief Executive Officer of Westar; Kevin Bryant, Chief Financial Officer of KCP&L; Steven Busser, Vice President – Risk Management and Controller for GPE; Charles Caisley, Vice President – Marketing and Public Affairs for GPE; Thomas Flaherty, Partner at PwC Strategy&; Dr. Arthur Hall, Director, Brandmeyer Center for Applied Economics; Melissa Hardesty, Senior Director of Taxes at KCP&L; Robert Hevert, Partner, ScottMadden; Darren Ives, Vice President – Regulatory Affairs at KCP&L; William Kemp, Senior Managing Director of Enovation Partners, LLC; Kevin Noblet, Vice President – Delivery at KCP&L; James Proctor,

President, James Proctor Consulting; and John Reed, Chairman and Chief Executive Officer of Concentric Energy Advisors.

42. Following the Commission's Order on Prehearing Motions, multiple witnesses re-filed their direct and rebuttal testimonies with certain information unredacted.[58]

C. Procedural History

43. On June 28, 2016, Joint Applicants filed an application seeking approval for GPE to acquire 100% of the stock of Westar in a transaction valued at approximately $12.2 billion, including assumed debt.[59]

44. On August 9, 2016, the Commission issued an Order on Merger Standards wherein the Commission reaffirmed the Merger Standards as enumerated in the November 14, 1991 Order approving the Kansas Power & Light and Kansas Gas & Electric merger in consolidated dockets 172,745-U and 174,155-U and as modified in the September 28, 1999 Order in Docket no. 97-WSRE-676-MER.[60] The Commission's August 9, 2016 Order on Merger Standards set out the standards to be used in determining whether a proposed merger will promote the public interest, and provided Joint Applicants time to supplement their Joint Application.[61]

45. On August 30, 2016, the Joint Applicants filed their response to the Commission's Order on Merger Standards (Response).[62] In their Response, Joint Applicants state they fully adopt the Merger Standards and any paraphrasing was not intended to change the Commission's Merger Standards.[63] Joint Applicants further explain in their Response that

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[58] Order on Prehearing Motions (Jan. 26, 2017).
[59] Joint Application, ¶6 (June 28, 2016).
[60] Order on Merger Standards, (Aug. 9, 2016).
[61] *Id*. at ¶5, Ordering Clause B.
[62] Joint Applicants' Verified Response to Commission's Order on Merger Standards (Aug. 30, 2016).
[63] *See id*. at ¶¶6-7.

despite the omission of the words "in excess of book value" in the recitation of Merger Standard (a)(iv) in the Joint Application, testimony supporting the Joint Application addresses this factor.[64] Finally, Joint Applicants' Response goes on to address the additional questions raised in the Commission's Order on Merger Standards.[65]

46. On September 9, 2016, Staff filed its Reply to the Joint Applicants' Verified Response to the Commission's Order on Merger Standards (Staff's Reply), asserting the Joint Applicants altered the Merger Standards to ease the burden on the Joint Applicants.[66] Staff noted several specific areas in which it believed Joint Applicants' Joint Application to be deficient.[67] Accordingly, Staff requested the Commission direct Joint Applicants to amend their Joint Application to rectify the deficiencies identified by Staff, or in the alternative, dismiss the Joint Application without prejudice. [68]

47. On September 12, 2016, the Citizens' Utility Ratepayer Board (CURB) filed its Response to Staff's Reply (CURB's Reply), agreeing with Staff that the Joint Applicantion is deficient.[69] CURB echoed Staff's request that the Commission direct Joint Applicants to amend their Joint Application to conform to the Merger Standards, or in the alternative dismiss the Joint Application without prejudice.[70]

48. On September 19, 2016, the Joint Applicants filed their Response to Staff's and CURB's Reply to Joint Applicants' Verified Response to Commission's Order on Merger

[64] *Id*. at ¶8.
[65] *See id.* at ¶¶10-19.
[66] Staff's Reply to Joint Applicants' Verified Response to Commission's Order on Merger Standards, ¶4 (Sept. 9, 2016).
[67] *See id.* at ¶¶9, 16.
[68] Staff's Reply, p. 10.
[69] CURB's Response to Staff's Reply to Joint Applicants' Verified Response to Commission's Order on Merger Standards (Sept. 12, 2016).
[70] *Id*. at ¶9.

Standards (Joint Applicants' Response to Staff and CURB's Replies).[71] Joint Applicants' Response to Staff's and CURB's Reply, among other things, reiterated that the Joint Applicants were not requesting modification to the Merger Standards, and that the Joint Application and testimony properly address the Commission's Merger Standards.[72]

49. On October 18, 2016, the Commission issued its Order Addressing Joint Applicants' Verified Responses on the Commission's Merger Standards.[73] In its Order, the Commission stated it disagreed with the Joint Applicants' characterization that Joint Applicants merely paraphrased the Merger Standards.[74] The Commission also noted that it has provided Joint Applicants with an opportunity to amend their Joint Application to conform to the applicable Merger Standards, but that Joint Applicants have elected not do to so and are therefore bound by their filings.[75]

50. On November 2, 2016, Joint Applicants filed their Motion for Leave to File Supplemental Direct Testimony and Petition for Reconsideration of Order Addressing Joint Applicants' Verified Responses on the Commissions (*sic*) Merger Standards (Motion and PFR).[76] In their Motion and PFR, Joint Applicants seek clarification as to whether the Commission's October 18, 2016 Order was intended to preclude Joint Applicants from filing supplemental direct testimony; seek reconsideration of the Commission's October 18, 2016 Order to the extent it precludes Joint Applicants from filing supplemental direct testimony; and requests the Commission grant Joint Applicants leave to file supplemental direct testimony

[71] Response to Staff's and CURB's Reply to Joint Applicants' Verified Response to Commission's Order on Merger Standards (Sept. 19, 2016).
[72] *Id.* at ¶¶7-10.
[73] Order Addressing Joint Applicants' Verified Responses on the Commission's Merger Standards (Oct. 18, 2016).
[74] *Id.* at ¶12.
[75] *Id.* at ¶11; subsequently, the Joint Applicants proffered supplemental direct testimony in response to the concerns articulated in the Commission's October 18, 2016 order which is further detailed in section C. Testimony, *infra*.
[76] Motion for Leave to File Supplemental Direct Testimony and Petition for Reconsideration of Order Addressing Joint Applicants' Verified Responses on the Commissions (sic) Merger Standards (Nov. 2, 2016).

addressing Merger Standards (a)(ii) and (a)(iv) in response to the Commission's October 18, 2016 Order.

51. On January 10, 2017, Staff filed its Motion to Declassify All Staff Testimony and Exhibits, requesting the Commission remove the confidential designation from all Staff testimony and exhibits, and to direct the refiling of the same as public.[77]

52. On January 11, 2017, Staff, CURB, BPU, and KEPCo filed a Joint Motion to Strike and for Sanctions against Joint Applicants, requesting the Commission prohibit Joint Applicants from introducing new evidence, supplementing facts, and inserting new methodologies related to merger savings, financial projections, and economic modeling and striking the same, or in the alternative, give no weight to such new evidence; and sanctioning Joint Applicants for discovery violations by not updating discovery responses when new information became available.[78]

53. On January 20, 2017, Joint Applicants filed its Response to Staff's Motion to Declassify All Staff Testimony and Exhibits, arguing for the preservation of all confidential designations.[79] Also on January 20, 2017, Joint Applicants filed its Response to Joint Motion to Strike and for Sanctions Against Joint Applicants, arguing all rebuttal was within the proper scope and further, that no discovery violations existed.[80]

54. On January 24, 2017, the Commission held a hearing on the following prehearing motions: (1) Joint Applicants' Motion for Order Defining Appropriate Cross Examination;[81] (2) Staff's Motion to Declassify All Staff Testimony and Exhibits; and (3) Joint Motion to Strike and for Sanctions against Joint Applicants.

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[77] Motion to Declassify All Staff Testimony and Exhibits (Jan. 20, 2017).
[78] Joint Motion to Strike and for Sanctions against Joint Applicants (Jan. 11, 2017).
[79] Joint Applicants' Response to Staff's Motion to Declassify All Staff Testimony and Exhibits (Jan. 20, 2017).
[80] Response to Joint Motion to Strike and for Sanctions against Joint Applicants (Jan. 20, 2017).
[81] Joint Applicants' Motion for Order Defining Appropriate Cross Examination (Jan. 11, 2017).

55. On January 26, 2017, the Commission issued an Order on Prehearing Motions: (1) advising parties that friendly cross-examination is to be avoided; (2) ordering any confidential designations other than those for attorney-client privilege, attorney work-product, or critical infrastructure information which poses a security risk if made public removed and all testimony refiled by 8:00 a.m. on January 30, 2017; and (3) denying the Joint Motion to Strike and for Sanctions against Joint Applicants.[82]

56. On January 30, 2017 through February 7, 2017, the Commission held an evidentiary hearing where it received testimony from expert witnesses regarding the Joint Application. During the hearing, the Commission permitted cross-examination of witnesses and admitted all pre-filed testimony of Staff, Joint Applicants, CURB, and other intervenors into the record.

57. On February 28, 2017, Joint Applicants filed their Initial Post-Hearing Brief.[83]

D. Summary of the Transaction

58. GPE will pay $8.6 billion for all of Westar's outstanding equity, while assuming $3.6 billion of Westar's debt for a transaction value of approximately $12.2 billion. Westar shareholders will receive approximately $60 per share. Each share of Westar stock will be converted into a right to receive $51 in cash plus an amount of GPE stock worth approximately $9. Therefore, the compensation to Westar shareholders will be approximately 85% cash and 15 % stock, amounting to an acquisition premium of approximately $4.9 billion or 233% over book value and $2.3 billion or 36% over Westar's market value or "undisturbed stock price."[84]

[82] Order on Prehearing Motions (Jan. 26, 2017).
[83] Joint Applicants' Initial Post-Hearing Brief (Feb. 28, 2017) (Joint Applicant's Initial Post-Hearing Brief).
[84] Corrected Direct Testimony of Jeffrey McClanahan, p. 2, ll. 11-29 (Jan. 27, 2017) (McClanahan Corrected Direct).

59. GPE will finance the $8.6 billion payment for Westar's equity with approximately 50% equity and 50% debt. After closing, Westar would become a wholly-owned subsidiary of GPE and Westar shareholders will own approximately 15% of GPE.[85]

II. CONTESTED ISSUES

a. Whether the Transaction is in the Public Interest

60. Pursuant to K.S.A. 66-136, no certificate of convenience and necessity granted to a public utility subject to Commission regulation shall be transferred, nor shall any contract or agreement affecting such certificate of convenience and necessity be valid unless the Commission approves such transfer, contract, or agreement.

61. The legal standard of review in considering certificate transfers and contracts or agreements affecting certificates of convenience and necessity is found in K.S.A. 66-131,[86] which requires the public convenience and necessity be promoted.[87]

62. This "public interest" standard has been further refined by case law. Specifically, "public convenience" means the convenience of the public, not the convenience of particular individuals.[88] Additionally, public necessity does not necessarily mean there must be some showing of absolute need; rather the use of "necessity" in this context has been held to mean a need without which the public is inconvenienced to the extent of being handicapped.[89]

[85] *Id.* at pp. 2-3.
[86] K.S.A. 66-131(a) states, in pertinent part, "[n]o person or entity seeking to construct electric transmission lines as defined in K.S.A. 66-1,177, and amendments thereto, or common carrier or public utility, including that portion of any municipally owned utility defined as a public utility by K.S.A. 66-104, and amendments thereto, governed by the provisions of this act shall transact business in the state of Kansas until it shall have obtained a certificate from the corporation commission that the public convenience and necessity will be promoted by the transaction of said business and permitting said applicants to transact the business of a common carrier or public utility in this state."
[87] *See* Consolidated Docket Nos. 172,745-U and 174,155-U, Order approving with Modification the Merger between KPL and KG&E, p. 35 (Nov. 15, 1991); "Consistent with its mandate in approving the initiation of utility service as set out in K.S.A. 66-131, the Commission concludes that mergers and acquisitions should be approved where the applicant can demonstrate that the merger or acquisition will promote the public interest."
[88] *See id., citing Central Kansas Power v. State Corp. Comm'n*, 206 Kan. 670, 676 (1971).
[89] *Id.*

63. Beyond the requirement of promoting the public convenience and necessity, Kansas statutes do not contain a specific standard for mergers.[90] In Consolidated Dockets 172,745-U and 174,155-D, the Commission issued an order approving the Kansas Power & Light and Kansas Gas & Electric merger.[91] In approving the merger, the Commission stated that mergers should be approved where the applicant can demonstrate that the merger will "promote the public interest," and listed several factors the Commission would consider in determining whether such a transaction would promote the public interest.[92]

64. In Docket No. 97-WSRE-676-MER, the Commission re-affirmed its Merger Standards, but indicated the standards are to be supplemented by other considerations relevant to the unique facts and circumstances of each proposed merger.[93] The Commission stated, "In essence, the question is whether the public interest is served by approving the merger as determined by the specific facts and circumstances of each case."[94] This order further slightly modified merger factor (c) relating to state and local economic impact, to add a consideration relevant to labor dislocations.[95]

65. On August 9, 2016, in the present docket, the Commission reaffirmed the Merger Standards espoused in Consolidated Docket Nos. 172,745-U and 174,155-U and as modified in Docket No. 97-WSRE-676-MER.[96]

b. Application of the Commission's Merger Standards

66. The Commission's August 9, 2016 Order on Merger Standards afforded parties the opportunity to suggest deviations or modifications by explaining the proposed modification

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[90] Consolidated Docket Nos. 172,745-U and 174,155-U, Order approving with Modification the Merger between KPL and KG&E, p. 34 (Nov. 15, 1991).
[91] *Id*.
[92] *Id.* at pp. 35-36.
[93] Docket No. 97-WSRE-676-MER, Order on Merger Application, ¶18 (Sept. 28, 1999).
[94] *Id.*
[95] *Id.* at ¶19.
[96] Order on Merger Standards (Aug. 9, 2017).

and provide grounds supporting the proposed modification.[97] Joint Applicants did not seek to provide support for any modification of the Commission's Merger Standards, and further filed a Verified Response to Commission's Order on Merger Standards affirming the Joint Applicants' acceptance of the Commission's Merger Standards without modification.[98]

67. In Staff's review of the Joint Application, Staff applied the Merger Standards as reaffirmed in the Commission's August 9, 2016 Order on Merger Standards in its analysis;[99] however, Staff—through Staff Witness Hempling—provides areas in which the Commission may articulate guidance on future mergers in light of the "new merger paradigm" following the repeal of the Public Utility Holding Company Act of 1935 in 2005, interceding the original formulation of the Commission's Merger Standards and the present proposed transaction.[100]

68. Joint Applicants filed Supplemental Testimony on November 2, 2016, specifically to address perceived deficiencies in the Joint Application pertaining solely to Merger Standards (a)(ii) and (a)(iv).[101] In rebuttal testimony and at the Evidentiary Hearing, Joint Applicants changed their position and advanced the argument that these Merger Standards no longer apply to the Commission's analysis of this proposed transaction because recovery of acquisition premium is not being requested.[102] Specifically, Merger Standards (a)(ii) *the effect of the transaction on consumers, including reasonableness of the purchase price, including whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger*

[97] *Id.* at ¶7.
[98] Joint Applicants' Verified Response to Commission Order on Merger Standards, ¶6 (Aug. 30, 2016).
[99] *See* McClanahan Corrected Direct; Direct Testimony of Justin T. Grady (Jan. 30, 2017) (Grady Direct); Direct Testimony of Adam H. Gatewood (Jan. 30, 2017) (Gatewood Direct); Direct Testimony of Robert H. Glass, Ph.D. (Jan. 27, 2017) (Glass Direct); Direct Testimony of Casey Gile (Jan. 27, 2017) (Gile Direct); Tr. Vol. 5, pp. 1194-95.
[100] *See* Hempling Direct; Tr. Vol. 5, pp. 1194, 1197-1208.
[101] Supplemental Direct Testimony of Kevin E. Bryant (Nov. 2, 2016) (Bryant Supplemental Direct); Supplemental Direct Testimony of Darrin R. Ives (Nov. 2, 2016) (Ives Supplemental Direct).
[102] *See* Rebuttal Testimony of Darrin Ives (Ives Rebuttal), Rebuttal Testimony of James Proctor, Tr. Vol 2, pp. 317, 351, 356, 363.

and whether the purchase price is within a reasonable range; and (a)(iv) *the effect of the transaction on consumers, including whether there are operational synergies that justify payment of a premium in excess of book value* are irrelevant to this proposed transaction according to Joint Applicants. Following this rationale, the Joint Applicants likewise downplay the significance of the merger savings in this transaction, also because no acquisition premium recovery is requested, and state in their Post-Hearing Brief, "…the amount of savings is not relevant where, as here, the merging parties are not seeking to recover the acquisition premium.[103]

69. Staff contends all Merger Standards remain relevant not only because the Commission's August 9, 2016 Order on Merger Standards set forth and reaffirmed the Commission's Merger Standards in their entirety, but also because the Joint Applicants are unable to make a solid, binding commitment that no recovery of the acquisition premium will ever be requested. The Joint Applicants have reserved the ability to request recovery of the acquisition premium if any party to a Westar or KCP&L general rate case propose the use of a consolidated capital structure.[104] Further, the Joint Applicants may also seek to recover capital cost increases associated with goodwill (acquisition premium) impairment if GPE determines that the impairment was a result of a future Commission order.[105] Without a real and meaningful commitment safeguarding customers against the acquisition premium and transaction costs, there is no reason to ignore certain sections of the Commission's Merger Standards as Joint Applicants would have the Commission do. Further, Staff testimony has shown that ratepayers are indeed paying for the costs of this transaction, including the acquisition premium, as is more fully

[103] Joint Applicants' Initial Post-Hearing Brief, p. 96.
[104] Ives Supplemental Direct, p. 12; Ives Rebuttal, Schedule DRI-3, p. 10.
[105] Tr. Vol. 4, p. 962-963.

developed below,[106] and therefore it is critical to include Merger Standards (a)(ii) and (a)(iv) in the Commission's analysis.

70. Staff witness Justin Grady testified in support of the Merger Standards, stating, "I think if you apply the standards in a comprehensive and measured and careful fashion, I think you will approve the appropriate kind of merger."[107] As noted by Mr. Grady, the current Merger Standards are flexible and applicable to both mergers consummated under a traditional framework and those resulting from the "new merger paradigm." Mr. Grady also testified, "…the [Joint] Application just doesn't fit the mold of the Merger Standards and I don't think it's because -- I don't think the result or the answer then is let's change the Merger Standards. I think -- I think from our perspective the answer is the transaction needs to be denied, it doesn't meet the Merger Standards."[108]

71. That being said, Staff consultant Scott Hempling provides testimony recommending that the Commission consider additional guidance and states specifically that "…rejection without more leaves a gap in guiding future merger transactions."[109] Staff is supportive of Mr. Hempling providing the Commission with a third-party expert's perspective of what additional issues might be considered in a merger. As stated by Mr. Grady, Staff believes the Merger Standards serve as a valuable screen to determine whether a proposed merger transaction promotes the public interest. In fact, because the Merger Standards are flexible and based on case specific facts, the current case failed the Merger Standards in part because of the financial engineering or double leverage used to finance the transaction, and the resulting decline

[106] Specifically, Joint Applicants intend to recover at least part of the acquisition premium indirectly, by coordinating their merger-related cost reductions and rate case timing so as to maintain, for a period of time, rate levels based on higher, pre-merger costs.
[107] Tr. Vol. 5, pp. 1191-1192.
[108] Tr. Vol. 5, pp. 1192-1193.
[109] Hempling Direct, p. 120.

in the post-transaction entity's financial health. Mr. Hempling explained to the Commission that the Public Utility Holding Company Act had precluded not only mergers that lacked geographic and operational logic, but also the use of double leveraging, since the ability to charge ratepayers an equity-level return for parent company injections financed with debt would lead to "higher and higher premia, [and] more and more leveraging at the holding company level such that the gap between the ultimate ultimate value of the utility service and the amount paid for the acquisition would widen and you would not have economic logic to the acquisition…."[110]

72. Mr. Hempling further testified that the Joint Applicants' proposal of savings allocation by regulatory lag is inconsistent with regulatory principle and limits the Commission's options and abilities regarding savings allocation.[111] This approach would give GPE control over the timing and amount of savings that will flow back to customers, displacing the Commission's role as the entity statutorily responsible for allocating savings between shareholders and customers. A byproduct of a new merger paradigm where holding companies are able to recover acquisition premiums indirectly through financial engineering, instead of directly recovering a premium over book value and justifying the premium with savings, this superficially benevolent pledge to return "100% of the savings to customers through the normal ratemaking process"[112] in effect causes the Joint Applicants to assert that since they are not requesting recovery of the acquisition premium, they should not have to commit to providing any verifiable level of savings beyond what might show up in a rate case whenever GPE decides a rate case will be filed. GPE's position in this proceeding is that it can pay whatever premium is necessary to strike a deal regardless of the level of savings that have been identified because it is not seeking to recover the premium directly through rates. Instead, GPE is financing the

[110] Tr. Vol. 5, p. 1200.
[111] Henpling Direct, pp. 105-108.
[112] Ives Rebuttal, p. 10.

premium by using holding company leverage to shield the debt from the ratemaking process. Therefore, according to Joint Applicants, even one dollar of savings should suffice for a determination that the transaction is in the public interest.[113] Staff does not agree that the Commission's merger standards can or should be interpreted this way.

73. In response to this, and numerous other deficiencies with the proposed transaction noted in Mr. Hempling's and other Staff witnesses' testimony, Mr. Hempling recommends the Commission provide clarification on its merger policy.[114] Interceding the development of the Commission's Merger Standards in 1991 (and slightly modified in 1999), and today's proposed transaction between GPE and Westar, was the repeal of the federal Public Utility Holding Company Act, which served largely to prohibit the excess of purchase price over economic value embodied by this Transaction.[115] Staff would note that the Commission's Merger Standards performed well as a screen by requiring analysis that identified the double leverage issue. However, Mr. Hempling recommends the Commission seize this opportunity to gain insights from this proceeding relevant to how to align its policies with the current forces so transacting parties can act in a manner more in line with the public interest.[116]

74. While Staff believes the Merger Standards as articulated in the Commission's August 9, 2016 Order on Merger Standards are appropriate and have allowed Staff and parties to fully analyze whether the proposed transaction promotes the public interest, Staff welcomes additional guidance from the Commission should the Commission find it necessary to provide. Specifically, to the extent the Commission finds it necessary to refine its standards to provide additional guidance or more specifically address the "new merger paradigm" as discussed by

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[113] Bryant Supplemental Direct, p. 6.
[114] Hempling Direct, pp. 116-120.
[115] Hempling Direct, p. 122; Tr. Vol. 5, pp. 1197-1208.
[116] Hempling Direct, p. 123; Tr. Vol. 5, pp. 1197-1208.

Staff witnesses Hempling and Grady, such guidance is welcomed by Staff and would be justified by the record.

75. Particularly, the Joint Applicants assert, “Staff had no intention of applying the Merger Standards as they have been applied in the past.”[117] Moreover, despite “fully adopting” the Commission’s Merger Standards, Joint Applicants assert certain Merger Standards are irrelevant or not applicable to the Commission’s analysis and seem to not appreciate why the acquisition premium in this proposed transaction is relevant to the Commission’s decision. Based on the Joint Applicants’ assertions, it clear that they are interpreting the Commission’s Merger Standards and prior Commission Orders related to the Merger Standards differently than the other parties in this case. Should the Commission agree with Staff’s analysis, the Commission could choose to provide its interpretation of the Merger Standards if the Commission believes it will provide clarity.

c. Summary of Staff’s Conclusions: The Proposed Transaction Evaluated in Light of the Commission’s Merger Standards Does not Promote the Public Interest

76. Based on an analysis of the Commission’s Merger Standards, and as will be more fully set forth and detailed below, Staff recommends a finding that this proposed transaction does not promote the public interest, and should therefore be denied.

77. As is summarized in the Direct Testimony of Staff witness Jeff McClanahan, Staff’s thorough analysis—based on the facts specific to this case—led Staff to the inescapable conclusion that the proposed transaction has fundamental flaws that cannot be remedied, even with merger conditions. The primary fundamental flaw that precludes any recommendation of approval is the fact that the purchase price of $12.2 billion is too high because it results in GPE

[117] Joint Applicants’ Initial Post-Hearing Brief, p. 19.

and its utility subsidiaries being in a significantly weaker financial position post-acquisition.[118] This flaw goes directly to the Commission's Merger Standard (a)(i), *the effect of the transaction on consumers, including the effect of the proposed transaction on the financial condition of the newly created entity as compared to the financial condition of the stand-alone entities if the transaction did not occur.* It also impacts the evaluation of Merger Standards (a)(ii)[119] and (a)(iv)[120].

78. Mr. McClanahan identifies several other fundamental flaws, which include: (1) the fact that ratepayers will pay for the acquisition premium implicitly through financial engineering;[121] (2) failure of the Joint Applicants to demonstrate quantifiable savings;[122] and (3) failure of Joint Applicants to provide sufficient persuasive evidence regarding the continued financial health of the post-transaction entity.[123] At the current transaction price, these flaws cannot be fixed.

III. LEGAL ANALYSIS

a. The Transaction is not in the Public Interest because the Purchase Price Creates Unreasonable Financial Risk Which Will Ultimately be Borne by Ratepayers

i. The Transaction Maximizes Gain to Shareholders at the Expense of Ratepayers

79. Joint Applicants claim customer benefits motivated this transaction. Messrs. Ruelle and Bassham assert that their primary purpose was to help the consumer.[124] However,

[118] McClanahan Corrected Direct, p. 3, 11-12, 27-28.
[119] Merger Standard (a)(ii) evaluates: The effect of the transaction on consumers, including reasonableness of the purchase price, including whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger and whether the purchase price is within a reasonable range.
[120] Merger Standard (a)(iv) evaluates: The effect of the transaction on consumers, including whether there are operational synergies that justify payment of a premium in excess of book value.
[121] This flaw impacts an evaluation of Merger Standards (a)(ii), (a)(iii), (a)(iv), (d), and (e).
[122] This flaw impacts an evaluation of Merger Standards (a)(ii), (a)(iii), (a)(iv), (c), (f), (g), and (h).
[123] This flaw impacts an evaluation of Merger Standards (a)(ii), (a)(iii), (a)(iv), (d), and (e).
[124] Direct Testimony of Mark Ruelle (Ruelle Direct), p. 3; Rebuttal Testimony of Mark Ruelle (Ruelle Rebuttal), p. 4; Rebuttal Testimony of Terry Bassham (Bassham Rebuttal), p. 20; Tr. Vol. 1, p. 133, 152-153, 156, 264.

despite assertions that this transaction was driven by customer benefits, the record supports that the true drivers of this proposed transaction involve financial benefits to the Joint Applicants. For Westar, its motivation was to obtain the highest possible purchase price, as detailed expressly in the Proxy Statement filed with the Securities and Exchange Commission and excerpted in Mr. Hempling's Appendix A. The economic drivers behind GPE's decision to pay that price are less obvious, but analysis shows they are not related to customer benefit. Staff witness Justin Grady has identified these items and their respective contribution toward the portion of the price above Westar's unaffected stock price.[125] Mr. Grady's analysis demonstrates that the four primary drivers behind the control premium—and by extension, the acquisition price—are:

> 1. GPE's expectation of retaining the difference in GPE's estimate of its cost of equity (as determined by Goldman Sachs & Co.) versus Westar's authorized return;
>
> 2. GPE's , and then charging ratepayers for an equity-level return on an investment financed with that lower-cost debt;
>
> 3. GPE's expectation of retaining operational cost savings between rate cases, including timing the savings and the rate cases to satisfy its premium-recovery goal; and
>
> 4. Accelerated use of net operating loss tax benefits.[126]

None of these four reasons involves a benefit to ratepayers.

80. Mr. Bryant testified that the benefits to customers are independent of the transaction price—that they would in theory still exist if the transaction occurred at a lower price; that "the efficiencies are the efficiencies."[127] However, Joint Applicants have stated there will not be a deal at a lower transaction price.[128] The dissonance between Mr. Ruelle's threat to

[125] Grady Direct, pp. 80-82.
[126] *Id.*
[127] Tr. Vol. 3, p. 710, ll. 4-10.
[128] Ruelle Direct, p. 10; Tr. Vol. 1, p. 209; Tr. Vol. 3, p. 757.

drop out if the purchase price drops, and his pre-filed testimonial insistence that his priority was his customers, should be obvious. If the "efficiencies are the efficiencies," and if his customers come first, then Mr. Ruelle should be satisfied with any premium. Intending to sacrifice all customer efficiencies if one does not obtain the maximum shareholder gain is not the reasoning of a person who puts his customers first. Mr. Ruelle's candor on the witness stand thus has more credibility than his pre-filed document: For Mr. Ruelle, the "driving force" gain to Westar shareholders, with customer benefits only an afterthought.[129] The record is clear that the disparity between the size of the acquisition premium and the anticipated cost savings from the merger renders it very difficult—and perhaps impossible—for this transaction to promote the public interest.

81. The Joint Applicants commonly refer to the proposed transaction as “common sense” and an “old fashioned utility merger between neighboring utilities” to imply obvious benefits of the transaction.[130] Staff does not necessarily disagree that there can be synergies or efficiencies to be had from the merger of two adjacent investor-owned electric utilities—although the Joint Applicants failed to show why many of their claimed synergies are not readily attainable (or already available) without the merger. Any efficiencies that exist today will not disappear merely because this Commission finds that this Transaction, with its excessive premium and its insufficient showing of savings, and with its origins in an auction conducted by Westar to extract the maximum gain, is not the appropriate path for realizing those efficiencies. likely always be there.

82. If customer interests were truly important to Westar, it would seek a merger *with GPE* at the highest price GPE could afford *without compromising GPE’s financial integrity*. Or,

[129] *See* Hempling Direct, p. 23-25.
[130] *See* Bassham Rebuttal, p. 5; Ruelle Rebuttal, p. 3; Joint Applicants’ Initial Post-Hearing Brief, p. 2.

it could have simply agreed to a merger of equals, with each entity's shareholders receiving their appropriate share of the newly created company. Either of these options could have allowed GPE to afford to guarantee benefits to Kansas ratepayers (such as a rate moratorium or upfront rate credits, and assuming those benefits existed) that have been so frequently part of mergers in Kansas. In contrast, Westar turned down several offers from GPE, each one priced higher than the previous one, and instead initiated an auction process whereby it cajoled a higher and higher purchase price from various bidders.[131] Interestingly yet, Westar first approached Bidder A and not GPE, because Westar was unsure whether GPE could finance a transaction of this magnitude, and "nobody would have batted an eye about [Bidder A's] ability to write a $7 or $8 billion check."[132] Despite the stars being aligned, GPE was not Westar's first option to merge. Only when it could command the maximum gain that GPE was willing to pay was Westar willing to "align" its interests with its customers.

ii. The Purchase Price is Too Rich for GPE, Creating Substantial Financial Risk

83. Staff's concerns are rooted in the unavoidable truth that the high price of this transaction causes too much financial risk for GPE and its subsidiaries. As will be detailed below, the excessive purchase price and attendant debt financing place significant risk on GPE, its subsidiaries, and ultimately ratepayers.

84. Multiple statements by Joint Applicant witnesses show that even Westar believed GPE may have been reaching beyond its limits with this transaction at this purchase price. For example, Mr. Ruelle testifies Westar regards GPE as an underdog, a "little engine that thinks it can" acquire Westar, considering the proposed transaction to be "a big stretch" for GPE.[133]

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[131] *See* Grady Direct, Exhibit JTG-16 (Joint Proxy Statement) p. 52 - 65.
[132] Tr. Vol. 1, p. 180.
[133] Tr. Vol. 1, p. 192.

Furthermore, Mr. Bryant confirms that "[t]here is no doubt this transaction is a stretch for Great Plains Energy."[134] The record shows that Joint Applicants recognize GPE is stretching itself thin—too thin according to Mr. Grady's detailed analysis—in consummating this transaction.

85. Although Mr. Ruelle and Westar had doubts about GPE's willingness or ability to finance this transaction at the price Westar sought, now that Westar has an agreement that maximizes its gain those doubts have disappeared: "[S]ince [GPE has] already financed it…it's kind of no longer a concern."[135] It is critical to note that the detriment to the public interest is not ameliorated when GPE completes the financing process—it begins.

86. The purchase price of approximately $60 per share of Westar stock, along with GPE's "highly aggressive" financing strategy,[136] forces GPE to take on approximately $4.4 billion of debt at the holding company level.[137] Adding this debt changes GPE's capital structure from roughly 50%/50% debt-to-equity ratio to 60%/40%.[138] This added leverage brings about significant added financial risk. While GPE asserts this risk will be borne by shareholders, the business structure of GPE would necessarily expose Westar, KCP&L, and their ratepayers to the financial risks of this transaction. This is not just Staff's opinion. It is the opinion of every intervenor witness who addressed this subject; and, more importantly, three sophisticated credit rating agencies. Furthermore, the record shows that proper ring-fencing protections to fully insulate and adequately protect ratepayers from these financial risks are fundamentally incompatible with GPE's business structure and could not be implemented.[139]

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[134] Tr. Vol. 3, p. 758.
[135] Tr. Vol. 1, p. 180.
[136] Gatewood Direct, p. 20, quoting Moody's RAS Correspondence, p. 6.
[137] Direct Testimony of Kevin Bryant, p. 9.
[138] Gatewood Direct, pp. 15, 27.
[139] *See* ¶¶150-166, 192-197, *infra*.

87. This transaction brings about the financial risk of—and consequences associated with—unreasonably high leveraging at the holding company level, leveraging which GPE has provided the Commission no plan to pay down. This combination of high debt and uncertainty about debt reduction results in a significant likelihood of credit rating downgrades, not only at the holding company level, but also at the operating companies due to linked credit profiles. Additionally, the likelihood of having to refinance acquisition-related debt in a rising interest rate environment presents an additional financial risk.

88. These risks, which Joint Applicants assert are only risks to shareholders, are in actuality risks to ratepayers, because they are the predominant source of any potential revenue GPE would use to service and pay down its debt can only be supported by GPE's subsidiary regulated public utility operating company revenues, derived from upstream dividends issued to GPE. Indeed it is the presence of captive ratepayers that makes the capital markets willing to finance this Transaction to begin with.

iii. GPE has failed to demonstrate a viable plan to deleverage its balance sheet and pay down transaction-related debt

89. The amount of leverage taken on by GPE is regarded by numerous equity analysts as a concern.[140] The amount of leverage gives rise to issues of contention in future rate cases,[141] weakens GPE's balance sheet,[142] and creates debt levels notably higher than GPE's peers.[143] GPE's decision to incur the risks associated with taking on higher leverage, itself, has an impact on the company's return on equity and credit rating.[144]

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[140] *See* Gatewood Direct, p. 25-26.
[141] Gatewood Direct, p. 26.
[142] *Id.*
[143] *Id.*
[144] Gatewood Direct, p. 24; Grady Direct, p. 59.

90. GPE projects to take on approximately $4.4 billion in debt to finance this transaction, contemplating debt maturity in the following amounts along the indicated timeframe:[145]

Year 3	$750 million
Year 5	$1.5 billion
Year 7	$750 million
Year 10	$1.5 billion

91. It is important to remember that this additional leverage is likely a permanent part of GPE's capital structure.[146] In response to Staff concerns that GPE's financial models only extended out three years, and that GPE had not demonstrated a plan or ability to deleverage, Joint Applicant Witness Bryant presented a forecast projecting transaction-related net free cash flows through 2022.[147] The table shows a cumulative net free cash flow of $494 million in 2020.[148] At best, the <u>only</u> substantive analysis put on the record by Joint Applicants that purports to support 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.

92. Despite containing fatally flawed assumptions, which are discussed fully below, the transaction-related net free cash flows detailed by Joint Applicants to demonstrate their ability to repay transaction-related debt are insufficient to cover even their first contemplated debt maturity obligation of $750 million in year three following the close of the transaction.

[145]Tr. Vol. 3, p. 739; Staff Exhibit 11.
[146] Gatewood Direct, p. 20; *See also,* Exhibit BPU-5 (Moody's May 18 RAS letter), "Kansas and Missouri service territories are not high growth areas that will provide Great Plains with a clear path of paying down the acquisition debt, so we view the $4.3 billion of Scenario 4 debt and the $4.6 billion of Scenario 5 debt as permanent leverage in Great Plains capital structure."
[147] Tr. Vol. 3, p. 719; Rebuttal Testimony of Kevin Bryant, p. 22.
[148] Rebuttal Testimony of Kevin Bryant, p. 22.

Without sufficient cash flows to meet debt obligations, Joint Applicants will likely seek to refinance this transaction-related debt.[149] Refinancing this debt in a potentially rising-interest rate environment brings about further risk and uncertainty. Joint Applicants maintain this risk would be specific to GPE shareholders, and that customers would be protected.[150] However, customers cannot be fully protected from financial risk at the holding company level, and financial risk to GPE will have an impact on customers and rates.[151]

93. Mr. Bryant testified at hearing that the table illustrating transaction-related net free cash flows was simply an example of how Joint Applicants *could* repay transaction-related debt.[152] Mr. Bryant implied that other income, such as upstream dividends from GMO or KCP&L, could assist in transaction-related debt repayment,[153] which raises this question: Why then was a more complete and robust analysis, presumably supporting a *greater* ability to repay transaction related debt, not provided? An illustration is not a plan. Mr. Bryant's illustrative example should not be accepted by the Commission as ability to deleverage nor should the Joint Applicants' unsupported assertion that it has the ability to pay down transaction-related debt within three-to-five years be given any weight.[154]

94. When examined on this illustrative table, Mr. Bryant testified that the accumulation of $494 million in net free cash flows relied on the assumptions that: (1) 100% of Westar's earnings would be dividended up to GPE,[155] despite representations to credit rating agencies that upstream dividends would remain in the 55% to 62% range (with the remainder of Westar's retained earnings remaining on Westar's books and thus available for customer

[149] Tr. Vol. 3, p. 741.
[150] Tr. Vol. 3, p. 741.
[151] *See* ¶¶108-112, 177-191, *infra.*
[152] Tr. Vol. 3, pp. 724, 731.
[153] Tr. Vol. 3, p. 724.
[154] For additional discussion of the permanent nature of GPE's new debt, see Tr. Vol. 4, pp. 893-895.
[155] Tr. Vol. 3, p. 724.

needs);[156] and (2) dividends to GPE shareholders would remain stagnant at $1.11 per share,[157] despite representations to shareholders that dividend growth targets of 5% to 7% were incremental opportunities attributable to the proposed acquisition of Westar.[158] Furthermore, the model assumes the filing of one rate case—a 2018 rate case with rates effective February of 2019, which returns approximately $50 million in savings (cumulative of Westar and KCP&L) to customers in Missouri and Kansas—but does not contemplate the filing of any subsequent rate case which would flow 100% of achieved savings back to customers.[159] Adjustments of each of these flawed assumptions to conform with the Joint Applicants' representations to credit rating agencies, shareholders, and the Commission significantly reduces net free cash flows[160] and, necessarily, GPE's ability to repay transaction-related debt. Put another way, the only plan Joint Applicants offered to illustrate they had the ability to pay down *some* of the transaction-related debt due in five years relied on an aggressive upstream dividend policy from Westar to GPE and suspending dividend growth to GPE shareholders. It is critical to note that this deleveraging "plan" is not consistent with the assumptions provided to credit rating agencies, and brings a strong likelihood of a credit rating downgrade to Westar based on warnings from sophisticated credit rating agencies.[161]

iv. Refinancing Risk

95. In response to examination on the gap between (a) transaction-related net free cash flows illustrated by Joint Applicants, and (b) the anticipated debt maturity dates of acquisition debt, Mr. Bryant testified that acquisition-related debt could be refinanced at the

[156] Tr. Vol. 3, p. 717.
[157] Tr. Vol. 3, p. 730.
[158] Tr. Vol. 3, pp. 713-714.
[159] Tr. Vol. 3, pp. 726-727.
[160] Tr. Vol. 3, pp.731-735.
[161] *See* ¶¶98-107, *infra*.

debt's maturity.[162] Refinancing this debt in the future adds yet a further layer of financial risk to this transaction, as the refinancing could occur at a time when interest rates are higher.[163] Because the probability of an interest rate hike is real, a prudent business would take this risk into account. The Joint Applicants did not.

96. Joint Applicants have testified that interest rates are at historic lows.[164] By definition, historic lows are not permanent lows. Notwithstanding the sophisticated analysis of expert financial and economic forecasters lending to credit rating agencies' opinions, logic suggests that interest rates will likely go up. This raises the question: What then will happen when GPE is forced to refinance this transaction at *higher* interest rates? The record already is missing any facts supporting GPE's ability to repay its transaction-related debt and is stretching itself to the financial breaking point to close this transaction. The record contains no evidence that the holding company can withstand additional financial pressure. Without this evidence, the Commission cannot make the necessary finding that GPE will remain financially healthy.

97. Mr. Bryant argued that the risk of refinancing in a higher interest rate environment would fall only on shareholders; however, as is developed in below, this is in actuality a risk for ratepayers as well.[165]

v. Risk of Credit Downgrade

1. Westar

98. Credit agency reports indicate a weaker financial profile for the newly-created entity as compared to KCP&L's and Westar's current financial profile.[166] Critiquing Westar, Moody's has stated it expects Westar "to increase its dividends from the amount it has

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[162] Tr. Vol. 3, p. 741.
[163] Gatewood Direct, p. 18-20.
[164] Tr. Vol. 1, p. 26, "Today's historically low interest rates allow GPE to finance the transaction cost effectively…"
[165] *See* ¶¶108-112, *infra*.
[166] Gatewood Direct, p. 8.

historically paid to shareholders, in order to come more in-line with the 70% corporate payout of GPE and in order to help shoulder the load of acquisition debt."[167] As noted above, Moody's warned—and Mr. Bryant concurred—that an aggressive upstream dividend policy by Westar will be regarded as a credit negative and therefore could lead to a credit rating downgrade of Westar. Yet, when developing the assumptions that would form the basis of GPE's only debt repayment analysis in the record, GPE assumed 100% of Westar's regulated earnings would flow up to GPE in order to pay down transaction-related debt.[168]

99. Moody's further opined, "the limited parent financial flexibility at GPE, weak consolidated financial metrics and demand for increased utility dividends will constrain the ratings of Westar at Baa1, despite prospects for improvement after conclusion of its wind expansion."[169] In other words, Westar customers were likely on the verge of receiving the benefits of higher debt ratings and lower interest costs prior to the announcement of this transaction. These benefits have 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—sacrificed without any guarantee of customer benefits. Moody's caution directly contradicts unsupported assertions from GPE witnesses that the utilities' credit profiles would be "unaffected" by the transaction.[170] Finally, Moody's noted "a high potential for additional ring-fencing type provisions to be introduced from the KCC as part of the requirements for merger approval. Should the upstream dividend demands for Westar become excessive or substantial customer benefits (e.g. bill credits

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[167] Gatewood Direct, p. 10. *See also* Westar Energy, Inc.; Vertically Integrated Regulated Electric Utility; Moody's Investor Services, Credit Opinion (June 2, 2016).
[168] Tr. Vol. 3, p. 724.
[169] Gatewood Direct, p. 10. *See also* Westar Energy, Inc.; Vertically Integrated Regulated Electric Utility; Moody's Investor Services, Credit Opinion (June 2, 2016).
[170] Bryant Rebuttal, p. 20, Tr. Vol. 3, pp. 563-64 (Reed). At hearing, GPE Witness Robert Hevert agreed that Westar's credit metrics are not "unaffected" by transaction, as GPE witnesses Bryant and Reed had previously asserted, Tr. Vol. 4, pp. 851-853.

or rate freezes) result in a multi-year reduction of Westar's retained cash flow, there would likely be negative ratings pressure <u>at the utility</u>."[171]

100. GPE is dependent upon Westar and KCP&L—specifically upstream dividends of the utilities—to meet its obligations relevant to the acquisition-related debt. However, Westar and KCP&L both have their own long-term debt obligations at the utility level, potentially bringing into conflict these separate debt obligations and by extension each entities financial health. This is likely the reason for Moody's prediction of ring-fencing restrictions on the amount of dividends paid from Westar to GPE as a means of safeguarding Westar's financial health. While this type of restriction would serve to protect Westar, it could potentially harm GPE, as GPE is dependent on that dividend stream to meet its own debt obligations. This is the type of conflict that arises when the "driving force" for a transaction is not customer benefit but Westar shareholder gain. Moreover, it is important to note Moody's credit opinion—one of the opinions which Joint Applicants celebrate as supporting the creditworthiness of the transaction—does not contemplate insulating ring-fencing conditions or methods of delivering value to customers (e.g., rate freezes or rebates), as neither were included as assumptions in GPE's presentation to Moody's, despite both of these being the traditional practice in Kansas.[172] 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;[173] in other words, not the type of ring-fencing protections that would provide true separation and insulation for Westar from GPE's financial risks.

101. In addition to Moody's, S&P voiced concern over the financials of this transaction. Even based on some of the overly-simplified assumptions GPE supplied to S&P as

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[171] *Id.* (emphasis added).
[172] Gatewood Direct, p. 11.
[173] TR. Vol. 1, p. 112, Tr. Vol. 3, p. 742. *See also*, Gatewood Direct, p. 21; BPU Exhibit 4, Appendix.

part of S&P's review, S&P affirmed Westar's and KG&E's current rating, but noted a change to a negative outlook from the previous stable outlook.[174] S&P explained, "the negative outlook reflects the potential for lower ratings on Westar, after the merger closes, if the combined entity's financial performance weakens such that funds from operations to total debt is consistently less than 13% after 2018."[175]

102. Finally, Fitch expressed strong concerns over the proposed transaction: "Fitch believes that the completion of the acquisition, based on the proposed financing structure as disclosed, would result in a one or two notch downgrade of Westar's ratings."[176]

2. GPE

103. In addition to concerns relevant to Westar, Moody's public statements express deep concern regarding the amount of leverage taken out by GPE. Moody's states,

> The transaction's financing plans are viewed as a signal that Great Plains' management and board of directors have a higher risk tolerance for leverage than previously considered, which is a long-term credit negative. With little financial cushion, Great plains will be more exposed to risks associated with successfully executing transition and integration plan and long-term issues, such as waning regulatory support and softening of regional macro-economic fundamentals.[177]

104. Moody's goes on to opine that, "[w]hile no change to utility ratings would likely occur at the close of the transaction, the high amount of family leverage would begin to weigh on upward ratings mobility of the subsidiaries, due to the contagion risk at that parent level and increased need for upstream dividend support."[178] Moody's assessment of a utility downgrade being unlikely was predicated on GPE not implementing "an aggressive upstream dividend

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[174] Gatewood Direct, p. 11.
[175] Gatewood Direct, p. 12; "Westar Energy Inc. and Sub Rtgs Affirmed and Outlook Revised to Negative on Proposed Acquisition by Great Plains Energy," Ratings Direct: S&P Global Ratings (May 31, 2016).
[176] Gatewood Direct, p. 13; "Fitch Places Westar on Negative Watch Following Acquisition Announcement," (June 1, 2016), accessed at https://www.fitchratings.com/site/pr/1005447.
[177] Gatewood Direct, p. 14; Moody's Investor Service, "Moody's Places Great Plains Energy on Review for Downgrade; Westar Energy, Kansas City Power & Light and KCP&L Greater Missouri Operations Affirmed; Outlooks Stable (May 31, 2016).
[178] BPU Exhibit 5, p.4.

policy" at Westar.[179] GPE's only debt repayment analysis in the record however relies on 100% of Westar's regulated earnings paid to GPE as a dividend, i.e. the most aggressive upstream dividend policy possible.

105. Despite the fact that the well-articulated insights of sophisticated credit rating agencies indicate serious concern for the financial health and flexibility of the post-transaction entity, GPE attempts to downplay the warnings of these rating agencies and represents the rating agencies support this transaction.[180] Further, the scenarios evaluated by these rating agencies do not account for any type of ring-fencing protections for the operating utilities—a factor that could further impair the financial health of GPE.[181]

106. Notwithstanding concerns relevant to the operating utilities' credit ratings following certain events that could apply downward ratings pressure, the credit rating of GPE is highly relevant to the Commission's analysis as the record supports the credit ratings of the holding company and subsidiary operating companies will likely be linked.[182] The linkage of GPE's credit rating with Westar's and KCP&L's means that financial risks at the holding company level will have a direct impact on the utility subsidiaries' credit ratings, and by extension, could result in direct and indirect costs to ratepayers. It is also direct and observable evidence that the utilities are not insulated or isolated from GPE's financial health. True ring-fencing that allows the utilities to become financially autonomous and insulated from holding company financial risk would result in unlinked credit ratings.[183]

[179] BPU Exhibit 5.
[180] Rebuttal Testimony of Kevin E. Bryant, p. 23-24; Tr. Vol. 1, p. 106.
[181] Tr. Vol. 1, p. 111-112.
[182] Tr. Vol. 3, p. 589-590, 742.
[183] Tr. Vol. 5, p. 1137, 1165, 1168-70. *See also,* Direct Testimony of David E. Dismukes, Ph.D., pp. 43-44 (Jan. 27, 2016).

107. Staff witness Adam Gatewood testified as to the parent company's absolute control over the financing and operations of the subsidiary.[184] Credit rating agencies recognize the control and interrelated nature of such relationship, and consequently only allow for, at most, a couple of notches difference in the credit rating of the parent and the subsidiary.[185] A weakness at one level will negatively impact the credit rating of the other entity or entities.[186]

vi. Financial Risks Translate to Risks to Ratepayers

108. Joint Applicants assert this transaction cannot move forward if the Commission believes the consolidated capital structure should be recognized in the utilities' rates. Staff's testimony shows that GPE's retention of lower capital costs is one of the major drivers behind this transaction. This is another way of saying that GPE could not have agreed to such an excessive purchase price unless it expected to have Westar charge rates reflecting capital costs exceeding actual costs, then have Westar dividend the difference to GPE. More specifically, GPE admits that it has already committed this excess to pay for the acquisition premium (and actually agreed to pay the premium on the premise that it would receive this excess), so it cannot share those cost-savings with ratepayers.[187] Therefore, it is undeniable that customers are paying for the acquisition premium. In this way, the Joint Applicants found a method of paying for the acquisition premium while contending they need not justify it with savings (or demonstrate and share those savings with customers). The problem with this approach is that operating savings are not the same as capital cost savings produced by financial engineering. The latter comes with real costs, risks, and detriment to the public interest.

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[184] Gatewood Direct, p. 41.
[185] *Id.*
[186] *Id.*
[187] Ives Supplemental Direct, p. 12; Tr. Vol. 4, pp. 892-93.

109. Joint Applicants then say that if they cannot recover the premium from ratepayers indirectly (by charging ratepayers for capital costs that are not actually incurred), they seek to recover the acquisition premium directly (by putting the premium in rate case). Since one way or the other, the premium would be recovered from ratepayers, savings related to this transaction must be adequately demonstrated and must justify the acquisition premium – which they do not. Absent a reasonable, proven relationship between premium and savings, there is no protection against acquisitions whose price bears no relation to true economic value.

110. Applying Commission precedent, specifically the Commission's methodology from docket 97-WSRE-676-MER, Staff witness Grady determined the amount of acquisition premium potentially eligible to be recovered from ratepayers.[188] Mr. Grady's calculations and analysis returned a *maximum* justifiable acquisition premium of $342.57 million to be amortized over 35 years, or $9.79 million annually for GPE.[189] When allocated by customer count to determine Westar's share, the methodology supported an annual amortization of the acquisition premium in Westar's rates of approximately $4.37 million.[190] Interestingly, this maximum allowable *direct* recovery of acquisition premium is far less than the amount Joint Applicants expect to extract from ratepayers *indirectly* through financial engineering. Mr. Grady's analysis was unrebutted by the Joint Applicants, unchallenged at the evidentiary hearing, and proves unequivocally that this merger is far from an "old fashioned" merger where the size of the acquisition premium is directly and quantifiably linked to the expected level of operating costs savings that are expected.

111. GPE's four regulated utility operating companies would be nearly its entire source of income. Put another way, ratepayers are the only source of income for GPE's subsidiaries;

[188] Grady Direct, p. 44-45; Staff Exhibit JTG-4.
[189] *Id.*
[190] *Id.*

and subsidiary dividends to the holding company are GPE's only source of income. No matter how Joint Applicants attempt to spin it, ratepayers are paying for this transaction; likewise, ratepayers are exposed to the risks of this transaction.

112. Staff also notes the as yet unresolved issue of Missouri's affiliate transaction rule, for which GPE has yet to receive a waiver. Absent such a waiver, KCP&L and GPE would be required to provide goods and services to Westar at the *greater* of fair market value or fully distributed costs.[191] And, conversely, KCP&L and GPE would be required to compensate Westar for goods and services provided by Westar at the *lesser* of fair market value or fully distributed costs. These asymmetrical pricing concerns, which could harm Kansas ratepayers, were noted in the Direct Testimony of Ann Diggs[192] and Staff's Reply to Joint Applicants' Verified Response to Commission's Order on Merger Standards dated September 9, 2016. While GPE is currently seeking a variance from Missouri's rule, the Missouri Commission has not yet taken action on the request. In fact, instead of ruling on GPE's specific request, the Missouri Commission has instead opted to assert jurisdiction over the transaction as a whole.[193] Therefore, it is extremely unlikely Missouri will decide the matter before April 24, 2017, when an order is due in this proceeding.[194] The Commission, should it entertain the notion of approval of the proposed transaction, should only do so based on a condition that GPE receives the variance for Missouri's affiliate transaction rule. This condition is not an acquiescence by Staff to any of GPE's arguments; rather, without this explicit condition, it is Staff's assertion that Kansas ratepayers will suffer significant harm.

[191] See Missouri Code of State Regulations, 4 C.S.R. *§* 240-20.015 .
[192] *See* Direct Testimony of Ann Diggs, December 16, 2016, pp. 65-67.
[193] Missouri Public Service Commission File No. EC-2017-0107, Report and Order, February 22, 2017.
[194] Missouri Public Service Commission File No. File No. EM-2017-0226, et al., Order Setting Procedural Schedule, March 8, 2017. "Therefore, GPE's request for a final Commission order by April 24 is unreasonable, absent a demonstration of extraordinary circumstances. GPE's stated reason for the expedited treatment – to allow the merger transaction to be concluded in late April, as the parties anticipated – fails to demonstrate an extraordinary situation."

b. The Transaction is not in the Public Interest because it Precludes Recognition of GPE's Lower-Cost Consolidated Capital Structure in Rates, Resulting in Non-Cost-Based Unjust and Unreasonable Rates

113. Staff does not support the level of leverage GPE is employing to complete this transaction. Staff bases this position on its own observations and the warnings of the credit ratings agencies regarding future financial risk. This position is explored at length above where the financial risk to the utilities and their customers is demonstrated. However, assuming the Commission is willing to accept the financial risk posed by this highly leveraged transaction, the question becomes whether and how that less costly, but riskier, capital should be recognized in customer rates. The Joint Applicants argue it should not. Staff contends that GPE's consolidated capital structure must be recognized in the ratemaking process for the utilities' rates to remain just and reasonable. This issue greatly impacts customer rates and the financial health of the utilities. Therefore, it is highly relevant to Commission Merger Standards (a)(i) and (a)(iii).

i. Recognizing the GPE Consolidated Capital Structure in the Operating Utilities' Rates is Necessary to Produce Just and Reasonable Rates

114. In his Direct Testimony, Staff witness Adam Gatewood explains that, post-transaction, Westar and KCP&L customers will be asked to pay for a more expensive capital structure than GPE is using to capitalize the consolidated company under the Joint Applicants' proposal.[195] Because GPE is taking on significant additional low-cost debt to complete this transaction, its post-transaction weighted average cost of capital will be significantly reduced. For rates to remain just and reasonable, this cost reduction must be reflected in customer rates.[196]

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[195] Gatewood Direct, p. 35.
[196] Gatewood Direct, pp. 35-36.

115. Mr. Gatewood explains that it is easy to determine the capital structure a standalone, publicly-traded company such as Westar is using to finance its rate base. However, that exercise becomes more difficult when the company becomes a wholly-owned subsidiary that depends solely on its parent company for equity capital. This is problematic because a holding company can simply issue debt and use the proceeds to make an equity infusion to the subsidiary. Therefore, the capital structure a holding company assigns to its subsidiaries will not necessarily reflect the capitalization of the holding company and may, in fact, be significantly more costly.[197] Mr. Gatewood explains the problem in more detail:

> In those instances, if regulators merely accept the subsidiary's capital structure without reviewing the capital structure of the parent, it will result in a windfall to the parent company's shareholders. The shareholder windfall occurs because the stockholders of the parent company collect an equity level return on what is actually debt capital. Moreover, the income tax gross up of the equity capital exacerbates the windfall. Therefore, the windfall to the shareholders of the parent company is unreasonable as it is an unnecessary cost paid by ratepayers through rates that fails to reflect the much lower true cost of capital for the utility.[198]

116. Mr. Gatewood goes on to note that the cost reduction (in consolidated company capital costs) that GPE is seeking to withhold from customers is in the range of $90 to $136 million annually, depending on whether GPE or the utilities' costs of debt are used to set revenue requirements. This retention of lower capital costs is the "financial engineering" cited by Moody's, and it is one of the major drivers behind this transaction, i.e., one of the major reasons why the purchase price is so high, while bearing no relationship to economic value created.[199] For that is what financial engineering is: creating gain for shareholders, but not for customers, and doing so not by improving productivity but by moving numbers around spreadsheets.

[197] Gatewood Direct, pp. 36-37.
[198] Gatewood Direct, p. 37.
[199] Gatewood Direct, p. 38; Grady Direct, pp. 58-67.

117. In addition to maintaining just and reasonable rates by recognizing the decrease in GPE's capital costs, Mr. Gatewood offers another compelling reason why the operating utilities' rates should reflect GPE's more leveraged capital structure. In his direct testimony, Mr. Gatewood notes that Staff nearly always relies on the lowest cost capital structure between a wholly-owned subsidiary utility and its parent company. He explains that "this approach is reasonable because it recognizes the reality of the parent company's absolute control over the subsidiary."[200] And more to the point, he states:

> [T]his is a reasonable means to reduce or eliminate incentives to manipulate subsidiary capital structure solely for the benefit of stockholders. Staff's policy recommendation on capital costs simply seeks to treat capital costs like all other parent-subsidiary transactions and applies an asymmetrical approach. Just as with the parent providing labor or office space to the subsidiary, the parent should not profit from providing capital to the subsidiary at a higher cost than it incurred to obtain the capital. In some sense, recognizing the consolidated capital structure is a form of ring-fencing.[201]

118. As explained by Mr. Gatewood, using the least cost capital structure to set rates proactively removes a parent company's incentive to overleverage its capital structure to profit from transactions with its subsidiaries that only amount to financial engineering.[202] This policy is far better than reactive ring-fencing requirements that we hope will work after financial problems begin to surface. Furthermore, true ring-fencing measures that effectively insulate a subsidiary may only intensify financial distress at the parent level.[203]

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[200] Gatewood Direct, pp. 40-41.
[201] Gatewood Direct, p. 41.
[202] Gatewood Direct, p. 42.
[203] *Id*.

ii. The Commission has Broad Legal Authority to Recognize any Capital Structure that will Result in Just and Reasonable Rates and has Most Often Adopted Staff's Policy of Recognizing the Lowest-Cost Capital Structure to Meet that Standard

119. In his rebuttal testimony, KCP&L witness Robert claims the Commission generally only recognizes two guiding principles when considering the capital structure it will recognize to set rates: 1) the capital structure should match the assets used to provide utility service, and 2) the reasonableness of a given capital structure is assessed by reference to industry practice.[204] While the Commission has employed a wide variety of benchmarks to assess capital structure, including those referenced by Mr. Hevert, its decisions have been much more nuanced than Mr. Hevert implies. And the Commission has never faced a Transaction with such a high price, with or without clarity on whether that price is supported by real savings. Rather than rigidly applying the overly simplified, limited principles suggested by Mr. Hevert, the Commission and Staff have always focused on the overall reasonableness of the end result. This approach has been universally upheld by Kansas courts.

1. Commission Decisions Typically Recognize the Lowest-Cost Capital Structure to Ensure Rates Remain Just and Reasonable

120. The Commission has most often opted to recognize the least cost capital structure to balance ratepayer and shareholder interests. For instance, when utilities' actual capital structures have been equity-rich, the Commission has imposed lower-cost hypothetical structures in line with industry standards.[205] When utilities' actual capital structures employ more low-cost debt, the Commission has refused to utilize more balanced hypothetical capital structures, as that

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[204] Hevert Rebuttal, p. 14.
[205] Docket No. 02-BLVT-377-AUD, Order, October 10, 2002, ¶ 21.

would result in an unjust windfall to shareholders.[206] In those cases, the Commission found it was necessary to recognize the utilities' actual capital structures, even though they were not "optimal" or reflective of industry standards. Depending on the facts and circumstances in any particular rate proceeding, the Commission has consistently scrutinized the capital structure used to develop a revenue requirement to protect customers from unjust and unreasonable rates.[207] In other words, the Commission adjusts capital structure not as end in itself but as a way to accomplish a broader objective required by statute. That is precisely what the Staff recommends the Commission do here.

121. Particularly relevant to this proceeding, the Commission has explicitly recognized a consolidated company capital structure to set rates when that structure contains more leverage than the operating utility. That arrangement, financial engineering through double leverage, is precisely upon what the Joint Application depends. When presented with this issue, the Commission has consistently expressed an overarching concern that ratepayers should not pay equity level returns on debt investment, especially where the financial health of an operating utility is linked to the financial well-being of its parent company,[208] as Westar and KCP&L would be to GPE.[209] For instance, in Docket No. 03-WHST-503-AUD, the Commission decided to impute the more debt-laden capital structure of Wheat State Telephone Company's parent company (Golden Wheat) instead of assigning the company a capital structure reflective of industry standards. The order states:

> Staff recommends using the actual capital structure of Golden Wheat, which is 87.77% debt and 12.23% equity. (Staffs August 6, 2003 revised schedules,

[206] Docket No. 03-WHST-503-AUD, Order, September 29, 2003, ¶ 30 (03-503 Order); Docket No. 03-HVDT-664-RTS, Order, November 7, 2003, ¶ 17.
[207] For instance, in the 03-503 Order, at paragraph 28, the Commission explicitly endorsed Staff's least-cost "asymmetrical" approach to capital structure.
[208] 03-503 Order, ¶¶ 25-30; Docket No. 04-AQLE-1065-RTS, Order on Reconsideration, March 14, 2005, ¶¶ 14-16. (04-1065 Order on Reconsideration, ¶¶14-16.)
[209] Gatewood Direct, p. 41; Tr. Vol. 4, pp. 849 to 853; ¶123 *supra.*

> Schedule C-1.) Staff maintains that the actual capital structure should be utilized unless it is clearly inappropriate. In this case, Staff asserts that using anything other than the actual capital structure would be unfair and would provide a windfall to shareholders. If a utility has a higher [level] of actual debt than what is in a hypothetical capital structure, the company would recover the higher equity return on what is actually debt. A hypothetical capital structure does not guarantee that there are actual dollars behind the capital structure percentages. As the corporate management determines the blend of debt and equity that is used to finance operations, allowing an equity return on debt would provide an incentive for management to increase debt levels and leverage capital structures. (Gatewood direct, 9-12; Transcript, 256-57,263,282-89.)
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> The Commission agrees with Staffs concerns if the hypothetical capital structure proposed by Wheat State were ordered. The hypothetical capital structure would allow an equity return on 48% of the capital structure when there was no actual equity underlying the structure. Because the return on equity is significantly higher than the return on debt, this would provide to the company a return that greatly exceeded what was justified by its corporate structure and financial requirements. Instead of paying the costs necessary for efficient and sufficient service (K.S.A. 66-1,189), 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. The capital structure proposed by Wheat State would not meet the mandate of K.S.A. 66-2008(c) to ensure that the KUSF is based on actual costs.[210]

122. In a more recent decision, the Commission again reasoned that it was necessary to set rates based on the consolidated company capital structure to avoid a shareholder windfall at ratepayers' expense. In Docket No. 04-AQLE-1065-RTS, the Commission held:

> As previously stated, the Commission may make and apply policy concerning the appropriate balance between the rates utility customers pay and the returns on capital utility investors receive, as long as such policy recognizes the constitutional protections applicable to both. Kansas Gas and Elec., 239 Kan. 483. The Commission is charged with maintaining a delicate balance between the interests of the utility and the consuming public. In this case, using the actual capital structure of Aquila will shield the ratepayers from providing an equity return on debt capital. To use the capital structure put forward by WPK would allow a benefit to the shareholders of Aquila on the whole. While there is no easy solution for a company so intricately entwined in its parent's financial affairs, the

[210] 03-503 Order, ¶¶ 27, 30.

> Commission finds and concludes that fairness to WPK's customers commands that Aquila's consolidated capital structure be employed.[211]

123. As will be fully explained below, the financial health of GPE's operating utilities is inextricably linked to GPE's financial health. The rating agencies say so, and common sense says so. A negative credit event at GPE will impact the credit of Westar and KCP&L. Cash constraints at GPE will cause upward dividend pressure at the utilities. When dealing with $4.4 billion of holding company debt that is supported only by the utilities' cash flows, these pressures are real and apparent. Because customers will be exposed to the financial risks associated with GPE's increased leverage, the benefits of that leverage must also be shared. Otherwise ratepayer risk subsidizes shareholder gain—the key ingredient in a transaction not based on real economic value.

124. Staff's research has found only one outlier case where the Commission chose to apply a more costly hypothetical capital structure, rather than the debt-heavy capital structure of the standalone electric utility. In Docket No. 01-WSRE-436-RTS, the Commission chose not to apply Western Resources' highly-leveraged structure, instead opting for a hypothetical structure Staff believed to best represent utility operations.[212] The Commission's reasoning was not discussed at length in its order. However, testimony cited in that decision made clear that numerous unregulated investments had left Western Resources over-leveraged and in potential financial peril.[213] While that proceeding was unique and fact-specific, Staff believes it serves as a stark warning of the compromises a Commission is asked to make when regulating a financially distressed utility.[214]

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[211] 04-1065 Order on Reconsideration, ¶ 16.
[212] Docket No. 01-WSRE-436-RTS, Order on Rate Applications, July 25, 2001, ¶¶ 34-39.
[213] *See* 01-436 Order, ¶¶ 8-14, 34-39.
[214] *See also*, Gatewood Direct, pp. 45-46, discussion of regulating financially-distressed utilities (Westar and Aquila).

2. Kansas Appellate Court Opinions Consistently Affirm the Commission's Wide Discretion to Utilize any Capital Structure that Produces Just and Reasonable Rates

125. In a series of decisions, the Kansas appellate courts have repeatedly found the Commission has broad authority to utilize, for ratemaking purposes, any capital structure that will result in just and reasonable rates. These decisions have specifically upheld Commission decisions to recognize hypothetical capital structures, highly-leveraged actual capital structures, and capital structures reflecting consolidated parent company operations.

126. In *Sw. Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 79, 386 P.2d 515, 549–50 (1963), the Kansas Supreme Court announced the Commission's general authority to utilize a reasonable capital structure when setting rates – and recognized that the Commission was not bound to accept the actual capital structure of the operating utility. In this landmark case, the Court upheld the Commission's use of a composite capital structure blending the capital structures of a holding company and its utility subsidiary.[215] What's more, in justifying the Commission's need to scrutinize a capital structure, the Kansas Supreme Court specifically identified the double leverage problem. The Court noted, "We would add that where a parent holding company maintains a high debt ratio in its capital structure while its operating subsidiary's debt is practically nil, a question might well arise in the minds of the members of a regulatory body as to reason and the effect."[216]

127. In several subsequent cases, the Kansas Court of Appeals upheld the Commission's use of a hypothetical capital structure to protect ratepayers when the utility had employed a more costly capital structure. In these cases, the Court cited the widely-accepted proposition that "the owners and management of a utility have the right to determine what the

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[215] *Sw. Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 79, 386 P.2d 515, 549–50 (1963).
[216] *Sw. Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 82, 386 P.2d 515, 551 (1963).

debt-equity ratio should be, but they may not always make the ratepayers foot the bill resulting from the choice."[217] The Court also explicitly noted that the Commission was not bound to any particular ratemaking formula. Therefore, the Commission had discretion to recognize any capital structure that would result in just and reasonable rates.[218]

128. Even more pertinent to the present case, the Kansas Court of Appeals has twice upheld the Commission's use of a consolidated company capital structure when setting an operating utility's rates. In *Wheat State Tel. Co. v. State Corp. Comm'n of State*, 88 P.3d 260 (Kan. Ct. App. 2004)(unpublished decision), the Court found no fault with what the Appellant complained was the Commission's "practice of accepting whatever capital structure that will result in the lowest rate of return for the company," which caused the Commission to impute the parent company's capital structure to its utility subsidiary. (That, by the way, is not what Staff is doing here. Staff is not randomly selecting a capital structure to lower rates; it is using the GPE consolidated capital structure to avoid having ratepayer risk subsidize shareholder gain—and to signal that future acquisition prices must be reasonable relationships to real economic value.) Similarly, in *Aquila, Inc. v. State Corp. Comm'n of State*, 115 P.3d 794 (Kan. Ct. App. 2005) (unpublished decision), the court again upheld the use of a consolidated capital structure that was more debt-laden than the structure proposed by the utility applicant. In that case, the Court specifically found the Commission's decision allowed a constitutionally-adequate rate of return under U.S. Supreme Court precedent.

129. It is notable that, despite a wealth of precedent on this issue, the Joint Applicants cite no Kansas case law on capital structure in their legal brief and virtually no Commission

[217] *Sekan Elec. Co-op. Ass'n, Inc. v. State Corp. Comm'n*, 4 Kan. App. 2d 477, 480, 609 P.2d 188, 191 (1980); *Kansas Indus. Consumers v. State Corp. Comm'n*, 30 Kan. App. 2d 332, 339-342, 42 P.3d 110, 115-117 (2002); *Moundridge Tel. Co. v. Kansas Corp. Comm'n*, 361 P.3d 523 (Kan. Ct. App. 2015)(unpublished opinion).
[218] *Sekan Elec. Co-op. Ass'n, Inc. v. State Corp. Comm'n*, 4 Kan. App. 2d 477, 481, 609 P.2d 188, 192 (1980).

decisions specific to capital structure.[219] Of course, these omissions are not surprising as the law is quite problematic for the Joint Applicants' position on this issue. What is shocking to Staff is the repeated expression of surprise from company executives that capital structure is an issue in this case. These individuals talk of an assumption that the Commission would set rates using the companies' preferred methodology.[220] As demonstrated above, a simple review of past Commission practice does not support the Joint Applicants' position.

130. The Joint Applicants wish to tie the Commission to specific guidelines in this proceeding – thereby binding future Commissions to those same principles when setting GPE subsidiaries' rates. However, Kansas law does not support rigid guidelines for setting a capital structure. Rather, it is supportive of wide Commission discretion on this issue, consistently upholding decisions that do not fit the Joint Applicants' preferred approach. The Joint Applicants now suggest the Commission should limit its own authority by adopting the strict guidelines supporting the Joint Applicants' position in this particular case, or risk the possibility of future requests for rate recovery of a $5 billion acquisition premium.

iii. The Joint Applicants' Arguments against Recognizing GPE's Consolidated Capital Structure in the Utilities' Rates are Flawed and Favor Shareholders' Interests

131. GPE witness Robert Hevert sets out several arguments to support the Joint Applicants' request to use the operating company capital structures when setting rates. These arguments are not new. To some extent, they are the same arguments rejected by the Commission and Kansas appellate courts in the rulings cited above. However, Staff will address each.

[219] Joint Applicants' Initial Post-Hearing Brief, pp. 39-56.
[220] *E.g.*, Tr. Vol. 1, p. 138-40.

132. First, Mr. Hevert argues that only two general principles have guided past Commission decisions on capital structure: 1) the capital structure should match the assets used to provide utility service, and 2) the reasonableness of a given capital structure is assessed by reference to industry practice.[221] With respect to the first principle, that the capital structure should match the assets used to provide utility service, Mr. Hevert seems to argue that the additional leverage is only being used to pay for the acquisition premium, not to support utility services (or the assets necessary to provide those services), so the Commission should ignore it when setting rates. First, the record leaves no doubt that GPE is not separately financing the book value and acquisition premium portions of the transaction –paying for the acquisition premium with only debt.[222] GPE is borrowing money to buy control of Westar, its franchises, its assets, is work processes—everything Westar has that makes possible the revenues that GPE expects to receive through dividends. However, assuming *arguendo* that it is possible to isolate the use of the debt to pay for the Acquisition Premium, this still does not support Mr. Hevert's argument that the debt is not used to fund utility operations. The debt was used to purchase all of the equity in a business whose sole operations are utility operations. In other words, Westar's assets and utility operations could not have been purchased without the additional debt; and Westar's operations provide the only income supporting that debt. Thus, it is illogical, and unconnected to reality, to hypothetically separate one from the other.

133. It is also important to remember that GPE's only income-producing assets are its electric utility subsidiaries, and that GPE will have full control over how those utilities are financed.[223] Depending on its fiscal goals, GPE can alter the capital structure of any or all of its

[221] Hevert Rebuttal, p. 14.
[222] Tr. Vol. 3, pp. 743-44; Tr. Vol. 4, p. 891.
[223] Gatewood Direct, pp. 36-37, 41; *See* Discussion of "assigned" capital structures at Tr. Vol. 4, pp. 873-74; pp. 880-81. *Also see*, Tr. Vol. 4, pp. 857-58.

utilities at any time. Therefore, GPE's consolidated structure *is* the best ongoing representation of financing available to provide utility service. This directly contravenes the Joint Applicants' assertion that Staff does not consider the nature of utility operations when selecting a capital structure to set rates.

134. The Direct Testimony of Mr. Gatewood supplies an even more precise reason for the Commission to reject this argument. Mr. Gatewood states,

> The "acquisition premium" does not produce any cash flow or earnings that can support interest and principal payments on those bonds. That debt will be supported by the dividends (cash flows) that GPE receives from its ownership of Westar, KCPL, and KCPL-GMO common stocks. Thus, it is not reasonable to believe that the $4.4 billion of debt can be separated from the cash flows that the Joint Applicants use to support the debt. In other words, the only security GPE can offer its creditors is the cash flow from its stake in the operating-utilities.[224]

135. Mr. Hevert's argument also ignores the fundamental basis of cost-based ratemaking. As noted by the Kansas Court of Appeals, "[t]he rate of return, which is multiplied against the utility's rate base, is generally calculated based on the company's "cost of capital." The Commission *examines the company's capital structure to identify the sources of its capital*, including long-term debt, preferred stock, and common stock. The cost of each of these items of capital is determined."[225] To ensure rates remain "cost-based" the Commission must examine the source of funds to determine their cost. In this case, the operating utilities' equity is drawn solely from GPE.[226] Furthermore, since GPE's subsidiaries are not autonomous in any sense, their capital policies are entirely at the discretion of GPE.[227] For all these reasons, it is reasonable for the Commission to recognize GPE's sources and cost of capital when setting the operating utilities' rates.

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[224] Gatewood Direct, p. 40.
[225] *Moundridge Tel. Co. v. Kansas Corp. Comm'n*, 361 P.3d 523 (Kan. Ct. App. 2015). (Emphasis added.) *See also*, Tr. Vol. 4, pp. 887-88.
[226] Gatewood Direct, p. 36.
[227] Gatewood Direct, pp. 36-37, 41.

136. In their Initial Post-Hearing Brief, the Joint Applicants argue the source of funds used by the investors in Westar is irrelevant for determining its cost of capital for rate-making purposes.[228] This may be true when Westar is not exposed to the financial risks of any one particular shareholder. It is not true when it has only one shareholder, has no true financial autonomy from that shareholder, and is therefore exposed to the financial risk of that one controlling shareholder.[229] Presumably, GPE would not have paid a $2.3 billion dollar *control* premium if it did not anticipate exercising financial and operational control over Westar. Of course, a normal shareholder with a small stake in the company does not pay this premium and cannot exercise control over the company to meet his or her own financial needs. GPE, on the other hand, would control Westar's financial and operational decisions. In this way, control is closely tied to financial risk exposure. It is, therefore, a key distinguishing factor when Staff decides whether an individual shareholder's cost of capital is relevant for ratemaking purposes.

137. Mr. Hevert's second principle, that a capital structure's reasonableness should be assessed by reference to industry practice, is similarly flawed. While this is an important benchmark, past Commissions have often ended up using a capital structure that is not reflective of industry standards to set rates. As noted above, hypothetical "industry standard" capital structures are frequently rejected when actual or parent company structures contain more leverage. In such situations, using the actual structure, even if it is not "optimal" or does not reflect industry standards, protects ratepayers from paying equity level returns on debt investment. Mr. Hevert's rigid principle fails to account for this difference.

[228] Joint Applicants' Initial Post-Hearing Brief, p. 45.
[229] See comprehensive discussion of "source of funds" and investor control at Tr. Vol. 5, pp. 1139-1149.

138. Mr. Hevert also seems to recognize here that GPE's post-transaction capital structure would be less than optimal for an electric utility.[230] Therefore, he posits, it cannot be used to set Westar and KCP&L's rates. Staff and the ratings agencies obviously agree that GPE's new capital structure is suboptimal and carries excessive and unnecessary risk. What is unclear from Mr. Hevert's testimony is why this is a prudent approach for GPE if it is not for Westar and KCPL. After all, GPE's only income-producing assets are fully rate-regulated electric utility companies. Mr. Hevert admitted at hearing that GPE is not like other holding companies with diversified holdings, a possible justification for a holding company to have a different capital structure than each of its individual subsidiaries.[231] Mr. Hevert even acknowledged that GPE "absolutely" faces the exact same business risks as the utilities it owns.[232] In other words, GPE seems to be admitting that its own capital structure is too risky for a standalone electric utility. However, inexplicably, GPE believes that blend of financing is somehow acceptable for a company whose *only* substantial income producing assets are four electric utilities. This is an arrangement unrestrained by any fiscal or economic logic, yet GPE wants this Commission to approve of its decision.

139. Finally, Mr. Hevert argues, instead of giving ratepayers the financial benefits associated with parent level debt, the "industry norm" is to shield ratepayers from the parent company's financial risk with ring-fencing. This solution is not unreasonable, in theory. However, as demonstrated above, Westar and KCP&L cannot be insulated from the financial risk associated with the debt GPE would incur to purchase Westar, given the degree of

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[230] Hevert Rebuttal, pp. 14-17.
[231] Tr. Vol. 4, pp. 844-48; 882-85. *See also*, Tr. Vol. 1, pp. 235-236, quoting Westar CEO Ruelle: "I think it was Mr. Bassham said, you know, you look at some utility holding companies like Berkshire Hathaway. They've got hundreds of businesses. They are manufacturers. They make underwear. They have Dairy Queen. That has nothing to do with utility business in Iowa or Nevada or Oregon and you shouldn't take that into consideration in making rates."
[232] Tr. Vol. 4, pp. 847-48.

operational and financial integration anticipated between Westar and GPE following the transaction. Quite simply, the record shows that GPE cannot consider real ring-fencing that would fully insulate the utilities and their customers likely leading to, and evidenced by, unlinked credit ratings.[233] GPE is only willing to consider their own heavily-caveated "financial commitments" that will not truly insulate customers from the immense financial risk of GPE's additional leverage. Of course, as noted above, effective ring-fencing is not a viable solution in this case because of GPE's corporate structure[234] and its method of financing this transaction. The credit ratings agencies have confirmed that true ring-fencing, beyond the "financial commitments" suggested by the Joint Applicants, would be a credit negative for GPE.[235] GPE assures the Commission that their "financial commitments" are not a credit negative,[236] and impliedly, are not viewed by Moody's as true ring-fencing.[237] Because of the significant debt GPE seeks to incur to fund this transaction, it literally cannot afford to allow its subsidiaries to become completely financially and operationally autonomous.

140. Because effective ring-fencing was not proposed by GPE and would not be consistent with GPE's financing and operational plans, Mr. Hevert's suggestion that the Commission should rely on ring-fencing is irrelevant. At hearing, even Mr. Hevert admitted that his approach of relying on ring-fencing would not be appropriate if the ring-fencing was not effective.[238] Because customers will be exposed to risks associated with GPE's debt, they must also benefit from the lower cost of that financing.

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[233] Tr. Vol. 5, pp. 1137, 1165, 1168-70; Dismukes Direct, pp. 43-44.
[234] As noted elsewhere, GPE is merely a shell for its utility subsidiaries. It has no other income-producing assets to service holding company debt, as may be the case with larger, more diverse holding companies.
[235] *See* Gatewood Direct, pp. 15, 20-21, 24.
[236] Tr. Vol. 3, p. 742.
[237] *See* Gatewood Direct, p. 21.
[238] Tr. Vol. 4, pp. 842 - 843.

141. However, it is worth noting that the Commission could consider recognizing the consolidated capital structure of GPE when setting the utilities' rates, even where the utilities are entirely insulated from financial risk. This principle flows from basic regulatory restrictions commonly associated with affiliate transactions where a public utility must demonstrate the actual cost to its affiliate of providing goods or services to the utility when seeking recovery of such costs.[239]

142. In his prefiled testimony and during the hearing, Staff witness Adam Gatewood compared Staff's lowest-cost capital structure policy to an affiliate transaction rule that would prevents a holding company, or other affiliate, from profiting from its relationship with a regulated entity. During the hearing, he testified, "[I]t's in essence not allowing a parent company to profit from financing a subsidiary. I mean, that's profit over and above what it cost to provide the funds for whether it's labor, building lease, capital for financing, buying equipment, we look at that…also in terms of an affiliate transaction issue."[240] If the Commission does not recognize GPE's actual weighted average cost of capital when setting the utilities' rates, GPE would stand to unreasonably profit from an affiliate transaction because it would receive a margin on capital it provides to the operating companies in excess of its actual cost to acquire that capital.

[239] *See* K.S.A. 66-1403: "In ascertaining the reasonableness of a rate or charge to be made by a public utility, no charge for services rendered by a holding or affiliated company, or charge for material or commodity furnished or purchased from a holding or affiliated company, shall be given consideration in determining a reasonable rate or charge unless there be a showing made by the utility affected by the rate or charge as to the actual cost to the holding or affiliated company furnishing such service and material or commodity." Also *see*, *Sw. Bell Tel. Co. v. State Corp. Comm'n of Kansas*, 4 Kan. App. 2d 44, 47–49, 602 P.2d 131, 135–37 (1979) (holding that a showing of actual cost, alone, does not conclusively establish a presumption of reasonableness).

[240] Tr. Vol. 5, p. 1168; See also, Gatewood Direct, p. 42.

iv. Approval of this Transaction will Hamstring this Commission and future Commissions' Ability to Effectively Regulate Westar and KCP&L for Many Years Because those Commissions will be Forced to Set Rates Based Only on the Operating Utilities' Capital Structures

143. The Commission's Merger Standard (d) asks, "[w]hether 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." In his Direct Testimony, Staff witness Adam Gatewood explains why the transaction will diminish the Commission ability to "effectively regulate" the operating utilities post-transaction.[241] He notes, "even though the Transaction does not change the Commission's jurisdiction or legal authority to regulate the newly created entity, the financial weakness highlighted by the ratings agencies will likely leave the Commission fewer options."[242] In particular, Mr. Gatewood highlights the use of GPE's consolidated capital structure to set rates as one ratemaking tool the Commission may be forced to abandon if it approves the transaction.

144. As described above, this Commission currently enjoys wide discretion to recognize any capital structure that will produce just and reasonable rates. It has often used that discretion to recognize the most efficient or lowest-cost capital structure, as recommended by Staff. As described above, this policy ensures rates remain just and reasonable by recognizing decreased capital costs, and it also eliminates the incentive to engage in double leveraging, a form of financial engineering employed by a holding company to earn equity level returns on debt investment.[243] As discussed at hearing, Staff and the Joint Applicants' positions on this issue are irreconcilable because the transaction, by its very nature, is dependent upon the

[241] Gatewood Direct, pp. 43-46.
[242] Gatewood Direct, pp. 43.
[243] Gatewood Direct, pp. 41-42.

financially-risky behavior Staff's position aims to prevent.[244] As such, GPE presents the Commission with an option aptly described as "heads I win, tails you lose": allow the highly-priced, highly-leveraged transaction, set rates in a manner that accommodates the high price and the high leveraging (thereby setting a precedent that encourages more such transactions), or GPE will terminate the transaction.

145. The Joint Applicants have stated that the transaction cannot proceed if the Commission chooses to set rates using the consolidated capital structure.[245] However, assuming the transaction does move forward, all parties recognize GPE will be in a more perilous financial situation if it is not allowed to retain the profits associated with double leverage now, as well as into the future. For example, Mr. Gatewood and GPE witness Kevin Bryant both note that recognition of the consolidated capital structure to set rates would inevitably cause a downgrade in GPE's credit, which would, in turn, negatively impact Westar and KCP&L.[246] Therefore, if the Commission approves this transaction, it risks excluding itself and all future commissions from utilizing the consolidated capital structure to set Westar's rates without causing financial stress on GPE and ultimately the utility operating companies, even if that approach is warranted to protect consumers. Doing otherwise would severely damage the financial health of GPE, which then would seek greater returns from the operating utilities to replace those funds. The Joint Applicants have admitted this fact by stating that they <u>will</u> seek to recover the $5 billion acquisition premium in rates if the Commission *ever* uses GPE's true capital structure to set rates.[247] In consideration of these facts, Staff recognizes this is a fundamental threshold issue that must be considered in this proceeding.

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[244] Tr. Vol. 4, pp. 878-80; Tr. Vol. 5, p. 1161.
[245] Ruelle Rebuttal, pp. 2, 13, 36-37; Bryant Rebuttal, p. 26.
[246] Gatewood Direct, pp. 43-46; Bryant Rebuttal, p. 26.
[247] Ives Supplemental Direct, p. 12; Direct Testimony of Andrea Crane, December 16, 2016, pp. 19, 25-26.

v. Summary of Capital Structure Issue

146. Staff urges the Commission to find the lower cost capital structure of a holding company should be recognized when setting its' operating utilities' rates. This treatment ensures those rates are based on actual costs, producing a just and reasonable result. As cited above, this regulatory practice is rooted in past Commission practice and widely accepted by the Kansas appellate courts. Staff understands this treatment cannot be applied once the transaction is approved without harming the financial integrity of GPE and its subsidiaries. Therefore, to ensure just and reasonable rates in the future, the Commission must express its preference for the consolidated capital structure in this proceeding. Waiting for a future rate proceeding will be too late.

147. It is important to recognize that Staff's position on capital structure is consistent with its longstanding policy on this issue. In taking this position, Staff's intent was not to "kill the deal," though Staff understands that may be the ultimate effect from the Joint Applicants' perspective—an effect arising not from Staff's intent but from the intersection of two factors: an excessive price and proper regulatory response. Joint Applicants want the Commission to believe that adopting Staff's recommendation will ensure "the benefits of the lower cost debt ($90 million to $136 million annually) will not accrue to anybody."[248] This is wordplay and misdirection. It is GPE's "highly-aggressive"[249] financing plan that has limited the Commission's options to a choice between transaction approval and just and reasonable cost-based rates. The Joint Applicants, themselves, have presented the Commission with a "take it or leave it" proposition. However, if the Joint Applicants are truly interested in capturing benefits and efficiencies for customers, they are free to restructure the financing or even negotiate a new

[248] Joint Applicants' Initial Post-Hearing Brief, p. 51.
[249] Gatewood Direct, p. 20, quoting Moody's Ratings Assessment Service correspondence.

purchase price that will not financially imperil the surviving entities. These are the true barriers withholding consumer benefits – not Staff's insistence on just and reasonable, cost-based rates.

148. GPE's consolidated capital structure should be recognized in the utilities' rates to ensure they remain cost-based. For this reason, application of Merger Standard (a)(iii) does not support approval of the proposed transaction. Staff also recognizes that using the consolidated capital structure to set rates, while entirely necessary and appropriate, could further imperil the financial standing of the consolidated company. Therefore, application of Merger Standard (a)(i) does not support approval of the transaction. Put another way, if the proper regulatory response to a proposal is to make the proposal unworkable, the problem is with the proposal, not with the regulatory response. Finally, approval of the transaction may prevent this Commission – and future Commissions – from ever recognizing GPE's lower-cost capital structure when setting rates. This loss of ratemaking discretion would significantly diminish the Commission's ability to effectively regulate Westar and KCP&L's rates. Thus, application of Merger Standard (d) also does not support approval of the transaction. Quite simply, the proposed transaction requires too many compromises – from financial risk exposure to non-cost-based rates to diminished ratemaking discretion – and demonstrates too few firm benefits to warrant approval.

c. An Overpriced Acquisition Cannot be Repaired by Conditions

149. Thorough and adequate ring-fencing might protect Westar from being milked by GPE; but it does not protect Westar from being undernourished by GPE. Given that GPE would be Westar's sole source of equity capital post-transaction, Westar will be at risk of having insufficient equity capital in light of the financial strain GPE experiences by taking on the acquisition debt.

i. **True ring-fencing protections have not been offered by Joint Applicants**

150. Joint Applicants claim they offered ring-fencing protections in the Rebuttal Testimony of Darrin Ives; specifically, that Joint Applicants' commitments 10 through 16[250] amount to "significant ring-fencing conditions that collectively ensure that the transaction will benefit customers and protect them from potential harm due to the financing structure or relationship of Westar and KCP&L with GPE or its affiliates."[251] According to Joint Applicants, these ring-fencing commitments are intended to "insulate customers from any potential negative impact from the Transaction caused by the higher leverage at the parent company.[252] These words constitute aspiration rather than guarantee.

151. The 43 commitments offered by the Joint Applicants in Mr. Ives' Schedule DRI-3 are not true and effective ring-fencing protections. The financial commitments contained within Mr. Ives' Schedule DRI-3 do not truly insulate customers from financial harm. For the most part, they merely provide reactive reporting mechanisms after financial harm has occurred. Specifically, commitment 14 provides guidance on an offered filing with the Commission *after a credit rating downgrade occurs.* Other financial commitments use weak wording such as, "plan to use;"[253] "intend to utilize;"[254] and "shall [not] seek an increase,"[255] which have little to any binding effect on Joint Applicants, and do nothing to proactively insulate customers from significant financial risks.

152. In Joint Applicants' Initial Post-Hearing Brief as well as at the Evidentiary Hearing, Joint Applicants attempt to prove they offered ring-fencing conditions throughout the

[250] "Financial and Ring-fencing Conditions," Ives Rebuttal, Schedule DRI-3.
[251] Ives Rebuttal, p. 1.
[252] Ives Rebuttal, p. 31.
[253] Ives Rebuttal, Schedule DRI-3, No. 10.
[254] Ives Rebuttal, Schedule DRI-3, No. 13.
[255] Ives Rebuttal, Schedule DRI-3, No. 15.

pendency of this docket.[256] As Mr. Gatewood articulated at hearing, though interestingly not cited by Joint Applicants in their Post-Hearing brief on this issue, Staff did not view the financial commitments offered by the Joint Applicants—including the provisions alluded to in the Joint Application, provisions mentioned in technical conferences, and provisions contained within schedule DRI-3 attached to Mr. Ives' rebuttal testimony—to be considered ring-fencing conditions. As discussed above, these provisions do not function in a way which would meet even Joint Applicants' definition of ring-fencing as advanced by Mr. Reed.[257] Further, Moody's did not regard these provisions as ring-fencing, as they stated in their May 12, 2016 RAS Letter, "no ring-fencing type provisions are introduced that would significantly limit the upstream dividend capability of the Westar or Great Plains utility,"[258]—and subsequently verbally confirmed to Joint Applicants that the financial commitments provided in Schedule DRI-3 were not a credit negative event.[259]

153. Mr. Gatewood testified at the Evidentiary Hearing that Staff did not regard any provisions suggested by Joint Applicants as true ring-fencing. He stated, "I don't recall any time in which ring-fencing proposals were provided. And by ring-fencing, that going to—that's going to include the rating agencies."[260]

154. What's more, the commitments proffered by the Joint Applicants only purport to provide protection to the utility subsidiaries for some of the quantifiable risks associated with a credit downgrade below investment grade. This ignores (1) the risks and costs to ratepayers even if the utility or its holding company is not ultimately downgraded below investment grade; and

[256] Joint Applicants Initial Post-Hearing Brief, pp. 64-66; Tr. Vol. 5, pp. 1157-1161.
[257] In his rebuttal testimony, Mr. Reed defines ring fencing as "financial conditions (e.g., securities restrictions, dividend restrictions, and capital availability covenants) and related governance conditions (e.g., restrictions on the ability to pledge assets) that are intended to financially and/or operationally isolate and protect one entity from its parent and other affiliates. (Reed Rebuttal, p. 87.)
[258] Tr. Vol. 1, p. 112; BPU Exhibit 4, Appendix.
[259] Tr. Vol. 3, p. 742.
[260] Tr. Vol. 5, p. 1159.

(2) the qualitative (unquantifiable) risks to ratepayers associated with a financially weakened utility or its holding company.

155. To the first set of risks, the example from KCP&L's rate cases in Commission Dockets 09-KCPE-246-RTS and 10-KCPE-415-RTS more fully explained below illustrate that even when a utility is not ultimately downgraded below investment grade, financial difficulty can and often does have real costs and consequences to a utility and its ratepayers. When faced with a credit downgrade resulting from poor financial decisions while building its Iatan 2 power plant, GPE immediately sought to cut O&M, capital expenditures, and issue high-cost securities.[261] KCP&L then attempted to recover those high-cost securities from customers in its next rate case.[262] This germane example illustrates that Westar and KCP&L customers could still face risks when GPE experience financial difficulty, but it ultimately not downgraded.

156. To the second set of risks, operating against the backdrop of $4.4 billion in debt causes it to become more difficult and more costly to raise capital for utility infrastructure development, causes utility management to shift focus from quality of service and sufficient and efficient service in favor of cost-cutting measures, and ultimately renders rate proceedings more contentious and litigious with an increase push for non-traditional ratemaking mechanisms like riders, surcharges, and deferred accounting, to mitigate the effects of regulatory lag.

ii. Joint Applicants' Proposed Financial Commitments fall short of the Conditions Approved in Less Risky Algonquin/Empire Transaction

157. In Joint Applicants' Initial Post-Hearing Brief, they state "[s]chedule DRI-3 contains a number of the conditions agreed upon as part of the Kansas Commission's approval of the Empire Merger Docket…" This is an incomplete and thus inaccurate comparison of provisions between schedule DRI-3 and conditions from the Unanimous Settlement Agreement

[261] *See* Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, pp. 39-45.
[262] *Id.*

reached in Docket No. 16-EPDE-410-ACQ.[263] Not only are the provisions offered by Joint Applicants less protective than those from Empire Merger Docket, Staff's financial concerns in this transaction were far greater than any financial concerns present in the Empire Merger Docket. Accordingly, any claim by GPE that the Empire provisions would work to remedy Staff's concerns in this docket are inapt. Specifically, the size of Empire operations as compared to the resulting pro forma entity did not raise as much concern for Staff as in this proposed transaction; Empire's parent (Liberty) and ultimate parent (Algonquin) were not forecasted to experience a credit downgrade as a result of the transaction as GPE is here; the Empire transaction was more conservatively financed (i.e., 53% to 55% debt at the consolidated entity following close of the transaction); and Empire explicitly agreed to use the least-cost capital structure in Kansas rate cases and its AERR rider.[264] Put another way, the Joint Applicants' proposed commitments are not as substantive as the conditions in the Empire Merger docket, and even if they were, they would still not be enough to address Staff's concerns relative to GPE's proposed acquisition of Westar. Specific examples of areas where the Empire Merger financial conditions are superior to those offered by the Joint Applicants in this transaction are as follows:

158. Joint Applicants' commitment 10 requires no more than 65% debt in the capitalization of Westar and KCP&L.[265] This equates to a requirement that 35% of the capitalization be equity. In contrast, the Empire Settlement requires Empire to maintain 40% equity as a percentage of capitalization.[266]

[263] Joint Motion for Commission Approval of Unanimous Settlement Agreement, Exhibit A (Oct. 6, 2016) ("Empire Settlement"); Order Granting Joint Motion to Approve the Unanimous Settlement Agreement and Approval of the Joint Application, Exhibit A (Dec. 22, 2016).
[264] Tr. Vol. 5, pp. 1187-88.
[265] Ives Rebuttal, Schedule DRI-3, No. 10.
[266] Empire Settlement, ¶35.

159. Joint Applicants' commitment 13 states that KCP&L and Westar plan to use utility specific capital structures.[267] This ensures that the financial engineering that the Joint Applicants plan to use to pay for the acquisition premium will exist in future rate cases. The Empire Settlement states that Empire will present evidence in rate cases as to which capital structure in its corporate family is the least cost.[268] This least cost analysis is inclusive of, but not limited to the consolidated Algonquin capital structure.[269] This provision of the Empire Settlement is consistent with Staff's recommendation concerning capital structure in this docket.

160. The Empire Settlement states, "[i]f the Commission determines that Empire District Electric Company's (EDE's) and/or the Financing Affiliate's Corporate Credit Rating decline has caused its service to decline…," Empire is to file reports that demonstrate its ability to safeguard capital for the utility.[270] If Empire cannot, then Empire is to pursue true ring-fencing separation ("EDE shall execute reasonable steps to ensure EDE's S&P or Moody's Corporate Credit Ratings will be based upon its own stand-alone credit quality.").[271] Joint Applicants' corollary commitment is contained in No. 14(iv) and is only activated following a decline in credit quality *below investment grade*.[272] Moreover, Joint Applicants' commitment does not include consequences should it not be able to satisfy the conditions in the report.[273] Note that Empire's condition is not limited to a credit rating decline below investment grade, but is based upon *any* credit rating decline.[274]

[267] Ives Rebuttal, Schedule DRI-3, No. 13.
[268] Empire Settlement, ¶36.
[269] *Id.* at ¶26.
[270] Empire Settlement, ¶60.
[271] *Id.*
[272] Ives Rebuttal, Schedule DRI-3, No. 14(iv).
[273] *Id.*
[274] Empire Settlement, ¶60.

161. The Empire Settlement contains provisions pertinent to upstream cash flow restrictions in the event of a credit rating decline below investment grade.[275] This provision refers to dividends and the repurchase of upstream equity from the parent company.[276] Joint Applicants' corresponding commitment refers only to Common Dividend restrictions (and therefore does not include or reference any other upstream cash to GPE—a potential loophole for the movement of cash from the subsidiary utilities to GPE).[277]

162. The Empire Settlement includes the filing of a Comprehensive Risk Management Plan in the event of a credit rating decline.[278] This credit rating decline is not limited to merely a decline below investment grade.[279] Conversely, Joint Applicants' corresponding commitment is limited to only credit rating declines below investment grade.[280]

163. The Empire Settlement includes an unequivocal and unconditional exclusion of Goodwill Impairment costs from determination of Empire's rates.[281] Joint Applicants corollary commitments contain the caveats of, "unless caused by KCC Order."[282] Such qualification is not present in the Empire Settlement.

164. The Empire Settlement excludes all severance costs from future ratemaking requests.[283] Joint Applicants' corresponding commitment only excludes Change in Control severance costs.[284]

165. The Empire Settlement unequivocally and unconditionally removes all transaction costs from future and current Empire rate proceedings.[285] Joint Applicants' corresponding

[275] Empire Settlement, ¶61.
[276] *Id.*
[277] Ives Rebuttal, Schedule DRI-3, No. 14(v).
[278] Empire Settlement, ¶62.
[279] *Id.*
[280] Ives Rebuttal, Schedule DRI-3, No. 14(vi).
[281] Empire Settlement, ¶67.
[282] Ives Rebuttal, Schedule DRI-3, Nos. 16, 20.
[283] Empire Settlement, ¶27.
[284] Ives Rebuttal, Schedule DRI-3, No. 19.

condition qualifies this exclusion based on Joint Applicants receiving their preferred capital structure treatment in future rate proceedings.[286]

166. Staff does not present this critique of Joint Applicants proposed financial commitments to suggest changes that could lead to effective ratepayer protections *for this transaction*—rather Staff is merely responding to Joint Applicants' assertion that its financial commitments are "consistent with, or provide greater protection than, those contained in the Settlement Agreement filed by the parties to the Algonquin Power & Utilities acquisition of Empire District Electric Company."[287] A careful review and comparison between the Joint Applicants' proposed financial conditions and the Empire Stipulation easily disproves this assertion. In fact, all the Commission must really do is observe the provisions of the Empire Settlement that require Empire to submit evidence in future rate cases supporting the least cost capital structure in the Empire corporate family, including but not limited to the consolidated Algonquin capital structure, to see that the Empire Settlement contains provisions which by Joint Applicants' own admission would terminate this transaction.

iii. Staff's Conclusions and Recommendation are not Outside the Mainstream

167. Joint Applicants statement on page 66 of its Initial Post-Hearing Brief is purely illogical. Joint Applicants "caution that if the KCC imposes additional conditions on Joint Applicants beyond those contained in Schedule DIR-3," the Commission may render the transaction infeasible. They go on to say, "[w]hile this potential could have been avoided through negotiations…the time for negotiations has passed." Despite Joint Applicants' repeated

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[285] Empire Settlement, ¶27.
[286] Ives Rebuttal, Schedule DRI-3, No. 21.
[287] Rebuttal Testimony of John Reed, p. 97; *See also* Ives Rebuttal, p. 41.

claims attempting to vilify Staff and placing blame on Staff that no settlement was reached,[288] it is actually Joint Applicants who are taking the "take it or leave it" stance. Here, they are warning the Commission not to extract any further concessions or conditions beyond what Joint Applicants have offered, claiming it would make the proposed transaction infeasible. However, Joint Applicants' brief implies such further concessions or conditions could have been negotiated as part of a settlement without rendering the transaction infeasible—but now it is simply too late for that? That does not go to the feasibility of the transaction so much as it goes to the passage of time and Joint Applicants' rigid posture throughout this transaction.

1. The Financial Structure of this Transaction Inherently Conflicts with the Public Interest and Precludes Settlement

168. Joint Applicants' statements that they were not afforded an opportunity to negotiate a settlement is an attempt at distraction that is simply without merit, not to mention internally contradictory. As Staff witness Gatewood was cross-examined, Joint Applicants attempted to secure an admission from Mr. Gatewood that Joint Applicants had proposed ring-fencing conditions in various technical conferences.[289] Notwithstanding the disagreement between Staff and Joint Applicants on whether the provisions offered by Joint Applicants are or are not truly ring-fencing protections, Joint Applicants' examination necessarily acknowledges that conversations and technical conferences took place.[290] It is contradictory and inaccurate, then, to assert that Joint Applicants were "[not] afforded that opportunity…[not] afforded parties who were willing to hear lots of ideas and discuss those ideas."[291]

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[288] *See* Ruelle Rebuttal, p. 13; Joint Applicants' Initial Post-Hearing Brief at pp. 64-66.
[289] Tr. Vol. 5, pp. 1157-1161.
[290] Staff notes the content of such discussions were of a type which could easily evolve into settlement discussions, and as such, took the cautious position of not disclosing details of those discussions on the record.
[291] Tr. Vol. 1, p. 272.

169. Joint Applicants attempt to assert that the mere fact that Staff engaged Mr. Hempling is evidence that Staff had prematurely decided to recommend rejection of this transaction, and that Mr. Hempling was effectively "in charge" of Staff's positions and recommendations.[292] Joint Applicants state, "[t]he approach advocated by Mr. Hempling and followed by Staff for purposes of this case is based on the inherent belief that the interests of utility shareholders and utility customers are not aligned, *see, e.g.,* Hempling Direct, p. 36, and ignores the decision made long ago by policy makers to rely upon the private investor ownership of public utilities."[293]

170. At the Evidentiary Hearing, Joint Applicants unsuccessfully attempted to show that Staff decided that its recommendation would be to reject the transaction at the time Staff hired its consultant Scott Hempling. Specifically, Joint Applicants asked Staff witness McClanahan the following question:

> Q. At the time Staff retained Mr. Hempling, had Staff already decided to recommend rejection of the transaction?
>
> A. No. In fact, we felt like Mr. Hempling's issue regarding sharing of control premium would be the biggest issue that we would have to address in this case and *that was based on our belief that we would be recommending approval*, but as we continued to evaluate the case, we just ran across additional roadblocks.[294]

171. Quite to the contrary, the record supports that Staff was not predisposed to recommending denial of this transaction.[295] Staff had identified financial engineering and consequences associated with the large acquisition premium as concerns early on—prior to engaging Mr. Hempling.[296] Staff had communicated its position on capital structure and financial engineering to the Joint Applicants early in the proceeding, both though conversations

[292] Joint Applicants' Initial Post-Hearing Brief, pp. 19-26.
[293] Joint Applicants' Initial Post-Hearing Brief, p. 22.
[294] Tr. Vol. 2, p. 459 (emphasis supplied).
[295] Tr. Vol. 2, p. 475.
[296] Tr. Vol. 2, p. 459.

as well as formal discovery.[297] Further, Staff had frank discussions with the Joint Applicants concerning merger savings estimations early in the process, including during pre-filing meetings.[298] Staff also had conversations with the Joint Applicants regarding credits to ratepayers and rate moratoriums.[299] Finally, in Joint Applicants' examination of Mr. Gatewood, he confirmed that Staff and the Joint Applicants talked numerous times during the pendency of this case and before Staff filed direct testimony on the topic of each party's position on capital structure.[300]

172. Mr. Grady noted in his direct testimony that the rich purchase price did not leave room for the typical regulatory concessions; and as Joint Applicants stated in testimony and at hearing, a rate moratorium, sharing of the control premium, or recognition of the consolidated capital structure would terminate the proposed transaction.[301] These early, frequent, and substantive conversation regarding Staff's concerns about this proposed transaction were not required by the procedural schedule in this docket. Rather, they were pursued in a good-faith and earnest attempt to determine whether the Joint Applicants would be capable of accepting solutions that would address Staff's concerns in this proceeding. Ultimately, it became clear that the Joint Applicants could not afford to address Staff's or other intervenors' concerns in any substantive or meaningful fashion given the exceptionally high purchase price and debt-heavy financing associated with this transaction. And so, rather than renegotiate the purchase price in an effort to save a transaction for which they claim customer savings were the "driving force," they carried on with the high-priced transaction presented here—in in the apparent hope that the Commission would ignore its expert Staff.

[297] McClanahan Corrected Direct, p. 24.
[298] Tr. Vol. 2, p. 446.
[299] Tr. Vol. 5, p. 1183.
[300] Tr. Vol. 5, pp. 1128-29.
[301] Grady Direct, pp. 7, 95-96.

173. The very simple distillation of this particular issue is that Staff did not compromise on its position because Staff did not believe a compromise of its position would promote the public interest. Staff identified serious and fundamental flaws with this transaction which it ultimately concluded could not be fixed with conditions. Staff recognized that very basic, elementary, and necessary aspects of this transaction were so contrary to the public interest that Staff could not recommend approval of the proposed transaction even with conditions.

174. Such a recognition by Staff should not prejudice the Commission against Staff's review, conclusions, and recommendation; nor is it a fair criticism of Staff's position. Simply put, this Transaction had too high a price to be susceptible to a settlement.

2. Nearly Every Intervening Party to this Docket Outright Opposed the Proposed Transaction

175. Joint Applicants' Initial Post-Hearing Brief focuses nearly exclusively on criticisms of Staff's positions in this docket.[302] Staff is criticized for not effecting a settlement in the docket, and Staff is accused of having a "take it or leave it" attitude.[303] As noted above, this is simply untrue. Further, it ignores that nearly every other intervenor to this docket likewise opposes this proposed transaction. Multiple other sophisticated parties independently identified many of Staff's concerns with the transaction as well, and likewise independently recommended denial of the Joint Application.

176. The fact that Joint Applicants did not reach a settlement with any party to this docket indicates that perhaps it is the Joint Applicants who are inflexible and have adopted a "take it or leave it" stance in this matter. That is not to say Joint Applicants are necessarily obstinate or difficult to work with; rather, they simply could not afford to compromise on any point due to the excessive purchase price and financing associated with this proposed transaction.

[302] *See generally*, Joint Applicants' Initial Post-Hearing Brief.
[303] Joint Applicants' Initial Post-Hearing Brief, pp. 56-59.

iv. High Risks Associated with GPE's Resultant Lack of Financial Flexibility and Probably Impact on Ratepayers

177. At the Evidentiary Hearing, GPE CEO Terry Bassham stated he can be expected to "keep his word," and not pass along holding company financing costs to ratepayers.[304] However, past behavior demonstrates that assurances are not always reliable. Despite Commission-ordered protection mechanisms and formal assurances, KCP&L has previously sought for ratepayers to bear the expense of financial risk-taking at the holding company level.[305] Mr. Bassham was examined on a series of issues arising from pervious Commission dockets 09-KCPE-246-RTS and 10-KCPE-415-RTS relative to KCP&L's Contribution in Aid of Construction (CIAC) .[306]

178. While Mr. Bassham was unable to recall many of the specifics of the CIAC issue and resulting request KCP&L made of its ratepayers,[307] Staff recalls the issue with utmost clarity and regards the cautionary tale as an indication of the type of harm that may befall ratepayers following the close of this transaction. Staff emphasizes this real world example because of the numerous parallels to the proposed transaction.

179. CIAC was the name given to the additional non-cash amortization expense included in KCP&L's revenue requirement to enhance KCP&L's cash flows and support its credit metrics during KCP&L's regulatory plan that supported the Iatan I coal plant environmental retrofit and construction of the new Iatan II coal plant.[308] In order to effectively guarantee KCP&L remained investment-grade during the pendency of its five-year regulatory plan, KCP&L focused on the investment grade target ranges for two key credit metrics published

[304] Tr. Vol. 1, p. 146.
[305] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, pp. 39-44.
[306] Tr. Vol. 1, pp. 144-146.
[307] Tr. Vol. 1, pp. 144-146.
[308] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 40, fn. 31.

by Standard & Poor's (S&P); Funds From Operations Interest Coverage (FFO/Interest) and Funds From Operations as a Percentage of Debt (FFO/Debt).[309]

180. In order to meet the key investment grade target ranges, additional revenues necessary to reach the credit metrics, over and above Staff's traditionally calculated revenue requirement a CIAC amount was calculated and included in Staff's revenue requirement analysis in each rate case.[310] The CIAC mechanism provided additional cash flows, if needed, for KCP&L to ensure that the investment grade target range was achieved during the term of the five-year regulatory plan.[311]

181. In Docket 09-KCPE-246-RTS, KCP&L unilaterally chose to reduce its CIAC request.[312] Key details of the specific events giving rise to the CIAC issue are confidential, and in lieu of submitting a confidential brief, Staff has elected to summarize the situation generally, but urges the Commission to review the recitation of events in Mr. Grady's Confidential Direct Testimony in the 10-KCPE-415-RTS docket.[313] In summary, KCP&L was authorized to utilize an accounting mechanism to ensure it maintained key investment-grade credit metrics during the pendency of its Iatan construction program. However, KCP&L failed to meet the intent of the agreed-to methodology by unilaterally choosing to not use the CIAC mechanism's formula to determine the additional cash flows needed. KCP&L requested $11.2 million in additional cash flows, but the agreed-to CIAC credit metric calculation demonstrated a need for $115.4 million.[314] In response to Staff's concerns, KCP&L witness Michael Cline testified, "[b]ecause the metrics that result from this case and requested level of CIAC, as shown in Schedule MWC-4

[309] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, pp. 39-41; *See generally*, Dockets 09-KCPE-246-RTS and 10-KCPE-415-RTS.
[310] *See generally*, Dockets 09-KCPE-246-RTS and 10-KCPE-415-RTS.
[311] *Id.*
[312] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 40.
[313] *Id*. at pp. 39-45.
[314] *Id*. at pp. 41-42.

are broadly consistent with the May metrics, we would anticipate no change to the agencies' views of KCP&L's credit profile".[315] Mr. Cline also stated, "If the Company chooses not to seek the entire CIAC amount, it is because it has weighed its options, the potential effects on its customers and its impact on the financial community and determined to forego requesting the full CIAC amount."[316]

182. On February 26, 2009—shortly after Mr. Cline filed the testimony quoted above—GPE met with S&P and Moody's to review KCP&L's updated financial projections.[317] During this meeting, KCP&L was informed that a credit downgrade was imminent absent corrective action on its part.[318] The actions KCP&L took to avoid the credit rating downgrade were to reduce operating and maintenance expense, reduce capital expenditures, and issue $287.5 million of mandatory convertible debt at a cost of 13.6%.[319] In the 10-415 Docket, KCP&L sought to include the high cost mandatory convertible debt in its cost of capital, and Staff's opposition is the crux of Mr. Grady's testimony in that docket.[320]

183. This CIAC issue is a real-world example of how GPE regards financial risk and how that risk impacts ratepayers, despite regulatory protections and formal assurances. As noted previously, the CIAC issue includes many parallels to the current proposed transaction. Specifically, KCP&L asserted that its financial projections based on a much reduced CIAC amount would meet the credit rating agencys' investment grade target range for the agreed-upon credit metrics.[321] KCP&L's financial projections were wrong. As a result, KCP&L faced a credit downgrade. This parallels the credit rating circumstances of the proposed transaction;

[315] *Id*. at p. 41.
[316] *Id*. at p. 42.
[317] Tr. Vol. 1, p. 144.
[318] Tr. Vol. 1, p. 145; Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 43.
[319] *Id*.
[320] *See generally,* Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady.
[321] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 41.

specifically, Mr. Bryant's speculation that neither GPE's post-Transaction degree of leverage nor its one-notch credit rating downgrade is permanent.[322] Mr. Bryant testified:

> …it absolutely is our intended plan to delever. Obviously, we're going through our planning process now as we go through these hearings and our annual five-year planning. So we will be more precise. But certainly my intention is to pay down debt within three years. The numbers Ms. Smith just went through just show the dividends from Westar. The Commission should note that dividends are available from GMO and KCP&L which not only services the debt but creates about at least 300 million of available cash flow by 2020, which is in our pro forma model. *So my intention would be to pay off 3 to 500 million of debt within 3 to 5 years, have, have pretty good view that if we paid off that level of debt, that one notch we've talked about throughout these proceedings of losing, the credit rating falling from Baa2 to Baa3, I think we would get that notch back and be at the same place we were when we started to go through the transaction.*[323]

184. While Staff has no reason to doubt the sincerity of Mr. Bryant's testimony, the CIAC example proves that financial forecasts are not always accurate and that GPE can and has made errors in judgement when relying on financial forecasts. Therefore, Joint Applicants are in error when they aggressively asserts that:

> Credit rating agencies knowledgeable about the Transaction have stated that the credit ratings of the utilities (Westar and KCP&L) will maintain their current strong investment grade ratings, and the credit ratings of GPE as a holding company will remain investment grade, although GPE's credit rating is expected to be maintained at current levels by one agency, and likely reduced one notch by the other credit rating agency.[324]

185. Joint Applicants are in error because they ignore the plain and unambiguous warnings the credit ratings also provided in reference to the quote above, which were discussed in more detail above.[325]

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[322] Joint Applicants' Initial Post-Hearing Brief, p. 12; Joint Applicants' Initial Post-Hearing Brief specifically refers to a "potential credit rating downgrade," however as noted in Staff's Response to Joint Applicants' Motion to Reopen the Record, Moody's Press Release confirms GPE's downgrade from Baa2 to Baa3.
[323] Tr. Vol. 3, p. 746-747 (emphasis supplied).
[324] Joint Applicants' Initial Post-Hearing Brief, p. 32.
[325] *See* subsection c.v., *supra*.

186. GPE also asserts that the CIAC example noted above demonstrates that it can work through negative credit ratings issues and that it knows how to manage credit risk.[326] GPE fails to acknowledge that its reliance on a financial forecast that was significantly wrong, instead of simply utilizing the agreed-upon cash flow support mechanism approved by the Commission, led it to make an expensive error in judgement.[327]

187. This parallels the proposed transaction in that GPE relies on a short-term financial forecast via its model extending through 2020, without acknowledging a need to extend financial models out farther.[328] GPE also states that it has "…a long history of managing its financing needs efficiently and effectively in light of conditions prevailing when decisions need to be made…"[329] GPE's statement is hubris given that the financial forecast relied on in the CIAC example was significantly wrong and required an expensive remedy—a remedy that the company attempted to recover from ratepayers. Moreover, GPE asserted in the 09-246 case that it did not anticipate a change to the credit rating agencies views of KCP&L's credit profile based on its financial forecast.[330] GPE was willing to make a high risk decision then and is clearly willing to make a high risk decision in this case.

188. Additionally, KCP&L failed to follow the intent of the 04-1025 Docket Stipulation and Agreement by unilaterally deciding the amount of CIAC it would request.[331] When the financial forecast KCP&L relied on turned out to be significantly wrong, GPE implemented remedies to avoid a credit rating downgrade.[332] Two of these remedies, reduced O&M spending and capital investment, were potentially harmful to customers and were direct

[326] Tr. Vol. 1, p. 145.
[327] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 43.
[328] Rebuttal Testimony of Kevin E. Bryant, p. 22-24.
[329] Joint Applicants' Initial Post-Hearing Brief, p. 36.
[330] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, pp. 41-42.
[331] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 41.
[332] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 43.

results of financial pressure at the holding company level.[333] The third remedy involved issuing high cost mandatory convertible debt at a cost of 13.6%, which would only be harmful to ratepayers if KCP&L sought to recover the high cost debt in rates.[334] And, KCP&L did seek to recover the high cost debt despite the fact that it failed to utilize the CIAC mechanism agreed to in the 04-1025 Docket.[335]

189. On this topic, the parallel to the proposed transaction is highlighted in the Joint Applicants' assertion:

> Staff's concerns in this regard assume that the Commission is not and cannot be an effective regulator. However, as noted by Joint Applicant witness Ruelle, the Commission has demonstrated its ability to protect customers from parent actions in the past, such as when Western Resources became financially unstable in the early 2000's due to a series of poor decisions.[336]

190. It is not Staff's position that the Commission "is not and cannot be an effective regulator" post-transaction. Rather, Staff's has testified that, "[g]iven the fact that the post-transaction entity will have little financing cushion, a future Commission will be *under pressure* to adopt practices that it might not otherwise adopt in order to provide the regulatory support that Moody's is concerned might wane."[337]

191. Further, the Joint Applicants' statement is misleading as they assert they recognize Commission's authority to "protect customers" in the current case, yet they fail to commit that without question, they will not petition the Commission for rate relief for any financial issue that might impact shareholders. The CIAC issue in the 04-1025 case clearly demonstrates that GPE sought rate relief from its customers for an error in judgement based on

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[333] *Id.*
[334] *Id.*
[335] Docket No. 10-KCPE-415-RTS, Direct Testimony of Justin T. Grady, p. 45.
[336] Joint Applicants' Initial Post-Hearing Brief, p. 28.
[337] McClanahan Corrected Direct, p. 44 (emphasis supplied).

its reliance of a significantly wrong financial forecast, instead of a Commission-approved CIAC mechanism. Therefore, Staff's stated position remains correct; the Commission will be under pressure to adopt positions or practices it might not otherwise adopt because GPE will be the entity putting the pressure on the Commission to resolve financial issues. While Staff has confidence that this Commission and future Commissions will act to protect ratepayers, this action will not come without great time, expense, and effort by Staff and others in litigating a sure-to-be-contentious issue, as was GPE's request to recovery the 13.6% convertible debt from ratepayers in the 10-415 docket.

v. Sufficient, Effective Ring-Fencing Protections Cannot be Applied to GPE and Its Subsidiaries

192. Due to the inextricably intertwined structure between GPE and its subsidiaries, in which GPE exercises control, the proposed transaction cannot survive the application of true ring-fencing provisions. Numerous Directors and employees overlap, serving in dual roles. GPE has no other income-producing assets to service holding company debt, as may be the case with larger, more diverse holding companies.

193. In rebuttal testimony and at the evidentiary hearing, Joint Applicants cited the effectiveness of ring-fencing protections employed by entities such as Enron and Oncor, noting in certain situations, ring-fencing completely insulated utility customers from bankruptcy at the holding company level.[338] These provisions referenced as able to insulate utility customers from a holding company bankruptcy include:

- The utility subsidiary must maintain a board of directors that (1) does not include any members from the boards of directors of the parent company; and (2) consists of a majority of directors that qualify as independent directors under the standards of the New York Stock Exchange.

[338] Tr. Vol. 1, pp. 265-266; Tr. Vol. 3, p. 556, 559-563.

- The utility subsidiary's board of directors shall have the sole right to determine dividends and cannot be overruled by the board of the parent company on dividend policy, debt issuance, capital expenditures, management and service fees and appointment/removal of board members.

- The utility subsidiary will not enter into any inter-company debt transactions with the parent company.

- The utility subsidiary will not share any credit facilities with an unregulated affiliate, parent company, or parent company affiliate.

- The utility subsidiary will not seek to recover from its customers any costs incurred as a result of a bankruptcy of parent company or parent company's affiliates.

- The utility subsidiary, the parent company, and parent company affiliates will provide notice of their corporate separateness to all lenders.[339]

194. Joint Applicants tout these provisions, implying that similar protections exits relative to GPE/Westar or GPE/KCP&L; however Mr. Reed testified that the commitments in Schedule DRI-3 are not as extensive as the elements of Oncor's Ring-Fence—generally noted above.[340]

195. In fact, conditions sufficient to fully and completely insulate utility ratepayers from a holding company bankruptcy cannot be implemented for GPE. The corporate family utilizes the same Board of Directors for each entity.[341] Further, such measures are not possible when the utility subsidiary has only one shareholder, has no true financial autonomy from that shareholder, and is therefore exposed to the financial risk of that one controlling shareholder.[342] Ring-fencing measures sufficient to truly protect ratepayers (i.e., a non-consolidated or de-linked credit profile for Westar and GPE) would require significant corporate restructuring of GPE and its subsidiaries. The true separation offered by these comprehensive ring-fencing measures – though necessary when dealing with billions of holding company debt –likely wouldn't be

339 "What are the Terms of Oncor's Ring-Fence?", Staff Exhibit 1, p. 3.
340 Tr. Vol. 3, p. 561.
341 Ruelle Direct, p. 18, 39; Ives Rebuttal, Schedule DRI-3, No. 2; Tr. Vol. 1, p. 259-260.
342 See comprehensive discussion of "source of funds" and investor control at Tr. Vol. 5, pp. 1139-1149.

accepted by GPE due to its status as a holding company with no other income producing assets than its regulated utility operations.

196. As noted in the Washington Utility and Transportation Commission case considering the MidAmerican Energy Holding Company acquisition of PacifiCorp cited by both Mr. Hevert and Mr. Reed, ratepayers should not receive the benefits of holding company financing when they are insulated from holding company financial risks.[343] It is logical to imply the converse—instances where no adequate ring-fencing protections exist to insulate ratepayers from the burden of risks and costs borne at the parent level do not justify withholding the benefits of those same parent-level activities from ratepayers. Said another way, if Westar and KCP&L ratepayers are not protected from the risks and costs caused by the leverage at GPE, then Westar and KCP&L ratepayers should not be denied the benefits of the holding company financing cost savings.

197. Here, Westar and KCP&L *cannot* be protected from GPE's financial risk due to GPE's corporate structure, degree of operational integration with the utilities, and Westar and KCP&L's financial dependency on GPE as its sole source of equity capital. It logically follows, then, that the only suitable substitute to adequate ring-fencing is—as more fully laid out above—a least-cost capital structure which appropriately recognizes the risks borne by ratepayers by affording ratepayers the benefits of the holding company financing.

d. When the Only True Source of Recovery of the Acquisition Premium is Through Ratepayers, Merger Savings Matter

198. As was more fully developed above, KCP&L and GPE are inextricably intertwined, and Westar, as a subsidiary of GPE, would likewise be similarly intertwined with GPE. Further, GPE's only substantial income producing assets are fully regulated electric

[343] Washington Utilities Transportation Commission, Docket No. UE 050684, Order No. 4, at 103-104; Rebuttal Testimony of Robert Hevert, p. 8; Rebuttal Testimony of John Reed, p. 92.

utilities.[344] Necessarily, GPE will be dependent upon Westar, KCP&L and its non-Kansas jurisdictional operating utilities for income to meet its acquisition-related debt obligations.

199. The Joint Applicants assert that the amount of the acquisition premium should not factor into the Commission's decision because the Joint Applicants are not requesting recovery of the premium.[345] The Joint Applicants further insinuate that the amount of merger savings is likewise not relevant to the Commission's decision in this transaction.[346] But the price being paid, and the savings being produced, are the essence of economic value. The Joint Applicants are saying, necessarily, that in determining whether a $12.2 billion transaction is in the public interest, economic value is irrelevant. Staff can only wonder: What then, is the public interest for?

200. With such a level of inextricable connection and financial reliance, utility customers are necessarily exposed to the financial risks at the holding company level. As such, the amount of the acquisition premium and credibility of merger savings are relevant to the Commission's decision in this matter.

201. Furthermore, the fact that the Joint Applicants want to reserve the ability to recover the acquisition premium in a future proceedings illustrates the importance of a traditional acquisition premium analysis that involves the net present value of savings compared to the size of the acquisition premium—an analysis that is contemplated in Merger Standard (a)(ii) and (a)(iv), and methodology used by the Commission in Docket 97-WSRE-676-MER and Consolidated Dockets 172,745-U and 174,155-U. Of course, the fact that the Joint Applicants intend to indirectly recover the acquisition premium from customers (by withholding operational

[344] Tr. Vol. 1, p. 252.
[345] Rebuttal Testimony of Kevin E. Bryant, pp. 8, 33, Ives Rebuttal , pp. 7, 20, 23; Rebuttal Testimony of James M. Proctor, pp. 17-18, 26-27, 39.
[346] Joint Applicants' Initial Post-Hearing Brief, p. 96.

savings and by charging customers for capital costs that are not actually incurred), as discussed above, is yet another reason why savings must justify the total purchase price.

202. Therefore, Staff urges the Commission to give no weight to the Joint Applicants' claims that certain Merger Standards—specifically Merger Standard (a)(ii) and (a)(iv)—do not apply, and to adopt Staff's recommendations and conclusions concerning these standards. Particularly, that the purchase price is relevant to the Commission's decision in this matter; that the amount of the acquisition premium is relevant to the Commission's decision in this matter; that the amount of savings/operational synergies are relevant to the Commission's decision in this matter; that a determination of whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger is relevant to the Commission's decision in this matter; and that a determination of whether operational synergies justify the payment of a premium in excess of book value is relevant to the Commission's decision in this matter.

e. Merger Savings Lack Credibility

203. The merger savings presented by the Joint Applicants in this case should be rejected.[347] The Joint Applicants have engaged in procedural tactics that cast doubt on the credibility of the presented merger savings, Mr. Kemp lacks independence in this proceeding, and the presented merger savings are so lacking in substance and reliability that they should be given no weight.

i. The Joint Applicants' Procedural Tactics Call Into Question the Credibility of Savings Estimates

204. The first procedural tactic employed by the Joint Applicants which calls into question the credibility of calculated savings is the fact that the Joint Applicants amended the

[347] Staff Direct Testimony of Ann Diggs, p. 68-69 (Jan. 27, 2017) (Diggs Direct).

Commission's Merger Standards in their Joint Application.[348] Specifically, the Joint Applicants removed key phrases from the Merger Standards that pertain to savings in an apparent attempt to ease their burden of proof.

205. Merger Standard (a)(ii) required an analysis of whether the purchase price was reasonable in light of the savings that could be "demonstrated" from the merger.[349] The Joint Applicants removed the word "demonstrated" and replaced it with "potential savings caused" by the merger.[350]

206. Merger Standard (a)(iii) required an analysis of whether ratepayer benefits "resulting from the transaction" could be quantified.[351] Joint Applicants removed "resulting from the transaction" from the standard and rephrased (a)(iii) as "whether ratepayers' benefits can be quantified."[352]

207. The Joint Applicants have been adamant that the "paraphrasing" of the 1991 Merger Standards does not change the meaning of the Merger Standards.[353] This is simply false. The words "demonstrated" and "potential" have markedly different meanings. Further, the complete removal of "resulting from the transaction" from (a)(iii) would mean that savings do not have to be transaction-related.

208. It is not Staff's desire to ascribe ill-intent to this modification of the Merger Standards, but it is clear that the changes to the Merger Standards would have eased the burden

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[348] *See* Joint Application, pp. 8-9 (June 28, 2016).
[349] *See* Order on Merger Standards, p. 3 (Aug. 9, 2016). The full text of (a)(2) reads: (a) The effect of the transaction on consumers, including: (ii) reasonableness of the purchase price, including whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger and whether the purchase price is within a reasonable range.
[350] *See* Joint Application, p. 8 (June 28, 2016).
[351] *See* Order on Merger Standards, p. 3 (Aug. 9, 2016).
[352] *See* Joint Application, p. 8 (June 28, 2016).
[353] *See* Joint Applicants' Verified Response to Commission's Order on Merger Standards, pp. 3-4 (Aug. 30, 2016).

on the Joint Applicants specific to proving the merger savings were demonstrable and transaction related.[354]

209. The second procedural tactic employed by the Joint Applicants was an to attempt to bolster their savings estimates by reference to information not in the record and utilize a witness that Staff was unable to rebut on the record, namely Thomas Flaherty.

210. Mr. Steven Busser filed rebuttal testimony indicating that the efficiencies that were developed in the pre-announcement period had been "further refined and affirmed through the Integration project over the last six plus months…"[355] It was elicited during cross examination that Mr. Busser prepared a December 20, 2016, Steering Committee report which contained the most succinct level of detail on efficiencies.[356] The referenced document is not in the record, so any references to updated efficiencies should be rejected as procedurally improper.

211. Mr. Thomas Flaherty did not file direct testimony, but made various assertions regarding the feasibility of the savings projections in his rebuttal testimony filed January 9, 2017.[357] This testimony should be given no weight as it contained information the parties' expert witnesses had no ability to analyze or rebut on the record. There is no reason why Mr. Flaherty's testimony could not have been offered with the Joint Application. The Joint Applicants' Closing Brief is replete with citations to Mr. Flaherty. Any references to Mr. Flaherty or his testimony should be given no weight.

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[354] *See* Staff's Reply to Joint Applicants' Verified Response to Commission's Order on Merger Standards, p. 2 (Sept. 9, 2016).
[355] Great Plains Energy Inc., Rebuttal Testimony of Steven P. Busser, p. 6 (Jan. 9, 2017) (Busser Rebuttal).
[356] Tr. Vol. 5, p. 1222 (Busser).
[357] *See generally* Great Plains Energy Inc. Rebuttal Testimony of Thomas J. Flaherty (Jan. 9, 2017) (Flaherty Rebuttal).

ii. Mr. Kemp Lacks Independence and the Presented Merger Savings Lack Credibility

212. Mr. Kemp lacks independence in this matter and the presented merger savings are not credible. As such, Mr. Kemp's testimony should be given no weight.

213. First, Mr. Kemp and his savings estimation team were provided "minimum annual targets" of $50 million, $100 million, and $150 million in savings for 2018, 2019, and 2020, respectively, before their analysis even began.[358] It is unknown who provided these targets to Mr. Kemp. However, the fact that Mr. Kemp was provided annual savings targets up front seriously calls into question his independence and the credibility of his analysis.[359]

214. The Joint Applicants challenge this argument in their Initial Post-Hearing Brief by arguing that Staff presented no evidence or logical explanation as to how such targets, in fact, biased the results.[360] Joint Applicants have the burden backwards. The fact that Mr. Kemp was provided any "targets" at all is enough to cast doubt on the credibility of his analysis. It is the Joint Applicants' burden to explain how the targets did not bias the results. They did nothing to carry this burden. Why was Mr. Kemp not simply asked to calculate savings? It is because, as explained by Ann Diggs, GPE was trying to develop a number high enough to get investors to support the transaction, but low enough to keep the Commission from requiring regulatory gain-sharing with ratepayers.[361] This is supported by the fact that GPE plans to retain $324 million of the savings through 2020 rather than share the same with customers.[362]

215. Second, Mr. Kemp did not even lay a foundation for or support his own savings model in his direct testimony. This calls into question the credibility of his work product. On

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[358]Diggs Direct, p. 14.
[359]Diggs Direct at 16-17.
[360]*See* Joint Applicants' Initial Post-Hearing Brief, p. 86.
[361]Diggs Direct at 14-17.
[362]Diggs Direct at 16.

June 28, 2016, when the Joint Applicants filed their Joint Application, Mr. Kemp filed direct testimony with respect to merger savings.[363] Mr. Kemp attached Exhibit WJK-3 which contained a summary of estimated transaction savings, totaling $63 million, $149 million, and $199 million for 2018-2020, respectively.[364] Although Mr. Kemp utilized a "merger savings model" to develop his estimates, such model was not attached to his testimony.[365] It is only in the record due to the discovery process and counter-party witnesses' decisions to include it with their own testimony.

216. Third, Mr. Kemp likened his "analytical approach" to evaluating the savings in this case to the 2008 Aquila acquisition.[366] The facts do not support this claim. The savings in this case were developed over a three week period with limited involvement and data from Westar.[367] The savings in the Aquila acquisition were developed over a six month period with extensive involvement from both companies and greater access to data.[368] Mr. Kemp's analysis in this case is essentially a preliminary analysis rather than a thorough and reliable savings estimation analysis, and should therefore be given little to no weight.[369] Moreover, its purpose was to help GPE justify its purchase price, not to support any guarantee of benefits to the customers.

217. Fourth, the Joint Applicants argue in their brief, and Mr. Kemp argued in his testimony, that GPE achieved savings greater than initially estimated from the Aquila transaction, and his estimates in this transaction are consistent with the range of industry

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[363]Great Plains Energy Inc., Direct Testimony of William J. Kemp (Kemp Direct), p. 2 (June 28, 2016).
[364]Kemp Direct, Exhibit WJK-3.
[365]Staff Exhibit No. 20 contains the "T&D CAPEX" worksheet from the full savings model. Dr. Jonathan A. Lesser attached the entire savings model to his testimony filed Dec. 16, 2016, as Exhibit JAL-25.
[366]Kemp Direct at 19.
[367]Diggs Direct at 23.
[368]Diggs Direct at 23-24.
[369]*See* Diggs Direct at 25.

experience in similar transactions.[370] These statements are misleading as Mr. Kemp's own data from 36 mergers going back to 1997 ultimately shows that mergers achieve a mere 0.1% non-fuel operations and maintenance savings.[371] Additionally, the final realized savings three years after the Aquila acquisition were lower than estimated, and in fact, the only area where GPE exceeded estimates was in the transmission category, which is non-jurisdictional to the Commission.[372]

218. Finally, GPE witness Mr. Noblet contradicts a portion of Mr. Kemp's testimony regarding capital expenditure (capex) reductions used to support savings estimates. With respect to the "T&D CAPEX" tab of Mr. Kemp's savings model, Mr. Kemp stated in his rebuttal testimony that it was an assumed level of distribution capex reductions.[373] Staff had been critical of this adjustment in its direct testimony given the introduction by Westar of the Electric Distribution Grid Resiliency (EDGR) program in its last rate case.[374] The total amount Mr. Kemp projected in savings was $214 million in distribution capital expenditures.[375] However, in Mr. Noblet's rebuttal, he said that the $214 million in savings comes predominately from re-prioritization and project realignment on the transmission side of the budget, not the distribution area.[376] These statements are in direct contradiction to each other and cast doubt on the credibility of Mr. Kemp's projections, or Mr. Noblet's revision of the savings estimates.

iii. Savings Estimates Lack Substance and Reliability

219. Aside from the aforementioned issues, the lack of substance and reliability of the projected merger savings indicate they do not amount to substantial competent evidence.

[370] *See* Joint Applicants' Initial Post-Hearing Brief, pp. 86, 88.
[371] Diggs Direct at 19-21.
[372] *See* Diggs Direct at 22.
[373] Great Plains Energy, Inc. Rebuttal Testimony of William J. Kemp, p. 48 (Jan. 9, 2017).
[374] Direct Testimony of Walter P. Drabinski (Drabinski Direct) at 60-66 (Jan. 27, 2017).
[375] *See* Staff Ex. 20, p. 4. The $214 million figure is a summation of the "Distribution Capital Savings" line in the table. Tr. Vol. 6, p. 1456-57 (Noblet).
[376] Great Plains Energy, Inc. Rebuttal Testimony of Kevin T. Noblet, p. 33 (Jan. 9, 2017).

220. With respect to generation savings, the units scheduled for closure to create savings were picked without any analysis of how those closures would affect system stability or reliability.[377] Many of the units were previously scheduled for retirement before the acquisition was announced.[378] The Joint Applicants did not perform an analysis of the potential for sales of energy or capacity without the existing generating assets.[379] The Joint Applicants did not offset plant closure savings with increased costs to fuel consumption or purchased power, even though such increases were projected to be $25 million per year within 10 years.[380] The Joint Applicants did not provide any plan to address stranded costs that would be caused by retirement of the proposed generating units, and actual costs to achieve plant retirements are nearly 10 times that of Mr. Kemp's estimates.[381] Overall, the generation plant retirement and related cost savings projections provided by Mr. Kemp have no real basis in fact and are not supported by the level of analysis one would expect for a merger of this size.[382]

221. With respect to transmission and distribution savings, the most obvious error is a planned reduction to Westar's distribution capital expenditures by $70 million per year—when in 2015, Westar indicated in Docket No. 15-WSEE-115-RTS that its distribution system was in need of repair.[383] The EDGR program proposed by Westar was projected at $886.8 million over 15 years.[384] Given this identified need, this adjustment to reduce Westar's distribution capital expenditures defies logic. Furthermore, Mr. Kemp's adjustment was based on distribution spend

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[377]Drabinski Direct at 23-24.
[378]Drabinski Direct at pp. 24-25.
[379]Drabinski Direct at p. 33.
[380] Drabinski Direct at p. 40.
[381]Drabinski Direct at pp. 36, 44.
[382]Drabinski Direct at p. 46.
[383]Drabinski Direct at pp. 60-63;Docket No. 15-WSEE-115-RTS, Direct Testimony of Jeffrey W. Cummings, Exh. JC-1 (Mar. 2, 2015).
[384]Drabinski Direct at p. 60.

per customer, which is illogical given that there is very little correlation between the number of customers and the amount of capital needed to maintain reliable and safe service.[385]

222. With respect to supply chain savings, most of the proposed savings could be achieved without the merger.[386] Given that Westar and GPE are sophisticated utilities, savings that could be achieved by having larger economies of scale could be achieved through the use of procurement groups.[387]

223. With respect to the shared services transactions savings, after being informed through discovery that the headcount reductions in those departments were "hard inputs," Staff found that to the contrary, headcount reductions were based simply off a percentage (%) reduction, which was usually 40%.[388] The interview notes that supported these "hard inputs" were severely lacking in any detail which would support the proposed headcount reductions.[389] Additionally, the benefit loading rates and severance costs were incorrectly calculated, and no adjustments were made to reflect that remaining executives would see increased workloads and responsibilities, and would be employees of a larger organization, all of which would likely result in salary increases.[390]

224. Finally, the actual quantification of customer benefits provided by the Joint Applicants is not credible.[391] This is because the ratepayer benefits were allocated to subsidiaries based upon customer count rather than detailed and comprehensive cost allocation methodologies, and the benefits themselves were actually "gross efficiencies" without cost-to-

[385]Drabinski Direct at pp. 64-65.
[386]Drabinski Direct at p. 86.
[387]*Id*.
[388]Diggs Direct at pp. 37-38.
[389]*Id*.
[390]Diggs Direct at pp. 40-48.
[391]Diggs Direct at pp. 51-52.

achieve (CTA) factored in.[392] Factoring in such CTA results in the Joint Applicants retaining 84.4% of savings achieved from 2017-2020, rather than the 74.2% presented.[393]

225. For these foregoing reasons, the Commission should reject the Joint Applicant's presentation of merger savings.

f. Even Assuming Merger Savings Estimates are Fully Realized, Target Amounts are Insufficient to Justify the Acquisition Premium

226. Notwithstanding paragraphs 203-225 above, even if the Commission were to accept Joint Applicants' savings estimates, the transaction as proposed by Joint Applicants does not promote the public interest in light of Merger Standard (a)(ii).[394] The purchase price, inclusive of the acquisition premium, is not reasonable in light of the Joint Applicants' savings estimates.[395]

227. In the 97-676 Merger Docket, the Commission allowed the Joint Applicants in that docket to amortize half of the expected net present value of after-tax savings expected to result from the merger over 35 years.[396] Using this methodology from the 97-676 Merger Docket, Mr. Grady testified that the upper limit of acquisition premium appropriately recoverable directly from ratepayers in this proposed transaction is $342.57 million total for GPE.[397] This figure is less than seven percent of the acquisition premium contemplated by this transaction.[398]

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392 *Id.*
393 Diggs Direct at p. 52.
394 *See generally,* Hempling Direct, pp. 87-103; Grady Direct, pp. 8-41.
395 *Id.*
396 Docket No. 96-WSRE-676-MER, Order on Merger Application, ¶34 (Sept. 28, 1999).
397 Grady Direct, pp. 44-45; Staff Exhibit JTG-4.
398 $342.57 million divided by $4.9 billion equals 6.99%, rounded.

228. Said another way, roughly fourteen percent[399] of the acquisition premium in this transaction could arguably be justified by savings, and therefore potentially be considered reasonable.

229. Joint Applicants argue that Staff has “suggested” merger savings must equal or exceed the acquisition premium.[400] Interestingly, this assertion does not cite to the record, and is not an accurate reflection of Staff’s position on the issue. Staff does not assert that the acquisition premium must be limited at $685.15 million, or the savings must reach seven times the level projected by the Joint Applicants for the operational synergies to justify payment of a premium $4.9 billion in excess of book value. Rather, in concluding that the public interest is not promoted in light of Merger Standards (a)(ii) and (a)(iv), Staff is asserting that merger savings, which—using the Commission’s methodology from the 96-676 Merger Docket—support less than fifteen percent of the acquisition premium, clearly do not justify the payment of the acquisition premium in this proposed transaction and the acquisition premium is therefore not reasonable in light of demonstrated savings.

g. The Commission Should Adopt Quality of Service Requirements in Merger and Acquisition Transactions to Ensure Promotion of the Public Interest

230. The Commission should not approve the acquisition, but if it does, it should adopt quality of service requirements going forward.[401] The adopted requirements should involve improvement over current service levels because K.S.A. 66-131 requires that an acquisition

[399] $685 million divided by $4.9 billion equals 14%, rounded.
[400] Joint Applicants’ Initial Post-Hearing Brief, p. 96.
[401] Gile Direct, p. 2, 4.

"promote" the public convenience and necessity, and the Joint Applicants have made the claim that service quality will "improve" throughout their testimony, or at least not degrade.[402]

231. Quality of service is important in this case because the Joint Applicants state they plan to reduce operating and capital expenditures by $200 million in 2020 and beyond.[403] The Commission should ensure that these reductions do not come at the cost of reliability and customer service.

232. There are several key concerns with the planned reductions put forth by the Joint Applicants.

233. First, the Joint Applicants plan to close generating units, but they have not conducted any comprehensive studies that evaluate the impact of the potential generating unit retirements on system stability or reliability.[404]

234. The Joint Applicants also plan to cut distribution capital expenditures for Westar at a time when Westar has an "aging electric distribution infrastructure and legacy assets that need refurbishment or replacement, heavily loaded substation transformers… [and] lack of remote monitoring and operation equipment [which] results in limited visibility into asset/system operating parameters and, in the event of an unplanned outage, lengthens service restoration."[405] Cuts are expected to be approximately ($70) million per year rather than a $59 million increase as proposed by Westar in 2015 under its EDGR program.[406]

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[402]Gile Direct at 3, 5; *See* Great Plains Energy Inc., Direct Testimony of Charles Caisley, p. 5 (June 28, 2016); Great Plains Energy Inc., Direct Testimony of Scott H. Heidtbrink, p. 6 (June 28, 2016); Great Plains Energy Inc., Direct Testimony of Steven P. Busser, p. 10 (June 28, 2016).
[403]Kemp Direct, p. 6.
[404]Drabinski Direct, pp 31-32.
[405]Docket No. 15-WSEE-115-RTS, Direct Testimony of Jeffrey W. Cummings, Exhibit JC-1, (March 2, 2015).
[406]Drabinski Direct, pp. 62-63.

235. The Joint Applicants propose to cut ($3.4) million annually from Westar's Vegetation Management program even though there is significant exposure to distribution line storm damage if vegetation management is inadequate.[407]

236. The Joint Applicants propose to cut twenty-four (24) full time employees (FTEs) from the transmission and distribution engineering, planning, asset management, vegetation management, and operations planning departments.[408] Notably, the reduction in (6) FTEs from KCP&L's transmission and distribution engineering department will have a negative impact on the companies' ability to continue to support a comprehensive Engineering Standards Program.[409]

237. Finally, because of the financial risk that GPE is taking with this acquisition, GPE may be pressured or forced into deferring maintenance and system improvements in order to pay debt and/or reserve cash for shareholders.[410]

238. The Commission should adopt the position put forth by Staff witness Casey Gile. That is, if the Commission approves the acquisition, it should require all interested parties to develop a plan using Staff's conceptual outline.[411] Such plan should adopt requirements and penalties for failure of operating utilities to meet reasonable performance thresholds for both reliability and customer service.[412] While these requirements will not guarantee that quality of service will stay the same or improve, they will incentivize the company to carefully select where to cut costs. Detrimental impacts on customer service do not promote the public interest.[413]

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[407]Drabinski Direct, pp. 56, 67.
[408]Drabinski Direct, pp. 57-58.
[409]*Id*. at 58.
[410]Gile Direct, pp. 8-10.
[411]Gile Direct at 17-18.
[412]Gile Direct at 10, 15.
[413]Gile Direct at 18.

h. Economic Issues

i. The Proposed Transaction will Negatively Affect the Kansas Economy

239. Beyond 2020, the Joint Applicants have indicated that they will achieve annual operations and capital expense savings of roughly $200 million.[414] Of that, $55.4 million of savings comes from labor reductions in Kansas.[415] Thus, the $55.4 million reflects a reduction in Kansas demand.[416]

240. By 2020, the Joint Applicants estimate sharing $27.79 million with Kansas ratepayers via lower rates.[417] Out of the aforementioned $55.4 million in labor savings, this leaves $27.61 million in savings that will go to shareholders.[418] Assuming that 2% of GPE shareholders are Kansans, then Kansas shareholders will receive approximately $0.55 million.[419] Thus, the total savings returned to Kansans is $28.34 million, an increase in direct demand.[420]

241. Dr. Glass identifies the economic channels through which the reductions in wages, salaries, and benefits resulting from eliminating jobs (the primary savings generator) will flow through the Kansas economy.[421] To estimate the effect this will have, Dr. Glass, for illustrative purposes, uses GPE's 2020 savings estimates and maps the estimated savings as they flow through the different channels in the Kansas economy.[422]

242. Subtracting the savings to Kansans from the reduction in demand indicates this Transaction will result in an estimated ***net loss*** to the Kansas economy of $27.06 million in

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[414]Kemp Direct, p. 6 (June 28, 2016). *See* Staff Exh. 19, p. 2 (indicating $198.6 million in savings in 2020).
[415] Glass Direct, p. 9.
[416] *Id*. Note that Staff only examined the economic impacts through 2020, because the financial forecasts and savings estimates provided by the Joint Applicants before Staff filed its Direct Testimony only extended through 2020. To Staff's knowledge, there are no specific plans regarding the sharing of savings beyond 2020.
[417] *Id*.
[418] *Id*.
[419] *Id*.
[420] *Id*.
[421] *Id*. at 8-9.
[422] *Id*.

2020.[423] Any savings achieved by the Joint Applicants reflects dollars that will no longer be used to purchase goods and services in Kansas. Therefore, if the Joint Applicants no longer pay $55.4 million to Kansas laborers, those dollars are lost to Kansas unless they are provided to Kansas shareholders or shared with Kansans via lower rates. Because the Joint Applicants propose to only share $27.61 million of the savings with Kansas ratepayers, and approximately 2% of GPE shareholders are Kansans, there is a net loss to the Kansas economy of $27.06 million in 2020.

243. The Joint Applicants do not agree that there is a net loss to the Kansas economy, and instead assume that the utility employees that lose their jobs will find replacement work of equal pay in Kansas.[424] This is a faulty assumption.

244. As explained by Dr. Glass, because of the weakness of the Kansas economy, the Kansas labor market, and local labor markets, jobs eliminated to create savings for the acquisition will likely result in permanent job losses to the Kansas economy.[425]

245. This is because the Kansas economy lacks an internal mechanism to sustain economic growth above the level of the broader United States economy, and in fact the Kansas Economy tends to decline relative to the United States economy absent a positive economic shock.[426] From 2000 to 2015, the employment growth rate for the United States was 7.4%, while the employment growth rate for Kansas was 4.1%.[427]

246. Further, the decline in Kansas per capita personal income statistics from 1980 to 2006 and the sustaining of the ratio of non-farm employment during that period also suggests

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[423] *Id*. at 10.
[424] Great Plains Energy Inc. Rebuttal Testimony of Arthur P. Hall, Ph. D (Hall Rebuttal), pp. 4-5, 9 (Jan. 9, 2017).
[425] Glass Direct at 11-12.
[426] Glass Direct at 14-15.
[427] Glass Direct at 18, Table 1.

that Kansas has increasingly become an economy comprised of lower wage jobs relative to the United States.[428]

247. The only exception to this general decline in Kansas economic growth is Johnson County.[429] For the 2000-2015 period, if the Kansas portion of the Kansas City Metropolitan Statistical Area (KS KC MSA), which includes Johnson County, is removed from the economic growth data, Kansas' employment growth was actually a negative 0.4%.[430] The 4.1% growth was only achieved through a 14% employment growth in the KS KC MSA.[431]

248. Statistics provided by the Philadelphia Federal Reserve Bank (Philadelphia Fed) also indicate that since the beginning of the Great Recession, Kansas' labor market has not recovered nearly as well as the United States as a whole.[432] In fact, Kansas' expected employment growth is still about half of the United States employment growth.[433]

249. Finally, based upon United States employment data from the Bureau of Labor Statistics, jobs in the Kansas Utility Industry, and specifically the electric power generation, transmission, and distribution sector have largely declined since the 1990's.[434] This suggests that job losses - particularly in electric power generation, transmission, and distribution industry - will not be absorbed by the rest of the utilities industry.[435] Such jobs will likely be permanently lost.[436]

250. The Joint Applicants' witness, Dr. Arthur Hall, argues that the employees that lose their jobs as a result of the acquisition will be able to find replacement jobs in Kansas

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[428] *Id*. at 15.
[429] *Id*. at 15-17.
[430] *Id*. at 18, Table 1.
[431] *Id*.
[432] Glass Direct at 19-20. The Great Recession began December 2007.
[433] Glass Direct at 21.
[434] Glass Direct at 29-30.
[435] *Id*. at 30.
[436] *Id*.

because of the "dynamic nature" of the Kansas labor markets.[437] He then attempts to support this argument by discussing "job churn."[438] Dr. Hall argues that "job churn" is a natural market process and states that Kansas usually has enough new businesses being born or expanding to absorb the jobs that expired because of businesses dying or contracting.[439] In addition, Dr. Hall states that higher "job churn" is associated with economic growth: "Economic growth and job churn are complimentary processes."[440]

251. Unfortunately, Dr. Hall's own data from Figure 1 indicates that "job churn" in Kansas has slowed significantly since the 1990s.[441] The average job creation rate has fallen 23.4% from the average in the 1990s to the average from 2009 to 2014.[442] At the same time, the job destruction rate has only fallen 11.5% over the same period.[443] The result is that net annual job growth averaged 2.4% from 1990 to 2000 while the net annual job growth averaged 0.3% from 2009 to 2014.[444] If faster "job churn" is associated with economic growth, as Dr. Hall argues, then his own data indicating declining "job churn" indicates declining economic growth in Kansas.

252. Additionally, Dr. Hall's analysis does not include any investigation of the types of jobs that are churning over in Kansas, or whether high-paying jobs are being eliminated and replaced with low-paying jobs. As indicated by Dr. Glass, Kansas' economy is becoming one with lower wage jobs compared to the United States economy.[445] Furthermore, Dr. Hall ignores

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[437] Hall Rebuttal at 8-12.
[438] *Id*.
[439] Hall Rebuttal at 9.
[440] *Id*.
[441] *Id*. at 8-9.
[442] These figures are extrapolated from Figure 1 and the associated data from the U.S. Census Bureau, Business Dynamics Statistics, as noted in Dr. Hall's Rebuttal Testimony at Footnote 6. http://www.census.gov/ces/dataproducts/bds/.
[443] *Id*.
[444] *Id*.
[445] Glass direct at 15.

the specialized nature of the jobs lost and treats them as though they are fungible.[446] Thus, Dr. Hall's analysis is incomplete and his conclusions are incorrect.

253. Dr. Hall also attempts to support his position on the Kansas labor market by presenting a chart showing the migration of Internal Revenue Service (IRS) tax filers into and out of Kansas.[447] The chart itself is not helpful to Dr. Hall's argument, as Dr. Hall himself states that "unfortunately, Kansas has experienced a persistent net outflow" of IRS tax filers.[448] This indicates workers are choosing to leave the state of Kansas to seek employment elsewhere, which is exactly what Dr. Glass argues will happen as a result of the acquisition related reduction in force.

254. The Commission should ultimately conclude, based upon Dr. Glass' testimony, that the acquisition will have a negative effect on the Kansas economy.

ii. Closing Efficient Generating Units to Create Savings Will Lead to Economic Waste

255. Maximizing energy resources and reducing economic waste of energy resources are mirrored concepts that fall into the category of economic efficiency.[449] Dr. Glass notes that the primary concern with the Joint Applicants' savings proposal is shutting down a power plant that is still economically efficient.[450] If the Joint Applicants shut down efficient generation just to create transaction savings, it would waste Kansas energy resources.

256. Dr. Glass used dispatch by the SPP as an indicator of the economic efficiency of a generating plant. The SPP dispatches generation for its territory using economic dispatch with reliability constraints.[451] If a plant is dispatched a significant amount by the SPP, then it must be

[446]*See* Hall Rebuttal at 10.
[447]Hall Rebuttal at 13-14.
[448]*See* Hall Rebuttal at 14.
[449]Glass Direct at 36.
[450]Glass Direct at 40.
[451]*Id*. at 37-38, 40.

economically viable.[452] Dr. Glass's analysis makes it is clear that closing any of Westar's four coal plants would lead to economic waste.[453] Specifically, based on the economic efficiency standard, the premature closing of Lawrence Energy Center results in economic waste and is not in the public interest.[454] For this reason, Dr. Glass and Mr. Drabinski argue that if the transaction is approved, the Commission should reserve the right to prevent the premature closure of Kansas generation plants.[455]

257. The Joint Applicants' Initial Post-Hearing Brief takes issue with Dr. Glass's comments upon economic waste and the closing of the Lawrence Energy Center.[456] The Joint Applicants argue that Staff disregards the fact that no final decisions regarding plant closures will be made until after an IRP is completed.[457] This statement shows that the Joint Applicants are hiding the ball. The Lawrence Energy Center was presented to Staff as a planned closure that partially justified its savings estimates.[458] Staff, although it did not believe the savings estimates were credible, took them at face value to conduct its analysis of economic waste. Now, the Joint Applicants argue that no final decisions have been made with respect to plant closures.[459] This indicates that the savings projections should not be relied upon by the Commission. The Joint Applicants cannot have it both ways by arguing Dr. Glass's concerns are unfounded because plant closings are not definite, while at the same time arguing that they are definite enough to demonstrate savings. If taken at face value, as Dr. Glass did, the premature closing of the Lawrence Energy Center will lead to economic waste.[460]

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[452] *Id*. at 37.
[453] *Id*. at 38.
[454] *Id*. at 40.
[455] *Id*. at 40; Drabinski Direct at 13.
[456] Joint Applicants' Initial Post-Hearing Brief, p. 129-130 (Feb. 28, 2017).
[457] *Id*.
[458] Drabinski Direct at 36-37.
[459] Joint Applicants' Initial Post-Hearing Brief, p. 130 (Feb. 28, 2017).
[460] Glass Direct at 4.

IV. CONCLUSION

258. This proposed transaction does not promote the public interest. It satisfies two private interests—GPE's interest in adding utility monopolies to its monopoly holding company system, providing government-protected access to large earnings streams; and Westar's interest in finding the one acquirer that would pay the highest gain to Westar shareholders while winning regulatory approval. The record evidence in this proceedings shows the public interest was only incidental to these two private interests.

259. Moreover, GPE proposes to take on $4.4 billion in debt to pay a $2.3 billion, 36% control premium. The control premium overcompensates Westar shareholders, as its value is rooted in factors unrelated to shareholder risk-taking or executive decision-making. The value stems from GPE's expectation of earning equity returns on debt investment, its expectation of earning actual returns exceeding required returns; GPE's intent to keep merger savings whose creation are not the result of either utility's skill; and the ability to monetize net operating losses on the books of GPE's non-utility affiliates.

260. To pay off this transaction-related debt, GPE intends to use financial engineering retention of savings via its control of information and rate case timing to prevent the Commission from passing along savings to ratepayers, and timely setting just and reasonable rates.

261. Furthermore, this increased and unnecessary leverage at the holding company level will leave GPE less able to weather declines in revenue, which will pressure the Commission to place GPE's financial condition ahead of Kansas's needs, and ahead of ratepayers' needs, for many years and many rate cases to come.

262. The Joint Applicants assert that the amount of the acquisition premium should not factor into the Commission's decision because the Joint Applicants are not requesting recovery of the premium. The Joint Applicants further insinuate that the amount of merger savings is likewise not relevant to the Commission's decision in this transaction. But the price being paid, and the savings being produced, are the essence of economic value. If economic value is irrelevant in a determination of whether at $12.2 billion transaction is in the public interest, what interests, then, are truly protected in a public interest determination?

263. Such a flawed transaction should be rejected by the Commission for failing to promote the public interest; likewise, the Joint Application should be denied.

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VERIFICATION

STATE OF KANSAS)
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Amber Smith, of lawful age, being duly sworn upon her oath deposes and states that she is Chief Litigation Counsel for the State Corporation Commission of the State of Kansas; that she has read and is familiar with the foregoing *Post-Hearing Brief of Commission Staff,* and attests that the statements therein are true to the best of her knowledge, information and belief.

Amber Smith

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SUBSCRIBED AND SWORN to before me this 13th day of March, 2017.

PAMELA J. GRIFFETH
Notary Public - State of Kansas
My Appt. Expires 08-17-2019

Pamela J. Griffeth
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My Appointment Expires: August 17, 2019

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