THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

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

JOINT APPLICANTS' INITIAL POST-HEARING BRIEF

Cathryn J. Dinges (#20848)
Senior Corporate Counsel
Westar Energy, Inc.
818 South Kansas Avenue
Topeka, Kansas 66612
Phone: (785) 575-8344
Facsimile: (785) 575-8136
cathy.dinges@westarenergy.com

Martin J. Bregman (#12618)
Telephone: (785)760-0319
BREGMAN LAW OFFICE, L.L.C.
311 Parker Circle
Lawrence, Kansas 66049
Email: mjb@mjbregmanlaw.com

COUNSEL FOR WESTAR ENERGY, INC.

Robert J. Hack (KS #12826)
Telephone: (816) 556-2791
Roger W. Steiner (KS #26159)
Telephone: (816) 556-2314
Kansas City Power & Light Company
One Kansas City Place
1200 Main Street – 19th Floor
Kansas City, Missouri 64105
Facsimile: (816) 556-2787
E-mail: rob.hack@kcpl.com
E-mail: roger.steiner@kcpl.com

Glenda Cafer (#13342)
Telephone: (785) 271-9991
Terri Pemberton (#23297)
Telephone: (785) 232-2123
CAFER PEMBERTON LLC
3321 SW 6th Avenue
Topeka, Kansas 66606
Facsimile: (785) 233-3040
E-mail: glenda@caferlaw.com
E-mail: terri@caferlaw.com

COUNSEL FOR GREAT PLAINS ENERGY INCORPORATED AND KANSAS CITY POWER & LIGHT COMPANY

TABLE OF CONTENTS

I. Introduction

On May 31, 2016, Great Plains Energy, Incorporated ("GPE"), the parent company of Kansas City Power & Light Company ("KCP&L") announced that it had reached a definitive agreement to acquire 100% of the stock of Westar Energy, Inc. ("Westar[1]") in a transaction then valued at approximately $12.2 billion, including assumed debt (the "Transaction"). Upon closing, Kansas' two largest jurisdictional utilities will be owned by GPE. Westar will become a wholly owned subsidiary of Great Plains Energy. On June 28, 2016, KCP&L and Westar filed a Joint Application seeking approval for GPE's acquisition of Westar.

The evidence in the record clearly shows that the Transaction promotes the public interest as required to be approved under the Commission's Merger Standards. The Transaction presents a tremendously beneficial outcome for the State of Kansas, its communities, customers served in Kansas by Westar and KCP&L, and the Commission, as well as Westar and GPE shareholders and should be approved subject to the conditions and commitments offered by the Joint Applicants. *See* Ives Rebuttal, Schedule DRI-3.

For the convenience of the Commission, the brief has been organized using the topic headings utilized at the evidentiary hearings. The failure to address any argument in opposition to the Transaction in this brief does not indicate agreement or acquiescence.

II. Executive Summary

Although there has been much discussion about the ability to demonstrate actual savings before the Transaction closes, there is no doubt that this "common sense" merger will bring significant savings to KCP&L and Westar and provide significant, long-term benefits to the customers of both companies. *See* Bassham Direct, pp. 7-8, 10-15; Ruelle Direct Testimony,

[1] Kansas Gas and Electric Company ("KG&E") is a wholly-owned subsidiary of Westar. For purposes of this brief the term "Westar" includes Kansas Gas and Electric Company.

pp. 22-26; Bassham Rebuttal, p. 5. The combination of these two companies in an "old-fashioned" merger of utilities will permit the elimination of duplicate processes through both organizations, bring economies of scale to several functions, and increase purchasing power resulting in on-going savings of millions of dollars. Some of these efficiencies will allow the merged company to operate with fewer employees but these reductions will be achieved primarily through natural attrition, minimizing the impact on KCP&L and Westar's employees. Bassham Direct, p. 7; Ruelle Direct, p. 16. In fact,

> GPE estimated that the Transaction would produce total savings of approximately $426 million over a 3.5-year period from mid-2017 to the end of 2020. Ongoing savings beyond 2020 would be close to $200 million per year. This includes both O&M expense savings and the revenue requirement impact of capital expenditure reductions.

Kemp Direct Testimony, p. 6. CURB witness Crane stated that she was persuaded that the Joint Applicants' testimony and financial modeling of savings are reasonably quantified, Crane Direct p. 47, and that several factors suggest that the acquisition of Westar by GPE could result in cost savings that are at least as great as an acquisition by some other entity. *Id*. at pp. 6-7.

While the Transaction will undoubtedly produce substantial savings that will accrue to customers, it has also been structured to insulate these same customers from its costs and risks because rate recovery of the acquisition premium is not requested and because a comprehensive set of ring-fencing and other regulatory conditions and commitments has been proposed. The Transaction will be financed on a balanced basis with approximately 50% of the purchase price financed with equity and approximately 50% financed with debt. Bryant Direct Testimony, p. 9; Tr. Vol. 3, Bryant, p. 703. All of the financing for the Transaction has been undertaken by GPE and all debt incurred for the Transaction will be the obligation of GPE with no guarantee from or recourse to any utility subsidiary. Bryant Direct, pp. 9-10. The acquisition premium will be recorded on GPE's books and will not be pushed down to Westar's books. Busser Direct, p. 12. GPE has committed not to seek recovery of the acquisition premium from utility customers.[2] *See, e.g.,* Bassham Rebuttal, pp. 12-13. Additionally, Joint Applicants' proposed ring-fencing will effectively insulate utility customers from risks associated with the financing of the Transaction or the possible impairment of the acquisition premium – or goodwill – asset. Reed Rebuttal, p. 88.

The combination of KCP&L and Westar will create substantial benefits. For this reason, it has been the subject of periodic discussions over at least several decades. As Westar's former Chief Executive Officer James Haines explained, "the sense of the transaction being proposed now 'began to emerge at least as early as the late 60's with the joint planning between KG&E and KCP&L for the construction of La Cygne Station and then for Wolf Creek.'" Ruelle Rebuttal, pp. 39-40, *quoting* Public Hearing Transcript, Haines, p. 62. At the public hearing in this matter, Mr. Haines explained that conversations concerning the potential combination of KG&E and KCP&L continued in 1985, that there were attempts in mid-1990s to combine KCP&L and Westar and in the late 1990s to combine KCP&L, Westar and Aquila but that those attempts failed. Public Hearing Transcript, Haines, p. 63. After his return to Westar in December 2002, "Mr. Haines concluded that the consolidation that would 'create the most compelling opportunities to reduce costs and improve quality of service was with KCP&L' and

[2] As will be discussed, GPE's commitment not to seek recovery of the acquisition premium in rates has one exception – if any party seeks to impose GPE's consolidated capital structure which includes substantial Transaction debt on its operating utilities for purposes of setting rates – and this reflects a reasonable allocation of benefits between customers and shareholders. Ives Supplemental Direct, p. 12; Tr. Vol. 2, Ives, pp. 428-430. The Commission can, and should, put that issue to rest by ruling that rates will be set by the actual capital structure of the utilities post-closing as long as that capital structure continues to represent the mix of capital used to fund the utilities and continues to reflect standard utility industry balance.

had several meetings with KCP&L's CEO to discuss a possible merger. Those attempts, too, were not successful." Ruelle Rebuttal, p. 41, *quoting* Public Hearing Transcript, Haines, p. 64.

The history of the efforts of KCP&L and Westar to combine demonstrates the difficulty of achieving a merger even with the potential for significant efficiencies. As Mr. Ruelle testified, "Transactions often are a careful balance of competing interests. Only when favorable conditions exist for that fragile balance are transactions like the present one likely to be proposed, and if proposed, likely to be successfully consummated." Ruelle Rebuttal, p. 10.

It is also highly unrealistic to assume that a merger could be completed at a purchase price different from the price agreed to in the Transaction. GPE witness Kevin Bryant was asked whether he believed a transaction between GPE and Westar could occur at a different price. In answer, he stated:

> I've got no reason to believe that. This is a complicated transaction, got to put a number of pieces together. Both Companies had shareholder votes. I know Westar had shareholder lawsuits against it when looking at the purchase price. As I think Mr. Ruelle mentioned this in his testimony up here on the stand, there are a lot of stars that have to come in alignment for one of these transactions to happen. To expect to reset that bar and have those stars come in alignment again, I, I think history has shown that that is tough. This transaction has been tried in history before. It may be another 20 years before we get another crack at it.

Tr. Vol. 3, Bryant, pp. 757-58. Therefore, Staff's suggestion by Mr. Hempling, Tr. Vol. 5, Hempling, pp. 1206-1207, that the Transaction should somehow be "re-structured" is not reasonable.

The Transaction is "the single best action we can take to mitigate some of the rising costs and rising customer impacts that we both in our industry are facing." Tr. Vol. 4, Ives, p. 1049. The Commission will be presented with evidence of actual Transaction savings during the first two series of post-closing rate cases because KCP&L and Westar must make such showings in order to obtain rate recovery of transition costs under Merger Condition 19 in Schedule DRI-3 of Mr. Ives' rebuttal testimony. If this Transaction does not proceed either because of a rejection or approval with unreasonable conditions, it is extremely unlikely that another proposal will be brought forth that can meet the Commission's requirements. *See* Ruelle Direct, p. 10. ("If the Commission cannot find it in its authority and reason that this advances the public interest, I cannot imagine another transaction ever being able to do so.") GPE emerged as the winner of Westar's competitive process because it was able to deliver the greatest efficiency savings. Bryant Rebuttal, pp. 40-41. Simply put, there is no other deal. Or, as Joint Applicants' witness Reed put it:

> Mergers are binary "yes" or "no" matters. They are either approved (with conditions that do not materially impact the risk or value to shareholders) or they will not go forward. Merger-related customer (and shareholder) benefits will only be realized if the merger is completed. Applicants make substantial investments in resources to evaluate and consummate a merger and are unlikely to expend these resources unless there is a reasonable opportunity for sustainable shareholder value to be created. This is only possible if sustainable customer value is created. The two objectives are, and should be, aligned creating a win/win scenario for customers and shareholders.

Reed Rebuttal, p. 18.

The proposed transaction will be beneficial to state and local economies and to the communities served by Westar and KCP&L. The efficiencies created by the Transaction will result in energy costs that are less expensive for customers than they would be absent the merger and lower energy costs will have a positive economic impact for Kansas. Hall Rebuttal, pp. 19-20. The Transaction ensures local control of the two largest utilities in the state and GPE has made significant commitments to Kansas, local communities and employees that help to solidify the economic benefits.

In summary, the Transaction meets the Commission's Merger Standards which will be set forth fully in the sections that follow. The purchase price, when an accurate comparison is conducted, is comparable to what has been paid in other recent transactions. Bryant Direct, p. 11. The merger will generate significant savings for customers while protecting them from the financing costs of the Transaction and rate recovery of the acquisition premium. It will be beneficial to the state of Kansas, the communities served by Westar and GPE and pass the other Merger Standards.

The Commission should approve the merger subject to the conditions and commitments proposed by the Joint Applicants.

III. <u>The Public Interest (Including Transaction Overview, Buyer/Seller Rationale, Kansas Merger Standards and Future Regulatory Impact)</u>

<u>*Summary*</u>

The proposed Transaction makes good sense and will clearly generate significant savings to the benefit of customers that are available through no other course. The Transaction has been designed to provide all of the benefits to customers in the normal course as rates are set after closing while placing the risk on GPE shareholders. Because customers are protected from the acquisition premium and Transaction financing and because Westar and GPE are neighbors, the Transaction is far superior to acquisitions of KCC-jurisdictional utilities recently approved by the Commission and meets the Merger Standards as they have been applied for over two decades. The approach advocated by Staff's Regulatory Consultant and adopted by Staff has been rejected by commission after commission and is inconsistent with the Merger Standards.

Argument

A. Transaction overview and buyer/seller rationale – the merger just makes sense.

In this docket, GPE and Westar ask the Commission to approve the acquisition of Westar by GPE. GPE will purchase all of the outstanding common stock of Westar at a price of approximately $60 per share.[3] GPE will pay approximately $8.6 billion to Westar shareholders for their stock.[4] Bryant Direct Testimony, p. 6. The purchase is to be made with a balanced mix of capital using 50 percent equity and 50 percent debt. Tr. Vol. 3, Bryant, p. 703. All of the capital being raised will be used in the Transaction. As GPE's Senior Vice President – Finance and Strategy and Chief Financial Officer, Kevin Bryant, put it: but for the need to pay for the transaction and the acquisition premium, GPE "wouldn't have issued a nickel of debt…." *Id*. at 749.

The merger will be good for customers and help both KCP&L and Westar adapt to changes in the industry. As Terry Bassham, Chairman, President and Chief Operating Officer of both GPE and KCP&L testified:

> This Transaction is one example of consolidation among many in today's electric industry operating environment which has been characterized in recent years by increasing costs and flat, to even declining customer usage putting significant upward pressure on rates paid by customers. GPE and Westar will be better together than either could be individually on a stand-alone basis. There are a number of reasons why the acquisition of Westar complements Great Plains Energy's current operations. First, this transaction will enable efficiencies and savings that cannot be obtained by either GPE or Westar on a stand-alone basis, and these efficiencies and savings will keep rates lower in the future than they would

[3] Because the purchase price will paid partly in GPE common stock, the exact price per share cannot be determined until closing of the Transaction.

[4] In addition to the consideration of approximately $8.6 billion to be paid to Westar's shareholders, $3.6 billion of outstanding Westar debt will remain on Westar's books, bringing the total overall enterprise value for Westar to $12.2 billion. Bassham Direct Testimony, p. 4.

> have been absent this Transaction benefitting customers and our economy, as electricity is a key input into the entire economy.
>
> Because Westar's Kansas service territory is adjacent to KCP&L's Kansas service territory we expect significant savings opportunities will be available soon after the close of the Transaction related to combined operations of many functions within KCP&L and Westar…. As discussed in the Direct Testimony of William Kemp, GPE estimates that approximately $65 million in Transaction-related savings will be achieved in the first full year after closing, and that achieved savings are estimated at nearly $200 million in the third full year after closing. These savings – unattainable for GPE and Westar on a stand-alone basis – ensure that customers will receive substantial benefits in the form of lower future rate increases than would be possible in the absence of the Transaction. Furthermore, as discussed in more detail in the Direct Testimony of Darrin Ives, savings that result from the Transaction are an ongoing reduction to the level of anticipated increase in our cost of service and will continue to benefit customers every time we file a rate case.

Bassham Direct Testimony, pp. 10-11.

The changes discussed by Mr. Bassham are driven in large part by customers' demands. As he stated on the witness stand:

> …customers want more from their utility. It used to be that they sign up for service and you provide service, send them a bill, and if they don't pay, you give them notice and end up having to cut them off. Now they want to talk to you about other energy efficiency products or solar or what part of your portfolio is renewable. And customers are asking more questions than they used to as well. And I think you see that among all our utilities. When I started in the business 30 years ago, we used to call them ratepayers. We didn't call them customers. Well, that's wrong. They are customers. So you just see I think that across the industry right now.
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> * * * * *
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> …It's all about the customer right now. Again, that's, that's why rates are important. That's why services are important. And that why I'm driving efficiencies because this transaction would help us over the long term be more efficient.

Tr. Vol. 1, Bassham, pp. 155-56.

Mr. Bassham's sentiments and explanation were echoed in the testimony of Mark Ruelle, President and Chief Executive Officer of Westar. He stated, that in deciding Westar's direction, its management and board needed to consider size, circumstances, timing and value. He explained:

> Size matters in this industry. Virtually no other industry is this capital intensive. Single, complex pieces of equipment can cost hundreds of millions of dollars; some a billion or more. With that capital intensity comes significant fixed costs. Scale matters, in that a company's ability to spread those fixed costs over a large customer base reduces the prices for those who pay those costs; that is, our customers. But with scale comes more complexity. No longer do companies have a few customers that they can know by name and handle on a personal basis, but rather, efficiency across scale requires yet more complex systems. With that added complexity, come more economies of scale. Though it may not sound like it, much of what I just described is progress.
>
> In that context, it's not surprising then, that consolidation in our industry has continued, with the result being fewer companies serving more customers.
>
> As we considered the rising cost environment, coupled with the fact that we collect our revenues based primarily on the volume of electricity sales; sales that are, at best, pretty flat, maybe even declining, the inevitable conclusion was to expect more price increases. As we considered different ways to moderate future price increases, size and scale became an obvious tool to consider. Pooling resources with another company would allow Westar to be part of a more efficient company and spread costs over a larger platform to the benefit of customers in the form of reduced future rate increases. If we can deliver expected financial results without so much reliance on future rate increases, that's a win-win. There is one thing probably everyone reading this testimony can agree on, and that's nobody likes price increases. I am confident the scale resulting from this Transaction will reduce the size of necessary future rate increases, which is good for customers and our state's economy, as energy costs are a key factor in the costs of producing virtually everything in our state.

Ruelle Direct Testimony, pp. 8-10.

The Transaction has been structured to place virtually all of the risk on GPE shareholders yet provides all of the long-term benefits to utility customers by simply continuing to apply longstanding, widely accepted ratemaking practices. Consistent with existing practice, the utility retains efficiency savings only until rates are reset in a rate case, at which point 100% of the savings flow through to customers. As Mr. Ruelle put it:

> …we have structured the transaction to be pretty one sided in favor of customers asking them not to have to pay for any of the merger costs or the premium, but they get the merger savings back in the normal course. We stylize this so that the Commission doesn't need to do anything novel to make this work. We are not asking you for any new rate making authority. We're not asking you for some kind of complicated true-up. We're asking you just to continue to use the ratemaking methods, the periodic rate cases.

Tr. Vol. 1, Ruelle, p. 264.

In addition to the customer-friendly treatment of savings proposed in the filing, the Joint Applicants have proposed, in response to proposals made and concerns raised by other parties, a comprehensive set of ring-fencing provisions which are comparable to or provide greater protection than those contained in the recently approved acquisition of Empire District Electric Company by Algonquin Power & Utilities. Reed Rebuttal, p. 97. The ring-fencing conditions and commitments are also consistent with those that have been adopted in other recent utility mergers across the U.S. *Id*. "These ring-fencing measures and financial conditions provide appropriate protections to Kansas customers and isolate the operating utilities from any potential financial difficulties at GPE. *Id*. at p. 98.[5] Adoption of these measures will protect customers while allowing the Transaction to move forward and bring the benefits of savings to customers.

[5] Having supported a settlement in the Empire case that included ring-fencing provisions, *see*, Order Granting Joint Motion to Approve Unanimous Settlement Agreement and Approval of the Joint Application, Docket No. 16-EPDE-410-ACQ ("Empire Merger Order"), Exhibit A (Unanimous Settlement Agreement), in this docket, Staff takes the position that ring-fencing is "not sufficient" and "largely reactionary." Gatewood Direct Testimony, p. 42. In lieu

Admittedly, the Transaction is a large one for GPE. Tr. Vol. 1, Bassham, p. 157. However, GPE's actions to date and the reaction of financial markets demonstrate that the Transaction is sound and executable. As Mr. Bassham noted, GPE has already completed the financing of the equity and was able to hedge its debt costs. *Id*. Both of GPE's equity offerings associated with the Transaction – $1.6 billion of common stock and $863 million of mandatory convertible preferred stock – were approximately two times oversubscribed indicating the favorable view of the Transaction by some of the most sophisticated investors in the world. Bryant Rebuttal, p. 9.

Acceptance of the Transaction by the financial community notwithstanding, the Joint Applicants acknowledge that there is some level of risk in this undertaking just as there is any activity. But Mr. Ruelle put the risk in perspective when he testified:

> There is always risk. Every time we send our linemen to work on a hot line, there is risk. Every time we replace or repair a piece of equipment, there is risk. **Identifying risk is not the stopping point for an analysis; it's the starting point for an analysis**. And then you've got to ask yourself a few more questions, what is the probability of the risk? What are the ways that the risks can be eliminated or mitigated? And then if there is remaining risks, who do they land on? And then are the benefits worth whatever remaining risks there are and who they land on.

Tr. Vol. 1, Ruelle, pp. 263-64 **(emphasis added)**.

In this case, the answers to the questions posed by Mr. Ruelle are key. The risks associated with the Transaction are largely the financial risks associated with increased leverage at GPE and the recording of the acquisition premium at GPE. These risks have been willingly

of industry-standard ring-fencing, Staff proposes to require use of GPE's post-transaction capital structure in future ratemaking proceedings for Westar and KCP&L. *Id*. As will be discussed in Section IV.B.2., Staff's proposal is not ring-fencing at all but a device offered to kill the Transaction. Staff's pseudo-ring-fencing would give all the benefits of the financing that makes the Transaction possible to utility customers while leaving GPE shareholders all of the associated burdens.

accepted by GPE's shareholders and investors and any potential residual impact on customers has been addressed and mitigated by ring-fencing conditions, supported by the Commission's broad regulatory oversight and authority. Put simply, the fact that both Westar and KCP&L are regulated by the KCC ensures that customers will be protected.

With regard to the first item (increased leverage due to Transaction debt held by GPE), it should be noted that the risk is isolated at the GPE level both in the near-term and over the long-term. To date, even though one of two rating agencies (S&P has affirmed GPE's current credit ratings) has placed GPE on credit watch for a likely downgrade – that would keep GPE at investment grade – both have confirmed the credit ratings for both KCP&L and Westar. Tr. Vol. 3, Reed, pp. 578-79. Consequently, if the Transaction closes, it is expected that Westar and KCP&L will, as required by prior Commission orders (*see Western Resources*, Docket No. 01-WSRE-949-GIE, Order, at ¶ 42 (July 20, 2001)), have credit ratings comparable to other electric utilities of similar risk. Tr. Vol. 3, Reed, p. 579. Moreover, as Mr. Bryant testified, neither GPE's post-Transaction degree of leverage nor its one-notch potential credit rating downgrade is permanent[6]. He stated:

> …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

[6] The initial reaction by Moody's to place GPE on credit watch due to the Transaction is not unusual. Bryant Direct, p. 21.

> 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.

Tr. Vol. 3, Bryant, pp. 746-47. And, as has been stated, the ring-fencing proposed by the Joint Applicants is designed to ensure that whatever residual risk may exist from leverage at GPE will not place customers at risk over the near- or long-term. Reed Rebuttal, p. 88. GPE will take steps to reduce Transaction debt after the closing and its financial condition will get stronger each year.

As to the second source of financial risk – recording of the acquisition premium at GPE – any associated risk is remote, speculative and borne exclusively by GPE's shareholders. As has been stated, GPE will not seek to recover the acquisition premium from customers. Likely because past merger applicants have generally proposed to recover some or all of their acquisition premiums in rates (*See, e.g.,* discussion of the KPL/KGE merger in Proctor Direct pp. 11-12 and of the Western Resources/KCP&L merger at *id.* at pp. 14-15), this approach has caused needless concern in this proceeding because some of the parties fail to recognize how different this application (and the accounting requirements currently in force) are from those past transactions. How, some parties have asked, can the merger be viable if GPE does not recover the acquisition premium? Joint Applicants' witness GPE's Vice-President-Risk Management and Controller, Steven Busser provided the answer. As he testified, the acquisition premium – the difference between the purchase price and Westar's book value – is not an expense to be recovered but an asset that will be recorded as "goodwill" on the GPE consolidated financial books. Busser Direct Testimony, pp. 11-12. The acquisition premium will not be pushed down to Westar's books. Busser Direct, p. 12. In fact, while amortization of goodwill may have been required in the past, current accounting rules no longer allow it. *Id*. Under current accounting rules, the acquisition premium will be reflected as "goodwill" on GPE's books subject to an impairment test at least annually. "If no impairment exists, that asset simply continues on the books indefinitely, at the same amount." *Id*. Moreover, as Mr. Busser explained, the possibility of an impairment is remote because the incremental cash flows from Westar to GPE combined with the ongoing cash flows from KCP&L and GMO will produce a fair value calculation well in excess of the book value of the utilities plus the goodwill associated with the Transaction. Tr. Vol. 4, Busser, pp. 961, 967-69. Although remote, should an impairment occur, GPE's proposed ring-fencing commitments will insulate utility customers from any of the consequences. Reed Rebuttal, p. 88.

In recent months, the Commission has witnessed – and ruled favorably on – other examples of the consolidation occurring in the utility industry. Thus, the Commission approved the applications in the Empire Merger Docket and 16-ITCE-512-ACQ ("ITC Merger Docket"), respectively, for the acquisitions of Empire District Electric Company by Algonquin Power & Utilities and ITC Great Plains by Fortis, Inc. The proposal in this case has several major advantages compared to those recently approved transactions that demonstrate the superiority of the Transaction from the perspective of customers. Unlike the proposed merger of GPE and Westar, the Empire and ITC acquisitions involved purchases of KCC-jurisdictional utilities by distant corporations[7] in which the creation of synergies was not a likely benefit. In the ITC Merger Docket, for instance, Staff stated that the purchase price was not supported by any anticipated savings or operational synergies. ITC Merger Docket, Order Approving the Transaction with Conditions, at ¶ 26 (October 11, 2016). And in the Empire Merger Docket, Staff witness Grady testified that the benefits provided to customers from the merger were

[7] Fortis Inc. is a publicly traded holding company existing under the laws of Newfoundland and Labrador, Canada, with its principal offices in St. John's, Newfoundland and Labrador. ITC Merger Docket, Order, at ¶ 11. Algonquin Power & Utilities Corp. is a North American diversified generation, transmission and distribution utility based in Oakville, Ontario, Canada. Joint Applicants Exhibit 5, at p. 27.

"minimal." *See* Direct Testimony of Justin Grady, Empire Merger Docket, at pp. 11-12 (October 6, 2016).[8] By contrast, the merger of GPE and Westar has a number of characteristics that were not present in those recently approved by the Commission:

> …including good fit, joint KCP&L/Westar ownership of generating facilities, contiguity of KCP&L/Westar service territory, complementary operational strengths and substantial experience of both KCP&L and Westar with this Commission's regulatory practices and expectations…which likely could not be replicated by any purchaser other than GPE.

Bassham Direct, p. 12. Given the sizable and undeniable benefits of the Transaction to Westar and KCP&L's customers and the deliberate efforts to isolate customers from risk at the GPE level, this Transaction is clearly superior to the Empire and ITC acquisitions the Commission recently approved. The Transaction should be approved without conditions beyond those proposed in Schedule DRI-3 to Mr. Ives' rebuttal testimony.

B. <u>The Transaction passes the Commission's Merger Standards as they have been applied in past cases.</u>

As the Commission noted in its Order on Merger Standards in this docket, in consolidated dockets 172,745-U and 174,155-U, related to the merger of The Kansas Power and Light Company ("KPL")[9] and KGE, the Commission stated that mergers should be approved when the applicants "can demonstrate that the merger 'will promote the public interest.'" Docket No. 16-KCPE-593-ACQ, *Order on Merger Standards*, at ¶ 3, *quoting* Order, Consolidated Dockets 172,745-U and 174,155-U (November 14, 1991) (the "1991 Merger Order"). In its 1991 Merger Order, the Commission further stated:

[8] The Commission took administrative notice in this case of Mr. Grady's testimony in the Empire docket at Tr. Vol. 2, p. 499.

[9] The Kansas Power and Light Company is the predecessor to Western Resources, Inc., which in turn is the predecessor to Westar Energy, Inc.

In determining whether a transaction promotes the public interest, the Commission looked to the variety of sources presented by the parties in their testimony and briefs. The Commission adopts the following list of factors it will weigh and consider in determining whether the proposed transaction promotes the public interest:

a. The effect of the transaction on consumers, including:

   (i) 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;

   (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;

   (iii) Whether ratepayer benefits resulting from the transaction can be quantified;

   (iv) Whether there are operational synergies that justify payment of a premium in excess of book value;

   (v) The effect of the proposed transaction on the existing competition.

b. The effect of the transaction on the environment.

c. Whether the proposed transaction will be beneficial on an overall basis to state and local economies and to communities in the area served by the resulting public utility operations in the state.

d. Whether the proposed transaction will preserve the jurisdiction of the KCC and the capacity of the KCC to effectively regulate and audit public utility operations in the state.

e. The effect of the transaction on affected public utility shareholders.

f. Whether the transaction maximizes the use of Kansas energy resources.

g. Whether the transaction will reduce the possibility of economic waste.

> h. What impact, if any, the transaction has on the public safety.
>
> The Commission believes these factors will allow the Commission to uniformly review mergers and acquisitions that may be presented to the Commission in the future while maintaining some flexibility to deal with the particular circumstances of each transaction. Additionally, these factors will provide utilities contemplating a merger or acquisition with a standard that will be utilized to review any contemplated transaction.

Id.

As the Commission noted in its Order on Merger Standards, the standards were applied in the KPL/KG&E merger and reaffirmed in Docket No. 97-WSRE-676-MER (referred to by the Commission as the "97-676 Docket"; herein the order will be referred to as the "1999 Merger Order") in which the Commission approved the merger between Westar's predecessor and KCP&L. Order on Merger Standards, at ¶ 4. However, in the 1999 Merger Order, the Commission also "made clear they are to be supplemented by other consideration [sic] relevant to the unique facts and circumstances of each proposed merger." *Id*. In its Order on Merger Standards, the Commission reaffirmed the standards as modified in the 1999 Merger Order. The Commission stated that:

> any deviation from the standards reaffirmed in paragraph 5 of this Order to be clearly identified in the application and justified in supporting testimony. **Similarly, if Staff or an intervenor believes the standards need to be modified in a particular docket, they are obligated to explain the proposed modification and provide grounds supporting the proposed modification**.

Id. at ¶ 7 **(emphasis added)**.

As a result of the flexibility expressly provided in its orders, the Commission has never used the Merger Standards as a strict checklist and has never required any merger applicant to "check all the boxes." In fact, in case after case, as discussed by Joint Applicants' witness Proctor, the Commission has approved mergers without addressing individual factors listed in the standards. For instance, in the 1991 Merger Order, the Commission did not address reasonableness of the purchase price (1991 Merger Order, Proctor Rebuttal, p. 10); in the 1999 Merger Order, the Commission did not mention, much less analyze, the purchase price (*Id*. at p. 13); and in its order approving the purchase of Aquila by Black Hills and GPE, the Commission did not mention the amount of the acquisition premium, or even discuss the Merger Standards. *Id*. at pp. 23-24. *See* Direct Testimony of Justin Grady, Docket No. 16-EPDE-410-ACQ, at p. 11 (October 6, 2016).

More importantly, and particularly germane to the issues in this docket, in approving the acquisition of ITC Great Plains, the Commission stated: "Since the Transaction is not premised on operational synergies, whether operational synergies exist to justify payment of a premium in excess of book value is not material in determining whether the Transaction is in the public interest." ITC Merger Docket, Order Approving the Transaction with Conditions, at ¶ 30 (October 11, 2016). Conversely, where, as is the case here, the Joint Applicants are not seeking rate recovery of the acquisition premium, a comparison of anticipated operational synergies to the premium "is not material in determining whether the Transaction is in the public interest."

The Transaction will bring together two well-performing electric utilities with adjacent service territories and significant jointly-owned assets. Because of their familiarity with each other, the similarities of their operations, geographic proximity to each other, and the potential for economies of scale in several functional areas, a merger of these companies will provide significant savings for customers. At the same time, the Transaction has been structured to protect the financial viability of both the operating utilities and their parent company, GPE. After the Transaction, the combined companies will continue their commitments to providing high quality, reasonably priced electricity while protecting the environment, acting as good citizens of the state of Kansas, and otherwise meeting the requirements of the Merger Standards. These items will be discussed in detail in the pages that follow.

C. Staff proposes to apply a new and different standard that has never been accepted by any utility regulator in the United States.

Early in this proceeding, Staff took the position that the Joint Applicants had misstated and misapplied the Merger Standards in their application. *See Staff's Reply to Joint Applicants' Verified Response to Commission's Order on Merger Standards*, Docket No. 16-KCPE-593-ACQ (September 9, 2016). However, from their testimonial filings and the testimony in this proceeding, it is clear that from the very outset – even as Staff made its September 9th filing – Staff had no intention of applying the Merger Standards as they have been applied in the past.

On September 1, 2016, Staff hired its "Regulatory Consultant," Mr. Hempling. Joint Applicants' Exhibit 1, p. 1. As shown by the following exchange, when it hired its consultant, Staff was well aware that he would not follow the Commission's past practice under the Merger Standards:

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

Tr. Vol. 2, Hempling, pp. 494-95 **(emphasis added)**.

In stark contrast with the strict standard that Staff advocated to be imposed on the Joint Applicants, its "Regulatory Consultant" viewed the Merger Standard as a carte blanche. Thus, he stated that in reading the Commission's prior merger orders

> …what I found is a common factor among them was nearly in all cases a settlement where the Commission found the parties generally satisfied and approved it, so other than a list of criteria that are in the Commission's merger guidelines, I, **I saw an openness because of the public interest standard to articulate what guidance would be for the Commission, so I did not feel particularly bound by anything other than the statute and the Commission's general criteria that it puts in its guidance document**.

Id. p. 491 **(emphasis added)**.

Mr. Hempling acted on the "openness" that he perceived by bringing extreme and universally rejected concepts into this case. Thus, he admitted that:

- His position that a target utility should have "sought and screened potential acquirers based on customers benefits" has not been accepted by any regulatory commission. *Id*. at p. 488; Joint Applicants' Exhibit 3.

- No merger, to his knowledge, ever made explicit his belief that a utility violated its obligations by selling based on the highest price rather than the best possible performance. Tr. Vol. 1, Hempling, p. 510; Joint Applicants' Exhibit 7.[10]

- No jurisdiction had ever required a merger applicant to run an auction competition based on benefits to customers although he had proposed such an approach in Connecticut, the District of Columbia, Maryland, Louisiana and Hawaii. Tr. Vol. 1, Hempling, p. 512; Joint Applicants' Exhibit 9.

- This Commission has never required an applicant in a merger proceeding to find the best performer for customers. Tr. Vol. 1, Hempling, pp. 511-12; Joint Applicants' Exhibit 8.

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[10] During his cross-examination, Mr. Hempling stated that the answer contained an "intentional gap." On redirect, Mr. Hempling stated that it was "possible" that such a process had been followed in some merger but offered no evidence that such an event had ever occurred. *See* Tr. Vol. 2, Hempling, pp. 525-26.

- There is no legal authority of which he is aware that economies of scale do not support the retention of a control premium by the selling utility's shareholders. Tr. Vol. 1, Hempling, p. 513; Joint Applicants' Exhibit 10.

- There are no commission or court orders that have required utilities seeking to merge to provide objective comparisons between the chosen acquirer and others. Tr. Vol. 1, Hempling, pp. 513-14; Joint Applicants' Exhibit 11.

- He was not aware of any merger in the utility industry that had been implemented without payment of a control premium. Tr. Vol. 1, Hempling, pp. 516-17; Joint Applicants' Exhibit 13.

Mr. Hempling also relies heavily upon the concurrence filed by Justice Brandeis in *Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission*, 262 U.S. 544 (1923) for his claim that there is no legal protection afforded shareholders' interest in the acquisition premium. He states Justice Brandeis' language has been "repeated over the decades." Hempling Direct, p. 55. However on cross-examination, he admitted that the case in which the cited language was uttered was not a merger case but a rate case appeal (Tr. Vol. 2, Hempling, p. 514) in which the Court was addressing "whether a state regulatory commission in setting rates was required to use a fair value method where it took original book and adjusted for the change in value due to changes in the economy or whether it could be use some other method such as net book value." *Id*. He further admitted that he was not aware of any cases in which the Brandeis concurrence was applied in a merger proceeding (*Id*. at 516; Joint Applicants' Exhibit 12) and stated that he had not asserted that the Brandeis analysis caps investors' returns. *Id.*

If nothing else, Mr. Hempling has been doggedly consistent in advocating his universally rejected views. As Joint Applicants' witness Reed stated,

> Mr. Hempling has offered views here that are almost identical to those that he has offered to other commissions in other merger approval cases, and those positions can only be described as far

> outside the norms of regulation in North America (including KCC precedent in merger approval cases), and in sharp conflict with economic and financial principles – even the notion of private property rights – that underlie these regulatory norms. Based on my review of numerous merger approval cases, I am confident in agreeing with Mr. Hempling's own assessment of his track record in these other cases: no other regulatory commission has adopted these views (as discussed later in my testimony). This confirms, as I stated earlier, how outside the norm his views are.

Reed Rebuttal, p. 6.

The 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. Contrary to Mr. Hempling's jaundiced view, a "well-conceived" regulatory model recognizes the use of the corporate form of ownership in the industry and the value of mergers and provides utilities with incentives that are aligned with customer interests. Reed Rebuttal, p. 17. As Joint Applicants' witness Reed stated, the model:

> is characterized by an alignment of interests between shareholders and customers, and an active, informed regulatory agency that oversees the balance of interests. As a result of long-standing policy decisions, the vast majority of electric utility customers in the United States are served by investor-owned utilities that rely on capital markets to finance investments required to deliver value to customers, along with active oversight of major utility decisions and performance by professional regulatory agencies. It works particularly well when both utilities and regulators are able to take a long-term view.

Id.

Mr. Hempling was fully aware of the divergence of the views he espoused from prior Commission practice and the impact of a sudden change of course that would occur if his approach were to be adopted. Thus, in response to KCP&L Data Request No. KCPL-135, he stated:

> [Hempling's] testimony adheres to the Commission's merger standards, but applies them differently that the Commission has….
>
> …yes, it would be better for commissions to send clear signals before transactions are negotiated than to send those signals after negotiations. But the public interest is more important than the disappointment the companies will feel, and more important than whatever reputational hit the Commission would take from being perceived as changing its policies.

Joint Applicants' Exhibit 4.

As Mr. Hempling freely admits, his approach is a radical departure from the Merger Standards as applied by the Commission has in the past. Indeed, his approach is different from that taken by any commission in the United States at any time. *See* Reed Rebuttal, pp. 6, 24-26. Mr. Hempling readily admits that he did not feel bound in this case by the way in which the Kansas Commission had applied its Standards in past dockets. Tr. Vol. 2, Hempling, pp. 491, 494. And, despite his understanding that the Joint Applicants relied on past practice in fashioning the Transaction, Mr. Hempling cavalierly dismisses his repudiation of prior precedent as resulting in mere "disappointment" for the Joint Applicants and little more than a "reputational hit" to the Commission. Joint Applicants Exhibit 4. In fact, as Mr. Hempling – a regulatory attorney with years of experience – should know, acceptance of his suggestion that the Commission should so materially deviate from its past practice based on nothing more than his admittedly unconventional opinion of how regulation should work would result in a violation of legal requirement that this Commission follow past practice or provide a reasoned explanation of its change in course. *E.g., Western Resources, Inc. v. KCC*, 30 Kan. App. 2d 348, Syl. ¶ 7 (2002) ("Where the Kansas Corporation Commission rules in a manner inconsistent with a previous decision, the law requires that the commission explain its change in position."); *Home Tel. Co. v.*

KCC, 31 Kan. App. 2d 1002, 1012 (2003) (Not only must an agency's decreed result be within the scope of its lawful authority, but also the process by which it reaches that result must be logical and rational.") Adoption of his approach would "eliminate the potential that utility customers in Kansas (*i.e.*, every citizen and every business) will be able to benefit from utility mergers, now and in the future." Reed Rebuttal, at p. 24.

Mr. Hempling's approach – which would require a selling company to screen buyers first based on customer service and in which utilities would merge without paying a premium – is directly counter to the realities of a system that leverages the financial and operating strengths of regulated investor-owned utilities. As Mr. Ruelle testified, he and the board of directors have legal obligations to Westar's shareholders. Ruelle Direct, p. 12. At the same time, however, they must ensure that any proposed transaction meets the public interest. *See*, Tr. Vol. 1, Ruelle, pp. 223-24. As he stated, "We have to look at whether [a transaction is] going to work for the buying company shareholders, the benefit for the customers, the community, et cetera." *Id.* at p. 224.

Mr. Hempling attempted to use the "Background of the Merger" section of the GPE-Westar proxy filed with the Securities and Exchange Commission to show that in the sale Westar sought only the highest price without regard to shareholders. *See* Hempling Direct, pp. 19-23. However, as pointed out by Joint Applicants' witness Reed, Mr. Hempling misrepresents the purpose of the proxy and therefore misinterprets the document. As Mr. Reed noted,

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

Reed Rebuttal, p. 30.

Westar's actions in seeking a merger transaction were consistent with industry practice and with the course of action that led to Algonquin's acquisition of Empire that the Commission approved in December 2016. A review of the "Background of the Merger" section in Algonquin-Empire's proxy statement shows that it contains statements quite similar to those in the GPE-Westar proxy. For instance, the Algonquin-Empire proxy states (1) that on October 29, 2015, the board of directors met with outside advisors to consider, among other things, "options to maximize shareholder value," Joint Applicants Exhibit 5, pp. 29-30, (2) that on November 18, 2015, its financial advisor identified as "Tier 1" bidders a representative group that Empire's financial advisor "had the greatest likelihood to maximize shareholder value to Empire's shareholders, *id*. at 30, and (3) that "[b]ecause of the Board's view that the Tier 1 potential counterparties constituted a representative group of parties with the greatest likelihood to maximize value to Empire's shareholders, the Board determined not to invite other parties to participate in the Phase I process…. *Id*. at pp. 30-31. However, unlike GPE-Westar's proxy, there is no mention in the Background of the Merger section of the Algonquin-Empire proxy of "customers," "customer service" or "public interest" as a consideration in the auction process. *See* Joint Applicants Exhibit 5, pp. 29-36. By contrast, as pointed out by Mr. Ruelle, in the GPE-Westar proxy there are clear statements that, in seeking a merger partner, Westar sought to consummate a transaction in the public interest (Ruelle Rebuttal, p. 20, 21), and that one of the factors important to the Westar board in agreeing to a transaction would be commitments that a potential purchaser would be willing to make to Westar's customers, employees and communities. *Id*.

Despite the complete lack of support in decisions by any regulatory commission or court for multiple positions taken by Mr. Hempling, Staff witnesses followed his approach. Thus, Staff seems to have uncritically adopted Mr. Hempling's radical approach. Mr. McClanahan appears to have relied entirely upon Mr. Hempling – without any apparent regard for the fact that Mr. Hempling's positions have been consistently rejected in proceedings in which he testified, Tr. Vol. 2, McClanahan, pp. 456-474 – for his testimony that: the Transaction overcompensates Westar's shareholders (McClanahan Direct Testimony, pp. 10-11, fn. 12); "financial engineering" in the Transaction creates a fundamental flaw (*Id.* at pp. 12-13); Westar should have agreed to be acquired without demanding a premium (*Id.* at p. 17); and the rationale for "sharing" the control premium with Westar customers (*id.* at pp. 39-40). Similarly, the Commission's Chief of Accounting and Financial Analysis, Justin Grady, relies on the "policy recommendation" of Mr. Hempling for his recommendation that the control premium be credited to Westar customers. Grady Direct Testimony, pp. 78-79.

All of these positions are inconsistent with mainstream regulatory approaches and ignore the role of private property rights, corporations and corporate governance in the public utility industry. None of these positions are consistent with the Merger Standards or the manner in which the Commission has applied them over the years. They do not and will not yield an outcome that is in the public interest. These positions should all be rejected.

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

Summary

The merger will have no effect on the Commission's jurisdiction over either KCP&L or Westar. The only effect of the Transaction on Westar will be that it will have one shareholder rather than thousands. KCP&L will be unaffected by the Transaction. Both KCP&L and Westar will continue to be financially strong utilities subject to the Commission's plenary authority. Staff's stated concerns about the loss of potential competition are unsupported and speculative.

The Commission will continue to have the ability to benchmark the utilities using readily available industry data and to require corrective actions in the unlikely event they are necessary to ensure the financial health of the utilities.

Argument

After the merger, Westar will become a wholly owned subsidiary of GPE along with KCP&L and KCP&L Greater Missouri Operations ("GMO"). There will be no change to Westar that would affect the Commission's jurisdiction over it.

The only change in Westar is that it will have one shareholder where it currently has thousands, and that one shareholder – GPE – has owned and controlled KCP&L for more than fifteen years. Westar will continue to have its own separate corporate existence (Bassham Direct, p. 4, and capital structure, Ives Rebuttal, p. 43), will continue to issue its own debt (*id.*) and will continue to be subject to the Commission's plenary authority under Kansas law. *See* K.S.A. 66-101. Moreover, after the Transaction, it is anticipated that Westar will continue to be capitalized in a manner consistent with industry and past practice with both debt and equity ratios of approximately 50% of total capitalization. *See, e.g.*, Tr. Vol. 4, Hevert, p. 828. With regard to the utilities' capital structures, the Commission does not have to take GPE's word for it. The Merger Commitments and Conditions,

> …establish firm commitments to maintain separate capital structures, debt instruments, and credit ratings among GPE, KCP&L and Westar, to not guarantee the debt of other affiliates or pledge stock of an entity as collateral for obligations of another entity, unless otherwise authorized by the Commission. We state that KCP&L and Westar will maintain investment grade capital structures and commit to stated maximum levels of debt in the capital structure of the utilities and GPE (Nos. 10 and 12). The conditions also contain commitments to continue to conduct business as separate legal entities and to maintain separation of the assets of the affiliated companies unless otherwise authorized by the Commission (No. 11).

Ives Rebuttal, pp. 43-44.

After the transaction, KCP&L and Westar will continue to be the same financially strong utilities that they are today. The utilities are expected to maintain their current credit ratings. Tr. Vol. 3, Reed, pp. 578-79. The utilities will continue to be able to meet their public service obligations. The primary differences are that (1) the merged company will operate more efficiently and at lower costs than it was able to prior to the Transaction, and (2) Westar will now have one shareholder, GPE, as opposed to its many shareholders today. There is nothing in the Transaction that would change the Commission's ability to regulate either utility and in fact, the combination of two Kansas utilities will preserve, and perhaps strengthen its ability to exercise its authority over Westar and KCP&L. 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. *See* Ruelle Rebuttal, pp. 25-27.

Staff, again, through its consultant Hempling, argues that due to GPE's acquisition-related debt, the Commission will face pressure to protect GPE from competition by others, including companies that could perform more cost effectively. Hempling Direct, at 65-66.

Specifically, Mr. Hempling is referring to the requirement in New York that its investor-owned utilities consider "non-wires alternatives" before committing to a traditional wires investment that would otherwise be required to meet load growth. Reed Rebuttal, at 51. New York utilities are required to solicit interest from third parties to "determine if they can aggregate customer-sited solutions including energy efficiency, demand response, and distributed generation in sufficient quantity and with sufficient reliability such that load growth would be offset and the major project deferred or potentially avoided." Id. Mr. Hempling's argument is flawed for several reasons.

First, the Joint Applicants have demonstrated that GPE's acquisition-related debt will not impose additional risks on the operating utilities or customers. See Sections IV.A. and C., *infra.* Second, Mr. Hempling fails to make any connection between the alleged consequences of GPE's Transaction debt and pressure on the Commission to protect Westar and KCP&L from competition. Third, the "competition" Mr. Hempling envisions – having "non-wires alternatives" compete with utility investment – is far too speculative at this time to be applicable to this merger standard in Kansas. Reed Rebuttal, at 51-52. As noted by Mr. Reed, it is not yet clear that this new and as-yet untested policy will benefit New York customers and it is certainly not ripe for consideration as part of Kansas' Merger Standards. Reed Rebuttal, at 51-52. Finally, Mr. Reed also demonstrates that to accept Mr. Hempling's premise, one must assume regulatory failure – that the Commission somehow cannot or will not exercise its appropriate authority to regulate the utilities. Reed Rebuttal, at 52; see also Ives Rebuttal, at 25.

Mr. Hempling also argued that the merger of two adjacent utilities would eliminate "benchmarking competition" between them. Hempling Direct, pp. 112-13. However, as Joint Applicants' witness Reed pointed out, the Commission does not currently rely on comparisons between KCP&L and Westar, Reed Direct, p. 55, and, given the significant differences between their service territories such comparisons would be "difficult at best." *Id.* at p. 56. Moreover, "Utilities also routinely participate in industry benchmarking studies that are informative and which will continue to be available to the KCC." *Id*.

As a result, the Commission should reject Staff's arguments regarding the effect of the Transaction on competition and find that no adverse effect on competition will result from the Transaction. Mr. Gatewood also asserts that the Transaction will reduce the Commission's ability to effectively regulate the new entity because it will create a financially weaker utility. Gatewood Direct, p. 43. He claims the Transaction would leave the Commission with fewer options in the future, indicating the Commission might be hesitant to use a rate making principle, even if it is sound policy and established practice, if it is likely to result in a downgrade of the utility. Gatewood Direct, pp. 43-44. Mr. Gatewood attempts to use as an example the past Westar investigatory docket instituted when the management of Westar allowed its unregulated operations to threaten the financial condition of its regulated utility.[11] Gatewood Direct, p. 45. But as Mr. Ruelle explained at hearing, that docket is an excellent example of *the opposite* of what Mr. Gatewood fears. It shows the power held by the Commission to step in and ensure financial risks taken by one segment of a company do not impact the utility. As Mr. Ruelle testified,

> Back when Westar messed up badly in the late '90s and early 2000's? Shareholders took it, you know. They had a bad outcome. Customers' rates didn't get affected. I mean the Commission has a lot of authority to make sure nothing bad happens to customers, even if something bad could happen to shareholders…. And you have a lot of authority over and above that that you imposed on Westar as a

[11] Docket 01-WSRE-949-GIE, opened May 8, 2001 ("01-949 Docket").

> Commission at the time to make sure that when we messed up, it didn't splash on customers.

Tr. Vol. 1, Ruelle, pp. 256-266.

Staff also failed to explain that Westar's financial problems investigated in the 01-949 Docket were able to occur and get to the extreme point they did because there were no financial restrictions, or "ring fencing" measures, in place at the time. By the time the Commission became aware of the problems and stepped in to protect the utility, the utility's assets had already been used to secure heavy levels of debt incurred in bad unregulated business ventures. Tr. Vol. 2, Proctor, pp. 368-69. Even so, the Commission held sufficient authority to stop the hemorrhaging while protecting customers from the negative impacts. The present Transaction and Application is in stark contrast to the situation existing in the 01-949 Docket. Here, the Commission has all the information in advance and can put in place the ring-fencing protections necessary to ensure the conditions that led to the financial problems experienced by Westar in the early 2000's will not occur.

Staff's assumption that the Commission may shy away from taking appropriate regulatory action in the future is inconsistent with the Commission's past willingness to exercise proper regulatory power. This is the same argument as Mr. Hempling's above, and incorrectly assumes regulatory weakness or failure. Reed Rebuttal, at 52; Ives Rebuttal, at 25.

The Transaction will have no effect on the Commission's ability to regulate KCP&L and Westar and meets this Merger Standard.

IV. Financial Issues (Including Capital Structure, Treatment of Gain on Sale, Acquisition Premium, Reasonableness of Purchase Price, and Financial Impacts on Utilities, GPE and Shareholders)

A. Merger Standard (a)(i): "(a) The effect of the transaction on consumers, including: (i) The effect of the proposed transaction on the financial condition of the stand-alone entities if the transaction did not occur."

Summary

GPE is financing the Transaction on a balanced basis, with about 50% equity and 50% debt. Including Westar's current debt (which will remain on Westar's balance sheet), GPE's consolidated capital structure will become more highly leveraged (approximately 59% debt and 41% equity) than is typical for a utility. Debt costs are currently at or near historically low levels, and these low debt costs enable GPE to finance the Transaction while making commitments to (1) not seek rate recovery of the acquisition premium, and (2) reflect all Transaction savings in rates by continuing to apply traditional ratemaking practices. 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. GPE has proposed substantial financial integrity, ratemaking and ring-fencing commitments to protect customers from potential adverse effects of GPE's holding company Transaction debt.

In light of the substantial customer benefits expected from the Transaction, the speculative impact of GPE Transaction debt on utility customers and the substantial protections proposed by GPE to shield customers from any such impact, the Transaction is in the public interest under the analysis of merger standard (a)(i).

Argument

1. Financial Condition Post-closing

GPE's participation in the competitive process resulting in its winning bid and the Agreement for GPE to acquire Westar was guided by five fundamental principles, the first of which is: "The combined company must be strong financially." Bassham Direct, at 3. In furtherance of that principle, GPE put together a balanced plan to finance the Transaction, consisting of approximately 50% equity and 50% debt. Bryant Direct, at 9. Including the current Westar debt that will remain outstanding and on Westar's balance sheet, GPE's consolidated capital structure of approximately 41% equity and 59% debt post-closing will have more debt than is typical for an electric utility holding company. Bryant Direct, at 18. GPE also vetted its plans with two credit rating agencies – Standard & Poor's ("S&P") and Moody's[12] – to understand the Transaction's impact on the credit ratings of KCP&L, Westar and GPE[13]. Bryant Rebuttal, at 16. As a result, S&P has affirmed that the credit ratings of KCP&L, Westar and GPE will not change as a result of the Transaction. Bryant Direct, at 21. And while Moody's has also affirmed that the credit ratings of KCP&L and Westar will not change as a result of the Transaction, Moody's expects to downgrade GPE's credit rating by one notch after closing although that GPE credit rating by Moody's will remain investment grade. *Id*. To summarize, the table below depicts the pre- and post-closing credit ratings reported by S&P and Moody's:

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[12] The other oft-cited credit rating agency is Fitch, and neither GPE nor Westar maintained a relationship with Fitch at the time the Transaction was announced. Given Fitch's lack of detailed knowledge about the Transaction, Fitch's reports about it should be accorded no weight by the Commission. Bryant Rebuttal, at 25.

[13] Mr. Bryant also assessed the impact of the Transaction on KCP&L Greater Missouri Operations Company ("GMO"), although GMO has no Kansas operations and thus may not be of particular interest to this Commission.

	Standard & Poor's		Moody's	
	Pre-close	**Post-close**	**Pre-close**	**Post-close**
KCP&L	BBB+	BBB+	Baa1	Baa1
Westar	BBB+	BBB+	Baa1	Baa1
KG&E	BBB+	BBB+	Baa1	Baa1
GPE	BBB+	BBB+	Baa2	Baa3

Bryant Rebuttal, at 16. Upon closing, the credit ratings of GPE's utilities will be unchanged and the credit ratings of GPE itself will remain investment grade. Analysis of the financial condition of the combined company should not end there, however.

Information GPE presented to S&P and Moody's, which was also referenced in Mr. Bryant's direct testimony, demonstrates that GPE will possess sufficient cash flow to pay the cost of financing the Transaction during the first three and one-half years after closing (*i.e.*, 2017 through 2020). Bryant Direct, at 15-17. This is typically the most critical time for any significant transaction because all of the associated financing remains outstanding as there has not yet been sufficient time for debt levels to be paid down. As Mr. Bryant explains, GPE's credit metrics improve over time due to cash flow increases resulting from the Transaction. Bryant Direct, at 21-22. This can also be seen in materials provided to investors. KIC Exhibit 6, p. 13. GPE's improving cash flows and credit metrics over three to five years after closing provide the ability to begin paying down the Transaction debt, particularly when results from all of its utility operations (including KCP&L and GMO) are considered along with those of Westar. Bryant Rebuttal, p. 22-23; Tr. Vol. 3, Bryant, pp. 724, 753-754. Moreover, in the unlikely event that future cash flows are insufficient, GPE has options available to improve its cash position, including issuance of additional equity or reducing dividends paid to shareholders. Bryant Rebuttal, p. 20; Tr. Vol. 3, Bryant, p. 752. GPE has demonstrated the willingness and ability to take such actions when necessary in the recent past, such as when it reduced shareholder dividends and issued additional equity during a time of liquidity impairment due to the extraordinary 2008 economic downturn at the same time KCP&L was financing construction of Iatan. Tr. Vol. 3, Bryant, pp. 694-695.

Financial condition encompasses characteristics beyond credit ratings which also warrant consideration under merger standard (a)(i). Mr. Bryant notes that "as a combined company we will have increased scale, possess greater resources and overall be better positioned to serve customers and pursue investment opportunities that were not available to either company stand-alone." Bryant Direct, p. 12. And he also observes that the larger financial resources and balance sheet of the combined company provide it with greater ability to absorb the financial impact of significant negative events – such as storms or equipment failures, for example – than either company on a stand-alone basis. Bryant Rebuttal, p. 44. Additionally, S&P recognizes that:

> Prospectively, the combined entity would have more diverse electric utility cash flow sources, strengthening the excellent business risk profile.

Bryant Rebuttal, p. 24. Similarly, Moody's also notes additional financial condition benefits of the Transaction:

> The acquisition of Westar will enhance the business profile of Great Plains in many ways, including: increased size, scale and scope; operating cost synergies due to a contiguous service territory; core competency in managing Missouri and Kansas regulatory and political environments; and the addition of $1.2 billion of FERC regulated transmission rate base.
>
> ***
>
> From a strategic perspective Moody's sees Westar as a natural fit for Great Plains, given overlapping service territories and a shared ownership of the 1,170 mega-watt Wolf Creek nuclear generation facility. Utilities with contiguous service territories tend to produce higher operating cost synergies.

Bryant Rebuttal, pp. 24-25. Moody's also explains its expectations regarding the outcome of the Commission's review of the Transaction which are reflected in the business risk assessment informing Moody's ratings:

> We believe regulators will approve the combination because the reasoning behind spreading fixed costs across a larger asset base makes sense for all stakeholders. We also believe that regulators will approve the transaction based on prior approvals, such as when Kansas allowed Great Plains and Black Hills Corp. (Baa1 negative) to divide the assets of Aquila, Inc. within the state.

Id. These factors positively affect the financial condition of the combined company post-closing compared to either company on a stand-alone basis.

Staff criticizes GPE for not clearly laying out a plan to pay down Transaction debt. Gatewood Direct, p. 27. While expedient and convenient, this criticism is not persuasive. It falsely pre-supposes that a written plan is required to take action in the future when future conditions are presently uncertain. GPE has a long history of managing its financing needs efficiently and effectively in light of conditions prevailing when decisions need to be made, and GPE expects to make decisions regarding the pay down of Transaction debt in the future consistent with its past practice. As Mr. Bryant testified during the following exchange on the witness stand:

> Q: Do you need a written plan to pay down debt?
>
> A: [By Mr. Bryant] I think about that unwritten plan every day.
>
> ***
>
> Q: Do you need a written plan to pay down debt?
>
> A: I don't think so.

Tr. Vol. 3, Bryant, pp. 772-773. Mr. Bryant elaborated on the pay down of GPE's Transaction debt in response to a question from Commissioner Feist-Albrecht:

> Commissioner Feist-Albrecht: I think I just have one, one that Mr. Reed deferred to you and it had to do with delevering. And I think I kind of asked him, I think there was acknowledgement that there were no set plans. And as I recall I asked him what period of time the delivering might occur. And I guess the question is not just the time, but what kinds of factors would GPE consider in terms of making a decision to delever?
>
> Mr. Bryant: So, so 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 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, the credit rating falling from Baa2 to Baa3, I think we would get that notch back and be at the same place were when we started to go through the transaction.

Tr. Vol. 3, Bryant, pp. 746-747.

In sum, the Transaction debt being taken on by GPE and its shareholders is a measured risk that is reasonable in light of the benefits created by the Transaction and one which GPE fully understood would be reviewed by credit rating agencies as well as the KCC. Credit rating agencies have examined this risk and concluded that it will have no negative effect on the credit ratings of either Westar or KCP&L. Even though there is but a slim chance that Transaction debt held by GPE would negatively impact the credit ratings of KCP&L and Westar, GPE has proposed, as will be discussed below, substantial conditions and commitments to protect utility customers from potential adverse effects of GPE's Transaction debt. Bryant Rebuttal, pp. 28-32. Ultimately, the Transaction debt will have only a modest and near-term impact on GPE's credit rating that, on balance, is well justified by the Transaction's many benefits.

2. Effect on consumers

Staff and intervenors' single-minded focus on the credit rating and debt levels of GPE misses the mark. The utilities will issue their own debt that is separately rated by credit rating agencies, that is separate from the debt of each of the other utilities, and that is also separate from the debt of GPE. Ives Direct, p. 23; and Ives Rebuttal, Schedule DRI-3, pp. 3-4, Condition Number 10. It is the cost of this Westar and KCP&L debt that should be of most interest to the Commission. As noted above, however, the credit rating agencies do not expect the Transaction to result in any negative impact on the credit ratings of Westar or KCP&L. Bryant Rebuttal, p. 16.

Curiously, Staff and intervenors fail to recognize that GPE's Transaction debt is the linchpin enabling the creation of substantial customer benefits. As Mr. Bryant testifies:

> …this financing plan, which relies on substantial debt financing in the current unprecedented low-cost interest rate environment, *enables* the creating of an energy company with much larger scale. This new company will create billions of dollars of cost savings…

Bryant Rebuttal, p. 6 (emphasis in original). Not only will customers get the benefit of all of these savings in the normal course of ratemaking, but GPE is not requesting rate recovery of the acquisition premium. Ives Direct, p. 7, 20-21. Additionally, GPE has proposed numerous financial integrity, ratemaking and ring-fencing commitments to protect utility customers from any potential adverse effects of GPE Transaction debt. Bryant Rebuttal, pp. 28-32; Ives Rebuttal, pp. 40-40, Schedule DRI-3.

On balance, given the highly speculative impact of GPE's Transaction debt on Westar, KCP&L and their customers, the substantial customer protections proposed to protect utility customers from any adverse effects of GPE's Transaction debt and the substantial customer benefits enabled by GPE's Transaction debt (*e.g.*, no rate recovery of the acquisition premium and all Transaction savings reflected in rates through normal ratemaking practices), Joint Applicants submit that the Transaction satisfies merger standard (a)(i).

B. Capital Structure

Summary

A threshold issue in this case has turned out to be what the appropriate capital structure should be when setting rates for KCP&L and Westar in future post-closing rate cases. The overwhelming authority in Kansas and other jurisdictions supports Joint Applicants' position that the appropriate capital structure is one that reflects the capital used to finance the utilities' assets and operations. Consistent with this precedent, the Commission has adopted GPE's capital structure in KCP&L's most recent rate cases because it reflected the capital used in funding KCP&L's utility operations and was nearly identical to KCP&L's actual capital structure of approximately 50% equity and 50% debt. In connection with the Transaction, GPE will be issuing $4.4 billion in debt to fund the purchase of Westar's stock. All of the funds raised will be paid to Westar shareholders; none will be invested in physical assets of Westar. Because none of the incremental debt incurred at GPE will be used to fund either KCP&L's or Westar's utility operations, GPE's post-closing consolidated capital structure of 41% equity and 59% debt will not be appropriate for setting KCP&L's or Westar's rates because it will not reflect the mix of capital used to fund either KCP&L's or Westar's operations. Joint Applicants have provided compelling authority and support for the position that each utility company's separate capital structure should be used to set rates in future rate cases as long as that capital structure continues to accurately reflect the mix of capital used to fund each utility.

Staff argues that the Commission should adopt GPE's consolidated capital structure when calculating KCP&L's and Westar's future rates. Notably, in significant departure from precedent, Staff does not allege that the consolidated capital structure accurately reflects the *capital used to fund utility operations. Rather, Staff argues a fictional "recapitalization" has occurred, and that the Commission should adopt the consolidated capital structure as a regulatory tactic to discourage the parent companies of utilities from becoming highly leveraged without regard to the benefits of employing increased leverage at the parent level. Staff's "least cost capital structure" position is inconsistent with both Commission precedent and precedent of many other utility regulatory authorities across the country, not only because Staff applies its "least cost capital structure" position irrespective of whether the funds in the selected capital structure support the utilities' operations, but also because it ignores the reality that unique facts exist for each company that must be considered in each rate case. Indeed, adoption of Staff's recommendation would prevent the Transaction from closing, thus causing Kansas customers to lose the benefits of the Transaction, including the estimate of nearly $2 billion in merger savings it will generate in just the first decade after closing.*

Argument

1. Appropriate Capital Structure for Future Rate Cases.

An important issue in this case concerns the capital structure to be used to set rates for KCP&L and Westar in future post-closing rate cases. Joint Applicants submit that the individual capital structures of the utilities should be used because, once the Transaction closes and the $4.4 billion in Transaction debt goes onto GPE's books, the consolidated capital structure of GPE will not reflect the capital used to finance the assets and operations of the utility companies. Prior to the Transaction, the approximate equity/debt ratios of the GPE entities are: GPE – 50/50; and KCP&L – 49/51. Joint Applicants Exhibit 19. As such, there was little difference between using the KCP&L operating company's capital structures or the GPE consolidated capital structure to set rates for KCP&L prior to the Transaction and either the consolidated or operating company capital structure would reasonably reflect the capital used to fund utility operations. However, post-Transaction, the approximate equity/debt ratio of GPE on a consolidated basis will be 41/59 due to the Transaction debt incurred by GPE to purchase Westar's stock, while KCP&L's and Westar's will remain the same as before the Transaction (49/51 and 53/47, respectively). Joint Applicants Exhibit 19. It will not be appropriate to use the GPE consolidated capital structure to set KCP&L's and Westar's rates because GPE's consolidated capital structure which includes substantial Transaction debt will not reflect the capital used to fund the utilities' operations.

When the Joint Application was filed, Joint Applicants understood that the Commission's established policy on determining the appropriate capital structure for setting rates is to use a capital structure that reflects how the utility's assets and operations have been funded. Hevert Rebuttal, pp. 10-14. With this backdrop, Joint Applicants' represented in the Application that they would never request any portion of acquisition premium or transaction costs be included in KCP&L's or Westar's revenue requirements in future rate cases. Ives Supplemental, p. 12. The acquisition premium would stay on the financial books of GPE and, because GPE could obtain low-cost debt financing in today's capital market, GPE would be able to service the Transaction debt with cash-flow from normal and customary dividends received from its subsidiary utility companies and other sources, supplemented with whatever portion of merger-related savings would accrue between rate cases as a result of normal regulatory lag. Bryant Direct, pp. 15-17; Bryant Supplemental, p. 7. As such, customer rates would not be negatively affected by the Transaction, and the risk of the Transaction would fall only upon GPE's shareholders. Bryant Supplemental, p. 8.

However, through discussions with Staff and other parties held after the Application was filed, it became apparent to Joint Applicants that Staff and a few other parties would argue that the consolidated capital structure of GPE which would include substantial Transaction debt should be used to set future utility rates, apparently because that would result in a lower revenue requirement than using the capital structure of the utility companies. In taking this position, Staff abandoned the sound reasoning for use of the consolidated capital structure when it accurately reflects capital used in funding utility operations, asserting instead that the lowest cost capital structure should be used because, (1) low-cost debt financing obtained by a parent company to make its investments in its subsidiaries constitutes "recapitalization" of the entire family of companies, no matter how the debt is used by the parent[14], (2) adopting Staff's policy would discourage the parent companies of utilities from becoming highly leveraged, no matter what reason might underlie the increase in leverage at the parent level[15], and (3) such a policy is consistent with the Commission's past precedent.[16] Staff's arguments are unsound and contradict Commission precedent as described above and expanded upon below.

In response to this direct testimony, Joint Applicants submitted the rebuttal testimony of Mr. Robert Hevert explaining why Staff's position on capital structure is incorrect, unreasonable, unfair, inconsistent with precedent in Kansas and other jurisdictions, and counter-productive to promoting the public interest in Kansas. Mr. Hevert explained that Staff's attempt to use the consolidated capital structure which includes substantial Transaction debt incurred by GPE for rate-setting is what is commonly referred to as a "double leverage" adjustment; something proposed in only a few other jurisdictions and rarely adopted by public utility commissions. Hevert Rebuttal, pp. 4, 7-8.

[14] Gatewood Direct, pp. 38-41.

[15] Gatewood Direct, p. 42.

[16] Gatewood Direct, pp. 41-42.

Mr. Hevert testifies that Staff's position regarding the use of the consolidated capital structure which includes GPE Transaction debt for ratemaking purposes is flawed in a number of aspects:

- Staff's proposed $401 million "double leverage" adjustment would have the practical effect of terminating the Transaction, even though the adjustment has no meaningful support in theory or in practice.
- Long-standing practice among utility commissions is to establish rates based on operating company capital structures, not consolidated capital structures. They do so for the fundamental reason often expressed by this Commission: the ratemaking capital structure should be based on the capital used to fund the assets enabling the provision of utility service.
- Staff's definition of the "least cost" capital structure is greatly oversimplified, and ignores important factors that are crucial to the prudent, day-to-day management of utility balance sheets.
- Staff's position would effectively terminate the Transaction for the simple reason that capital cannot be used for two different purposes, at two different companies, at the same time. The acquisition debt is being issued and used by GPE to pay individual Westar shareholders for their stock. Because the acquisition premium is not an asset in rate base at the utility, the acquisition debt should not be used to reduce utility rates (even beyond the benefits of the merger savings) as a result of the higher debt leverage. Regulatory and financial practice call for the ratemaking capital structure to match the assets being financed.

Hevert Rebuttal, pp. 4-5.

The following addresses the arguments put forth by Staff[17] in support of its position.

2. Staff Incorrectly Asserts that GPE's Transaction Debt Constitutes "Recapitalization" of the Utility Companies.

Staff's double leverage adjustment is based, primarily, on Staff's assertion that GPE is "recapitalizing" KCP&L and Westar by virtue of the financing being undertaken to purchase Westar's stock. Gatewood Direct, p. 38. Staff fails to acknowledge that the low-cost debt being incurred by GPE will be used entirely to fund its purchase of the shares of Westar from individual Westar shareholders, that Westar itself will never take possession of any such funds, and thus it cannot be used to fund the utilities' assets or operations, and that neither Westar's nor KCP&L's capital structure will change as a result of the debt issuance by GPE. Hevert Rebuttal, p. 17.

Staff's recommendation improperly looks to the source of funds for the investor – that is, GPE – instead of the opportunity cost for the investor's funds.[18] However, the cost of equity is an opportunity cost that has to do with the risks of comparable investment opportunities. It has nothing to do with the source of the funds. Tr. Vol. 4, Hevert, p. 888. It is a well-established principle of utility regulation that the cost of equity depends upon the risk of the investment as opposed to the source of the funds. Tr. Vol. 4, Hevert, p. 924. Staff's position – that the return on an investment should reflect the source of funds – is inconsistent with basic financial

[17] A few other parties in the docket presented a position similar to Staff's on capital structure, but none put forth additional analysis beyond what Staff presents. Therefore, this Brief will refer only to Staff in this regard for brevity, but to the extent any other party made a similar argument, this Brief is intended to respond to those parties, as well.

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

principles and theory. Hevert Rebuttal, p. 19. To adopt Staff's proposed double leverage adjustment, the Commission would have to accept the notion that a company would have a different value depending on how investors fund their equity investments, which violates the economic "law of one price," which states that in an efficient market identical assets must have the same value. Hevert Rebuttal, p. 19.

At hearing, Mr. Gatewood attempted to maintain Staff's argument that the source of the funds GPE used to purchase Westar's stock is the relevant consideration in determining the utility's cost of capital. However, he acknowledged that the Commission does not look at the source of funds used by present Westar shareholders to buy their stock, and in fact, Staff does not know or care how present shareholders finance their purchase of the stock. Tr. Vol. 5, Gatewood, pp. 1146-47. And yet, Mr. Gatewood testified that post-Transaction, if the consolidated capital structure which includes substantial Transaction debt held by GPE is not used to set rates for Westar and KCP&L, then GPE will be receiving a higher return on the equity it is investing than what present shareholders are earning. Tr. Vol. 5, Gatewood, pp. 1147-48. When asked how he could know that since he does not know (or care) how present shareholders funded their purchase, Mr. Gatewood was unable to provide an explanation. Tr. Vol. 5, Gatewood, p. 1148. The fact is that whether Westar's stock is owned by multiple investors or by just one, the source of funds used by those investors is irrelevant for determining the cost of capital for rate-making purposes. Staff's approach is simply wrong. Cost of capital estimation is based on the fundamental principle of "opportunity costs," which represents the return forgone by investing in one asset (Westar) rather than another asset of comparable risk. Hevert Rebuttal, p. 19.

The customers of Westar and KCP&L are currently paying rates based on a proper capitalization ratio that will not change for Westar and KCP&L as a result of the Transaction. Westar and KCP&L presently issue their own debt and will continue to do so after the Transaction closes. Tr. Vol. 4, Hevert, pp. 858, 937-39; Tr. Vol. 2, Ives, pp. 440-41. Rates will stay the same post-acquisition, there will be no change in assets committed to public service by either company, business risks for the utilities will not change, and Westar and KCP&L will propose rates to be established in the first rate cases to be filed post-Transaction no later than January 1, 2019 for both companies using essentially the same equity/debt ratios as were used to set present rates. As depicted in Joint Applicants Exhibit 19, set out below, only GPE's capital structure will change post-Transaction due to the incurrence of the $4.4 billion of debt being used to fund the purchase of Westar stock from Westar shareholders.

	WESTAR		KCP&L	
	Without Merger	*With Merger*	*Without Merger*	*With Merger*
CAPITAL STRUCTURE[1]	53/47	53/47	49/51	49/51
RATES UNTIL 1ST RATE CASE AFTER CLOSING	Same as today, subj. to abbrev. case	Same as today, subj. to abbrev. case	Same as today, subj. to abbrev. case	Same as today, subj. to abbrev. case
1ST RATE CASE AFTER CLOSING	Filed by 1/1/2019	Filed by 1/1/2019	Filed by 1/1/2019	Filed by 1/1/2019
• Included in Cost of Service ("COS")	$40 MM expiring power contract, wind farm capex and other COS changes	$40 MM expiring power contract, wind farm capex and other COS changes	Customer information system capex and other COS changes	Customer information system capex and other COS changes
• Reduced by Merger Savings of:	$0.00	Merger Savings, if any	$0.00	Merger Savings, if any
QUALITY OF SERVICE	Same level of service	Same level of service enforced by potential penalties	Same level of service	Same level of service enforced by potential penalties
KCC JURISDICTION	100% of Westar's regulated retail operations	100% of Westar's regulated retail operations	100% of KCP&L's regulated KS retail operations	100% of KCP&L's regulated KS retail operations

[1] GPE capital structure is 50/50+/- (equity/debt) without merger, and approximately 41/59 with merger.

Staff argues that the incurrence of $4.4 billion in debt by GPE constitutes a "recapitalization" of the entire GPE group of companies. Gatewood Direct, p. 38. However, that is simply not the case. The debt being issued by GPE for this Transaction will be used entirely by GPE as an investor to purchase the stock of Westar from individual Westar shareholders; it will not create funds that support utility operations. Tr. Vol. 2, Ives, p. 441.[19]

Finally, Staff's position violates the *Hope* and *Bluefield*[20] standards – standards that Staff and the Commission have consistently endorsed and adhered to – with the probable consequence of such a decision being the flow of capital *out of* Kansas, forcing utilities to increasingly finance their operations with significantly reduced operating cash flows. Hevert Rebuttal, p. 6.

3. Staff Alleges its Position Will Discourage Parent Companies from Becoming Highly Leveraged.

Staff's next justification for recommending the Commission adopt a policy of using the "least cost capital structure" is that Staff considers it to be effectively a ring fencing measure because it removes the holding company incentive to engage in over leveraging. Gatewood Direct, pp. 41-42.

As a preliminary matter, it is not clear, and Staff not demonstrated, that a least cost capital structure is a valid objective, even if agreement could be reached on what that might be and how it would be established. Rather, there is general consensus that investor-owned utilities and their customers are best served by a *balanced* capital structure that remains reasonably close

[19] The same dollars cannot be used twice – once to purchase Westar's stock and again to recapitalize the utilities. The Commission recognized this concept in its December 28, 2005 Order in Docket No. 05-WSEE-981-RTS. In that rate proceeding for KPL/KGE, the Commission reversed an earlier decision it had erroneously made that accepted Staff's argument to use the unamortized portion of the gain on sale of KGE's interest in La Cygne as an offset to rate base. The Commission reversed and corrected its earlier decision, accepting KGE's position that the funds were used to purchase common stock, redeem bonds and retire high cost debt, and therefore, were not available to also be used as an offset to ratebase. Order, pp. 48-51.

[20] *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923) *("Bluefield")*; and (2) *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) *("Hope").*

to 50% debt, 50% equity with variations attributable to the financial performance and the pattern of debt and equity issuances. Hevert Rebuttal, p. 14.

Besides the paradox in Staff's position – that its ring fencing method would serve only to terminate the Transaction, thus making ring fencing unnecessary – Staff's approach also would not solve the concerns normally addressed by imposing actual ring fencing conditions. In fact, Staff's approach would cause other problems and issues, and would impose additional negative financial consequences on the parent, GPE, that would create the very financial instability about which Staff claims to be concerned. For example, in the present case, if the Commission determines that future rates should be set using a consolidated capital structure of 59% debt (and assuming GPE went forward with the Transaction in light of that finding), it would threaten GPE's ability to meet its financial obligations – exactly what Staff says it fears. It would place the utilities in the position of having to decide if they should leverage up to that debt ratio so as to align their actual capital costs with the rates set by the Commission. Mr. Hevert referred to this as "an untenable situation." Tr. Vol. 4, Hevert, pp. 878-79.

Mr. Hevert also addressed how Staff's "least cost" capital structure position greatly oversimplifies the complexities inherent in determining an appropriate capital structure for a utility company. Hevert Rebuttal, p. 7. He explained how higher leverage in the capital structure – actual or imputed from the parent – would impact other aspects of the return on equity calculation, a critical fact that Staff ignores. Imputing a higher risk capital structure to the utility increases the utility's financial risk, which translates into higher costs of debt and equity. Hevert Rebuttal, p. 21-22; Tr. Vol. 4, Hevert, pp. 926-27, 947-48. Presently, debt issued by the utility is based on the assumption that the utility will continue to be capitalized in a balanced manner consistent with industry practice. If the debt to equity ratio suddenly changes, that change will affect the risk assumed by creditors and therefore the terms at which they will extend credit to the utility. Additionally, if the Commission were to adopt a Staff recommendation which is so far out of the mainstream of utility regulatory practices, credit rating agencies would have to conclude that the regulatory environment in Kansas has dramatically deteriorated in a way that imposes higher risks on utilities. Such a change would be reflected in the credit ratings of utilities subject to the Commission's rate-setting regulation, also increasing cost of capital. Tr. Vol. 4, Hevert, pp. 926-27, 936. Staff assumes the Commission can impute the higher leveraged, higher risk capital structure of GPE to KCP&L and Westar while keeping all other aspects of the utilities' cost of capital the same. That is a fundamentally flawed assumption, and any conclusion drawn from such an analysis is invalid.

Mr. Hevert also explained that Staff's oversimplification incorrectly assumes that the "least cost" capital structure may be determined independently of the assets and operations it must finance. Hevert Rebuttal, p. 21. The operations of a utility company are capital intensive, and because of the utility's obligation to serve, it does not have full discretion over the timing of its investments. These realities make capital structure optimization both dynamic and complex, but Staff's approach incorrectly assumes that minimizing the weighted average cost of capital is a substitute for optimizing the capital structure. Hevert Rebuttal, pp. 21-22. This assumption by Staff is fundamentally incorrect when evaluating regulated utility companies. Operating utilities manage their capital structures in a manner that reflects the nature of utility operations; a practice consistent with the Commission's past findings but inconsistent with Staff's position on capital structure. Hevert Rebuttal, pp. 24-25.

As an over-arching conceptual matter, Staff's position is guided by a faulty premise — that it is always in the public interest to discourage a parent company from engaging in transactions that could result in it being more highly leveraged for a period of time. Mr. Hevert addressed the fallacy of this premise at hearing,

> Q: [By Ms. Cafer] If there's an opportunity to incur some – well, to incur debt for a period of time for a purpose that benefits everyone involved, do you believe that it's constructive regulation to just have a policy against allowing such a thing to happen no matter what?
>
> A: [By Mr. Hevert] I don't think so. I think to the extent that there are savings that would accrue to the ratepayers here and that those savings are enabled by the transaction that the risks of the transaction, the leverage is isolated to the shareholders and not to the ratepayers. I don't see why denying that type of transaction would be considered constructive.

Tr. Vol. 4, Hevert, p. 941.

Staff places a negative connotation on the term "financial engineering," but as Mr. Hevert explains, it is viewed by economists as "the means of implementing financial innovation." Hevert Rebuttal, p. 18. He references economic theory stating that financial innovation "is the dynamic force propelling the financial system toward its function of providing more efficient resource allocation in the economy," and that such innovation "benefits society by lowering transaction costs, completing markets, and making prices more informative." Hevert Rebuttal, p. 18. Consistent with Mr. Hevert's representations, the Commission's Chief of Economics and Rates, Dr. Robert Glass, testified at hearing that if the Transaction results in lower rates to customers, that would be an economic efficiency. Tr. Vol. 7, Glass, p. 1621.

In support of its capital structure recommendation, Staff presented an analysis purporting to show that the utilities' revenue requirements would be $90 - $136 million lower using a consolidated capital structure versus the actual operating companies' capital structures.[21] Gatewood Direct, p. 37; Tr. Vol. 5, p. 1138. Mr. Gatewood asserts that the benefits of the "lower

[21] Staff's calculation of this amount is erroneous because it assumes one aspect of the cost of capital analysis can be changed while keeping all others the same. The fallacy of this assumption is addressed later in this Brief.

cost capital structure" will accrue only to shareholders if the Commission does not use it to set rates. Gatewood Direct, p. 21. However, under cross-examination, Mr. Gatewood admitted that the benefits of the lower cost debt will not accrue to *anybody* if his recommendation is adopted, making his $90 - $136 million analysis meaningless. Tr. Vol. 5, Gatewood, pp. 1138-39. Staff has failed to explain to the Commission, the customers of Westar and KCP&L, and the shareholders of Westar and GPE why the Commission should adopt a policy that would terminate this Transaction, thus foreclosing customers and shareholders from the opportunity to reap its benefits.

4. Staff Incorrectly Asserts that its Position is Consistent with Staff's Testimony and the Commission's Findings in Previous Dockets.

Staff's third argument is that using the "least cost" capital structure is consistent with the Commission's past precedent. Gatewood Direct, p. 29. On the contrary, in past cases Staff and the Commission have sought to identify the capital structure that best represents the mix of capital used to finance the utility. Hevert Rebuttal, pp. 10-14. In some cases, including KCP&L's most recent rate cases, that analysis resulted in the Commission applying a consolidated capital structure because it represented the capital used to finance utility operations. Staff's approach in this case takes *the result* of the Commission's analysis under its policy and represents it as *the policy itself.*

Mr. Hevert provided a thorough review of a number of Commission orders, as well as the positions taken by Staff in some of these previous dockets regarding the proper method for determining an appropriate capital structure in setting rates. Hevert Rebuttal, pp. 10-14. In none of these dockets did the Commission adopt a policy of using a "least cost capital structure," or blindly using the parent's consolidated capital structure. As recognized by Staff counsel during cross-examination of Mr. Hevert at hearing, the Commission's previous decisions were "pretty fact specific … the Commission did not just refer to a set capital structure policy but instead it looked at the facts and it decided what structure would result in just and reasonable rates, correct?" Tr. Vol. 4, Hevert, p. 859. In response, Mr. Hevert confirmed his agreement with Staff counsel's representation, stating, "I agree, and that's the point of my testimony. That's the point of my review that the Commission does look at the facts and circumstances. It does consider the nature of utility operations and it does consider practice throughout the industry." Tr. Vol. 4, Hevert, p. 859.

Generally speaking, rates should be set based upon the actual capital structure of the utility operating company if it can reasonably be determined, if it is consistent with industry standards and prudently balanced (usually considered in the area of 50% equity and 50% debt). Tr. Vol. 4, Hevert, pp. 932-33. A hypothetical structure – such as an assigned capital structure, or a consolidated capital structure – may be adopted for the utility if there are circumstances in a case making it impossible to determine the utility's actual capital structure or if that structure is unreasonable or fails to reflect the capital used to fund the utility operations. Tr. Vol. 4, Hevert, pp. 880-81. That is not the case with KCP&L or Westar post-merger; both companies will continue to carry and issue their own debt, and will continue operating with capital structures that reflect the capital used to fund their utility operations and which fall squarely within the industry norm for a prudently managed utility. Hevert Rebuttal, p. 15; Tr. Vol. 4, Hevert, pp, 881-82.

Mr. Hevert testified that the position of Joint Applicants in this regard is also consistent with the approach and policy adopted by the FERC. FERC will use the utility operating company's capital structure if it meets three criteria: (1) it issues its own debt without guarantees; (2) it has its own bond rating; and (3) it has a capital structure within the range of capital structures approved by the Commission.[22] FERC has recognized that the capital structure is tied to the assets being financed and to the nature of utility operations. Hevert Rebuttal, p. 9. KCP&L and Westar meet all three of FERC's criteria now and will continue to do so post-Transaction. Hevert Rebuttal, p. 10; Tr. Vol. 6, Ives, pp.1605-06.[23]

Mr. Mark Ruelle was asked at hearing if it was the Joint Applicants' position that the Commission needs to find that a consolidated capital structure can never be used in the future. That is not Joint Applicants' position. Mr. Ruelle explained that, "when there is a significant deviation between what's right for the utility and what the holding company has on a consolidated basis, either more equity than typical or less equity than typical, then regulators deviate to impose the utility capital structure, You never deviate to be unusual. You deviate back to the usual." Tr. Vol. 1, Ruelle, pp. 275-76. The usual capital structure for KCP&L and Westar centers around 50/50, and it is Joint Applicants' stated intent that this will not change after the Transaction. Hevert Rebuttal, pp. 14-15. This capital structure is normal for a utility company, and it accurately reflects the actual mix of capital used to finance the utility's operations. That is the approach the Commission has applied in the past, and Joint Applicants are seeking affirmation from the Commission in this case that this "usual" utility capital structure will be deemed the appropriate one to use in the future setting rates. In fact, Staff is asking the Commission to adopt a policy that would result in the Commission deviating from the usual capital structure to an unusual, hypothetical one. Staff's position is inconsistent with Commission precedent, ignores the reality that each company will have important characteristics

[22] 148 FERC ¶ 61,049 Docket No. EL14-12-000, at 190.

[23] Mr. Ives explained that immediately post-closing, KCP&L and Westar will file an application with the FERC to modify their formula rates to use the utilities' capital structure instead of GPE's, since GPE's will no longer be appropriate. Mr. Ives testified that he has no reason to believe this application will not be approved by FERC.

unique to its situation that must be considered in each rate case, and if adopted by the Commission will prevent the Transaction from closing, thus causing Kansas customers to lose the benefits of the Transaction, including the estimate of nearly $2 billion in merger savings it will generate in the first decade alone post-closing.

One additional aspect of the capital structure issue that needs to be addressed concerns Joint Applicants' statement in the supplemental testimony filed by Mr. Darrin Ives on November 2, 2016, that if – and only if – any party to a future KCP&L or Westar rate case proposes to use GPE's or a consolidated capital structure that reflects the cost or proportion of debt used by GPE to finance the Transaction for purposes of setting utility rates, then Westar and KCP&L reserve the right to seek, in any such rate case, recovery of the acquisition premium and transaction costs associated with the Transaction. Mr. Ives explained that using the GPE or consolidated capital structure which includes substantial Transaction debt incurred by GPE to set utility rates would be inappropriate and unreasonable because, "among other reasons, the debt used by GPE to finance the Transaction will be dedicated to paying for the acquisition premium in excess of book value as well as transaction costs and none of the proceeds of that debt will be available to support the regulated operations of GPE's utility subsidiaries." Ives Supplemental, p. 12.

Some parties questioned this reservation, implying that it constitutes back-tracking by Joint Applicants on their representation in the Application that they would not seek recovery of the acquisition premium or transaction costs in rates. Tr. Vol. 1, pp. 246-47. This is patently false. Joint Applicants stand by their representation made in the Application, which assumes the Commission will not impose an unreasonable, asymmetrical ratemaking policy upon KCP&L and Westar in future rate cases. However, the mismatch proposed by Staff and others cannot be accepted in this or any future rate case. Staff expects that the earnings of GPE from the capital it deploys on plant, equipment and facilities for KCP&L and Westar would be reduced to reflect the lower-cost debt of GPE, while holding Joint Applicants to their promise that the acquisition premium (resulting from GPE's purchase of the shares Westar) purchased with that debt would not be part of utility rates. Joint Applicants expect the Commission would not accept such a one-sided, unfair and unreasonable approach.

In his testimony at the hearing, Mr. Ives explained how this reservation would work. He said that if the Commission decided in this case that it would use the consolidated capital structure to set utility rates in the future, the Transaction would not proceed. Tr. Vol. 2, Ives, p. 448. If the Commission indicates in this case that Joint Applicants' position on capital structure will be used in future rate cases, then GPE will go forward with the Transaction and will not request the acquisition premium be recovered in revenue requirements in future rate cases. If GPE violates this commitment and requests acquisition premium recovery in a future case, the Commission can, and should, reject the request. GPE has said it will not make such a request and will honor that promise. Tr. Vol. 2, Ives, pp. 449-50. However, in light of the arguments made by Staff and other intervenors in this case, there is concern that one of those parties might attempt to argue again in a future rate case that the consolidated capital structure which includes substantial Transaction debt of GPE should be used to set utility rates . Mr. Ives explained that Joint Applicants' reservation is intended to apply only to this situation so as to allow the Company to request inclusion of the acquisition premium in rates in response to a capital structure recommendation such as this, so as to match the benefits of the capital structure with the recovery of the assets that capital structure funded. Tr. Vol. 6, Ives. P. 1356. The reservation is to maintain symmetry in this regard should another party attempt to impose a mismatching asymmetry after the Transaction is closed. Tr. Vol. 2, Ives, pp. 447 - 450.

Mr. Ives made clear that what the Joint Applicants are expecting is for the Commission to address capital structure as they have done in the past, which is to look to a capital structure that is consistent with KCP&L's and Westar's peers and reflects the way that the funds are being used to make the investments in the utility. Tr. Vol. 2, Ives, p. 404. This does not mean the Commission is locking itself in so that only the utilities' capital structures can be used in future rate cases forever. If, at some point in the future, the consolidated capital structure of GPE better represents the capital used to fund the utility operations of KCP&L or Westar than the utilities' actual capital structure, then the Commission retains the ability to adopt the more accurate capital structure when setting rates. Tr. Vol. 2, Ives, pp. 404-06. Unlike Staff, Joint Applicants are not asking the Commission to adopt a hard-and-fast rule stating that the utility companies' capital structure must always be used; Joint Applicants are asking the Commission confirm, consistent with its past practices, that the appropriate capital structure for setting utility rates is the one that accurately represents the funds used to operate the utility. Tr. Vol. 2, Ives, pp. 442-43. After the closing of the Transaction and for a period of time thereafter, the consolidated capital structure of GPE which includes substantial Transaction debt will ***not*** accurately represent the funds that support the utility operations of KCP&L or Westar. However, the actual capital structures of KCP&L and Westar will qualify under that standard, and the Commission needs to confirm in this proceeding that those are the capital structures that will be used to set rates for the foreseeable future, so long as they remain accurate.

C. Ring-Fencing Protections.

Summary

Rather than kill the Transaction by adopting Staff's capital structure position that is well outside the mainstream, the Commission should follow established practice used by this Commission in its most recent merger order and other regulatory authorities when faced with *transactions funded substantially by parent holding company debt and impose effective ring-fencing measures that will insulate utility customers from financial risk resulting from GPE's higher debt post-Transaction. Ring-fencing conditions have evolved within the industry precisely to address Staff's concern. Ideally, a customized set of ring-fencing measures would have been developed among the parties and presented to the Commission as a package reflecting the give-and-take of a negotiation process resulting in terms that provide adequate customer protections and reflect unique circumstances while still allowing the Transaction to proceed and bring benefits to customers. However, because Staff has adopted a "take it or leave it" stance with respect to its position on the consolidated capital structure, and that position cannot be accepted by the Joint Applicants, the normal process was short-circuited in this case, requiring Joint Applicants to present additional ring-fencing measures responsive to concerns expressed in direct testimony of other parties to the proceeding and provide a path forward that would preserve the value of the Transaction for customers while providing appropriate insulating protections for Westar, KCP&L and their customers. Joint Applicants present a comprehensive ring-fencing proposal in Mr. Ives' rebuttal testimony, set forth in his Schedule DRI-3, which incorporates many of the terms proposed in the direct testimony of KEPCo's witness, Dr. Dismukes, as well as other conditions and commitments responsive to concerns raised in the direct testimony of other parties. The Joint Applicants' proposal is also similar to terms adopted by other public utility commissions in similar transactions. Joint Applicants shared this comprehensive package with its credit rating agencies and obtained their assurance that the terms would not negatively impact KCP&L's, Westar's or GPE's credit ratings. As such, if adopted by the Commission, the ring-fencing terms presented in Schedule DRI-3 will protect*

Westar and KCP&L utility customers from GPE's Transaction debt while still allowing the Transaction to close and bring the benefits of Transaction savings to customers.

Argument

"Ring-fencing" is a term used to refer to 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. In the context of utility regulation, ring-fencing is a tool used by regulators to isolate the financial risks of the utility from the risks of its parent company and affiliates, to protect utility customers. Ring-fencing encompasses a range of measures; the specific measures employed, if any, vary by utility transaction. Reed Rebuttal, p. 87.

In a proposed transaction such as the one in this case, the industry norm is to employ ring-fencing measures to protect customers from financial concerns related to the effect the transaction might have on the parent company's balance sheet. Reed Rebuttal, p. 86. Post-Transaction, GPE will have a higher financial leverage (*i.e.*, debt levels) for a period of time before it de-levers. The appropriate and customary way to protect the utility operating companies and their customers against this type of financial risk is to implement effective ring-fencing measures. Hevert Rebuttal, p. 9; Reed Rebuttal, p. 86. The intent of ring-fencing is to isolate the operating utility companies and their customers from the activities at the parent level. When ring fencing isolates the operating companies from the risk at the parent level company including the risk of leverage associated with transaction debt, then there is little or no risk borne by the operating companies that might negatively affect their utility customers. Reed Rebuttal, p. 87; Tr. Vol. 4, Hevert, p. 841.

It is common for utility mergers to rely on parent company debt to finance an acquisition transaction. Reed Rebuttal, p. 88. It is also common for public utility commissions to have concerns in such transactions regarding the impact of the higher leveraged parent company on the costs and operations of its subsidiary utility companies. Reed Rebuttal, pp. 96-97. In anticipation of these concerns, Joint Applicants proposed certain financial conditions in the direct testimony of Mr. Ives intended to address these concerns and protect the operating utilities and Kansas customers from any adverse financial impact that may occur as a result of the Transaction. Upon reviewing the direct testimony of other parties filed in this case on December 16, 2016, it became apparent that the parties felt more comprehensive ring-fencing was needed to ensure the Transaction would serve the public interest. While Staff took the position that the Application should simply be denied[24], certain other intervenors presented a number of additional ring-fencing measures for the Commission's consideration. Intervenor witnesses Dismukes, Lesser, and Gorman propose various ring-fencing measures to mitigate the financial risk for Kansas customers and the operating utilities.[25]

Joint Applicants took seriously the concerns of the parties, working to incorporate their concerns and ring-fencing suggestions into a comprehensive set of conditions the Commission could adopt to protect customers while having confidence that the package of conditions would not cause the Transaction to fail. Reed Rebuttal, pp. 96-97. The package created is discussed in the rebuttal testimony of Mr. Ives and set out in Schedule DRI-3 to that testimony. Schedule DRI-3 contains a number of the conditions agreed upon as part of the Kansas Commission's approval of the Empire Merger Docket, many of the conditions proposed by Dr. Dismukes in

[24] Gatewood Direct. P. 42.

[25] Dr. Dismukes testified on behalf of KEPCo, Dr. Lesser testified on behalf of BPU, and Mr. Gorman testified on behalf of KIC.

this docket, and conditions negotiated with the Missouri Public Service Commission Staff and the Missouri Office of Public Counsel. Ives Rebuttal, pp. 40-41. These commitments are summarized as follows: (Ives Rebuttal, pp. 42-48):

(a) General Conditions: Joint Applicants confirm their commitments regarding the location of corporate headquarters (No. 1), membership on the Board of Directors (No. 2), local charity giving and community involvement (No. 3), and the maintenance and promotion of low-income programs (No. 9). In addition, the Joint Applicants set out their commitments to honor existing collective bargaining agreements (No. 4), maintain existing compensation levels and benefits for Westar employees (No. 5), endeavor to achieve reductions in head-count through attrition or voluntary programs, and to do it in a balanced manner as between Kansas and Missouri. (Nos. 6-8).

(b) Financing and Ring-fencing Conditions: There are seven areas of ring-fencing commitments contained in the proposal. They establish firm commitments to maintain separate capital structures, debt instruments, and credit ratings among GPE, KCP&L and Westar, to not guarantee the debt of other affiliates or pledge stock of an entity as collateral for obligations of another entity, unless otherwise authorized by the Commission. They state that KCP&L and Westar will maintain investment grade capital structures and commit to stated maximum levels of debt in the capital structure of the utilities and GPE (Nos. 10 and 12). These conditions also contain commitments to continue to conduct business as separate legal entities and to maintain separation of the assets of the affiliated companies unless otherwise authorized by the Commission (No. 11). The Conditions contain commitments that the utilities (KCP&L and Westar) will utilize their respective utility-specific capital structure in future rate case filings, and identifies the evidence the utilities will provide in those future cases to demonstrate the components of their revenue requirements have not been negatively impacted by the Transaction (No. 13). In the unlikely event either KCP&L or Westar experiences a credit rating downgrade to below investment grade level as a result of the Transaction, the conditions set out specific notice and reporting requirements to be given to the Commission and steps to be taken in response to the downgrade, including treatment of the downgrade in future rate cases (No. 14).

Additionally, in the Conditions the Joint Applicants commit that they will not seek an increase to their cost of capital as a result of the Transaction or as a result of their ongoing affiliation with GPE or each other. If either utility seeks an increase in its cost of capital, the conditions state how such a request is to be supported in evidence to establish that it is not a result of the Transaction or affiliations with the other entities (No. 15).

Finally, the commitments confirm that the goodwill (acquisition premium) from the Transaction will stay on the books of GPE and will not negatively affect KCP&L's or Westar's cost of capital. Should impairment of the goodwill occur potentially impacting the utilities, rates will be adjusted as needed to remove the impact of the impairment. For five years post-Transaction, GPE will provide Staff and CURB its annual goodwill impairment analysis to allow them to monitor this issue (No. 16.)

(c) <u>Ratemaking, Accounting and Related Conditions:</u>

- Each utility will file a general rate case in Kansas no later than January 1, 2019 (No. 17).

- Each utility will use its actual capital structure with a guaranteed equity level that will not go outside of the stated parameters (No. 18).
- Transition costs can be deferred on the books of either KCP&L or Westar to be considered for recovery in their future rate cases. The burden of proving such costs are appropriate for inclusion in rates is on the utility (No. 19).
- The Joint Applicants will not include in rates any acquisition premium, transaction costs, including change in control severance costs, or termination fees associated with the transaction (Nos. 20 and 21).
- Rates for Westar and KCP&L will each reflect a cost of service that is not adversely impacted by the merger and that are commensurate with the financial and business risks attendant to their respective regulated utility operations (Nos. 22, 24 and 25), and that rates will not increase as a result of the Transaction (No. 23).

(d) Affiliate Transactions and Cost Allocations Manual ("CAM") Conditions: Joint Applicants commit to maintain separate books and records (No. 32), provide all affiliate service agreements within 60 days after the close of the Transaction (No. 27), and confirm specific agreements regarding access to books and records of the affiliates and compliance with the KCC's affiliate transaction rules (Nos. 28-30). Additionally, Joint Applicants commit that they will seek recovery of intercompany charges in their first base rate proceedings post-Transaction at levels equal to the lesser of actual costs or the costs allowed for such function in their most recent rate case prior to the closing of the Transaction (No. 31), and that they will meet with Staff and CURB no later than 60 days after the closing of the Transaction to provide information regarding adjustments to

KCP&L's and Westar's CAMs (No. 34). The Joint Applicants confirm they will maintain adequate records to support and allow the audit of allocation of centralized corporate costs (No. 35), and GPE agrees to file with the Commission the anticipated MPSC order in the proceeding wherein GPE has sought a variance form the Missouri Affiliate Transaction Rule 4 CSR 240-20.015 (No. 33).

(e) Quality of Service Conditions: KCP&L and Westar agree to provide electric service reliability and call center service that meets or is better than specific performance metric thresholds set forth in the schedules to Mr. Noblet's Rebuttal Testimony, and they agree to accept penalties for failure to meet those thresholds, as set out in those schedules, and they will provide quarterly reports on the relevant metrics (No. 36).

(f) Access to Records and Parent Company Conditions: Joint Applicants confirm that they will provide Staff and CURB with access to written information provided to common stock, bond or bond rating analysts, and will make available to them all books, records and employees to set rates and verify compliance with the companies' CAMs and any conditions ordered by the Commission (Nos. 37 and 38). The companies will provide Staff and CURB access to board of Directors' meeting minutes, subject to appropriate objections on relevancy grounds (No. 39), and they will retain records supporting their affiliate transactions for at least five years (No. 40).

Additionally, GPE and Westar commit and reaffirm prior commitments made to the Commission to comply with any previously issued orders applicable to Westar (No. 41), and GPE acknowledges the need to meet the capital requirements of its utility subsidiaries (No. 42), and GPE commits to provide to the Staff its integrated resource plan within 30 days of its filing in Missouri (No. 43).

Staff suggests that these traditional ring-fencing measures would be counter-productive in this case, and that the most appropriate protection would be the use of the parent company's capital structure or the consolidated capital structure which includes GPE's Transaction debt for purposes of setting the rates of the operating utilities. Gatewood Direct, p. 42. In making this recommendation, Staff was fully aware its capital structure "protection" would cause the Transaction to terminate. Tr. Vol. 5, Gatewood, pp. 1129, 1138. In other words, Staff knowingly chose to recommend outright rejection of the Joint Application rather than attempt to develop constructive ring-fencing measures that would protect customers while allowing the Transaction to close and thereby allow customers to obtain the benefit of Transaction savings. Staff's decision to proceed in this manner dictated that Joint Applicants present an enhanced package of conditions through rebuttal testimony in order to provide a path forward and supporting record by which the Commission could approve the Transaction and preserve its benefits for customers.

Throughout this proceeding, Joint Applicants have been open and willing to work with Staff and the other parties to find ways to address their concerns. At the time Joint Applicants filed their Application and direct testimony, they did not know the specific nature and extent of the concerns other parties might present. As a result, Joint Applicants' direct testimony attempted to anticipate concerns and suggest proposals intended to address anticipated potential concerns. Joint Applicants held technical conferences with the parties during the pendency of the case to explain aspects of the merger, answer questions, hear concerns and, hopefully, develop conditions that would help address the issues of Staff and intervenors well in advance of their filing direct testimony on December 16, 2016. Ives Rebuttal, p. 40. Joint Applicants proposed a number of ring-fencing conditions in the Joint Application and attempted to engage

Staff and the parties in discussions regarding potential enhanced ring-fencing conditions as a result of the technical conferences. Tr. Vol. 5, Gatewood, pp. 1158-61. However, Joint Applicants overtures were summarily rejected without counter-suggestions or further discussion of potential conditions or ring-fencing measures. Tr. Vol. 5, Gatewood, p. 1161.

While Staff's capital structure witness, Mr. Adam Gatewood, testified at hearing that "ring fencing didn't really come up until rebuttal testimony," Tr. Vol. 5, Gatewood, p. 1158, this representation is not accurate. Rebuttal testimony was not the first time Staff was presented with additional written ring-fencing conditions. Also, extensive ring-fencing conditions were proposed in the direct testimony of Dr. Dismukes filed on December 16, 2016, and Mr. Gatewood testified at hearing that Dr. Dismukes' "has very good points on how that could be done. Clearly there are utilities operating now under such ring fencing criteria. It can be done." Tr. Vol. 5, Gatewood, p. 1158. However, even though the procedural schedule allowed for Staff and intervenors to file cross-answering testimony, no party filed cross-answering testimony in response to Dr. Dismukes. The procedural schedule granted Staff and interveners the opportunity to identify any weaknesses they might have observed in Dr. Dismukes' proposals or endorse any of his proposed conditions. Mr. Gatewood chose not to file anything in response to Dr. Dismukes. Tr. Vol. 5, Gatewood, p. 1158. In contrast, Joint Applicants responded to Dr. Dismukes' proposals in their rebuttal testimony setting forth what additional conditions could reasonably be adopted by the Commission in approving the Transaction. Ives Rebuttal, pp. 41 and Schedule DRI-3.

In addition to the ring-fencing conditions proposed by Dr. Dismukes, KIC witness Mr. Gorman, requested the Commission impose restrictions upon GPE related to income tax elections. Gorman Direct, p. 5. His concern is that the parent company will make income tax decisions that benefit non-regulated affiliates to the detriment of the utility companies. Gorman Direct, p. 19. As explained by Company witness, Melissa Hardesty, this proposed condition is neither appropriate nor necessary and "may actually harm customers if GPE is not given the flexibility to manage the income taxes of its subsidiaries to minimize the tax liabilities on a consolidated basis." Hardesty Rebuttal, p. 6. Ms. Hardesty explained the importance of not restricting GPE's ability to respond to complex and constantly changing tax code rules to ensure the best overall outcome for all the entities. Hardesty Rebuttal, pp. 6-8. She also testified that historically GPE considered the best interests of its utility customers in making such decisions, and how the Commission's rate case audit process would easily identify any deviation from that practice. Tr. Vol. 4, Hardesty, pp. 954-58. As such, the income tax restrictions proposed by Mr. Gorman were not included in Schedule DRI-3 to Mr. Ives' rebuttal testimony and should not be adopted by the Commission.

The Joint Applicants caution that if the KCC imposes additional conditions on Joint Applicants beyond those contained in Schedule DRI-3, there is the possibility that one or some of those additional conditions could result in making the Transaction infeasible. While this potential could have been avoided through negotiations that would have ensured a set of conditions that would have allowed the Transaction to be completed on fair and reasonable terms, the time for negotiations has passed. Until the specifics of an additional condition are known and weighed in the context of an overall Commission Order, Joint Applicants cannot represent to the Commission what additional condition(s) may or may not be acceptable. Tr. Vol. 2, Ives, pp. 445-47. The acceptability of any additional condition would hinge on its impact on financial flexibility and credit quality as viewed by the rating agencies. As Mr. Ives explained at hearing, a package of conditions in a transaction like this often comes before the Commission through a negotiation process among the parties, which inherently reflects a "give-and-take" that, in its ultimate totality, have been accepted by the parties as acceptable for the Commission to adopt without threatening the viability of the underlying proposed transaction. Tr. Vol. 2, Ives, pp. 445-46. That did not happen in this case. As also discussed by Mr. Ives, the electric utility operating environment prevailing today – characterized by rising costs often driven by government mandates as well as flattening demand by customers for electricity – and cost of service expectations for KCP&L and Westar unrelated to the Transaction do not permit avoidance of the 2018 rate cases. Bassham Direct, p. 10; Tr. Vol. 1, Bassham, p. 83; Ives Rebuttal, pp. 50-52; Tr. Vol.2, Ives, p. 439; Tr. Vol. 4, Ives, pp. 1048-1049. Unlike circumstances in previous merger dockets where a rate moratorium period was considered a benefit to the utility because it provided an opportunity to recover a portion of an acquisition premium or its carrying costs[26], that is not the case now *unless* the major cost drivers during the moratorium (as identified by Mr. Ives on pages 50-52 of his rebuttal testimony and shown generally on the chart on page 46 of this brief) are carved out for recovery as was done in the Empire Merger Docket. Tr. Vol. 5, Grady, pp. 1182-83.

The Commission will be presented with evidence of Transaction savings in the first two series of post-closing rate cases for KCP&L and Westar because, in order to obtain rate recovery of transition costs, Westar and KCP&L will have the burden of proof to clearly identify where all transaction costs are recorded and of proving that recoveries of any transition costs are just and reasonable as their incurrence facilitated the ability to provide benefits to Kansas customers, including the avoidance or shifting of activities and costs. Ives Rebuttal, Schedule DRI-3, Merger Condition 19. Thus, as provided in Merger Condition 19, in order to recover transition

[26] Tr. Vol. 2, Proctor, pp. 365-368-

costs in future general rate proceedings, KCP&L and Westar must demonstrate efficiency savings in excess of any such requested transition cost recovery. Transaction savings will be captured to assess costs incurred by the combined company at discrete project levels (such as insurance costs, for example) and those combined company costs will be compared to the sum of stand-alone company costs of GPE and Westar for that item (historical pre-closing costs, adjusted for inflation), thus identifying efficiency savings achieved by the combined company post-closing. Tr. Vol. 4, Ives, pp. 1047-1050. Aggregating these projects will support efficiency savings achieved and will be provided by Westar and KCP&L in the first two general rate cases for each company post-closing as support for recovery of transition costs. In addition, this information will be utilized by GPE management to determine success in efficiency achievement and will be the basis for presentations to the GPE board of directors on that topic. Provision of this information in the first two general rate proceedings for each company post-closing, consistent with the provisions of Merger Condition 19, will provide the Commission, its Staff and the parties to those rate cases with detailed information regarding Transaction savings that will be necessary to support KCP&L and Westar's requests for rate recovery of transition costs.

The package of ring-fencing conditions set out in Mr. Ives' rebuttal testimony, Schedule DRI-3, is comprehensive and effective. The conditions will accomplish the goal of insulating customers from the Transaction-related debt at GPE and they are consistent with ring-fencing measures that have been adopted in other recent approved utility transactions. Reed Rebuttal, p. 88.

D. <u>Merger Standard (a)(ii): "(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".</u>

<u>*Summary*</u>

Staff misapplies this Merger Standard. In past cases, when applying this standard, the Commission has never made a ruling on the reasonableness of the purchase price in isolation. Rather, it has focused on the applicants' savings estimates to determine how much of the acquisition premium may be recoverable in rates. Joint Applicants are not requesting rate recovery of the acquisition premium in this Transaction. Nevertheless, it is clear that the purchase price is in line with other recent transactions including two recently approved by the Commission.

Staff's "gain on sale" proposal would constitute a "tax" that would effectively kill the Transaction. Staff's "gain on sale" argument misapplies precedent, is inconsistent with practices in other jurisdictions, lacks basis in sound financial theory and lacks legal basis. There is no support in prior decisions of this or other Commissions for Staff's proposal to impose what is effectively a tax on the control premium for the benefit of customers.

<u>Argument</u>

The Commission has never ruled on the reasonableness of the purchase price in past cases. Proctor Rebuttal, pp. 10, 13. When it has dealt with the acquisition premium, it has done so only to determine the amount recoverable in rates. *See, e.g.*, 1991 Merger Order, p. 107. Goldman Sachs (for GPE) and Guggenheim (for Westar) issued fairness opinions in support of the Transaction, including the purchase price, and the evidence in this case shows that when accurate comparisons are made, the purchase price is in line with other recent transactions including two recently approved by the Commission. Hevert Rebuttal, pp. 33, 38-44. The "gain on sale" precedent cited by Staff and its consultant does not apply to mergers. Reed Rebuttal, pp. 80-82. Staff's proposal to assess a tax on the control premium for the benefit of customers would merely increase the cost of the Transaction and ensure that the merger will not occur. Proctor Rebuttal, pp. 32-33.

1. In past cases, the Commission has not made any determination of the reasonableness of the purchase price "in light of the savings that can be demonstrated from the merger."

Although stated as a comparison of the purchase price to savings, as Mr. Proctor testified, this standard has really been used to determine how much of the acquisition premium could be amortized annually and recovered in rates. That approach can be traced to the fact that in past cases, merging parties have generally sought recovery of some portion of the acquisition premium through utility rates. For instance, in the two cases that form the basis for the Merger Standards, the applicants sought a return on and of a portion of the acquisition premium. \1991 Merger Order; 1999 Merger Order. However, despite the wording of Merger Standard (a)(ii), in neither case did the Commission make any determination concerning the reasonableness of either the purchase price or the resulting acquisition premium. Proctor Rebuttal Testimony, pp. 10, 13. As noted by Mr. Proctor in his testimony, in the 1999 Merger Order concerning the then-proposed merger of Western Resources (Westar's predecessor) and KCP&L, "in its Order, *the Commission did not even mention the amount of the AP or purchase price being offered by WRI for KCP&L's common equity*." *Id*. at p. 13 *(emphasis original).* Rather than focus on the purchase price in prior cases, the Commission has addressed in some but not all of those cases the amount of premium that could be recovered in rates. Here, as will be discussed in Section V.B below, that issue is not present because Joint Applicants are not requesting rate recovery of the acquisition premium.

2. The purchase price is reasonable.

The purchase price being paid by GPE for Westar is reasonable and in line with levels recently paid in other transactions in the marketplace. This is supported by the fairness opinions of Goldman and Guggenheim, the fact that the price was the result of an auction process, and by the comparative analysis performed by Mr. Hevert. Hevert Rebuttal, pp. 37-38, 40; Tr. Vol. 4, Hevert, p. 908. Staff argues the purchase price in this Transaction is unreasonable in comparison to other recent transactions in the marketplace. Grady Direct, pp. 13-14. Staff fails to consider the market context in its comparison analysis, and resorts to an inappropriate use of the Goldman and Guggenheim analyses to support its claim.

In one of his analyses, Mr. Grady attempts to recreate the Goldman DCF analysis, and use that re-creation to assess the effect of differing discount rates on the estimated Transaction value per share. In doing so, he assumes Free Cash Flow projections provided by Guggenheim would be the same as those calculated by Goldman even though there are differences between Guggenheim's DCF analysis and the one recreated by Mr. Grady. Hevert Rebuttal, pp. 44-45. He adjusts the first partial year cash flow on a *pro rata* basis to equal a full year while Guggenheim did not. Hevert Rebuttal, p. 44 He also assumes cash flows are received at the end of the year when they are received through-out the year. Hevert Rebuttal, p. 45. Although Mr. Grady claims to have successfully replicated Goldman's analysis, there is no way to know if that is accurate. Hevert Rebuttal, p. 44. Because of the errors and unsupported assumptions in his analysis, Mr. Grady's conclusions regarding their implications for the reasonableness of the Transaction value are highly questionable. Hevert Rebuttal, p. 46.

Even if his methods were reliable, the exercise he performs is an irrelevant calculation. As Mr. Hevert explains, taking one assumption from the Goldman or Guggenheim opinions and using it for calculations for which it was never intended is an invalid method, as well as a practice explicitly warned against by Goldman, Guggenheim and other financial advisors when they issue their opinions. Hevert Rebuttal, pp. 29, 33; Tr. Vol. 4, Hevert, pp. 912-13. Goldman explicitly states, "[T]he preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analysis or summary description. Selecting portions of the analyses or of the summary set forth above, without considering the analyses as a whole, *could create an incomplete view of the processes underlying Goldman Sachs' opinion*." (emphasis added.) Hevert Rebuttal, p. 32. Guggenheim states, "A fairness opinion therefore is not readily susceptible to partial analysis or summary description, and taking portions of the valuation and financial analyses set forth below, without considering such analyses as a whole, would in Guggenheim Securities' view *create an incomplete and misleading picture* of the processes underlying the valuation and financial analyses considered in rendering Guggenheim Securities' opinion." (emphasis added.) Hevert Rebuttal, p. 32. Mr. Hevert illustrates this point by using certain other assumptions extrapolated from the financial advisors' analyses as Mr. Grady did, causing the resulting share price to change substantially. Mr. Hevert was able to arrive at a share price of $60 just as easily as Mr. Grady produced lower share prices by the selective assumptions he misapplied. Tr. Vol. 4, Hevert, pp. 914-15; Tr. Vol. 4, Hevert, pp. 912-13.. Both analyses are worthless and no weight should be placed on either of them.

Mr. Grady also misrepresents the Goldman opinion in his analyses. He purposefully selects a single assumption underlying one of the methods used by the financial advisors to support his assertion that $1.094 billion of the $2.3 billion Control Premium being paid to Westar's shareholders should somehow be returned to ratepayers. Grady Direct, pp. 81-82. Staff's analysis is based on selected data contained in the fairness opinions, manipulated in a way that the financial advisors who prepared those opinions warn it should not be used. Hevert

Rebuttal, pp. 29, 33, 48; Tr. Vol. 4, Hevert, p. 913. Staff's analysis is not sound and Staff's conclusions should be rejected.

Mr. Grady also argues that the most significant contributing factor for GPE's decision to pay a $4.9 billion AP is his assertion that Westar and KCP&L have been receiving excessive authorized ROEs from the Commission. Grady Direct, p. 81. He states that the ROE used in the Guggenheim analysis was between 5.39% and 6.9% — "dramatically lower than the 9.35% Westar is authorized to earn on its regulated equity at the KCC." Grady Direct, p. 18. He further states that "[e]ven with this low range of required ROEs and WACCs, the highest per share value that Guggenheim could support with a DCF was $54.46/share. *Id.* He argues further that the cost of equity assumption in Goldman's calculations equates to 4.15%, "dramatically lower than the 9.35% authorized return included in Westar's rates in the 15-115 Docket." Grady Direct, p. 30. Mr. Grady's testimony is fatally flawed because he did not understand that the returns used by Guggenheim and Goldman were returns on the *market price* of Westar's equity and *not its book value*. In fact, as Mr. Hevert stated, because the financial advisors were using returns on market value, the returns they used were approximately equal to Westar's authorized return. He explained,

> [L]et's say that that 5 percent produces under some scenarios a market cost of $55 a share. Investors understand that rates are not set based on market values. Investors understand that rates are set based on book value. If you assume, then, that $55 a share is about twice its book value, that 5 percent return on equity is equivalent to about 10 percent return that would be set based on book value rate base basis.

Tr. Vol. 4, Hevert, pp. 889, 909, 921-22. In other words, because utility stocks trade at about two times book, the 4.15% *return on market value* calculated by Mr. Grady equates to a 9.3% *return on book value* – approximately equal to Westar's authorized rate of return.

A fairness opinion is provided by an external advisor expressing its opinion to a board of directors that the subject Transaction meets a threshold level of fairness. Hevert Rebuttal, p. 29. It is a complex process and it involves various judgments and determinations as to the most appropriate and relevant valuation and financial analyses and the application of those methods to the particular circumstances involved. Hevert Rebuttal, pp. 30 – 32. The opinion speaks to the fairness of the Transaction from a financial point of view, which inherently incorporates regulatory considerations, but is definitely not an analysis of a company's future or past required return on equity in the context of setting regulated utility rates. Tr. Vol. 4, Hevert, p. 898. However, that is how Mr. Grady misuses the return on equity component of the Goldman Sachs opinion in his analysis. While Mr. Grady did not make a recommendation at this time that the Commission use 5% as an ROE to set future rates for Westar or KCP&L, he did use an assumed ROE of 5% to calculate the $1.54 billion adjustment he recommends in this case. Tr. Vol. 4, Hevert, pp. 920-21. It is based on the same concept and suffers from the same fatal flaws.

Mr. Grady also supports his conclusion that the purchase price is unreasonable by relying on a flawed comparison to other recent transactions. He argues that, on the basis of P/E ratios and prevailing interest rates, the Transaction is the highest of any of those reviewed by Guggenheim. Using EV-EBITDA, he concludes that the Transaction value is higher than all but the acquisition of ITC by Fortis, Inc. Grady Direct, pp. 15-16. In both instances, Mr. Grady fails to reflect the fact that market conditions that supported transaction multiples evolved over time. Hevert Rebuttal, p. 37. Mr. Hevert corrected for this omission, showing that the GPE-Westar Transaction is just slightly below the average from the group when measured relative to prevailing market multiples. Hevert Rebuttal, pp. 37-39; Chart 5. The multiples in the present Transaction are well within the range of recent transactions. In fact, the premium to market percentage in this case of 22.21% is slightly *below* the average of 23.74%. Hevert Rebuttal, pp. 39-40. Mr. Hevert explained that, based on prevailing market conditions and the multiples being paid *at the time of the Transaction*, the price is reasonable. Hevert Rebuttal, pp. 38 - 43; Tr. Vol. 4, Hevert, p .908.

Mr. Grady also takes issue with Goldman's analysis of comparable transactions because it includes natural gas operations and the recent Fortis/ITC transaction. His argument is that these transactions should be excluded as they are not sufficiently comparable to the GPE/Westar Transaction. Grady Direct, pp. 24-25. However, by selectively excluding these transactions, Mr. Grady ignores more recent utility transactions in favor of those that support lower multiples. As such, he is trading one measure of comparability for another, while also reducing his sample size to only five transactions. Hevert Rebuttal, pp. 43-44. However, even excluding these other transactions, Mr. Hevert shows that the premium in this case is still well within the range of other recent transactions. Hevert Rebuttal, p. 43.

Choosing to travel Staff's newly adopted path for applying Merger Standard (a)(ii) would also place the Commission in the position of having to pick the most appropriate date to use for determining Westar's "undisturbed stock price" so that a Control Premium can be calculated. The "undisturbed stock price" is the price of the stock prior to it being impacted by the Transaction and the Control Premium is the amount of the purchase price paid above the undisturbed stock price. The Control Premium represents the value of having control of the entity. Hevert Rebuttal, p. 34. Mr. Grady choose November 3, 2015 as the undisturbed stock price date because around that time there was some mention of Westar's interest in a potential merger during an investor's call and, thereafter, the stock price ticked upward. This is also one of the dates used by Guggenheim in its presentation to Westar. Grady Direct, p. 24.; Tr. Vol. 4, Hevert, p. 903. Mr. Hevert reviewed the relevant market data in reaching his opinion that the *best* measure of the undisturbed price uses March 9, 2016, the date when a Bloomberg article leaked about the sales process being under way. March 9, 2016 was also a date used by Guggenheim in its presentation. Hevert Rebuttal, p. 34. Mr. Hevert explains that Westar's stock price returned to its normal level after the November 2015 uptick and that there were other events occurring in the market between November 2015 and March 2016 that would be expected to impact the market as a whole. Hevert Rebuttal, pp. 34-37. It was after the Bloomberg article in March of 2016 that discussions regarding a potential merger became more than mere speculation and the stock price rose and maintained its heightened level. Hevert Rebuttal, pp. 34-37; Tr. Vol. 4, Hevert, pp. 904-05.

In addition to his analysis of Westar's stock price movements, Mr. Hevert also considered market data showing trading volume during the period of time before and after the relevant dates in establishing an "undisturbed stock price". He said he would expect trading volumes to increase immediately after an event impacting the unaffected stock price; however, he did not detect any significant increase in trading volumes after November 3, 2015. In contrast, after March 9, 2016, he saw volumes much higher than average (fourteen standard deviations from average trading volumes).. Prior to November 4, 2015, trading volumes averaged 1.039 million shares, increasing to 2.18 million on November 4, 2015, settling back down to average thereafter, until increasing to 7.01 million shares on March 10, 2016. Hevert Rebuttal, p. 35. As Mr. Hevert testified, such deviations from normal trading volumes are unlikely to have happened just by happenstance. Tr. Vol. 4, Hevert, p. 945. This further supports his use of the March 9, 2016 date in determining the unaffected stock price. Tr. Vol. 4, Hevert, pp. 944-45.

3. While the analysis performed by Staff regarding the reasonableness of the purchase price is not a valid approach under the Commission's Merger Standards, even if it were, the relevant data and analyses support a finding that the Transaction is in the public interest. The "gain on sale" cases do not support giving a portion of the "control premium" to customers.

Following Mr. Hempling's lead, *See* Hempling Direct, p. 74, Staff asserts that regulatory decisions concerning treatment of the gain on sale of utility property support allocating 50% of what Staff identifies as the "control premium" in this case to utility customers. Grady Direct Testimony, p. 83. However, the proposal of allocating any portion of the control premium has been firmly rejected by regulators. Reed Rebuttal Testimony, pp. 80-82. A merger transaction is fundamentally different from a sale of a utility asset. As Mr. Proctor points out, when a utility sells an asset, it receives cash that remains within the company whereas the consideration in this Transaction is received by Westar's shareholders. Proctor Rebuttal, p. 33.

Mr. Hempling maintains that his recommendation is consistent with the principles articulated in *Kansas Power & Light Co. v. KCC*, 5 Kan. App. 2d 514 (1980) (the "Salina Office Building Case"). However, that case is not applicable here. The Salina Office Building Case involved the sale of a utility asset and the treatment of the funds received by the utility. As the Court stated: "As a general rule capital gains are retained by the utility and may be used for dividend distribution or reinvestment. When the utility seeks a rate adjustment, however, the KCC should consider the gain as a factor in the ratemaking process." *Id*. at 528. Here, of course, Westar receives no funds and has no capital gain because all proceeds of the Transaction go directly to Westar shareholders. Thus, there is no "capital gain" retained by the utility for the KCC to consider in this Transaction.[27]

[27] Even Mr. Hempling noted a difference between customers and shareholders in a sale of the company versus a sale of a company-owned asset. He stated: "In citing this precedent, I am not suggesting that the ratepayers' burden-

As Mr. Proctor notes, **there is no way for the Commission to "exert authority over Westar's shareholders and redistribute a portion of their proceeds from the Transaction to customers**." Proctor, p. 32 **(emphasis added)**. Why is that important? Because in the Transaction, all of the cash and stock paid by GPE will go to current Westar shareholders, *id*. at p. 33; none of the funds will go to Westar itself.[28] *Id*. Simply put – payment of a portion of the control premium would merely increase the cost of the Transaction because there are no funds that will be received by Westar to be shared with customers. As Mr. Proctor explained, any payment of a portion of the control premium to customers:

> …would have to come from Westar's or KCP&L's cash flow, or GPE's other cash flow, post-Transaction. Under Mr. Grady's proposal, GPE would pay; (a) the $4.9 billion AP to Westar's shareholders; (b) an additional $1.68 billion to Westar's customers under his "sharing" proposal; (c) flow additional merger savings to customers through the ratemaking process over time, and (d) not request customers pay for any of the AP or Transaction costs in rates.

Id. at p. 32. Staff's proposal to have Westar allocate money that it will not receive in the Transaction to its customers would effectively assess a tax of $1.68 billion on the Transaction. *Id*. Because the tax Staff would impose would do nothing but raise the cost of the Transaction, it would do nothing more than ensure that the Transaction does not occur and the related savings for customers will not be realized. *See* Bassham Rebuttal, p. 11 ("Staff's approach would result in a cost-prohibitive $1.5 billion 'adder' to the purchase price.")

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bearing in the context of a generating asset sold at a gain is itself analogous to the ratepayers' contribution to the control premium." Hempling Direct, p. 76.

[28] As previously discussed above in footnote, 21the Commission dealt with a similar issue related to KGE's use of the gain generated in the sale/leaseback of one of the La Cygne Station units. Prior to Westar's 2005 rate case, the Commission had adopted Staff's recommendation that the unamortized gain be used as a rate base offset. However, in *Westar Energy, Inc.*, Docket No. 05-WSEE-981-RTS, Order on Rate Applications, pp. 48-51 (December 28, 2005), the Commission reversed its previous decision and accepted Westar's argument that because the funds raised from the sale were used to purchase common stock, redeem bonds and retire high cost debt, those proceeds "cannot reasonably be used again to reduce ratebase." *Id*. p. 49.

E. <u>Merger Standard (e): "The effect of the transaction on affected public utility shareholders."</u>

<u>*Summary*</u>

Having overwhelmingly authorized the Transaction, GPE and Westar shareholders have diligently considered the associated opportunities and risks. This shareholder support is premised on Transaction parameters laid out in the Proxy Statement and other investor communications provided to GPE and Westar shareholders in advance of the September 2016 shareholder votes. This support was affirmed by GPE share purchasers in the subsequent equity offering that was approximately two times oversubscribed. There is no reason for the Commission to substitute its judgment for that of the financially sophisticated GPE and Westar shareholders and reject the Transaction on the basis of its effect on public utility shareholders.

<u>Argument</u>

Public utility shareholders affected by the Transaction – owners of GPE or Westar shares – have considerable control over their own destinies and the expertise to carry out that responsibility. If shareholders oppose the Transaction, they have the ability to sell their shares, or they could have voted their shares against the ballot measures necessary to authorize the Transaction to move forward.

GPE and Westar shareholders were asked to authorize the Transaction as defined by the following broad parameters:

- Purchase price as prescribed in the Agreement ($60/share; 85% cash and 15% stock);
- Purchase price would be financed with roughly 50% debt and 50% equity, including mandatory convertible preferred stock;
- Rate recovery of the acquisition premium would not be requested;

- Transaction savings would be reflected in customer rates in the normal course of ratemaking through post-closing rate cases, the first series of which would be filed in 2018; and
- Cash flows of the utilities after the Transaction would be consistent with and higher than pre-closing cash flows.

Grady Direct, Exhibit JTG-16, Proxy Statement Dated August 25, 2016, pp. 66, 170, Annex A, pp. A-3, A-72, A-73; Exhibit KIC-6, p. 13.

On September 26, 2016 at special shareholder meetings held by Westar and GPE, shareholders overwhelmingly supported the Transaction with over 92% of votes cast by GPE existing shareholders and over 95% of votes cast by Westar[29] existing shareholders in favor of the Transaction. Bryant Rebuttal, p. 9. Institutional shareholders own approximately 85% of GPE's common equity, and a vast majority voted in favor of the Transaction. *Id*.

The day after the shareholder vote, support for the Transaction was further validated when GPE successfully issued $1.6 billion of common stock and $863 million of mandatory convertible preferred stock to the public markets. Both offerings were approximately two times over-subscribed (meaning demand for shares exceeded the number of shares offered by approximately 100%) with approximately 60 institutional investors holding sizable and diverse investment portfolios participating in each offering. *Id*. The successful completion of these equity issuances demonstrates the favorable view of the Transaction by some of the most sophisticated investors in the world. *Id*.

[29] Staff and intervenors may argue that Westar shareholders will receive "windfall" profits from the Transaction and thus their support should be expected. But GPE stock will be a part of their compensation, so Westar shareholders have an obvious interest in GPE's financial viability post-closing. Moreover, the "windfall" argument fails to consider that the acquisition premium as measured against Westar's undisturbed stock price – $2.3 billion – compares favorably to the net present value of Transaction savings from 2017 forward calculated as approximately $3.6 billion by KEPCo witness Kirsch. Tr. Vol. 3, p. 771; and KEPCo Exhibit 9.

Nevertheless, certain Staff and intervenor witnesses (including Staff witnesses McClanahan Direct, pp. 32-33 and Grady Direct, p. 86; CURB witness Crane Direct, p. 58; BPU witness Steffen Direct, p. 66; and KEPCo witness Kirsch Direct, p. 50) testify that they believe the Transaction is likely to be detrimental to the interests of GPE shareholders. It is not at all clear why these individuals believe they are in a better position than GPE shareholders themselves to make this determination, but they apparently do. Tr. Vol. 2, McClanahan, p. 473-474.

Staff/intervenor witnesses' opinions that the Transaction will be detrimental to GPE shareholders focus too heavily on near-term risk and, as a result, fail to appropriately consider positive longer-term expectations. For example, as a result of GPE adding a third utility to its business, GPE shareholders will benefit from the resulting diversity and economies of scale that create a significantly improved ability for Westar and KCP&L to earn their authorized returns with smaller and less frequent rate cases. This increased scale also reduces the operating cost impact of major storms or equipment failures and improves regulatory diversity. Both S&P and Moody's commented favorably on these factors. Bryant Rebuttal, p. 44.

GPE and Westar shareholders can sell their shares at any time and had the opportunity to prevent the Transaction from moving forward through the shareholder votes held on September 26, 2016 and chose instead to authorize the Transaction by an overwhelming margin. Consequently, there is no reasonable basis for the Commission to reject the Transaction due to its effect on shareholders.

V. Savings and Integration

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

Summary

The proposed Transaction represents the best opportunity to respond to current industry challenges and slow the pace of rate increases for a large portion of Kansas electric consumers. The Transaction will result in millions of dollars of savings flowing to Westar and KCP&L customers, allowing customers the benefit of lower future rates than what will otherwise occur without the Transaction. Joint Applicants have shown that the efficiency estimates were developed based on the best information available. This information included data from Westar's data room, comparative industry data, and data from GPE's long familiarity with Westar's operations. GPE used a dual level approach that is consistent with utility industry practice. An extensive bottom-up approach allowed for the internal identification of savings and validation that the reasonably achievable savings are at least at the level needed to provide substantial customer and investor benefits. A top-down approach confirmed that the general level of savings is consistent with industry experience. An external expert conducted a third-party review of available savings from the bottom-up and top-down perspectives. The efficiencies levels are conservative and consistent with those of other prior industry transactions and neither under-state nor over-state the level of efficiencies available. Further work by the GPE and Westar Integration Project teams has validated the overall level of efficiencies. GPE stands ready to deliver these savings to customers. Absent this Transaction, these savings will not be realized by customers.

Argument

In applying this standard the Commission has recognized that "it is neither necessary nor desirable for the Commission to determine the anticipated savings for each category of estimated savings…", that "projections of costs savings are inherently merely estimates of what might occur", and that "[t]here is no objective basis for precisely determining how effectively or quickly the various cost savings measures can be implemented." 1991 Merger Order, at pp. 58-59.

1. Joint Applicants have quantified customer benefits resulting from the Transaction.

a. The efficiencies estimates were thoroughly vetted.

The building blocks of sound efficiencies estimates include (a) the identification of specific savings categories, (b) establishment of a defined process for savings identification and quantification analyses, (c) development of structural guidelines and estimation bases to guide the quantification of estimated savings, (d) definition of assumptions on savings drivers and timing, and (e) utilization of a robust financial tool to quantify savings estimates. Flaherty Rebuttal, pp. 19-20. As evidenced by the record, GPE utilized these building blocks in developing the efficiencies estimates supporting the Transaction.

The efficiencies estimates presented by Joint Applicants in support of the Application demonstrate that Transaction savings are approximated to be $426 million over a 3.5-year period from mid-2017 to the end of 2020, with ongoing savings beyond 2020 estimated at $176 million per year, net of transition costs. Kemp Direct, WJK-3, as updated in Kemp Rebuttal, WJK-3R. These efficiency estimates were developed by GPE management in collaboration with a team of industry experts led by Mr. Kemp of Enovation Partners, LLC ("Enovation"). Tr. Vol. 5, Kemp, p. 1297.

The process employed in developing the efficiencies involved a collaborative effort between GPE management and Enovation that utilized a five-step, bottom-up analysis to identify a reasonable level of efficiencies to support the bid for Westar. Kemp Direct, pp. 11-17; Flaherty Rebuttal, pp. 17-18. The analytical approach employed to determine the efficiencies estimate for this Transaction was similar to that utilized by GPE in the Aquila acquisition, and as such is one with which the Commission should be familiar. Kemp, p. 19. As noted by Messrs. Kemp and Busser, extensive amounts of GPE and Westar-specific data covering both historical and forecasted periods were analyzed as part of the bid process. Kemp Direct, p. 13, Busser Rebuttal, p. 8.

Specifically, the bottom-up analysis involved identifying the major areas where the greatest amount of savings were expected to be found, which resulted in a focused evaluation of the functional areas of Generation, Transmission & Distribution ("T&D")/Customer Service ("CS"), Shared Services, and Supply Chain. Kemp Direct, p. 13. This is consistent with the building blocks identified above. It was understood that additional savings areas would likely be identified and the efficiencies mix would shift during the integration process, in the event that GPE was the successful bidder. Kemp Direct, p. 14; Kemp Rebuttal, p. 9. All areas of GPE and Westar operations were mapped to one of these four functional areas, with one or more GPE executives being assigned as the analysis leader in each area, and Enovation providing consulting support to each executive. Kemp Direct, p. 13. Because the GPE executives involved will be the same individuals committing to achieve the savings and subsequently managing the operations after the close of the Transaction, their hands-on knowledge of operations, coupled with the mapping of functional areas helped minimize the risk of major areas being overlooked, and provided an accountability for the level of efficiencies. Kemp Direct, p. 12; Busser Rebuttal, pp. 7-8. Every executive understood the importance of developing a credible, achievable savings estimate for their area of responsibility. To the extent that there was any uncertainty at this stage of the process it led to a conservative estimate of savings since they would be incorporated in post-transaction budgets.

Baseline costs, against which savings will be measured, were established and defined by utilizing each company's most recent budgets and spending plans. Kemp Direct, p. 13. Items that would not affect valuation, such as fuel and purchased power expenses that are flowed through to customers in fuel clauses were excluded from the savings analysis. Kemp Direct, p. 14. Consistent with how the Commission has viewed merger savings historically, GPE counted only those operational and capital cost savings that were attributable to the Transaction, *i.e.*, they were directly created or enabled by the Transaction, and could not be realized in the normal course of business as separate companies. Kemp Rebuttal, pp. 11, 13. As Mr. Kemp explained, this included benefits that could demonstrably be achieved at significantly greater speed or lower risk, even if those benefits may hypothetically be possible to achieve as separate companies after normal business practices have been set aside. Kemp Rebuttal, p. 13. This approach is also consistent with Staff's position in other recent merger transactions. As noted by Staff witness Grady, the deferral of a rate increase in the Empire merger proceeding was viewed by Staff as merger-specific. Tr. Vol. 5, Grady, p. 1180. Applying the same logic, the acceleration of cost savings also reduces total revenue requirements and the need for rate increases, and is then merger-specific and should be included as a benefit of the Transaction.

In order to ensure consistency and comparability for the savings estimations among the functional areas, Enovation developed savings estimate templates and interview questionnaires to guide the analysis and discussion with each GPE functional leader. Kemp Direct, p. 14.

Enovation and GPE then collaboratively developed initial savings estimates by functional area, for the years 2017 through 2020. *Id.* The estimates included both O&M expense savings and capital expenditure reductions, as well as transition costs necessary to achieve the estimated savings, by year. *Id.*

The savings estimates also underwent a quality control review, which involved the lead GPE executive for each functional area reviewing, modifying if necessary, and signing off on the savings estimate for their respective area. Kemp Direct, p. 14. Throughout the process GPE executives also performed a top-down check to verify that the sum of the NFOM costs across their areas was equal to the companies' total NFOM costs. Kemp Direct, p. 17. Once the initial efficiencies estimates were quantified, they became the floor for future savings development, which occurred during the Integration Project efforts. Flaherty Rebuttal, p. 51.

GPE's general approach to estimating savings was consistent with industry practice. GPE's estimates of savings are reasonable, and generally consistent with the range of industry experience in similar transactions, as noted by two separate industry experts. Kemp Direct, pp. 31-35, Flaherty Rebuttal, pp. 37-38. Based on the facts that the efficiency estimates were reasonable, and that GPE has a proven track record of delivering substantial transaction-related savings, the Commission and GPE's Kansas customers can be reasonably assured that at minimum the targeted total annual savings will be achieved. Kemp Direct p. 38-39

b. <u>There was no bias inherent in the development of the efficiencies estimates.</u>

Staff and Intervenors suggest that the savings estimates are questionable because GPE management provided the Estimation Team with minimum savings targets, yet they offer no evidence or logical explanation as to how such targets, in fact, biased the results. In discussing this potential bias Staff states, "[i]t would be reasonable to expect the savings estimation team was motivated to find sufficient savings to meet the minimum annual targets", but then states, "even assuming the team was not motivated to pursue higher risk areas of savings in order to meet minimum targets, Joint Applicants could also be advantaged by estimated transaction savings that are purposefully too conservative." Diggs Direct, pp. 14-15, respectively. These statements contradict one another. Staff not only argues that the savings targets biased the Estimation Team to overreach for savings, but also that, even if there was no bias to overstate the efficiencies, then there was a bias to understate the efficiencies. It appears that Staff was determined to find fault in the efficiencies estimates no matter the results.

BPU witness Mr. Steffen equated the provisioning of the minimum savings targets to the Estimation Team to "reverse engineering". Steffen Direct, p. 52. Yet this argument ignores the overarching question posed to the Estimation Team by GPE management, which was "Are the reasonably achievable savings sufficient to meet the targets for making a competitive bid while maintaining GPE's financial and operational health and producing significant long-term benefits for customers and shareholders." Kemp Direct, p. 15, Kemp Rebuttal p. 8. As noted by Mr. Kemp, the Estimation Team had to find the right balance between developing achievable savings, maintaining the financial and operational health of the post-transaction company, and providing long-term benefits to both customers and shareholders. Kemp Rebuttal, p. 9 Engaging in reverse engineering in order to achieve an unobtainable efficiencies estimate would require the team to ignore the other two factors in the equation. There is simply no credible evidence to support that argument. The financial and operational health of the company, and the production of long-term benefits for customers and shareholders, were as paramount to the analysis as were the reasonably achievable savings.

In fact, all evidence supports the fact that the efficiencies estimates were not biased. As noted by Mr. Ives when asked about the consequences of failing to meet the efficiencies estimates,

> [t]he actual business consequences are delivering results less than what we told our shareholders, which could have market implications. That would also require us to deliver results less than what we've talked about to our customers and communities and regulators, which I think would not put us in very good favor. If you are asking for a specific dollar consequence, I, I think other than parties' assertions that the cost of service that we have brought in front of the Commission are, are imprudent or unreasonable because we didn't achieve savings that we should have, that may be the, the consequence in this room.

Tr. Vol. 6, Ives, pp. 1406-1407. Other consequences of not meeting the efficiencies estimates include GPE management having to rationalize performance shortfalls to the full management and the board in subsequent periods. Staff's expectation that there should be a "single declarative statement" to indicate that GPE executive management is committed to the attainment of the estimated savings overlooks the significance of what GPE executive management has affirmed. Flaherty Rebuttal, p. 51. GPE's sponsoring executives fully owned the efficiencies estimates. They signed off on the estimates, and will have joint and individual responsibility for achieving or exceeding the estimated efficiencies. Tr. Vol. 5, Kemp. P. 1260.

Further, the bias arguments put forth by Staff and Intervenors necessarily assume that the Enovation team compromised its industry reputation by fabricating unsupportable efficiencies estimates. Nothing in this record supports that position either. Mr. Kemp is a known quantity to the Commission and while his work in the Aquila transaction was performed during the integration phases of that transaction, he nevertheless assisted GPE in identifying and achieving the savings estimates in that matter. In fact, GPE achieved savings greater than initially estimated from the Aquila transaction. Kemp Rebuttal, p. 40. The record is replete with examples of the level of effort put forth in developing the efficiencies estimates and GPE's understanding of the consequences of failing to meet those estimates, which contradicts and negates the unsubstantiated allegations of bias put forth by Staff and Intervenors.

c. <u>Staff's argument that the timeline of the auction process was inadequate to provide for a sufficient efficiencies estimate is flawed.</u>

Staff and Intervenors argue that the efficiency estimates supporting the Transaction are compromised in part due to the timeline necessitated by the auction process utilized by Westar. However, this argument is unsupported and ignores several facts.

First, the argument ignores that the condensed timeframe of the auction-style process did not change the nature of the work performed. Flaherty Rebuttal, p. 18. Auction participants must still conduct due diligence, which GPE did in this case. This process included access to the Westar data room and the ability to ask questions of Westar management during bidder informational sessions. Further, auction-style processes are increasingly more commonplace in the industry, and successful transactions continue to occur with the underlying savings estimations being realized. Flaherty Rebuttal, pp. 18, 60. GPE's executives used the best information available to them to make timely business decisions. Tr. Vol. 5, Kemp, p. 1301. In light of such facts, Staff's argument that the auction environment timeline provides insufficient time to develop valid efficiencies estimates stands in contrast with what has been taking place in the industry over the past several years.

Second, the argument ignores the fact that the efficiencies are, in fact, measurable. As noted by Mr. Flaherty, "'[m]easurable' savings estimates can be identified and documented through a variety of means, including direct analysis, direct estimation or indirect comparison." Flaherty Rebuttal, p. 21. In addition to the extensive framework utilized to develop the pre-bid efficiencies estimates as outlined above, GPE had the benefit in this Transaction of not only having successfully completed a recent transaction (Aquila) with the assistance of Mr. Kemp, but also a familiarity of Westar from prior market and executive interactions and history. Flaherty Rebuttal, pp. 18-19. These factors provided the bid team with an additional basis for comparison in developing the efficiency estimates. Flaherty Rebuttal, p. 21.

d. Staff's criticism that Westar management was not involved in the development of efficiencies estimates is contrary to auction environments.

Any argument that GPE should have involved Westar management in the development of the efficiency estimates, as was done in the Aquila matter, ignores the distinct differences in circumstances between the two transactions. First, the Aquila acquisition involved a friendly acquisition process with a financially distressed seller (Aquila) looking for assistance. Tr. Vol. 5, Kemp, pp. 1302-1303. In competitive auction environments, such as that involved with the instant Transaction, the seller is not involved with the development or review of pre-bid efficiency estimates. *Id.; see also*, Busser Rebuttal, p. 9. In fact, with regard to the instant Transaction, the limitations on information sharing were not lifted until four months after the bid process concluded. Kemp Rebuttal, p. 8. This argument again ignores the level of work performed by GPE and its team of industry experts in the development of the efficiencies estimates.

e. The Integration Project has validated the initial efficiencies estimates.

Upon announcement that GPE was the successful bidder, GPE began implementing its Integration Project and delving deeper into the efficiencies estimates. The Integration Project consists of four general phases: Framework, Design, Integration Plans, and Day 1 Preparation. Busser Direct, pp. 3-5. The Integration Project is overseen by a senior executive-led steering committee that is provided progress reports on a weekly basis at a minimum. Busser Rebuttal p. 11. The project initiative is being led by Westar and GPE senior executives, with executives from both companies also jointly leading the functional Integration Teams that cover all areas of the combined companies. Busser Direct, pp. 3-4; Busser Rebuttal, p. 12. The Integration Teams have worked to review the assumptions that were used to develop the initial efficiencies estimates supporting the Transaction, and have either confirmed those assumptions, or identified where those assumptions may not have been accurate, and why. Busser Rebuttal, p. 22. The teams have also identified additional efficiency opportunities that were not identified through the initial efficiencies development process. *Id*. This team approach was utilized based on the recognition that the collective knowledge bases of the employees who work for each of the Integration Team leaders makes them well suited to identify additional areas to gain efficiencies through the Transaction. *Id*.

From the outset, GPE understood that the identification of additional savings areas and shifts in efficiencies mix were anticipated as part of the natural course of the Integration Project. Kemp Direct, pp. 21-22; Kemp Rebuttal, p. 9; Busser Direct, p. 8; Busser Rebuttal, p. 21; Tr. Vol. 5, Flaherty, p. 1334. From a larger, industry perspective, Mr. Flaherty observed that not only are such changes typical, but they are expected to occur, given the fact that many decisions relating to the Transaction require insight that is ascertainable only through the integration process. Flaherty Rebuttal, p. 23. To-date, GPE's confidence in the achievability of the overall efficiencies continues to grow. Busser Rebuttal, p. 14.

During the pendency of this case, Joint Applicants met with Staff and walked them through the planning and integration process, beginning to end. Busser Rebuttal, p. 21. Yet despite this fact, Staff argues that it was unable to verify the efficiency levels because the results of the integration process were not concluded. McClanahan Direct p. 13; Diggs Direct p. 29. This equates to an argument that Joint Applicants should have waited to file for approval of the

Transaction until the efficiencies could be finalized through the Integration Project. However, this argument not only radically discounts the extensive efforts expended in developing the pre-bid efficiency estimates, but it also ignores the inherent nature of estimates, which is that they are only proven, or final, once realized. Tr. Vol. 5, Busser, p. 1236. In other words, the efficiencies estimates will continue to be estimates until such time that they are captured post-close. This reality does not in any way negate or undermine the fact that the savings from this Transaction are real, or signify that the initial efficiencies estimates are unsupported. It merely reflects the reality of merger integration efforts, and is consistent with the Commission's historical understanding of the nature of efficiencies estimates, which is that "projections of cost savings are inherently merely estimates of what might occur." 1991 Merger Order, at p. 59. As explained by Mr. Busser, the timing for the filing of the Joint Application was based on an understanding that the sooner the Transactions is approved, the sooner the benefits can begin to flow to customers. Busser Rebuttal, p. 23. And because Joint Applicants were not planning on "updating" the overall level of efficiencies underlying the Transaction, it was appropriate to file as soon as practical, especially considering that seeking regulatory approvals occurs in parallel with integration efforts for these type transactions.[30] Tr. Vol. 5, Flaherty, p. 1338. Staff and intervenor arguments that GPE's savings estimates lack sufficient detail or plans to achieve are misplaced in light of the Commission's practice in cases such as this of using estimated savings levels.

Further, in response to Commissioner questions regarding the validity of the estimates, Mr. Flaherty reminded the Commission that not only were the efficiencies based on the best

[30] Joint Applicants do not accept the apparent controversy over the timing of their merger filing. There are numerous valid reasons for moving forward expeditiously, including the impact of uncertainty on employees and a desire to achieve merger benefits as quickly as possible.

information available at the time, but due to the nature of the bid process, which required GPE to qualify at each stage of the process in order to advance to the next level, the efficiencies were looked at twice. Tr. Vol. 5, Flaherty, pp. 1333-1334. Mr. Flaherty also noted that the timing of integration efforts is not always beneficial to the process, and that commissioners are frequently concerned with efficiencies estimates because commissions do not have perfect knowledge at the time when a decision must be made with regard to a given transaction. Tr. Vol. 5, Flaherty p. 1336. As is true in any transaction, there is a period of time when the filing for approval must be made, and the numbers available at that time are what support the case. Tr. Vol. 5, Flaherty, p. 1335. There is an understanding that additional insight will be gained through the integration efforts. Id. However, despite these imperfections, Mr. Flaherty reiterated that the process used by GPE is consistent with what he himself has used in other transactions, and because of that process employed, the efficiencies themselves provide a quantifiable case that support the Application. Tr. Vol. 5, Flaherty, p. 1336.

To address the concerns raised by Staff and Intervenor in Direct testimony with regard to the efficiencies estimates, Mr. Flaherty conducted an analysis of the initial efficiencies estimates established by GPE and Enovation that utilized the database developed by Mr. Kemp. When comparing the level of GPE efficiencies with other recent transactions utilizing his own database, Mr. Flaherty confirmed that the initial efficiencies estimates fell in a reasonable range. Flaherty Rebuttal, p. 11. To address some of the parties' arguments with regard to the inclusion of certain generation-related savings in the initial efficiencies estimate, Mr. Flaherty's analysis included a comparison of GPE's efficiencies estimates for Position Reductions and NFOM (Non-Fuel O&M) Savings that both included and excluded generation plant retirement impacts. Flaherty Rebuttal, pp. 10-11.

Specifically, Mr. Flaherty's comparison depicted the GPE and Westar metrics against the Low, Average and High metrics of the transaction set in his data base. As indicated in his analysis, the initial level of position reductions anticipated in the original pre-announcement work as a percent of the total baseline fell in the High range at 12.8% as compared to an average in the other transactions of 6.3%, and when generation plant retirement impacts were removed the position reduction level was still in the Average rage at 4.9%. Flaherty Rebuttal, pp. 10-11. From a year five non-fuel O&M perspective, the original pre-announcement work contemplated a savings level in the High range at 13.7% relative to the average of 7.0%, and when generation plant retirement impacts were removed, the level of O&M reductions remained in the High range at 8.2%. *Id*. Based on this analysis, Mr. Flaherty concluded that GPE pre-announcement efficiencies study sufficiently identified and quantified merger-related savings. Flaherty Rebuttal, p. 7. Mr. Flaherty also noted that the utility industry has a strong track record of attaining efficiencies estimates, whereas the same cannot be said for other industries. Flaherty Rebuttal, p. 11, Tr. Vol. 5, Flaherty, pp. 1331-1332. In fact, based on his vast industry experience, Mr. Flaherty stated that all utility companies with which he is familiar have attained their original level of savings estimates. Flaherty Rebuttal, p. 11. Mr. Flaherty's observations are consistent with the results of the Aquila transaction. Kemp Rebuttal, p. 52. And, if the Commission wishes further assurances with regard to the efficiencies, the Commission retains the authority to seek updates on progress and performance from GPE. As noted in Section IV.C. above, the Commission will be presented with evidence of Transaction savings during the first two series of post-closing rate cases when, consistent with Merger Condition 19, Westar and KCP&L seek recovery of transition costs.

It is not a novel concept that parties to a merger proceeding will disagree as to the validity, amount, and timing of efficiencies. The Commission has been faced before with such disagreement. In the 1991 Merger Order, the Commission noted that "Staff questioned the credibility of the Applicants' savings projections[,]" and argued "that the costs of the proposed merger outweigh the savings to be achieved." 1991 Merger Order, at pp. 52-53. CURB believed the costs were "excessive in relation to the benefits[.]" 1991 Merger Order, at p. 54. Similar arguments are made in this case but the level of verification being demanded by Staff in this proceeding with regard to the efficiencies estimates is inconsistent with the Commission's past understanding of the nature of efficiency estimations as being "projections of what might occur." 1991 Merger Order, at p. 59. The Commission should not be persuaded by such arguments. The Commission has previously found that the combination of Westar and KCP&L is beneficial to Kansas customers, and nothing about the underlying principles of that finding has changed. 1999 Merger Order, p. 8, ¶ 20, p. 12, ¶ 28. The Commission is also familiar with the work of both Mr. Kemp and Mr. Flaherty, and with regard to Mr. Flaherty the Commission has explicitly accepted his projections in the past. 1999 Merger Order, p. 11, ¶ 26.[31] The Transaction will result in hundreds of millions of dollars of savings flowing to customers, mitigating cost increases, and thereby resulting in lower future rates than what will otherwise occur without the Transaction. Tr. Vol. 4, Ives, p. 1049, Tr. Vol. 6, Ives, p. 1414.

[31] While Mr. Flaherty did not conduct the efficiencies estimates in this Transaction as he did in the previous KCP&L-Westar merger, his review and analysis of GPE's efficiencies estimates developed with Mr. Kemp, and the subsequent determination that such estimates were reasonable and consistent with other transactions with which he is familiar, should not be discounted by the Commission.

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

Summary

This standard is not relevant to the Transaction because the merging parties are not seeking recovery of the acquisition premium. Moreover, Staff has misapplied the Merger Standard in its testimony by suggesting that merger savings must equal or exceed the amount of the acquisition premium.

Argument

In applying this standard, the Commission has never required estimated savings to equal or exceed the acquisition premium. Proctor Rebuttal, pp. 10-11. Rather, it has used the savings estimate to determine the amount of acquisition premium that may be recovered in rates. *Id.* at pp. 10-14. Because the merging parties have indicated that they will not seek recovery of the acquisition premium in rates, this standard is irrelevant because the acquisition premium cannot have any impact on customers. Tr. Vol. 2, Proctor, p. 360.

1. While savings that will flow from the Transaction are significant, the amount of savings is not relevant where, as here, the merging parties are not seeking to recover the acquisition premium.

There can be little doubt that the merger of two adjacent utility companies will generate significant savings. In past merger proceedings, the inquiry under this Merger Standard was intended to establish how much of the acquisition premium would be allowed to be recovered from utility customers. *See, e.g.*, Proctor Rebuttal, pp. 10-14. The Commission has never imposed a requirement that merger savings equal or exceed the amount of the acquisition premium. *Id.* at pp. 10-11. And Mr. Proctor is not aware of any case in which the Commission denied a merger because estimated merger savings were less than the acquisition premium. *Id.* at p. 31.

The cases that underpin the Merger Standards demonstrate this point. In the KPL/KGE merger, the Commission found that the acquisition premium to be paid in the transaction was $388 million, 1991 Merger Order, at p. 60, and that savings estimates ranged from $219 million to $393 million. *Id.* Ultimately, the Commission found that $312 million was the net present value of reasonable expected merger benefits to customers. *Id*. at p. 61. In addition to finding that the savings were substantially less than the acquisition premium, the Commission further reduced the company's recovery of its costs by extending the amortization period of the allowed amount from 27 years to 40 years without carrying charges. *Id*. In other words, in the 1991 Merger Order, the Commission acknowledged that savings did not cover the entire acquisition premium. Yet, even with this finding, the Commission did not determine the purchase price to be excessive or not supported by savings. As Mr. Proctor notes, the Commission used this finding solely to limit the amount of the acquisition premium that would be recovered in customer rates. Proctor Rebuttal, pp. 10-13.

In its order approving the proposed Western Resources/KCP&L transaction, the Commission never even stated the amount of the acquisition premium. Proctor Rebuttal, p. 13. Discussing the acquisition premium without ever quantifying it, the Commission stated that the acquisition premium was "a contentious and vexing issue." 1999 Merger Order, at ¶25. The Commission found that the net present value of merger savings was $358.9 million. *Id*. at ¶27. The Commission provided two mechanisms for the company to recover a portion of the acquisition premium. First, the Commission ordered a four-year rate moratorium. In ordering the moratorium, the Commission stated

> During a moratorium, the utility is able to realize the benefits of lower operating costs while retaining the existing rate structure. This affords the Joint Applicants with an opportunity to recover a substantial portion of the merger-related savings. A rate

> moratorium gives the Joint Applicants a strong incentive to maximize savings as early as possible and allows the Joint Applicants to continue retaining savings immediately following the merger.

Id. at ¶31. Second, the Commission allowed the company to amortize $179.45 million – one-half the recognized savings from the merger – over a 35-year period without carrying costs. *Id*. at ¶34. Thus, in the WR/KCP&L merger, as in the KPL/KGE case, the Commission estimated savings to be realized and implemented a mechanism to give the lion's share of savings to customers. Joint Applicants' proposal in this case will yield the same result without the complications associated with tracking merger savings or amortizing an amount of acquisition premium in rates.

In this Transaction, by contrast to the KPL/KGE and WR/KCP&L cases, the merging parties have proposed to provide 100% of efficiency benefits to customers every time rates are reset through a rate case. Between rate cases, customers effectively receive additional benefits to the extent efficiencies allow the utility to defer a rate case. This approach is part of an integrated proposal that also includes GPE's commitment not to seek recovery of any of the acquisition premium, and to protect customers from risk associated with GPE's issuance of Transaction debt that makes the savings possible. Because Merger Standard (a)(iv) considers "the effect on consumers" of operational synergies and the acquisition premium, if there is no rate recovery of the acquisition premium, there can be no effect on consumers from the acquisition premium. Tr. Vol. 2, Proctor, p. 360. Consequently, this standard is irrelevant to approval of the Transaction.

VI. Quality of Service and Public Safety

A. Service Quality Standards

Summary

Joint Applicants propose quality of service standards, including exposure to potential penalties up to $12.328 million annually, for a minimum of three full calendar years after closing (2018, 2019 and 2020) to ensure that the Transaction does not result in degradation of service reliability or responsiveness. Joint Applicants' proposal is consistent with long-standing and recently re-affirmed Commission precedent while the proposals of Staff and CURB – who suggest that service quality standards should be set aside and addressed after the Commission issues its order – are incomplete, contain elements that have never before been approved by the Commission, or propose service level targets without information regarding the cost to attain those service levels.

Argument

While not an express element of the Commission's merger standards, the parties addressing quality of service standards generally agree that utility mergers and acquisitions can give rise to understandable concerns regarding the impact such transactions may have on the quality of service provided to customers during the transition period. Gile Direct, p. 3; Harden Direct, p. 3; Noblet Rebuttal, pp. 7-8. Consequently, in approving the recent acquisition of the Empire District Electric Company by Liberty Utilities, the Commission re-affirmed its long-standing practice of approving quality of service standards in its orders authorizing such transactions. In this regard, the Commission has consistently approved quality of service standards that are designed to prevent degradation of service quality as a result of the transaction.[32]

Consistent with this long-standing Commission precedent, Joint Applicants propose quality of service standards that:

- Require reporting of reliability and responsiveness measures beginning the first full calendar quarter ending after the Transaction closes;
- Establish penalty thresholds for reliability (SAIDI and SAIFI[33]) and responsiveness (agent service level and abandoned call rate[34]) on the basis of three years of KCP&L and Westar history with recognition of the distinct characteristics of their service areas and the variability inherent in such measures due to factors largely beyond utilities' control, such as weather;
- Impose penalties on the utilities – of up to $8.8 million per year for Westar and up to $3.528 million per year for KCP&L – for failure to maintain reliability and responsiveness at or above the threshold levels, as determined on a calendar year basis beginning the first full calendar year after closing with such penalty exposure remaining in effect for no less than three full calendar years (*i.e.*, January 1, 2018 through December 31, 2020); and

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[32] See, 1999 Merger Order, pp. 14-15 and Attachment B; Docket No. 07-KCPE-1064-ACQ ("07-1064 Docket"), Joint Motion and Settlement Agreement ("Aquila S&A"), filed Feb. 28, 2008, Attachments 1, 2 and 3; Docket No. 14-KGSG-100-MIS, Order Approving Unanimous Settlement Agreement, dated Dec. 19, 2013, Schedule 1 to Unanimous Stipulation and Agreement ("One Gas S&A"); and Empire Merger Order, Joint Motion for Commission Approval of Unanimous Settlement Agreement, filed Oct. 6, 2016, Exhibit A, Unanimous Settlement Agreement.

[33] SAIDI stands for system average interruption duration index and is a representation of outage duration, and SAIFI stands for system average interruption frequency index and is a representation of outage frequency.

[34] Agent service level is the percentage of calls answered within 20 seconds, and the abandoned call rate is the percentage of calls abandoned by customers before being answered.

- Permit penalty exposure for each individual measure to terminate only upon the utility's attainment of three consecutive years of penalty-free performance for that measure.

The complete description of Joint Applicants' proposed quality of service standards is explained on pages 16-32 of the rebuttal testimony of Mr. Noblet and set forth in Schedules KTN-1 through KTN-4.

The service quality standards proposed by Joint Applicants ensure that Westar and KCP&L will attend to their customers' service needs during 2018-2020 – the same period of time when the vast majority of Transaction savings will be achieved. Tr. Vol. 6, pp. 1446-1447; Kemp Direct, p. 19, l. 20 through 20, l. 23; Schedule WJK-3. This matching of time periods is logical and consistent with the period of time service quality standards have been approved by the Commission for prior transactions, but it is important to note that KCP&L and Westar's penalty exposure by measure under Joint Applicants' proposal does not terminate automatically after 2020, but only after three consecutive years of penalty-free performance for each measure. Tr. Vol. 6, Noblet, pp. 1445-1446. Failure to satisfy the standard in any year for a measure restarts the three-year clock for that measure. This structure provides additional assurance that GPE and its utilities will appropriately balance their customers' interest in service reliability and responsiveness while striving to obtain savings that will ultimately flow back to the benefit of customers in the form of lower rates than without the Transaction. The fact that implementation of best practices will continue beyond 2020 or that the roll-out of a new customer information system ("CIS") for Westar may also be implemented beyond 2020 is not a reasonable basis to extend the term of service quality standards and penalty provisions beyond the proposed three-year minimum. The CIS project was planned for KCP&L independent of the Transaction and

Westar was likewise planning to launch its own CIS project independent of the Transaction. Tr. Vol. 6, Noblet, p. 1447; Busser Rebuttal, p. 27. Thus, the KCP&L and Westar CIS projects are not driven by the Transaction and provide no basis to extend the term of Transaction-related service quality standards. Similarly, utilities routinely examine and adjust their internal processes in pursuit of more efficient and effective operations and these efforts, akin to implementation of best practices, are not accompanied by service quality standards.

Not only are Joint Applicants' proposed quality of service standards fully consistent with Commission precedent, they are also the only comprehensive set of such standards that exist in this record. This is because both Staff and CURB recommend that the Commission set this issue aside for purposes of its order in this proceeding and instead direct the parties to negotiate service quality standards and penalties after the issuance of the Commission's order in this case. Gile Direct, pp. 17-18; Harden Direct, p. 10. On the witness stand, Staff witness Gile repeatedly characterized Staff's proposal for this Transaction as "a starting point for discussion purposes." Tr. Vol. 6, Gile, pp. 1486-1496. This is a curious statement given Staff's refusal to date to engage in any meaningful discussions during the pendency of this case when such discussions would have been appropriate and could have been comprehensive. Tr. Vol. 5, Gatewood, pp. 1160-1161; Tr. Vol. 1, Ruelle, p. 272. This item should not be left unresolved in the Commission's order. Noblet Rebuttal, pp. 10-11. It would be unreasonable to issue an order on the merger and leave Joint Applicants with uncertainty of outcome in an area such as service quality standards and penalty provisions.

Staff and CURB's proposed service quality recommendations suffer from other serious shortcomings. Both Staff and CURB suggest that the baseline should be set by reference to "best of" statistical performance over an historical period, Gile Direct, p. 7; Harden Direct pp. 9, l. 21

through 10, l. 3, but this inappropriately fails to recognize that events outside the utilities' control, such as weather-related events that are not normalized, can have a substantial effect on statistical measures, both positive and negative. Noblet Rebuttal, p. 10. Staff also opines that service quality standards to be approved for this Transaction should require year-over-year improvement in order for Westar and KCP&L to avoid penalties. Gile Direct, p. 5. However, Staff witness Gile admitted that no prior Commission orders had approved or imposed transaction-related service quality standards that required improved performance to avoid penalties. Tr. Vol. 6, Gile, pp. 1485-1486. In fact, Joint Applicants have been unable to find any prior transaction-related order of this Commission requiring improved service quality as a result of a merger or acquisition. Ives Rebuttal, p. 39. Staff witness Glass acknowledges this practice in the following exchange:

> Q: Would you agree if rates would be lower with the merger than without that would be an economic efficiency?
>
> A: [By Dr. Glass] Yes.
>
> Q: And if the combined companies can serve customers with fewer employees over time, would you agree that would also be an efficiency?
>
> A: **As long as reliability stays the same, yes.**

Tr. Vol. 7, Glass, pp. 1621-1622 **(emphasis supplied)**. It appears that Staff may seek to justify requiring improved service quality as a condition of transaction approval on the basis of certain testimony by Joint Applicant witnesses Bassham and Caisley that the Transaction is expected to improve service quality. Gile Direct, p. 4. This Staff logic inappropriately fails to consider a number of important factors, including:

- The distribution systems and contact centers of both Westar and KCP&L will be essentially the same the day after the Transaction closes as they were before closing, and improving reliability performance metrics can be a lengthy, multi-year process Tr. Vol. 6, Gile, pp. 1481-1482;

- Adoption of best practices can take years as it may require the use of common information technology systems and platforms by both utilities before implementation can occur, Tr. Vol. 6, Noblet, pp. 1434-1435, 1442, and 1449-1450; and
- Service level objectives must be assessed in light of the cost necessary to attain and support them, and Staff admits that it has not assessed the cost necessary to attain service level improvements it has recommended. Noblet Rebuttal, p. 15; Tr. Vol. 6, Gile, pp. 1486-1496.

It would be particularly inappropriate for the Commission to adopt year-over-year improvement requirements without considering the trade-off between incremental improvements in service quality and the costs to achieve those improvements because customers will end up paying for enabling investments.

In addition, Staff suggests that the quality of service standards to be adopted in this case should remain in place "indefinitely." Gile Direct, p. 12. This too is inconsistent with the Commission's long-standing precedent, most recently re-affirmed when the Commission approved the Liberty/Empire transaction on December 22, 2016, which has not mandated service quality standards in connection with approval of a merger or other transaction for longer than three years.[35]

All customers have an interest in reliability and responsiveness of utility service, just as all customers are interested in reasonable rates for utility service. The need to balance these

[35] See, 1999 Merger Order, pp. 14-15 and Attachment B; Aquila S&A, Attachments 1, 2 and 3; One Gas S&A, Schedule 1; and Liberty/Empire Order, Exhibit A.

interests has long been recognized in Kansas statutes through the phrase "efficient and sufficient service." *See, e.g.*, K.S.A. 66-101b. There has been no suggestion in this record that Westar and KCP&L do not currently provide efficient and sufficient service, and the service quality standards recommended by Joint Applicants provide assurance that this appropriate balance will continue during the post-closing period when GPE, KCP&L and Westar will be striving to achieve Transaction savings. In contrast to the recommendations by CURB and Staff, the quality of service standards proposed by Joint Applicants are comprehensive and consistent with long-standing Commission precedent that was recently re-affirmed when the Commission approved the Liberty/Empire transaction. Consequently, Joint Applicants ask that the Commission adopt in full the quality of service standards explained on pages 16-32 of Mr. Noblet's rebuttal testimony and set forth in Schedules KTN-1 through KTN-4 as provided in Schedule DRI-3 to Mr. Ives' rebuttal testimony.

B. Merger Standard (h): "What impact, if any, the transaction has on public safety."

Summary

There is no reasonable basis to conclude that public safety will be negatively impacted by the Transaction due to the Joint Applicants' proposed quality of service standards to ensure reliability and responsiveness of service post-closing, the fact that savings to be achieved in the vegetation management area will not reduce the number of trees that are trimmed, the fact that capital expenditure savings in the transmission and distribution area will come largely from re-prioritizing transmission projects not from reductions in distribution system reliability capital expenditures and GPE's commitment to maintain the Raytown and Wichita contact centers.

Argument

Both Westar and KCP&L have provided electric service in Kansas for over 100 years. Consequently, the Commission, other public authorities in their service territories and customers served by KCP&L and Westar are familiar with their practices, culture and commitment to public safety. Two parties – Staff, through the testimony of Mr. Gile, and BPU, through the testimony of Mr. Krajewski – have noted the "potential" that the Transaction could have a negative impact on public safety. Gile Direct, pp. 8-10; and Krajewski Direct, p. 22. Neither has stated definitively that the Transaction will have such an impact, and both primarily point to cost reduction estimates in the area of vegetation management and distribution capital expenditures as the sources of their potential concerns. Gile Direct, pp. 8-10; and Krajewski Direct, pp. 22-23. In response, Joint Applicant witness Kevin Noblet makes it clear that savings to be achieved in vegetation management will not reduce the amount of tree trimming that occurs and, instead, will be achieved through efficiencies in how the vegetation management program is staffed, managed and executed. He also explains that the majority of capital expenditure reductions in the transmission and distribution area will come from re-prioritization and realignment of transmission capital and not a reduction in capital expenditures related to distribution system reliability. Noblet Rebuttal, p. 36; Tr. Vol. 6, Noblet, pp. 1456-1458, 1463. Even with those transmission capital expenditure reductions, however, the ongoing spend for Westar post-closing will be at or above Westar's five-year average transmission capital spending. Tr. Vol. 6, Noblet, pp. 1463-1464. Mr. Noblet makes it clear that KCP&L has adhered to its vegetation management cycles for nearly a decade and this consistency in approach, which enhances the efficiency and effectiveness of vegetation management practices, will be applied to the Westar system post-closing. Noblet Rebuttal, pp. 34-35. KCP&L's practice of mid-cycle inspection will also be applied to Westar post-closing, and this is expected to bring additional benefits to Westar in terms of vegetation management. Noblet Rebuttal, p. 36. Consequently, Joint Applicants assert that it is reasonable to expect that vegetation management practices will be both more effective and more efficient post-closing and, therefore, that the resultant public safety impacts should be neutral to positive as well.

Additionally, GPE intends to maintain both existing contact centers (KCP&L's in Raytown, Missouri and Westar's in Wichita, Kansas), and Joint Applicants' proposed quality of service standards ensure that reliability and responsiveness of service will not deteriorate as a result of the Transaction. Noblet Rebuttal, pp. 16-32, 36-37. In fact, having two contact centers approximately 200 miles apart is expected to provide better service and safety due to significant redundancy and the ability to route overflow calls during storms affecting only one service area. Heidtbrink Direct, p. 7. These actions provide assurance that the public safety impacts related to reliability and responsiveness – including answering customer phone calls quickly and minimizing the frequency and duration of service outages that could pose public safety hazards – will not deteriorate due to the Transaction either. Noblet Rebuttal, p. 35-37.

In sum, there is no reasonable basis to conclude that the Transaction will have any detrimental impact on public safety. In fact, given the quality of service standards Joint Applicants have proposed and other commitments GPE has made, it is expected that public safety will be the same or improved over time as a result of the Transaction.

VII. Environmental Impacts, Economic Impacts, Competitive Impacts, and Transmission and Wholesale Rates

A. Merger Standard (a)(v): "The effect of the proposed transaction on the existing competition."

Summary

The Transaction will not have any effect on existing competition. In Kansas, only one electric utility is permitted to serve retail customers in a specific geographical area and the Transaction will have no impact on the certificated territories of Westar and KCP&L. No party has challenged this conclusion. Staff's arguments regarding competition in the Southwest Power

Pool ("SPP") Integrated Market due to transmission congestion and competition from non-wires alternatives are not valid concerns with respect to the Transaction and should be rejected.

Argument

The proposed Transaction will not have an adverse effect on existing competition. The Transaction will have no effect on the certificated territories of Westar and KCP&L. Because Kansas only allows one electric utility company to serve retail customers in each geographical territory in the State, the Transaction will have no effect on existing competition in Kansas. See Retail Electric Supplier's Act, K.S.A. 66-1,170 *et seq.*; Ives Rebuttal, p. 24. No party to the docket disagreed with the conclusion that the Transaction will not affect competition in Kansas because utilities in Kansas have certificated territories. Instead, Staff offered testimony about alleged competitive impacts in the SPP Integrated Marketplace (IM), recommending an unnecessary and undefined preapproval process for plant closures, and offered speculative concerns about pressure the Commission might face to protect GPE from competition. Neither of these concerns or recommendations is valid.

1. The Commission should not impose a requirement for Westar and KCP&L to seek preapproval of plant closures because Staff's concerns are already addressed through other measures.

Staff suggests that the Transaction may affect competition because a generation plant closing could "create transmission congestion which would raise local electricity prices." Glass Direct, p. 35. Dr. Glass's concern is invalid because he ignores the measures already in place to control this type of effect on the transmission system and because he ignores the utilities' commitment and obligation to study and remedy any such effects before proceeding with a plant closing.

First, as Mr. Ives explained, Staff's concern about the potential creation of market power from a plant closing is not valid:

> There are many different situations in which the potential for market power can arise within a Regional Transmission Organization ("RTO"). A specific plant retirement is just one of them. Others include the loss of critical transmission lines. Some situations may be long-term in nature, while others are temporary. To address these concerns there already exists an SPP Market Monitoring Unit with procedures in place that evaluate potential market power conditions and initiate mitigation measures where necessary to prevent the exercise of market power. The Market Monitoring Unit also has the power to initiate investigations that can potentially lead to significant fines. As a result, the KCC does not need to approve plant closures to prevent the exercise of market power. The SPP is the appropriate entity, subject to FERC oversight, to address market power concerns.

Ives Rebuttal, p. 55-56. Additionally, as Dr. Glass himself admitted, the market is designed to adjust in order to address congestion on the transmission system, Tr. Vol. 7, Glass, p. 1631, and if the congestion rises to a certain level, the SPP transmission planning process will identify any necessary transmission line construction as economic projects in order to alleviate the congestion on the system. Tr. Vol. 7, Glass, p. 1631.

Second, transmission impacts are already studied as part of SPP's and the utilities' planning processes. SPP requires utilities to provide six months' notice before closing a generating plant "for the SPP to have sufficient time to study" possible "reliability and/or economic impact[s] on the SPP footprint." Tr. Vol. 7, Glass, pp. 1630-1631; Joint Applicants Exhibit 24. As Mr. Ives explained, in addition to notifying SPP of potential plant closings so they can be incorporated into SPP's planning process, Westar and KCP&L study the impacts of any plant closings and addressing any related transmission reliability concerns is always part of any plan to retire units. Ives Rebuttal, pp. 53-54. GPE's Integrated Resource Planning (IRP) process includes an evaluation of:

> the transmission impacts of any potential plant closures. The Companies will also notify the Southwest Power Pool ("SPP") of any planned retirements in order for SPP to study possible transmission system impacts. If a plant is determined to be

> necessary to maintain transmission system reliability, it will not be retired until mitigation measures are in place.

Ives Rebuttal, p. 54.[36]

Staff's proposed preapproval process is also undefined. Dr. Glass admits that he has not considered how a preapproval process for plant closings would work or the impact of such a requirement on the companies' or SPP's planning processes. Tr. Vol. 7, Glass, p. 1628. No such requirement exists today despite the fact that plant closings could potentially affect the transmission system even without the proposed Transaction. Tr. Vol. 7, Glass, pp. 1633-1634. Because Staff's concerns regarding transmission congestion are already addressed through the channels discussed above, the Commission should not impose such a requirement as a condition of approval of the Transaction.

2. Staff's argument that the Commission will feel pressured to protect GPE from competition from non-wires alternatives is speculative and, as a result, irrelevant to the application of the Commission's merger standards.

Staff, through its consultant Hempling, argues that due to GPE's acquisition-related debt, the Commission will face pressure to protect GPE from competition by others, including companies that could perform more cost effectively. Hempling Direct, pp. 65-66. Specifically, Mr. Hempling is referring to the requirement in New York that its investor-owned utilities consider "non-wires alternatives" before committing to a traditional wires investment that would otherwise be required to meet load growth. Reed Rebuttal, p. 51. New York utilities are required to solicit interest from third parties to "determine if they can aggregate customer-sited solutions including energy efficiency, demand response, and distributed generation in sufficient

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[36] If Westar or KCP&L were to proceed with a plant retirement without remedying a reliability impact on the transmission system, they would be in violation of North American Electric Reliability Corporation (NERC) requirements. See *generally* NERC Standard TPL-001-4, Transmission System Planning Performance Requirements.

quantity and with sufficient reliability such that load growth would be offset and the major project deferred or potentially avoided." *Id.* Mr. Hempling's argument is flawed for several reasons.

First, as discussed in depth above, the Joint Applicants have demonstrated that GPE's Transaction debt will not impose additional risks on the operating utilities or customers. *See* Section IV.A. and C., *supra.* Second, with regard to Mr. Hempling's assertion that the Commission will face pressure to protect GPE from competition, the "competition" Mr. Hempling envisions – having "non-wires alternatives" compete with utility investment – is far too speculative at this time to be applicable to this merger standard in Kansas. Reed Rebuttal, pp. 51-52. As noted by Mr. Reed, it is not yet clear that this new and as-yet untested policy will benefit New York customers and it is certainly not ripe for consideration as part of Kansas' Merger Standards. Reed Rebuttal, pp. 51-52. Finally, Mr. Reed also demonstrates that to accept Mr. Hempling's premise one must assume regulatory failure – that the Commission somehow cannot or will not exercise its appropriate authority to regulate the utilities. Reed Rebuttal, p. 52; *see also* Ives Rebuttal, p. 25. As a result, the Commission should reject Staff's arguments regarding the effect of the Transaction on competition and find that no adverse effect on competition will result from the Transaction.

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

<u>Summary</u>

Upon closing, GPE will have one of the largest portfolios of wind generation in the country, with over 3,000 megawatts of nameplate capacity, most of it located in Kansas. GPE has historically relied on integrated resource planning ("IRP") analysis to make long-term resource planning decisions, and will extend its IRP process to Westar. Because IRP analysis comprehensively addresses myriad issues attendant to long-term resource planning with the goal *of minimizing long-term retail revenue requirements, speculative concerns regarding stranded costs or other potential consequences of resource decisions do not warrant consideration when evaluating the potential impact of the Transaction on the environment. Given the extensive emission-free resources of the combined company and the strong energy efficiency track record GPE has established in Missouri, there is no reasonable basis to conclude that the Transaction will have a negative effect on the environment, and there is good reason to expect that the Transaction will have a positive effect on the environment.*

Argument

After the Transaction closes and all wind facilities currently under contract are placed in service, more than 45% of retail customer energy needs can be met with electricity that has been generated with no emissions. Heidtbrink Direct, p. 8. Among investor-owned utilities, the combined company will have one of the largest portfolios of wind generation in the country, consisting of over 3,000 megawatts of nameplate capacity, the vast majority of which will be produced with indigenous Kansas resources. *Id*. Additionally, both KCP&L and Westar have diligently undertaken extensive emission reduction efforts at their respective generating facilities with the result that neither company has a backlog of such work. *Id*. This provides substantial flexibility to mitigate potential customer impacts from future carbon regulation or other future environmental requirements. *Id*.

CURB witness Crane indicates that the Transaction could have a positive impact on the environment if coal-fired generating units are retired earlier than expected, although she does make additional ancillary comments that will be addressed below. Crane Direct, pp. 51-52. Staff takes the position, through Mr. Drabinski, that the Transaction will have no impact on the environment, positive or negative. Drabinski Direct, p. 11. The only other Staff/intervenor witnesses testifying on this subject, Mr. Chang for Sierra Club and Mr. Chriss for Walmart, express concern regarding the effect of the Transaction on the environment, and would prefer, respectively, that GPE increase energy efficiency efforts and wind resources and that the Commission order Westar and KCP&L to convene a stakeholder process to develop renewable proposals to be filed within one year of close. Chang Direct, pp. 33-34; Chriss Direct, p. 17. Sierra Club also recommends that the Commission order GPE to perform integrated resource planning ("IRP") analysis. Chang Direct, p. 34.

With respect to Sierra Club's recommendation that the Commission require GPE to perform IRP analysis, GPE fully intends to continue performing IRP analyses to assist in long-term resource planning when it owns Westar as it has in the past. Ives Rebuttal, p. 53. In fact, Joint Applicants have proposed a condition (Condition No. 43 in Sch. DRI-3 attached to Mr. Ives' rebuttal testimony) requiring the provision of such analyses to KCC Staff within 30 days of making required IRP filings in Missouri. GPE would be willing to provide the public version of such IRP filings to other entities. CURB witness Crane's concerns about potential stranded costs resulting from retirement of generating units are also addressed by this because generation decisions under IRP analysis take stranded costs into account in determining the long-term least cost revenue requirement[37]. Ives Rebuttal, pp. 27, 57-58.

As to Sierra Club's concerns regarding commitments by GPE regarding additional wind resources and energy efficiency efforts, they are not only unfounded, but in direct conflict with the facts. Upon combining, GPE will have a top ten, and maybe top five wind portfolio in the United States, and nothing in Joint Applicants' testimony suggests any diminishment of support

[37] Similarly, CURB witness Crane's concerns regarding rate structures that may promote energy consumption do not warrant consideration because the example she uses – Westar's inclining block rate design – has already been approved, and is not used by KCP&L; and she fails to consider other rate designs and demand-side management/energy efficiency programs deployed by KCP&L but not by Westar. Ives Rebuttal, p. 27.

for Kansas wind resources. Caisley Rebuttal, p. 14. As to energy efficiency programs, KCP&L has already stated and confirmed in action its commitment to energy efficiency. *Id*. In Missouri, KCP&L has the largest energy efficiency program by dollar spent per customer in the state. In Kansas, KCP&L currently has on file a proposal to expand its offerings into Kansas, and anticipates making a similar filing for Westar after the Transaction is complete. Caisley Rebuttal, p. 14-15. Obviously, the final word on whether and to what extent energy efficiency programs will be implemented in Kansas lies with this Commission, but whatever the result, it is clear that GPE will have done its part. As a result, Sierra Club's recommendations regarding additional wind resource commitments and energy efficiency programs are unwarranted and should not be adopted.

As to Walmart's recommendation that the Commission order Westar and KCP&L to make renewable filings within one year of closing, Westar currently has a wind generation tariff and Walmart witness Chriss acknowledges that "the economics of the tariff, due to low fuel costs, are currently not favorable for customer usage." Chriss Direct, p. 16. Consequently, there is no need to condition approval of the Transaction as recommended by Walmart. Ives Rebuttal, p. 63.

In summary, there is no basis to conclude that the Transaction will have a detrimental impact on the environment. To the contrary, it would be reasonable to expect the Transaction to have a favorable impact on the environment.

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

<u>Summary</u>

The proposed Transaction will be beneficial to state and local economies and to the communities served by Westar and KCP&L. The efficiencies created by the Transaction will result in energy costs that are less expensive for customers than they would be absent the merger *and lower energy costs will have a positive economic impact for Kansas through the "multiplier" impact. The Transaction ensures local control of the two largest utilities in the state and GPE has made significant commitments to Kansas, local communities, and employees that help to solidify the economic benefits that will result. Staff's single-minded view of the economic impact of the Transaction – and its argument that the Transaction must have a negative economic impact because it will result in a reduction in job levels – ignores GPE's plans to use attrition to achieve job reductions, the economic value to Kansas from the reduction in rates from levels that would exist absent the Transaction, and the significant value to Kansas that will result from payments to Kansas-based Westar shareholders. Staff's position that the Transaction will be detrimental to state and local economies is inconsistent with Commission precedent. As the Commission previously recognized in its 1991 Merger Order, a reduction in jobs is inevitable if the Commission wants more efficient utilities. However, given the attrition rate at Westar and KCP&L, this is an opportune time to achieve reductions with minimal employee impacts. Customers should not be asked to pay to sustain employment levels that are above efficient levels as the result of a merger. Nor should they be denied the benefits of a merger in order to preserve operations that could have been made more efficient through a merger.*

<u>Argument</u>

The proposed Transaction will be beneficial to state and local economies and to the communities served by Westar and KCP&L. The efficiencies created by the Transaction will result in energy costs that are less expensive for customers than they would be absent the merger and lower energy costs will have a positive economic impact for Kansas. Bassham Direct, p. 13; Ives Direct, p. 11; Tr. Vol. 1, Bassham, p. 92. Energy is a "key input into the entire economy, and keeping energy costs competitive is good for the Kansas economy." Ruelle Direct, p. 31.

As Mr. Ives explained, “virtually everything in the economy is powered in some way by electricity,” so “lower prices mean lower cost of factor inputs. As the lower input costs ripple through the economy, virtually everyone benefits.” Ives Direct p. 11; see also Ruelle Rebuttal, pp. 45-46. As discussed below, the economic benefits provided by the Transaction will be enhanced even further because the Transaction retains local control over the two largest utilities in Kansas and because of the commitments GPE has made to the state and local communities. Staff’s analysis regarding the economic impact of the Transaction is flawed because it ignores key components of the benefits that will result from the Transaction and its position is inconsistent with Commission precedent.

1. The Transaction retains local control of the two largest utilities in the state, which enhances the economic benefit from the merger.

The fact that Westar selected a purchaser that already has significant Kansas operations and ties to Kansas amplifies the positive impact the Transaction will have on the Kansas economy. The Transaction ensures that the two largest Kansas utilities will continue to be controlled locally and that jobs will not be lost to an out-of-state utility. Ives Direct, pp. 11-12; Ives Rebuttal, p. 28; Caisley Rebuttal, p. 3. As Mr. Ruelle explained, “[t]he fact that it turned out to be a combination with our next door neighbor, someone familiar to us and our state, and who shares similar commitments to its communities and employees was a sense of relief, both personally and I hope for others in our state.” Ruelle Direct, p. 5.

GPE is a Midwestern utility holding company whose utility operating companies serve nearly 250,000 customers in Kansas (in addition to serving over 600,000 customers in Missouri). Ives Direct, pp. 11-12. After the Transaction, GPE will have over 60% of its customers located in Kansas – approximately 950,000 customers – and will have a leadership team that lives and works in and within a few miles of Kansas. Bassham Direct, p. 7; Bassham Rebuttal p. 16; Heidtbrink Direct, p. 11. Mr. Caisley explained the significance of retaining local control:

> One of the most important benefits of this Transaction is that at its conclusion, the resulting company will be managed by people who live and work in Kansas or near Kansas in Western Missouri. Affordable, reliable and clean electricity is central to every aspect of our daily lives and is the economic lifeblood of any economy. Compared to the very real possibility that Westar could be acquired by a corporation located a significant distance from Kansas and therefore lacking in experience and familiarity with Kansas, this Transaction provides local management that is more accessible, more responsive, more knowledgeable about state and local issues and is more incentivized to go above and beyond to not only serve, but improve the communities they serve. This is because the leaders of the resulting company live in the same communities and raise their families in those communities.
>
> Local control means greater interaction and alignment between an electric utility and state and local policy makers. Local control means greater civic and charitable involvement. Local control means greater responsiveness to regulators and customers because management lives and works in the same communities. And, most importantly, local control means greater involvement in state and local economic development which benefits utilities, customers, elected leaders and communities alike. At the conclusion of this Transaction, GPE will have nineteen executive officers; eleven officers will live in Kansas with the remainder within ten miles of the Kansas border in Missouri. No other company that would buy Westar would have a majority of their executive leadership team in Kansas.

Caisley Rebuttal, pp. 2-3.

GPE has explained that maintaining a strong economic environment in the territories where it serves is essential to its business, explaining that it has “more incentive than any other entity” to “improve the economy in Kansas through promoting the use of Kansas energy resources, to keeping rates as low as possible, including by achieving or exceeding our efficiency targets, and aggressively working with local and state economic development organizations to promote increased business in Kansas.” Caisley Rebuttal, p. 4. According to Mr. Caisley, “GPE only succeeds if Kansas succeeds." *Id*; *see also* Ives Direct, p. 12. The benefits of retaining local control have been recognized by the numerous community and political leaders that have submitted letters in the docket supporting the Transaction. Bassham Rebuttal, p. 17; Caisley Rebuttal, pp. 5-6. Elected leaders who have endorsed the Transaction include "Kansas Governor Sam Brownback, Senate President Susan Wagle, Speaker of the House Ray Merrick, Mayor of Topeka Larry Wolgast, and Mayor of Wichita Jeff Longwell. Communities and economic development groups all across Westar's service territory also support the merger." Bassham Rebuttal, p. 17; see also Caisley Rebuttal, pp. 5-6.

2. GPE has made significant commitments to local communities, the State of Kansas, and employees.

GPE made significant commitments to the State of Kansas and the communities where Westar serves in the Merger Agreement, in the initial Application filed in this docket, and as part of the commitments it offered in rebuttal testimony as Schedule DRI-3 to the Rebuttal Testimony of Darrin Ives. Specifically, GPE has agreed to:

(1) Retain Westar's Topeka downtown headquarters as GPE's Kansas headquarters;[38]

(2) Retain Westar's contact center in Wichita;[39]

(3) Maintain aggregate levels of Kansas community support and charitable giving at Westar's 2015 levels until at least five years after the close;[40]

(4) Honor all existing collective bargaining agreements;[41]

(5) Maintain existing compensation levels and benefits of Westar employees for two years after the closing of the Transaction;[42]

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[38] Ives Direct, p. 12; Bassham Direct, p. 6; Heidtbrink Direct, p. 11; Caisley Rebuttal, p. 5; Ives Rebuttal, Schedule DRI-3, Commitment No. 1.

[39] Heidtbrink Direct, p. 7; Bassham Direct, p. 13.

[40] Ives Direct, p. 12; Bassham Direct, p. 15; Ives Rebuttal, Schedule DRI-3, Commitment No. 3.

[41] Ives Direct, p. 12; Bassham Direct, p. 5; Ives Rebuttal, Schedule DRI-3, Commitment No. 4.

(6) While recognizing that Transaction-related efficiencies will result in lower employee headcount for the combined organization in both Kansas and Missouri post-closing compared to the two stand-alone organizations prior to closing, GPE has indicated that it will achieve such Transaction-related efficiencies in a generally balanced way across both states;[43]

(7) GPE will not affect an involuntary reduction in workforce or involuntary retirement program due to the Transaction which results in a reduction in the Kansas-based workforce of KCP&L and Westar of greater than 20 percent for a period of three years after the date of the closing of the Transaction;[44]

(8) Make best efforts to achieve desired staffing reductions through natural attrition;[45]

(9) Consider targeted voluntary staffing reduction programs if natural attrition is not sufficient and where severance is unavoidable to honor and, in some cases, enhance, Westar's employee severance package;[46]

(10) Maintain and promote all low-income assistance programs consistent with those in place at all operating utility companies prior to the Transaction;[47]

After the initial filing was made in this docket, GPE announced its executive organizational structure, which demonstrated that GPE "will have a significant presence in Kansas after the Transaction is completed." Bassham Rebuttal, p. 16. On Day 1 after the Transaction closes, the executive team of GPE will include six former Westar executives, with five headquartered in Topeka and one in Wichita. Bassham Rebuttal, p. 16, Schedule TB-1; Ives Rebuttal, p. 29. GPE also indicated to Westar employees that they "do not intend to require employees to relocate in order to retain a job after the merger. With very few exceptions, we

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[42] Ives Direct, p. 12; Bassham Direct, p. 5; Ives Rebuttal, Schedule DRI-3, Commitment No. 5.

[43] Ives Rebuttal, Schedule DRI-3, Commitment No. 6.

[44] Ives Rebuttal, Schedule DRI-3, Commitment No. 6.

[45] Ives Direct, p. 12; Bassham Direct, p. 8-9; Ives Rebuttal, Schedule DRI-3, Commitment No. 7.

[46] Ives Direct, p. 12; Bassham Direct, pp. 8-9; Ives Rebuttal, Schedule DRI-3, Commitment No. 7-8.

[47] Ives Direct, p. 12; Ives Rebuttal, Schedule DRI-3, Commitment No. 9.

plan to allow employees to stay in their current work location and not require them to relocate from Topeka to Kansas City or vice versa." Bassham Rebuttal, p. 16. As Mr. Bassham explained, this will "help alleviate any impact to those communities that might have occurred if large numbers of employees were required to relocate." Bassham Rebuttal, pp. 16-17. The testimony of the Joint Applicants' witnesses during the evidentiary hearing served to further enhance the commitments to Kansas and local communities. For example, Mr. Caisley explained that although the Merger Agreement only requires GPE to keep the Topeka headquarters open for five years, GPE was committed to keeping that facility open in a more open-ended manner. Tr. Vol. 6, Caisley, pp. 1515, 1577.

Westar's CEO, Mark Ruelle, testified that GPE "knocked it out of the park" with its bid, not only on price but with its commitments to Kansas communities:

> **Everything we cared about, they hit it.** They gave us a full and fair price, in fact the best price of any of the bidders. They gave us a structure that kept the utilities' credit ratings unchanged. They kept a structure where the holding company would stay investment grade. **They made commitments to keep our headquarters in Topeka. They made commitments on charitable and community involvement. They made commitments to Wichita to keep the call center open. They continued our commitment to rebuild our service center that was outdated and obsolete in Wichita.** And the biggest one is they said they are not going to ask customers to pay for any of the merger costs or any of the premium.

Tr. Vol. 1, Ruelle, p. 269 **(emphasis added)**. Mr. Ruelle has also confirmed that GPE has exceeded his expectations with its performance relative to these commitments since the announcement of the Transaction. Ruelle Rebuttal, pp. 24-25.

3. Staff's analysis is flawed because it ignores key components of economic benefits associated with the Transaction.

Staff argues that the economic impact from job losses that will result from the Transaction outweighs the benefits to the economy from the savings provided to customers through lower rates than would have existed without the Transaction and from savings retained by Kansas shareholders.[48] However, Staff's analysis is flawed because it ignores the economic benefit from lower rates, ignores the manner in which GPE plans to achieve the reduction in employee count, and ignores large portions of the benefits the Transaction will provide to Kansas.

a. Staff ignores the benefits associated with achieving lower electric rates than would be possible without the Transaction.

When concluding that the Transaction would have a negative economic impact in Kansas, Dr. Glass ignores "the fairly basic economic impact question" of what happens to the money that Kansas electric customers would no longer spend on their utility bills, as the full cost savings from the Transaction are passed through in rates. Caisley Rebuttal, p. 11. "This money does not just disappear. It will become available as a pool of discretionary cash for business or residential spending in other areas." *Id*. The benefits of lower electric bills not recognized by Staff include:

- Improving the cost position of Kansas businesses vs. their competitors in other states, encouraging business creation and business investment in Kansas;
- Improving affordability for residents of all income levels in the service territories of Westar and KCP&L; and
- Increasing spending in other sectors of the Kansas economy, creating the potential for significant net gains in employment.

Caisley Rebuttal, p. 13.

Dr. Hall explained that every million dollars of lower electricity rates in the current Westar and KCP&L service areas will "create capacity in the broader Kansas marketplace to support 53 additional jobs and $1.6 million in additional income generation." Hall Rebuttal, p. 4. Additionally, Dr. Glass's assumption that those who might lose technical utility jobs as a result of the merger will have to leave Kansas to find new employment is faulty. The Kansas labor

[48] See Glass Direct, p. 3; Drabinski Direct, p. 12-13.

market is dynamic and "will like absorb the anticipated number of job reductions which may result from the Transaction, just as it absorbs – and adds to – the many tens of thousands of jobs that turnover in Kansas each year." Hall Rebuttal, pp. 4-5.

b. Staff ignores GPE's plans to achieve reductions in jobs through attrition.

Staff ignored "the fact that [GPE] plan[s] to accomplish the needed reduction in employee levels through voluntary methods as much as possible." Bassham Rebuttal, p. 18. Mr. Bassham has explained that job reductions will be "accomplished through good management and attrition as opposed to any layoffs that we would potentially have." Tr. Vol. 1, Bassham, p. 94. Dr. Glass admits that he only looked at the total reduction in number of jobs and did not consider GPE's plans to use attrition to accomplish the reduction:

Q. …When performing your evaluation on that issue, you looked at the total reduction in number of jobs that would occur as a result of the merger, but you did not consider how the reduction would be achieved. Is that correct?

A. Yes, that's true.

Q. So, in other words, you didn't take into account Great Plains' plan to achieve a significant portion of the job reduction through attrition. Is that right?

A. No. What I looked at was the spreadsheet that had, oh, the job losses and, for example, well, I just looked at the job losses that were identified. I didn't look at attrition, no.

Q. And so in your testimony, you don't discuss Mr. Bassham's or Mr. Ruelle's testimony about their plan to use attrition to achieve a significant number of the job reductions?

A. No, I don't discuss that.

Q. Would you agree that if someone retires from a technical job and then Great Plains decides not to fill that position then that employee – really no employee would have to leave the state to find a different job?

A. That's true, yes.

Tr. Vol. 7, Glass, pp. 1619-1620.

Both Westar and KCP&L are facing approximately 4-5% natural attrition per year due to retirements of baby-boomers. Ruelle Direct, p. 34. The day GPE announced the transaction, they "put a hiring freeze at KCPL so all of a sudden we weren't hiring and were able to pull together jobs we would have filled and didn't, and we've also offered a voluntary process for folks to leave which I think now we are at 180 positions, so we are trying to watch head counts." Tr. Vol. 1, Bassham, pp. 95-96. Mr. Ruelle confirmed that both companies are holding open positions to create more flexibility when combining the companies and attempting to achieve a reduction in employee count:

> We're taking care of our communities. And we're shrinking our work force at a time when people are volunteering to leave anyway. Baby Boomers are retiring. I mean, Terry has got like 180 people he is operating below budget right now, baling wire, but leaving, we have like 80 open right now. When Staff in its opening statement, they said oh, 260 jobs are going to be lost. Well, there will be 260 positions that are lower and lower payroll, but not 260 people put on the street. They are people that have largely already retired. We are like 250 at this, at this point.

Tr. Vol. 1, Ruelle, pp. 266-267.

As Mr. Ruelle testified, past behavior is the best indication of future behavior and GPE's past behavior has confirmed that it will work to achieve a reduction in employee count through voluntary means as much as possible. In response to a question from Commissioner Albrecht about whether there were "further work force reductions after the date of close" of the Aquila transaction beyond the 5% that received severance at close, Mr. Bassham confirmed that there were no additional layoffs, that they used attrition to achieve the needed reductions associated with the Aquila transaction, and that KCP&L has not had layoffs since he has been at the company, unlike many of the other companies in Kansas City. Tr. Vol. 1, Bassham, pp. 148-150.

Staff completely disregards the fact that a large portion of the needed job reductions will be achieved through attrition, helping to reduce any impact on the economy that otherwise might result.

c. Staff ignores large portions of the economic benefits the Transaction will provide to Kansas.

Staff's analysis ignores the significant economic benefits that will result from the payment to Kansas based Westar shareholders for their Westar stock and the capital gains taxes that will be paid to the state as a result. Dr. Glass admitted that he did not consider these items when looking at the economic impact of the Transaction:

> Q. So you didn't look at the benefit to the Westar shareholders today, the benefit they would get when they get paid for their talk stock?
>
> A. Well, yes – oh, no, that I did not take into account.
>
> Q. When doing your calculation, did you consider the benefit to the State of Kansas from the taxes that Kansas shareholders will pay on that amount they receive that they are paid for their stock?
>
> A. No, I did not.

Tr. Vol. 7, Glass, pp. 1624-1625.

According to Mr. Ruelle, Westar has about 18,000 Kansas shareholders who hold about 10.5 million shares. Ruelle Direct, pp. 31-32. The payment to Kansas-based Westar shareholders at $51 per share in case will total about a half billion dollars and the benefit to Kansas from capital gains taxes paid on that amount will be somewhere around $15 million. *Id*. These significant benefits were not included in Staff's analysis regarding economic impact of the Transaction.

d. Staff's position is inconsistent with Commission precedent.

Staff's conclusions are inconsistent with Commission precedent, which recognizes that it is not possible to have it both ways and achieve slower growing rates with no change in employment levels. In the 1991 Merger Order, in response to concerns raised by Staff about employment level reductions as a result of the proposed merger – concerns very similar to those raised by Dr. Glass in this docket – the Applicants explained that "the creation of jobs in Kansas should not be achieved through an inefficient utility infrastructure." 1991 Merger Order, Docket Nos. 172,745-U and 174,155-U (Nov. 14, 1991). The Commission, when concluding that the proposal would have a positive economic impact, agreed with the Applicants and stated that it "believes the policy of this State is that utilities should always strive to increase efficiency in providing safe, reliable utility service. Where synergies are available in the overlapping service territories, the Commission believes Applicants should act to capture those savings." *Id*.

Dr. Glass's position is similar to the position rejected by the Commission in its 1991 Merger Order. He seems to suggest that "elimination of any jobs, no matter how redundant, unnecessary or wasteful, would harm the Kansas economy." *See* Discussion of Staff's and Applicants' Positions in 1991 Merger Order (Nov. 14, 1991). Staff's "static viewpoint, if extended to its logical end, implies that Kansas would be better off if utilities employed many more people, older and less efficient generation plants continued to operate, and utility bills were much higher. Clearly there are major flaws in such logic." Caisley Rebuttal, p. 9; *see also* Tr. Vol. 1, Bassham, p. 133.

4. A reduction in jobs is inevitable if the Commission wants more efficient utilities; however, this is an opportune time to achieve reductions with minimal employee impacts.

GPE has forthrightly stated that the Transaction will result in fewer jobs. As Mr. Ruelle explained, there is "no doubt the combined company will be more efficient, and that means fewer jobs across both companies than exist with the two companies individually." Ruelle Direct, p. 33. However, Mr. Ruelle concludes that "this is the most jobs-friendly transaction we could have negotiated. By choosing GPE as our partner, we were successful in achieving important assurances for jobs and our communities." *Id*. Mr. Ruelle has also explained that Westar should not apologize "for finding responsible ways to be more efficient and using the present advantages of a unique demographic shift and natural retirements to become more efficient without doing so on the backs of our employees." Ruelle Rebuttal, p. 46.

Similarly, Mr. Bassham testified that no one would "dispute the fact that slowing the pace of rate increases will benefit the economy and is something that the Commission, Staff, CURB and all customers have been pushing for, especially in recent years." Bassham Rebuttal, pp. 18-19. However, in order to achieve that goal, "it is necessary that we become more efficient, which we will do through the Transaction, and along with increased efficiency comes a reduction in employment levels. It is not possible to have it both ways and achieve slower growing rates with no change in employment levels." *Id*. GPE has "committed to achieving any needed reduction in staffing in the least impactful way possible, utilizing all voluntary means available and taking full advantage of the large numbers of baby boomers naturally choosing to retire, before resorting to involuntary reductions." *Id*. The fact is that there will be fewer jobs as a result of the Transaction, which is the only way to reduce costs, a result GPE knows all parties – including the Commission, Staff, CURB, and customers – desires. However, it is clear that GPE plans to achieve the required reductions in a manner that is the best possible for employees and Kansas communities.

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

<u>*Summary*</u>

The Transaction will help to maximize the use of Kansas energy resources. Both Westar and KCP&L already serve their customers using significant amounts of Kansas wind energy and the combined company will be able to take further advantage of those resources in the future.

GPE has committed to include Westar in its IRP planning process by July 2017, which will result in the most efficient use of all of GPE's resources, including wind and other emission-free sources, to serve Westar's and KCP&L's customers.

Argument

The Transaction maximizes the use of Kansas energy resources. Both Westar and KCP&L have, without the Transaction, already committed to significant quantities of native Kansas energy resources, predominantly wind energy. Ives Direct, p. 13; Bassham Direct, pp. 13-14. The combined company will be in a better position to take further advantage of those resources in the future. Ives Direct, p. 13; Bassham Direct, pp. 13-14. After the close of the Transaction by the end of 2017, GPE will have more than 3,000 MW of wind generation (name plate capacity), with the potential for the development of more wind power in Kansas. Bassham Direct, p. 14. That amount of wind energy will be equivalent to "almost one-third of the total energy use" by GPE's customers after the Transaction closes. Bassham Direct, p. 14. The combined company will also continue to operate its other Kansas resources, including Wolf Creek Nuclear Generating Station (Wolf Creek), which is the only nuclear facility located in Kansas. After the close of the Transaction, Wolf Creek will be 94% owned by GPE's utility subsidiaries. Ives Direct, p. 13. When wind resources and Wolf Creek are considered together post-Transaction, GPE will be able to meet about 45% of its retail energy needs with emission-free energy. Bassham Direct, p. 14.

Staff suggests that the Transaction might somehow reduce the use of Kansas resources due to plant closures that may occur as a result of the Transaction. This concern misapplies the Commission's merger standard. Mr. Ives has explained that "KCP&L has a robust integrated resource planning ("IRP") process that evaluates the Company's generating resource needs going forward. Plant retirements are part of that process and all necessary costs are included." Ives Rebuttal, pp. 35-36. This process will be expanded to include Westar post-Transaction and GPE has clearly indicated that no plants will be retired without a full vetting through its IRP process. *Id*. If the IRP process determines that a Kansas generating plant should be closed, this would reflect the most efficient use of resources. *Id*. The Commission's Merger Standards review whether a transaction maximizes the use of Kansas energy resources but certainly do not "promote continued use of resources that result in greater cost to Kansas customers." *Id*.

Sierra Club argues that the Commission should require the Joint Applicants to commit to providing half of the needed energy to customers from Kansas wind resources and implement more energy efficiency programs. Chang Direct, pp. 4-6. However, "nowhere does the Sierra Club offer evidence that this Transaction will hurt the use of Kansas energy resources or the environment. Rather, the testimony simply articulates the Sierra Club's position that they would like to see either or both companies do more in these areas." Caisley Rebuttal, p. 15. As a result, there is no basis from Sierra Club's testimony "to conclude that the Transaction will have a detrimental impact on the environment or on the utilization of Kansas energy resources." *Id*.

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

Summary

The primary objective of the Transaction is to create efficiencies in the way that Westar and KCP&L operate. As a result of the Transaction, Westar and KCP&L will be able to serve customers for less than they would have been able to absent the Transaction and will be able to do so in a more efficient manner, ultimately with fewer employees. After the Transaction closes, GPE will utilize its IRP process to determine the most efficient combination of resources to serve *customers on a combined basis. As a result, the Transaction reduces the possibility of economic waste compared to what would have occurred without the Transaction.*

Argument

The Transaction will reduce the possibility of economic waste. Creating efficiencies is the primary driver of the Transaction. The savings – and resulting rates lower than would be possible without the Transaction – are an economic efficiency and reduce the possibility of economic waste. Ives Direct, p. 14; Tr. Vol. 7, Glass pp. 1621-1622. As Mr. Bassham explained:

> It is Great Plains Energy and Westar's objective to combine management practices and resources to achieve significant reduction in costs while further enhancing reliability and customer satisfaction, with rates lower than they would have been had the Transaction not occurred. The Transaction thus reduces the possibility of economic waste compared to what would be expected to occur in the absence of the Transaction.

Bassham Direct, p. 13; *see also* Reed Rebuttal, pp. 58-59 (explaining that the Transaction will reduce costs and encourage investments that benefit customers, as compared to the circumstances that would continue if the Transaction does not go forward; this increase in economic efficiency will produce a net reduction in economic waste).

Staff is concerned that the Transaction may result in the premature closing of a power plant, specifically the Lawrence Energy Center, which Staff argues would be economically inefficient and thereby increase economic waste. However, Staff's very narrow analysis on this issue does not consider anything other than unit dispatch within the SPP Integrated Marketplace. Dr. Glass agreed: "A: Well, I mean, I looked at what – at the possibility of closing a plant, but that was using integrated marketplace, so, no, I didn't use anything else to evaluate it. Q: Your focus was really on unit dispatch within the market? A: Yes." Tr. Vol. 7, Glass, p. 1621. Dr. Glass did not consider any other potential impact on economic efficiency that could result from the Transaction when forming his conclusion on this merger standard. When questioned, Dr. Glass agreed that "if rates would be lower with the merger than without that would be an economic efficiency" and that it would be an economic efficiency "if the combined companies can serve customers with fewer employees over time." Tr. Vol. 7, Glass, pp. 1621-1622. The Transaction is designed to achieve efficiencies in the operation of GPE's operating utilities and it is clear that an increase in operational efficiencies means a reduction in economic waste. *See* Hall Rebuttal, at 16-20

Staff's concern about "premature" closing of a power plant as a potential inefficiency also seems to disregard the fact that, as discussed above, GPE has committed to complete an IRP by July 2017 for all of its operating utilities and has indicated no final decisions regarding plant closures will be made until after the IRP is completed. Ives Rebuttal, p. 57. GPE's IRP process is very thorough and evaluates many factors. It involves a "very comprehensive and detailed evaluation and considers many factors such as the impact on future capacity needs, fuel costs, purchased power costs, off-system sales revenues, capital costs, environmental retrofits, environmental regulations compliance, and other factors pertinent to retail revenue requirement impacts." Ives Rebuttal, pp. 53-54. The IRP process is designed to determine the "most effective use of resources," Ives Rebuttal, p. 36, and as a result should produce the most economically efficient use of GPE's combined resources, reducing the possibility of economic waste.

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

Summary

A number of intervenors raise issues related to transmission service and generation service that are not jurisdictional to this Commission. In addition to being made in the wrong *forum, some of these arguments – such as those regarding consolidation of KCP&L and Westar transmission zones – are premature as GPE is not proposing to consolidate transmission zones at this time. The Commission should decline to rule on any of these claims as it lacks jurisdiction over them.*

Argument

A number of intervenors in the docket made arguments regarding the potential impact the Transaction could have on the rates they pay under wholesale power agreements and for transmission service purchased from the Southwest Power Pool and regarding the impact of the potential consolidation of Westar's and KCP&L's transmission zones.[49] The Commission should not give consideration to these arguments for several reasons.

First, with respect to consolidation of transmission zones, Joint Applicants are not seeking to consolidate the KCP&L and Westar (or any other) transmission zones in connection with the Transaction. Ives Rebuttal, p. 68. Any alteration of existing transmission zones or the creation of a new transmission zone is ultimately subject to review by the Federal Energy Regulatory Commission ("FERC") under its exclusive jurisdiction under section 205 of the Federal Power Act. Neither Westar, GPE nor SPP has made an application to FERC under section 205 of the Federal Power Act to combine the Westar and KCP&L transmission zones to create a single new transmission zone. Ives Rebuttal, p. 68.

Second, with respect to the impact of the Transaction on wholesale or transmission rates, the intervenors suggestion that the Transaction's purchase price might cause Westar's credit ratings to drop and this would impact wholesale or transmission formula rates is without merit.

[49] See, e.g., the Direct Testimony of Mr. Krajewski (BPU), James Brungardt (Sunflower and Mid-Kansas), Larry Holloway (KPP). Mr. Brungardt (Sunflower/Mid-Kansas), Mr. Doljac (KEPCo), and Mr. Krajewski (BPU).

The ratings agencies have confirmed that the Transaction should have no impact on Westar's and KCP&L's existing credit ratings. *See* Section IV.A., *supra*.

Furthermore, and most importantly, the issue of the impact of any change in credit ratings on the generation formula rates (GFR) or transmission formula rates (TFR) is not properly before this Commission. Ives Rebuttal, pp. 69-70. Westar's cost-based GFR tariff and rate schedules for full requirements electric service are approved by, and subject to, the exclusive jurisdiction of FERC. The TFRs are incorporated into the Open Access Transmission Tariff ("OATT") of the Southwest Power Pool ("SPP") that is also approved by, and subject to, the exclusive jurisdiction of, FERC. Ives Rebuttal, pp. 69-70. FERC has exclusive jurisdiction to determine the justness and reasonableness of wholesale sales and transmission rates under section 205 of the Federal Power Act. See *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966, 106 S. Ct. 2349, 2357, 90 L. Ed. 2d 943 (U.S. 1986) ("FERC clearly has exclusive jurisdiction" over the rates to be charged to interstate wholesale customers); *Kansas Indus. Consumers Grp., Inc. v. State Corp. Comm'n of State of Kan.*, 36 Kan. App. 2d 83, 101 (2006) ("FERC has jurisdiction to address rates for the transmission of electrical power and interstate sales of electrical power"); *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 851 (9th Cir.) ("the interstate 'transmission' or 'sale' of wholesale energy pursuant to a federal tariff – not merely the 'rates' – falls within FERC's exclusive jurisdiction"); *New Jersey Bd. of Pub. Utilities v. F.E.R.C.*, 744 F.3d 74, 80 (3d Cir. 2014) ("Section 201 of the FPA defined the Commission's jurisdiction as "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce").

Westar and GPE have filed a request under section 203 of the Federal Power Act for authorization of the Transaction and FERC must determine under section 203 of the Federal

Power Act whether the proposed transaction is consistent with the public interest. *See* Joint Application for Authorization of Disposition of Jurisdictional Assets and Merger under Sections 203(a)(1) and 203(a)(2) of the Federal Power Act, Docket No. EC16-146 (July 11, 2016). In making this determination FERC considers, among other things, the effect on rates. *Id.*; Ives Rebuttal, p. 70. Specifically, FERC examines the impact of the proposed transaction on transmission rates and cost-based rates for captive wholesale customers. *Id*. In doing so, FERC will consider hold harmless commitments made by the Joint Applicants to mitigate any potential impact of the Transaction on such rates. *Id*. In Joint Applicants' initial application to FERC for authorization for the Transaction and answer to protests, Westar and GPE committed to hold transmission and wholesale power and wholesale distribution service customers with cost-based rates harmless from the rate effects of the Transaction. Ives Rebuttal, p. 70; Answer to Comments and Protests of Great Plains Energy Incorporated and Westar Energy, Inc., Docket No. EC16-146 (Oct. 11, 2016). As a result, the Commission should not consider the claims by parties about the impacts of the Transaction on FERC-jurisdictional matters when making its decision in this docket.

VIII. Conclusion

The acquisition of Westar by GPE will combine financially strong, well-functioning, adjacent utilities and will make the utilities better together than any of them could be on a standalone basis. The combination of GPE and Westar will generate approximately $2 billion of savings over the first ten years post-closing for customers that help to offset the effects of declining demand and rising costs. The Transaction has been structured in a way that gives all the savings to customers through the normal ratemaking process and imposes all of the risks associated with financing it upon GPE's shareholders. Transaction savings will be demonstrated by KCP&L and Westar in the first two series of post-closing rate cases because doing so will be necessary to obtain recovery of transition costs under merger condition 19 as set forth in Schedule DRI-3 to Mr. Ives' rebuttal testimony. Additionally, GPE has proposed industry-standard ring-fencing provisions to ensure that utility customers will be isolated from GPE's financing risk.

The Transaction meets the requirements of the Commission's Merger Standards as they were promulgated and modified in the 1991 and 1999 Merger Orders and applied in numerous cases over two and a half decades. In developing their proposal, the Joint Applicants followed and relied upon the guidance of those orders and structured the Transaction in a way that promotes the public interest. Rather than accept and apply an approach advanced by Staff witness Hempling that has been rejected in numerous states and in fact has never been adopted anywhere, the Commission should apply its existing Merger Standards and approve the Transaction subject to the conditions and commitments proposed by the Joint Applicants in Schedule DRI-3 to Mr. Ives' rebuttal testimony.

Respectfully submitted,

/s/Robert J. Hack

Robert J. Hack (KS #12826)
Telephone: (816) 556-2791
Roger W. Steiner (KS #26159)
Telephone: (816) 556-2314
Kansas City Power & Light Company
One Kansas City Place
1200 Main Street – 19th Floor
Kansas City, Missouri 64105
Facsimile: (816) 556-2787
E-mail: rob.hack@kcpl.com
E-mail: roger.steiner@kcpl.com

/s/Glenda Cafer

Glenda Cafer (#13342)
Telephone: (785) 271-9991
Terri Pemberton (#23297)
Telephone: (785) 232-2123
CAFER PEMBERTON LLC
3321 SW 6th Avenue
Topeka, Kansas 66606
Facsimile: (785) 233-3040
E-mail: glenda@caferlaw.com
E-mail: terri@caferlaw.com

COUNSEL FOR GREAT PLAINS ENERGY INCORPORATED AND KANSAS CITY POWER & LIGHT COMPANY

/s/Cathryn J. Dinges

Cathryn J. Dinges (#20848)
Senior Corporate Counsel
Westar Energy, Inc.
818 South Kansas Avenue
Topeka, Kansas 66612
Phone: (785) 575-8344
Facsimile: (785) 575-8136
cathy.dinges@westarenergy.com

/s/Martin J. Bregman

Martin J. Bregman (#12618)
Telephone: (785)760-0319
BREGMAN LAW OFFICE, L.L.C.
311 Parker Circle
Lawrence, Kansas 66049
Email: mjb@mjbregmanlaw.com

COUNSEL FOR WESTAR ENERGY, INC.

CERTIFICATE OF SERVICE

I do hereby certify that on the 28th day of February, 2017, I electronically filed via the Kansas Corporation Commission's Electronic Filing System, a true and correct copy of the above and foregoing with a copy emailed to all parties of record.

Robert J. Hack
Robert J. Hack