**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Westar Energy, Inc. for approval of the Merger of Westar Energy, Inc. and Great Plains Energy Incorporated.	**)))))**	**Docket No. 18-KCPE-095-MER**

TESTIMONY IN SUPPORT OF

NON-UNANIMOUS SETTLEMENT AGREEMENT

PREPARED BY

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UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

March 12, 2018

Contents

I. Introduction, Qualifications, Purpose of Testimony

Q. Please state your name and business address.

A. My name is Justin T. Grady and my business address is 1500 Southwest Arrowhead Road, Topeka, Kansas, 66604.

Q. Are you the same Justin T. Grady who previously filed Direct Testimony pm January 29, 2018, in this case?

A. Yes.

Q. Please briefly describe the matter before the Commission in this Docket.

A. In this Docket, Great Plains Energy Incorporated ("Great Plains Energy" or "GPE"), Kansas City Power & Light Company ("KCPL"), and Westar Energy, Inc. and Kansas Gas and Electric Company ("Westar") (all referred to collectively as "Applicants") are seeking Commission authorization for GPE and Westar to merge in a Merger of Equals ("MOE") transaction. More specifically, the Application requests Commission approval of an Amended and Restated Agreement and Plan of Merger ("Revised Merger Agreement" or "Transaction") that calls for GPE and Westar shareholders to exchange their existing common stock for common stock of a new, yet-to-be-named holding company. The Revised Merger Agreement calls for Westar shareholders to receive one share of new holding company stock for each existing Westar share they own. GPE shareholders will receive .5980 shares of new holding company stock in exchange for each share they currently own of GPE.

Q. What is the purpose of your testimony in this matter?

A. In the testimony that follows, I will provide an analysis of whether the Non-Unanimous Settlement Agreement (Agreement), as filed, would promote the public interest by evaluating several of the Commission's Merger Standards, as affirmed by Commission Order in Docket No. 16-KCPE-593-ACQ (16-593 Docket).[1] I conclude that the proposed Transaction, as modified by the Agreement, will promote the public interest when evaluated through the Commission's Merger Standards.

[1] *See*, Order on Merger Standards, August 9, 2016.
http://estar.kcc.ks.gov/estar/ViewFile.aspx/20160809133305.pdf?Id=b9ac472c-6ba4-4915-9371-d81835f85d37

II. Merger Standards Evaluated

Q. What Merger Standards do you evaluate in this testimony?

A. The Merger Standards I cover are as follows:

(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; and

(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. Whether the proposed transaction will likely create labor dislocations that may be particularly harmful to local communities, or the state generally, and whether measures can be taken to mitigate the harm.

(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.

III. Executive Summary

Q. Please provide an executive summary of your testimony.

A. In the testimony that follows, I will present and support the following reasons why the Transaction, as modified by the Agreement, will promote the public interest:

1. The Agreement provides Westar and KCP&L customers much needed rate relief in the form of immediate and ongoing bill credits (for four years), imputed and guaranteed merger savings in the 2018 rate cases (which continue to provide value during the period of the rate moratorium), unmitigated refunds from the effects of the Tax Cuts and Jobs Act, and a base rate moratorium period of up to five years.
2. The Agreement equitably distributes the benefits of the Transaction between ratepayers and shareholders. Benefits to ratepayers over the first five years are guaranteed to occur and total $183.5 million ($148 million in Net Present Value (NPV) when using a discount rate of 7.5%). Benefits to shareholders are less certain and dependent upon the combined company succeeding in its merger savings estimates.
3. The Agreement properly incentivizes the Applicants to create merger savings, which will benefit ratepayers and shareholders. This is due to the five-year rate moratorium, Earnings Review and Sharing Plan (ERSP), and mandatory rate case at the end of five years that are part of the Agreement. If merger savings are achieved during the five-year rate moratorium, shareholders will benefit to the extent that the savings are in excess of bill credits and savings levels imputed in the 2018 rate cases. If merger savings levels exceed current projections, ratepayers will benefit through the Earnings Review and Sharing Plan (ERSP) portion of the

Agreement. Lastly, if merger savings are achieved, ratepayers will benefit from the mandatory rate review at the end of the rate moratorium because all savings will then be reflected in rates.

4. The Agreement will result in more effective regulation of Westar and KCP&L in the years that follow the merger. This is as a result of the five year rate moratorium, ERSP, and the filing of a third-party audit of cost allocations between the operating utilities and the newly formed holding company. The Commission has previously recognized the public policy benefits of rate stability achieved through a rate moratorium, and this Agreement achieves that result.

5. The labor protections and commitment to retain a Westar headquarters building for ten years in the Agreement will ensure that labor dislocations associated with the merger are mitigated and that employment loss is balanced over time between the combined company headquarters locations and between Kansas and Missouri.

IV. Conditions in the Agreement Related to My Direct Testimony

Q. What Conditions in the Agreement were responsive to the recommendations in your Direct Testimony?

A. There are several key conditions in the Agreement that closely resemble those I recommended in my Direct Testimony. Those conditions are as follows:

1. Upfront Bill Credits: The Agreement calls for $30,579,515 million in upfront bill credits for Kansas customers. This represents $23,065,299 for Westar customers and $7,514,220 for KCP&L's Kansas customers.

2. Annual Bill Credits for 2019-2022: The Agreement calls for additional bill credits over the years 2019 through 2022 totaling $45,869,276. This represents

$8,649,487 per year for Westar customers and $2,817,832 per year for KCP&L's Kansas customers.

2. General Rate Case Moratorium: The Agreement contains a provision that freezes Westar and KCP&L's base rates for a five-year period from the final Order date in KCP&L's upcoming rate case. This rate moratorium period is reduced to three years for either Westar or KCP&L in the event that the Commission authorizes a Return on Equity lower than the recommended 9.3% contained in the Agreement.

3. Guaranteed Merger Savings in Rates: The Agreement calls for Westar and KCP&L to impute a guaranteed level of merger savings in their 2018 rate cases in the amount of $7.5 million for KCPL's Kansas operations and $22.5 million for Westar.

4. Earnings Review and Sharing Plan (ERSP): The Agreement calls for Westar and KCP&L to file an ERSP in years 2020, 2021, 2022, and 2023. These reports will be in a form that resembles the reports attached to the Settlement as Attachments 2 and 3. The purpose of these reports will be to evaluate the earned Return on Equity (ROE) of both Westar and KCPL-KS on an annual basis, as calculated after making limited adjustments to present the financial results of the Companies on a traditional ratemaking (rate base, rate of return) basis.[2] In the event that the earned ROE of Westar or KCPL-KS exceeds 9.3%, any earnings in excess of those necessary to pay for the fixed bill credits discussed in item No. 2 above shall be split 50% to ratepayers and 50% to shareholders.

[2] Limited adjustments will also be made to eliminate expenses that the Commission has historically disallowed from ratepayer recovery.

5. Transition Cost Recovery: The Agreement calls for the Applicants to be allowed to recover $30,875,151 in Transition Costs over ten years, beginning with the 2018 rate cases. This equates to $2,318,313 annually for Westar and $769,202 annually for KCP&L Kansas.

6. Operating Headquarters Commitment: The Agreement calls for Westar to maintain the current Westar headquarters building as an operating headquarters for the Kansas operations for a minimum of five years and with a minimum of 500 employees. Additionally, the Applicants agree that they will maintain a Kansas headquarters building somewhere in Topeka, Kansas (if not at 800-818 South Kansas Avenue) for a period of at least ten years after the closing of the merger. This Kansas operating headquarters will house all levels of technical, managerial, and executive talent and payroll (including a regulatory affairs staff) and should be reflective of the fact that the combined company will have more employees in Kansas than in Missouri.

7. Employment Commitments: The Agreement recognizes that the combined company will have less employees as it works to be more efficient in the years to come, but the Applicants have committed to achieve any reduction in employment levels (including any reduction in Kansas headquarters personnel) in a fashion that is generally balanced between the States of Kansas and Missouri. To demonstrate compliance with this commitment, for the first five years after the merger closes, the combined company will file compliance reports with the KCC detailing the employment levels of the Company, by work location, across both states. This

report will be filed quarterly for two years and annually for the three years thereafter.

V. Review of Merger Standards (a) (i)

Q. Please provide a summary of your analysis of this Transaction, as modified by the Agreement, in light of Merger Standard (a) (i).

A. Merger Standards (a) (i) is as follows:

(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; [...]

Nothing in the Agreement changes Staff's initial assessment of the impact of this merger 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. As discussed in Staff witness Adam Gatewood's Direct Testimony from pages two through six, Staff's position is that this merger does not harm the Applicants' financial health, in stark contrast to the Transaction denied by the Commission in the 16-593 Docket. In fact, as evidenced by S&P changing its ratings outlook from "Outlook Stable" to "Outlook Positive" in response to the announcement of the Transaction, the Transaction may ultimately be beneficial to the Applicants' financial health. Staff contends that the Transaction will promote the public interest when viewed in light of Merger Standard (a) (i).

VI. Review of Merger Standards (a) (ii) and (a) (iv)

Q. Please provide a summary of your analysis of this Transaction, as modified by the Agreement, in light of Merger Standards (a) (ii) and (a) (iv).

A. Merger Standards (a) (ii) and (a) (iv) are as follows:

> (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;
>
> (iv) whether there are operational synergies that justify payment of a premium in excess of book value; […]

In my Direct Testimony on pages 10-18, I evaluate these two merger standards together due to the significant overlap in these standards as recognized by the Commission's Order denying the original Transaction in the 16-593 Docket.[3] I discuss the concerns Staff had with the original Transaction and how those concerns have been resolved with the revised Transaction. I then discuss why Staff believes the traditional or literal application of these Merger Standards is difficult to perform, and of uncertain relevance, given the revised Transaction was structured as a Merger of Equals (MOE). I conclude that the revised Transaction will promote the public interest when evaluated under these two Merger Standards. Nothing in the Agreement changes my assessment of this Transaction as addressed in my Direct Testimony. Therefore, the conclusions I reached on pages 17-18 of my Direct Testimony remain relevant and accurate, that is:

[3] See April 19, 2017 Order denying original Transaction, page 23. http://estar.kcc.ks.gov/estar/ViewFile.aspx/20170419160027.pdf?Id=105231db-6aa0-4a0d-9849-6408429d807a

- The Transaction has addressed all of the concerns that Staff addressed regarding merger standards (a) (ii) and (a) (iv) in our review of the original Transaction in the 16-593 Docket;
- The Transaction is an MOE, without a true purchase price, acquisition premium, cash payment, or control premium, from one group of shareholders to another;
- The Applicants have committed to never seek recovery of merger goodwill from ratepayers, and that commitment does not rely on the Commission using a particular capital structure for ratemaking purposes; and
- Because the Transaction does not rely on excessive Transaction-related debt to pay for a large purchase price or acquisition premium, Staff does not have the financial engineering concerns with this Transaction that we did with the original one.

For all of these reasons, Staff contends that this Transaction, as modified by the Agreement, can be viewed as promoting the public interest when viewed in the light of Merger Standards (a) (ii) and (a) (iv).

VII. Review of Merger Standard (a) (iii) and (e)

Q. Please provide a summary of your analysis of this Transaction, as modified by the Agreement, in light of Merger Standards (a) (iii) and (e).

A. Merger Standards (a) (iii) and (e) are as follows:

> (a) The effect of the transaction on consumers, including:
>
> (iii) whether ratepayer benefits resulting from the transaction can be quantified;
>
> (e) The effect of the transaction on affected public utility shareholders.

In my Direct Testimony on pages 18-42, I consider these two standards in the same section because I believe they are integrally related with this Transaction. Staff's position expressed in my Direct Testimony is that there are significant quantifiable benefits from this Transaction, however, as originally filed, most of those benefits flowed to shareholders as opposed to ratepayers for an indefinite time. Relying on these analyses, I presented recommendations to the Commission that would introduce more balance between ratepayers and shareholders in the distribution of benefits from the merger. Many of these recommendations are contained within the Agreement. With these modifications, Staff contends the Transaction will promote the public interest when viewed in light of Merger Standards (a) (iii) and (e).

A. Provisions of the Agreement that relate to Merger Standards (a) (iii) and (e)

Q. Which provisions of the Transaction, as modified by the Agreement, do you believe support a finding that this Transaction will promote the public interest as determined through an evaluation of Merger Standards (a) (iii) and (e)?

A. The key provisions of the Transaction, as modified by the Agreement, that provide quantifiable ratepayer benefits are as follows:

- Upfront bill credits of $23,065,299 for Westar's retail customers and $7,514,220 for KCP&L's Kansas (KCP&L-KS) retail customers;
- Annual bill credits in years 2019, 2020, 2021, and 2022 for Westar and KCP&L-KS customers in the amount of $8,649,487 for Westar customers and $2,817,832 for KCP&L customers. These bill credits total $45,869,276 over four years;

- A five year base rate moratorium for Westar and KCP&L-KS, unless the ROE granted in either utility's 2018 rate case is less than 9.3%, then the rate moratorium is three years;
- Guaranteed merger savings imputed in the 2018 rate cases in the amount of $22.5 million for Westar and $7.5 million for KCP&L-KS. Because there is a rate moratorium in the Agreement, these benefits can be assured to continue to provide value for customers for up to five years;
- Westar and KCP&L have agreed to forego their ability to demonstrate under-earnings at the time of the federal tax law change as an offset to benefits otherwise due to customers from January 1, 2018, through the effective date of retail rates as a result of the 2018 rate cases. This provision is worth approximately $48.7 million to Westar customers and $31.7 million to KCP&L-KS customers;
- An agreement by Westar and KCP&L to recommend a 9.3% ROE in their 2018 rate cases. This provision effectively lowers Westar's requested rate increase amount by $22.2 million in Docket No. 18-WSEE-328-RTS;
- Westar and KCP&L have agreed to submit to an Earnings Review and Sharing Plan (ERSP) during years 2020 through 2023 (based on the reported financial results from 2019-2022. This provision will ensure that ratepayers will share in 50% of any overearnings that occur during the rate moratorium (in excess of the amounts necessary to pay for annually recurring bill credits discussed above). These overearnings could occur because of an abnormally hot summer, a sudden uptick in electricity usage, if the Applicants exceed initial expectations for merger savings,

or any other reason that causes the earned ROE of either utility to exceed 9.3% during the moratorium period; and

- The recovery of transition costs in an amount limited to $50 million (out of an estimated $76 million) on a total company basis, over ten years without return. This equates to a total of $30,875,151 after allocation to Westar and KCPL-KS, or an annual amount of $2.318 million annually for Westar and $769,202 annually for KCPL-KS.

B. These Provisions Provide Substantial Guaranteed Customer Benefits

Q. Why do the above provisions of the Transaction, as modified by the Agreement, promote the public interest as determined through an evaluation of Merger Standards (a) (iii) and (e)?

A. Taken as a whole, the provisions of the Agreement identified above guarantee ratepayers substantial quantifiable benefits as a result of this Transaction. Staff has calculated $183.5 million in guaranteed ratepayer benefits (NPV of $148 million[4]) in the first five years alone. This calculation does not account for the possibility of any shared over-earnings during the rate moratorium associated with Staff's ERSP, the reductions in Westar's rate case request associated with Westar's agreement to recommend a 9.3% ROE, or the unmitigated ratepayer benefits of federal income tax reform that Westar and KCP&L have agreed to in this Agreement. This calculation can be seen in the table below and relies strictly on the guaranteed ratepayer benefits of upfront bill credits, annually recurring bill credits for years two through four, and guaranteed rate case savings for five years less the costs of transition costs amortized to customers during this time. As the Commission can

[4] Assumes a 7.5% Discount Rate.

see, I have also calculated the NPV of benefits to Kansas customers for the ten and twenty year period as well.

Settlement Scenario Kansas Customer Merger Related Net Savings Distribution
(Amounts in Millions)

Year #	Year	Gross Savings	Transition Costs	Net Savings	Bill Credits	Rate Case Credits	Transition Costs	Customer Benefits	Shareholder Benefits	Net Benefits
	2016-2017	-		-	-	-	-	-	-	-
1	2018	29.7	(18.2)	11.5	30.6	-	-	30.6	(19.1)	11.5
2	2019	61.0	(3.9)	57.1	11.47	30.0	(3.2)	38.2	18.9	57.1
3	2020	78.2	(1.9)	76.3	11.47	30.0	(3.2)	38.2	38.1	76.3
4	2021	80.8	(1.6)	79.2	11.47	30.0	(3.2)	38.2	41.0	79.2
5	2022	86.7	(1.5)	85.2	11.47	30.0	(3.2)	38.2	47.0	85.2
6	2023	88.6	-	88.6	-	30.0	(3.2)	26.8	61.9	88.6
7	2024	90.5	-	90.5	-	89.5	(3.2)	86.3	4.3	90.5
8	2025	92.5	-	92.5	-	89.5	(3.2)	86.3	6.2	92.5
9	2026	94.5	-	94.5	-	89.5	(3.2)	86.3	8.3	94.5
10	2027	96.6	-	96.6	-	89.5	(3.2)	86.3	10.3	96.6
11	2028	98.7	-	98.7	-	89.5	(3.2)	86.3	12.4	98.7
12	2029	100.8	-	100.8	-	99.6	-	99.6	1.2	100.8
13	2030	103.0	-	103.0	-	99.6	-	99.6	3.4	103.0
14	2031	105.3	-	105.3	-	99.6	-	99.6	5.7	105.3
15	2032	107.6	-	107.6	-	99.6	-	99.6	8.0	107.6
16	2033	110.0	-	110.0	-	99.6	-	99.6	10.4	110.0
17	2034	112.4	-	112.4	-	111.0	-	111.0	1.4	112.4
18	2035	114.9	-	114.9	-	111.0	-	111.0	3.8	114.9
19	2036	117.4	-	117.4	-	111.0	-	111.0	6.4	117.4
20	2037	120.0	-	120.0	-	111.0	-	111.0	9.0	120.0
Totals		1,889.3	(27.1)	1,862.2	76.4	1,539.6	(32.3)	1,583.8	278.4	1,862.2
5 Year NPV at 7.5%								**$ 148**	**$ 93**	**$ 240**
5 Year NPV Distribution								**61%**	**39%**	**100%**
10 Year NPV at 7.5%								**$ 352**	**$ 148**	**$ 500**
10 Year NPV Distribution								**70%**	**30%**	**100%**
20 Year NPV at 7.5%								**$ 690**	**$ 169**	**$ 859**
20 Year NPV Distribution								**80%**	**20%**	**100%**

The “Gross Savings” and “Transition Costs” columns on this table were constructed by allocating all merger savings estimates and transition costs incurred after January 2018 (consistent with the total company amounts supported by Staff witness Ann Diggs’ Direct Testimony) to Westar and KCPL-KS. The sum of these two columns equals the column “Net Savings.” The next three columns represent the bill credits, guaranteed merger savings reflected in the 2018 rate cases, and the transition costs recovered from customers, all as called for in the Agreement. These three columns sum to the "Customer Benefit" column heading. Whatever is not accounted for in the "Customer Benefit" column is distributed to the "Shareholder Benefit" column.

As the Commission can see, the benefits of the Agreement that are reflected in this table, which are guaranteed for customers, amounts to $148 million in NPV when discounted at 7.5%. This table also supports an estimated $352 million in NPV benefits for customers over 10 years if the Applicants are successful at achieving the merger savings estimated in the Application. Lastly, this table supports the conclusion that 61% of the estimated merger savings for the first five years are guaranteed to flow to ratepayers, with 39% going to shareholders *if* the Applicants are successful at creating merger savings and controlling costs. It should be noted however, that this table does not reflect the fact that shareholders have to pay for the transaction costs associated with this merger, which ratepayers are not being asked to pay. These tables also do not account for any non-merger savings that the Applicants expect to achieve in the years following the merger.

C. Rationale for Shareholder Sharing of Merger Savings

Q. Why is it reasonable for shareholders to share in some of the Merger Savings created from the merger?

A. The Commission has previously recognized that it is important for both shareholders and ratepayers to benefit if a merger is to promote the public interest. For example, in Docket No. 97-WSRE-676-MER (97-676 Docket), the Commission said:

> In considering the public interest, it has been of primary importance to the Commission that the merger appears to result in increased efficiencies for

> the merged company, a substantial level of savings that can benefit both shareholders and ratepayers, enhancement of the reliability of electric service in the area, and a stronger, financially secure public utility.[5]

In this case, the primary mechanism by which shareholders are able to benefit and retain some merger savings is by way of a rate moratorium recommended by Staff and CURB and contained within the Agreement. In addition to support for the concept of allowing shareholders to retain a reasonable amount of merger savings, there is ample support for the concept of doing so through the implementation of a rate moratorium. For example, in the 97-676 Order, the Commission stated as follows:

- "Although the evidence is conflicting as to the precise amount, the Commission agrees that there will be substantial savings related to the merger, and finds that it is reasonable and appropriate for these savings to be shared between ratepayers and shareholders." (Page 10 of the Order)
- "The Joint Applicants will have the opportunity to recover merger-related savings through a rate moratorium." (Page 12 of the Order)
- "A rate moratorium provides the Joint Applicants with a reasonable opportunity to retain merger savings." (Page 13 of the Order)
- "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

[5] *See* Order on Merger Application, Docket No. 97-WSRE-676-MER, ¶20, page 8.

> Joint Applicants to continue retaining savings immediately following the merger." (Page 13 of the Order)

In the 97-676 Order, the Commission also ordered the Joint Applicants to file a rate case during the final year of the moratorium so that all cost savings could be passed back to ratepayers, which is consistent with that provision of the Agreement in this Docket. Lastly, as discussed above, the Applicants have not asked ratepayers to pay any transaction costs associated with this merger. These costs are substantial and must be paid for by shareholders, so it only makes sense to allow shareholders to retain some merger related benefits in compensation for the risks and costs of the merger that are appropriately not borne by ratepayers.

D. Conclusion of Merger Standards (a) (iii) and (e)

Q. What are your conclusions with regard to your evaluation of the Transaction, as modified by the Agreement, in light of Merger Standards (a) (iii) and (e)?

A. I contend that this Transaction, as modified by the Agreement, should be viewed as one that promotes the public interest when viewed in the light of Merger Standards (a) (iii) and (e). This Agreement guarantees $148 million in NPV benefit to ratepayers in the first five years after the merger. In addition, customers have the certainty of knowing that there will not be any additional base rate increases during the rate moratorium. If the Applicants are successful at creating merger savings, the benefits to ratepayers could be even greater because of the Earnings Review and Sharing Plan, which only shares over-earnings with customers, but requires the utility to manage through any under-earnings. Lastly, a mandatory rate review following the rate moratorium will represent an opportunity to recognize the full amount of merger savings for the benefit of customers.

VIII. Review of Merger Standard (d)

Q. Please provide a summary of your analysis of this Transaction, as modified by the Agreement, in light of Merger Standard (d).

A. Merger Standard (d) is as follows:

> (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.

In my Direct Testimony, my evaluation of the Transaction under this Merger Standard concluded that the regulation of the combined company in the years that follow the merger would become more reactive and the burden of ensuring that the combined company's rates were just and reasonable would shift to Staff and the Commission. As a result of this analysis, I recommended that the Commission require the Applicants to submit to an Earnings Review and Sharing Plan, which would monitor the earnings levels of Westar and KCP&L and require 50% of any over-earnings in excess of those used to pay for bill credits to be returned to customers in the form of a bill credit. As discussed above, the Agreement in this Docket contains Staff's recommended ERSP and, therefore, I contend that the 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.

A. Explanation of the ERSP

Q. Please provide an explanation of the ERSP and an example of how it would work?

A. The specifics of the ERSP are contained within paragraph 34 of the Agreement. This provision would require Westar and KCPL to file an annual report by March 31 of each year 2020 through 2023 detailing the actual earned ROE for the prior calendar year on its Kansas jurisdictional utility operations.

The report would utilize the actual financial results for each utility, as adjusted to conform to standard rate base, rate of return ratemaking conventions. In the event that the ERSP report showed an earned ROE above the Commission-authorized ROE, an allowance would first be made for the amount of earnings necessary to pay for the guaranteed customer payments listed in paragraph 33 of the Agreement. If there are still earnings in excess of 9.3%, then 50% of the over-earnings would be passed back to customers in the form of a bill credit.

B. Example Calculation of ERSP Bill Credits

Q. Please provide an example of how a bill credit would be calculated under the ERSP.

A. If an ERSP report shows that Westar is earning 9.75% in 2019 (after making all the required ratemaking adjustments), then 50% of all earnings above the $8,649,487 guaranteed customer payment will be refunded back to customers. This is illustrated in the chart below which appeared in a March 7, 2018, investor presentation of the Applicants summarizing the Agreement for shareholders.

Illustrative 2019 Westar ERSP Calculation			
Rate Base (RB)	$5.75B	ERSP revenue surplus[1]	$11.97M
Equity Ratio	51%	Annual bill credits	$(8.65M)
Equity portion of RB	$2.9B	ERSP revenue surplus after bill credits	$3.32M
Effective Tax Rate	26.5%	Customer share @ 50%	$1.66M
ERSP Authorized ROE	9.30%	Earnings impact of ERSP sharing	$(1.22M)
ERSP Earned ROE	9.60%	Earned ROE	9.56%

1. ERSP revenue surplus: ((ERSP calculated earned ROE – ERSP authorized ROE) * equity portion of rate base) / (1 - tax rate)

In the event that an ERSP report shows that Westar or KCPL were earning below 9.3%, there will be no rate adjustment.

C. Support for the ERSP in the Agreement

Q. Why does the ERSP contained within the Agreement resolve Staff's original concerns with this Transaction regarding Merger Standard (d)?

A. Staff contends that the five-year rate moratorium and ERSP contained within the Agreement provides a structured, reasonable, and balanced regulatory solution to the challenge of determining the proper method of regulating the Applicants in the years following the merger. This plan will enable the Commission to proactively monitor the earnings levels of Westar and KCPL in the years after the merger which will lead to more timely and effective regulation of these utilities. This plan also enhances the combined company's incentive to achieve merger savings because they will have the ability to share in any cost savings that result in utility over-earnings, but they will not be able to file a rate case to recover under-earnings. Additionally, the plan provides ratepayers with base rate certainty over the five years after the merger, and they have the comfort of knowing that they will share in any earnings in excess of 9.3% ROE during this period.

Q. Do you view the ERSP as being a superior alternative to a pure five-year rate moratorium without the earnings review process?

A. Yes. The ERSP is superior to a five-year rate moratorium on its own because ratepayers don't have the ability to share in over-earnings during a pure five-year rate moratorium. Additionally, the annual review of Westar and KCPL's earnings will complement the Commission's monitoring of whether the combined company has been successful at achieving merger savings and what level of capital expenditures is being invested in utility operations, by utility. In this fashion, the ERSP results in more timely, proactive, and effective regulation of the combined company in the years that follow the merger compared to a simple five-year rate moratorium.

D. Conclusion on Evaluation of Merger Standard (d)

Q. Do you believe this Transaction, as modified by the Agreement, will promote the public interest when viewed in light of Merger Standard (d)?

A. Yes. Given Staff's recommendation that the Commission implement an ERSP for both Westar and KCPL in the years that follow the merger is included in the Agreement, I am convinced that the public interest will be promoted by this Transaction in light of Merger Standard (d). The ERSP provides a structured, balanced, and reasonable solution for the issue of how to share merger savings that accumulate in the years following the merger between ratepayers and shareholders. It will result in more timely, proactive, and effective regulation of the combined company, which will promote the public interest.

IX. Review of Merger Standard (c)

Q. Please provide a summary of your analysis of this Transaction in light of Merger Standard (c).

A. Merger Standard (c) is as follows:

> (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. Whether the proposed transaction will likely create labor dislocations that may be particularly harmful to local communities, or the state generally, and whether measures can be taken to mitigate the harm.

In my evaluation of this Merger Standard in my Direct Testimony, I focused on the impact of the merger on the community of Topeka and the State of Kansas from the viewpoint of the combined company's plans for Westar's existing corporate headquarters and for employment between the States of Kansas and Missouri in the years following the merger. Staff witness Dr. Robert Glass also addresses this Merger Standard in his testimony. I concluded that the Applicants' commitment to maintain the Westar headquarters building with a minimum of 500 employees for five years is helpful but insufficient in these circumstances. Additionally, I recommended that this commitment should be extended to ten years and should contain additional language to achieve employment loss in Kansas overtime in a fashion that is generally balanced with Missouri.

Ultimately, the Applicants agreed to include Staff's recommended commitments in the Agreement, so I contend that the Transaction will promote the public interest when viewed in the light of Merger Standard (c).

A. Headquarters and Employment Commitments in the Agreement

Q. Please identify the commitments in the Agreement relative to Westar's headquarters building and employment in Kansas.

A. The following commitments are included in the Agreement:

- In addition to the Applicants' commitment to retain the current Westar headquarters building as an operating headquarters for the Kansas operations for a minimum of five years and with a minimum of 500 employees, the Applicants will maintain an operating headquarters somewhere in Topeka, Kansas, (if not at 800-818 South Kansas Avenue) for a minimum of ten years;
- The Kansas operating headquarters will house all levels of technical, managerial, and executive talent and payroll (including a regulatory affairs staff) and should be reflective of the fact that the combined company will have more employees in Kansas than in Missouri; and
- The combined company will achieve headcount related efficiencies (including any reduction in Kansas headquarters personnel) through normal attrition and other voluntary means over time that are generally balanced across the states of Kansas and Missouri;

In order to demonstrate compliance with these commitments, the combined company will be required to file quarterly compliance reports providing details about the status of the Company's employment levels, by location, for two years. Thereafter, the information will be provided annually for the next three years.

B. Conclusion on Evaluation of Merger Standard (c)

Q. Do you believe this Transaction, as modified by the Agreement, will promote the public interest when viewed in the light of Merger Standard (c)?

A. Yes. The provisions in the Agreement that allow Staff to draw that conclusion are the commitment to retain the current Westar headquarters building for five years with a minimum of 500 employees; the commitment to maintain an operating headquarters with all levels of technical, managerial and executive talent and payroll, somewhere in Topeka for at least ten years; and the commitment to achieve headcount-related efficiencies in a voluntary means in a fashion that are generally balanced between the states of Kansas and Missouri. With these commitments in the Agreement, I believe the Transaction will promote the public interest as determined through an evaluation of Merger Standard (c).

X. Conclusion

Q. Please provide a summary of your Testimony and recommendation to the Commission.

A. I have evaluated this Transaction, as modified by the Agreement, using several of the Commission's Merger Standards, including (a)(i), (a)(ii), (a)(iii), (a)(iv), (c), (d), and (e). My conclusions are as follows:

- Unlike the transaction presented in the 16-593 Docket, Staff is not concerned about the financial condition of the combined company in the years that follow the merger. In fact, as evidenced by S&P changing its ratings outlook from "Outlook Stable" to "Outlook Positive" in response to the announcement of the Transaction, the Transaction may be beneficial to the Applicants' financial health;
- The Transaction, as modified by the Agreement, will provide a guaranteed $183.5 million of benefits to customers ($148 million in NPV) over the next five years. This guaranteed benefit to ratepayers is equitable and balanced given the fact that benefits to shareholders are less certain and dependent upon the combined company achieving its stated efficiency goals;
- The five-year rate moratorium and ERSP will allow regulation of the combined company to be more effective in the years that follow the merger. These regulatory tools will also maximize the incentive of the combined company to create merger savings, to the longer-term benefit of customers;
- The employment and operating headquarters commitments in the Agreement will mitigate any particularly harmful labor dislocations.

Overall, my conclusion is that the Transaction, as modified by the Agreement, will promote the public interest. My recommendation is that the Commission approve the Agreement and the Transaction, as modified.

Q. Does this conclude your testimony?

A. Yes it does. Thank you.

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Justin Grady, being duly sworn upon his oath deposes and states that he is a Chief Auditor for the Kansas Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Staff Testimony in Support of Non-Unanimous Settlement Agreement*, and attests that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Justin Grady
Chief Auditor
State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 12th day of March, 2018.

VICKI D. JACOBSEN
Notary Public - State of Kansas
My Appt. Expires 6-30-18

Vicki D. Jacobsen
Notary Public

My Appointment Expires: June 30, 2018

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18-KCPE-095-MER

I, the undersigned, certify that a true and correct copy of the above and foregoing Staff Justin Grady 's Testimony in Support of Non-Unanimous Settlement Agreement was served via electronic service this 12th day of March, 2018, to the following:

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