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

In the Matter of the Joint Application of Sunflower Electric Power Corporation and Mid-Kansas Electric Company, Inc. for an Order Approving the Merger of Mid-Kansas Electric Company, Inc. into Sunflower Electric Power Corporation.	**)))))))**	**Docket No. 19-SEPE-054-MER**

DIRECT TESTIMONY

PREPARED BY

Adam H. Gatewood

UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

January 4, 2019

Q. Would you please state your name and business address?

A. My name is Adam H. Gatewood. My business address is 1500 Southwest Arrowhead Road, Topeka, Kansas, 66604.

Q. Who is your employer and what is your title?

A. I am employed in the Utilities Division of the Kansas Corporation Commission (Commission) as a Senior Managing Financial Analyst.

Q. What is your educational and professional background?

A. I graduated from Washburn University with a B.A. in Economics and a Masters of Business Administration. I have filed testimony on cost of capital and related financial issues before the Commission in more than 140 proceedings. I have also filed testimony on cost of capital issues before the Federal Energy Regulatory Commission in natural gas pipeline and electric transmission dockets. I have submitted testimony or reports and recommendations on 10 dockets involving mergers and acquisitions.

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

A. My testimony provides Commission Staff's position of the proposed merger between Sunflower Electric Power Corporation (SEPC) and Mid-Kansas Electric Company, Inc. (MKEC), collectively referred to as the "Joint Applicants."

Executive Summary

Q. Can you please summarize Staff's position on the proposed merger between SEPC and MKEC?

A. Yes. Staff's investigation found the proposed merger between SEPC and MKEC will promote the public interest. Staff reached this conclusion after reviewing the proposed merger in light of applicable Kansas statutes and the Commission's Merger Standards.[1] Accordingly, Staff recommends the Commission approve the merger. In the testimony that follows, I detail Staff's analysis of the proposed merger and rationale for recommending its approval.

Background

Q. What is the transaction proposed by the Joint Applicants in this Docket?

A. The proposal involves the members of MKEC contributing their equity ownership in MKEC to SEPC while concurrently MKEC will merge into SEPC (referred to as the "Transaction" in my testimony). SEPC will be the surviving corporation. The formal documentation of the merger between MKEC and SEPC was filed with the Application as Exhibit JA-2. Exhibit JA-2 is the Agreement and Plan of Merger MKEC and SEPC have agreed to.

Q. Who are the parties involved in this transaction?

[1] The Commission's Merger Standards were recently affirmed in Docket No. 16-KCPE-593-ACQ. *See* Order on Merger Standards, Docket No. 16-KCPE-593-ACQ (Aug. 8, 2016).

A. MKEC is a non-profit membership corporation operating on cooperative principals. Its members consist of Lane-Scott Electric Cooperative Inc.; Prairie Land Cooperative, Inc.; Western Cooperative Electric Association, Inc.; The Victory Electric Cooperative Association, Inc.; Wheatland Electric Cooperative, Inc.; and Southern Pioneer Electric Company. Five of MKEC's members are cooperative public utilities. Southern Pioneer Electric Company is a not-for-profit taxable Kansas corporation and is itself a wholly-owned subsidiary of a Kansas cooperative public utility, Pioneer Electric Cooperative, Inc.

SEPC is a non-profit membership corporation. Its members consist of Lane-Scott Electric Cooperative Inc.; Prairie Land Cooperative, Inc.; Western Cooperative Electric Association, Inc.; The Victory Electric Cooperative Association, Inc.; Wheatland Electric Cooperative, Inc.; and Pioneer Electric Cooperative, Inc.

Q. What utility services provided by SEPC and MKEC are regulated by the KCC?

A. I have been informed by counsel that as certificated public utilities, the Commission has broad authority over the Joint Applicants. For example, in certain circumstances the Commission has jurisdiction over rates the Joint Applicants charge on sales for resale. Additionally, in certain circumstances, the Commission has jurisdiction over MKEC and SEPC's administration of their respective members' tariffs on the respective members' 34.5 kilovolt (kV) sub-transmission facilities. As appropriate under Kansas law, the Commission will continue to have jurisdiction over SEPC's services after the Transaction. The Federal Energy Regulatory Commission (FERC) has authority over the rates and services for transmission facilities placed under the Southwest Power Pool's (SPP) Open Access Transmission Tariff (OATT). K.S.A. 66-104d(f), as amended during the last legislative session, removed from the Commission's jurisdiction certain aspects of cooperative electric public utility operations. Specifically, the Commission no longer maintains jurisdiction over a cooperative electric public utility's charges or fees for transmission services that are recovered through an open access transmission tariff of a regional transmission organization that has its rates approved by FERC.[2] A vast majority of the Joint Applicants' revenues are derived from either FERC-regulated services or services that are subject to self-regulation through the provisions of K.S.A. 66-104d. As a result, today the KCC is not the primary economic regulator of SEPC and MKEC, and this will continue to be the case after the Transaction. For context, the Commission has direct rate setting authority over 10% of SEPC's total revenues and 6.7% of MKEC's total revenues.[3]

<u>Kansas Statutes:</u>

Q. Can you please discuss the Kansas Statutes referenced by the Joint Applicants?

A. The Joint Applicants cite to applicable Kansas Statutes: K.S.A. 66-101, K.S.A. 66-104, K.S.A. 66-131, K.S.A. 66-136, K.S.A. 17-78-104. Staff agrees with these citations. I am addressing this issue from the perspective of a financial analyst with advice from with legal counsel.

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[2] 2018 Kansas Session Laws, Regular Session, Ch. 6 § 2.

[3]

<u>Sunflower Electric Power Corporation</u>

	% of Total Rev		
Total Revenues		$ 207,647,721	KCC 2017 Annual Report; Operating Revenues, p. 8 line 1
KCC Regulated Revenues	10.04%	$ 20,838,269	KCC Annual Report; Gross operating revenue derived from Kansas intrastate operations
FERC Regulated Transmission Forumla Rates	13.30%	$ 27,624,164	Gross Revenue Requirement; Projected Net Revenue Requirment, For 12 months ended December 31, 2019

<u>Mid-Kansas Electric Company, Inc.</u>

	% of Total Rev		
Total Revenues		$ 187,243,250	KCC 2017 Annual Report; Operating Revenues, p. 8 line 1
KCC Regulated Revenues	6.7%	$ 12,467,362	KCC Annual Report; Gross operating revenue derived from Kansas intrastate operations
FERC Regulated Transmission Forumla Rates	22.9%	$ 42,952,310	Gross Revenue Requirement; Projected Net Revenue Requirment, For 12 months ended December 31, 2019

Q. Are SEPC and MKEC certified public utilities?

A. Yes. SEPC and MKEC hold K.S.A. 66-131 certificates of convenience and necessity to operate as public utilities in Kansas.

Q. Regarding certificates of convenience and necessity, why is Commission approval required to complete the transaction?

A. The Transaction involves both the transfer and enlargement of Certificates of Convenience and Necessity. The Transaction changes how SEPC and MKEC operate and perform their responsibilities as public utilities. This is because MKEC will cease to exist while SEPC will assume the assets, capital, obligation, certificates and responsibilities of MKEC. As such, the Transaction involves both K.S.A. 66-136 (certificate transfer) and K.S.A. 66-131 (certificate enlargement). Commission approval of the Transaction requires the Joint Applicants to show that completing the Transaction will promote public convenience and necessity.

Q. Can you briefly describe the transfer of certificates of convenience and necessity?

A. The relevant section of K.S.A. 66-136 states that:

> No franchise or certificate of convenience and necessity granted to a common carrier or public utility governed by the provisions of this act shall be assigned, transferred or leased, nor shall any contract or agreement with reference to or affecting such franchise or certificate of convenience and necessity or right thereunder be valid or of any force or effect whatsoever, unless

> the assignment, transfer, lease, contract or agreement shall have been approved by the commission…

A public utility cannot assign or transfer a Certificate of Convenience and Necessity or contract referring to or affecting such Certificate unless approved by the Commission.[4] The Transaction calls for MKEC to transfer all of its properties, rights, privileges, immunities, power, franchises, debts, liability, obligations and duties to SEPC, as well as its Certificates, and all corporate and utility functions to SEPC.[5] These actions directly affect MKEC's and SEPC's Certificates of Convenience and Necessity.

Q. Can you briefly describe the enlargement of SEPC's certificate of convenience and necessity?

A. Just as with K.S.A. 66-136, Commission approval under K.S.A. 66-131 is required because the Transaction changes MKEC's and SEPC's operations and responsibilities. SEPC's Certificate of Convenience and Necessity must be expanded to take on MKEC's operations and service obligations. The fundamental question in K.S.A. 66-131 of "what promotes the public convenience and necessity" is a more nebulous inquiry than K.S.A. 66-136. The relevant section of K.S.A. 66-131 states that,

> (a) No person or entity seeking to construct electric transmission lines as defined in K.S.A. 66-1,177 and amendments thereto, or common carrier or public utility, including that portion of any municipally owned utility defined as a public utility by K.S.A. 66-104, and amendments thereto, governed by the provisions of this act shall transact business in the state of Kansas until it shall have obtained a certificate from the corporation commission that public convenience and necessity will be promoted by the transaction of said business and permitting and applicants to transact the business of a common carrier or public utility in this state…

[4] K.S.A. 66-136.
[5] Application, Exhibit JA-2, p. 2.

Under Kansas law, a public utility cannot transact the business of a public utility until it obtains a Certificate from the Commission that the public convenience and necessity will be promoted.[6] "In determining whether such certificate of convenience should be granted, the public convenience ought to be the Commission's primary concern, the interest of public utility companies already serving the territory secondary, and the desires and solicitations of the applicant a relatively minor consideration."[7] "Public convenience means the convenience of the public, not the convenience of particular individuals."[8] "Public necessity does not necessarily mean there must be a showing of absolute need. As used, the word 'necessity' means a public need without which the public is inconvenienced to the extent of being handicapped."[9] Evaluating the public convenience and necessity, or lack thereof, is best established by proof of the conditions existing in the territory to be served,[10] and the Commission may draw its own conclusions regarding these conditions.[11] The Commission also has authority to impose lawful and reasonable conditions on the granting of a Certificate. A condition is lawful if it is within the statutory authority of the Commission and all statutory and procedural rules are followed. A condition is reasonable if based on substantial competent evidence.[12]

Q. How does the Commission evaluate mergers and acquisitions to ensure the

[6] K.S.A. 66-131.
[7] Kansas Gas & Elec. Co. v. Pub. Serv. Comm'n of Kansas, 251 P. 1097, 1099.
[8] Central Kansas Power Co. v. State Corp. Comm'n, 206 Kan. 670, 676 (1971).
[9] *See* Cent. Kansas Power Co., 206 Kan. at 676, (internal quotations retained); See also General Communications System, Inc. v. State Corporation Commission, 216 Kan. 410, 415-418 (1975), (Indicating the Commission has approved certificate requests upon the mere showing the request demonstrated only a nebulous necessity.).
[10] *See* Cent. Kansas Power Co., 206 Kan. at 677, 482 P.2d at 7.
[11] *See id.*
[12] Kansas Electric Power Cooperative, Inc. v. Kansas Corporation Commission, 235 Kan. 661, 665, 683, P.2d 1235 (1984).

transactions meet the standards of K.S.A. 66-131 and K.S.A. 66-136?

A. Over the past 25 years, the Commission has relied on Merger Standards originally set out in Consolidated Dockets 172,745-U & 174,155-D,[13] later affirmed and slightly revised in Docket No. 97-WSRE-676-MER,[14] and again affirmed by the Commission on August 9, 2016, to evaluate whether a merger would promote the public interest.[15] The Merger Standards pose questions on eight distinct topics and inquire about consequences a transaction may have on stakeholders including utility customers, utility stockholders, utility employees, the Commission that regulates the utilities, and the communities where the utility operates.

Q. Do all of the merger standards apply to each and every transaction?

A. All of the Merger Standards are "applied" to evaluate whether a transaction is in the public interest. In my experience, seldom do all of the Merger Standards and their subparts apply equally or with the same level of impact to the evaluation because they have little or no measured effect on stakeholders. This is not to say that we should ignore those Merger Standards. Rather, parties need to explain why a particular Merger Standard is of little consequence. That explanation and analysis aids policy makers in understanding the implications of a transaction.

Q. Do you believe that the Joint Applicants addressed the Merger Standards?

A. Yes, with the caveat that Staff issued data requests to color in details on some distinct

[13] Consolidated Docket Nos. 172,745-U & 174,155-D, Order, November 15, 1991, pp. 34-36.
[14] Order on Merger Application, 97-WSRE-676-MER, Sept. 28, 1999.
[15] *See* Order on Merger Standards, Docket No. 16-KCPE-593-ACQ (Aug. 8, 2016).

issues; namely financial projections, post-closing compliance with loan covenants, estimated timing and procedures for merging transmission facilities and rates for services provided under the SPP OATT, as regulated by FERC. The two primary witnesses for the Joint Applicants are H. Davis Rooney, Vice President and Chief Financial Officer of both SEPE and MKEC, and Stuart S. Lowry, President and Chief Executive Officer of both SEPE and MKEC. Mr. Rooney addresses Merger Standards (a)(i), (a)(ii), (a)(iii), (a)(iv), (d), (e), and (g). Mr. Lowry addresses Merger Standards (a)(v), (b), (c), (d), (e), (f), (g), and (h).

<u>Application of Commission Merger Standards to Evaluate the Transaction</u>

Q. How do the Merger Standards apply to this transaction?

A. For each Merger Standard I will summarize the Joint Applicants' testimony and present Staff's position on that Merger Standard. In these summaries, I introduce the particular Merger Standard and its area of inquiry. Given the Commission's recent affirmation of the Merger Standards, I also individually list each standard in its relevant section so there can be no confusion as to which standard controls. The Merger Standards are as follows:[16]

a. The effect of the transaction on customers, 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;

[16] Consolidated Docket Nos. 172,745-U & 174,155-D, Order, pp. 34-36 (Nov. 15, 1991); Order on Merger Application, Docket No. 97-WSRE-676-MER (Sep. 28, 1999); Order on Merger Standards, Docket No. 16-KCPE-593-ACQ (Aug. 8, 2016).

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

iv. Whether there are operational synergies that can justify payment in excess of book value; and

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 public safety.

Q. Are there any unique characteristics of the Transaction to keep in mind while reviewing the Merger Standards?

A. The Transaction, like every merger and acquisition brought before the Commission, is unique. Three characteristics that stood out to me as I studied the Transaction were:

1. There is no premium paid to either party because there is no purchase price and there is no additional leverage applied to complete the Transaction;
2. There are no additional capital costs caused by completing the Transaction; and
3. The two corporations have, to the degree possible, operated as one since MKEC was formed.

Essentially, the Transaction looks more like the combining of sister companies owned under the same umbrella of a parent.[17] With those characteristics of the Transaction in mind, I evaluated the Transaction to determine if it is likely to result in a financially weaker enterprise and if there are benefits that will accrue to stakeholders. With no acquisition premium paid and no additional capital costs incurred, Staff believes the "threshold" quantity of savings necessary to meet the Merger Standards is low as there are not substantial additional costs to offset with savings in order to achieve a net-positive benefit.

Q. Can you provide a summary of benefits the Joint Applicants' indicate will result from the Transaction?

A. Yes. The Joint Applicants demonstrate that the Transaction is very likely to result in a financially sound utility and there are quantifiable operational savings to be had. Davis Rooney cites five ways the benefits accrue from the Transaction: (1) strengthening the financial condition of the surviving public utility; (2) improving the credit profile to lower the cost of debt service; (3) stabilizing wholesale rates through scale and mitigation of impacts from load variations; (4) diversifying the surviving entity's generation fleet; and (5) other savings associated with merging two companies.[18]

Q. Would you please begin detailing your review of the Merger Standards as applied to the Transaction?

A. The first of the Merger Standards is an evaluation of the effect of the merger on customers. In particular, Merger Standard (a)(i) focuses on the financial condition of the surviving

[17] The "parent" in this scenario would be the member-owners of MKEC and SEPC because, for all intents and purposes, MKEC and SEPC are "owned" by the same distribution cooperatives.
[18] Rooney Direct, p. 3.

entity on a pre-merger and post-merger basis.

> *Merger Standard (a)(i):*
> *(a) The effect of the transaction on customers, 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.*

Q. What are the Joint Applicants' position regarding this standard?

A. Mr. Rooney states there will be a net improvement in the merged entity's financial condition over the financial condition of MKEC and SEPC continuing as standalone companies. Of the five benefits Mr. Rooney cites to, strengthening the financial condition (benefit number 1) and improving the credit profile (number 2) are benefits responding directly to Merger Standard (a)(i).

Q. Do you agree with the Joint Applicants' assertion that the Transaction will improve the combined entity's financial condition over that of SEPE and MKEC on their own?

A. Yes, I believe the Joint Applicants have made a credible argument showing the potential improvement in the combined entity's financial condition as a result of the Transaction. The Joint Applicants state that combining the financial strengths and weaknesses of SEPC and MKEC results in a merged company with a stronger financial profile. One example of that is the capital structure. SEPC has a considerably higher equity ratio at 55% than that of MKEC at 13%. The combined company will have an equity ratio of about 30%.[19] I reviewed the published report by Moody's Investor Services on generation and transmission cooperatives[20] and it indicates that the equity ratios of both companies are

[19] Rooney Direct p. 9; lines 2-12. Rooney workpapers provided in response to data requests KEPCo 1-16 and KCC 5.

[20] "Ratings Methodology: U.S. Electric Generation & Transmission Cooperatives"; Moody's Investor Services, April 15, 2013.

consistent with investment-grade ratings of other generation and transmission cooperatives. The merged equity ratio of 30% would remain well within the range of investment-grade.[21] Clearly, the change in the equity ratio is beneficial to MKEC. Additionally, MKEC brings its own benefits to the Transaction. MKEC has actively borrowed through a syndicate of banks to fund a line of credit and insurance companies to place long-term debt, while until recently SEPC has borrowed from the Rural Utilities Services (U.S. Department of Agriculture). Going forward, the merged entity will have access to the relationships established with MKEC.

Q. Will the merged company be in compliance with the existing debt covenants?

A. Pro-forma financials prepared by the Joint Applicants in response to Staff's data requests indicate that the merged company will be above the minimum financial ratios to comply with their debt covenants. This is not surprising since the Joint Applicants are not taking on any additional leverage to complete the Transaction.

Q. Does the Transaction satisfy Merger Standard (a)(i)?

A. Yes I believe it does.

Q. Did you evaluate the Transaction under Merger Standard (a)(ii)?

[21] With respect to the Joint Applicants' use of the Moody's document, it is important to note there are limitation with this document. It is useful as it provides a picture of important financial issues and metrics to view the transmission and generation cooperatives. In Staff's view, it does not carry the weight of a credit analysis prepared and published by a ratings agency. Mr. Rooney uses the methodology as a guide to evaluate the Joint Applicants' financial health with and without the Transaction. He makes it clear that this is his analysis, applying the information published by Moody's. His analysis is helpful in addressing the Merger Standards even though it does not carry the same weight as a published credit opinion that is specific to this transaction.

A. Yes. Like Merger Standard (a)(i), Merger Standard (a)(ii) focuses on the effect of a proposed transaction on customers and includes evaluation of the purchase price and the reasonableness of it given anticipated savings.

> *Merger Standard (a)(ii):*
> *(a)The effect of the transaction on customers, 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.*

To evaluate this Merger Standard, Staff considers: (1) whether the purchase price is commensurate with other recent utility transactions according to commonly accepted measures of purchase price evaluation, and (2) whether the agreed upon purchase price can be justified by the operational synergies or cost savings that can be demonstrated from the merger.

This Merger Standard does not present a threshold question or assessment for the Transaction because the two entities are combining their existing financial positions to become one company. The Transaction it is not a purchase of stock or assets and neither party is receiving or paying a premium to merge. In addition, there is a level of potential savings discussed in Mr. Rooney's testimony[22] and detailed in his work papers. If Merger Standard (a)(ii) is assessed, it would be positive as the purchase price is in essence zero dollars and the Joint Applicants have identified savings that are likely to occur with the Transaction.

Q. Does the Transaction satisfy Merger Standard (a)(ii)?

A. Yes I believe it does.

[22] Rooney Direct p. 11.

Q. Did you evaluate the Transaction under Merger Standard (a)(iii)?

A. Yes. Merger Standard (a)(iii) focuses on the effects of a merger and whether ratepayer benefits can be quantified.

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

Q. What was Staff's conclusion regarding the Transaction and Merger Standard (a)(iii)?

A. Staff believes the Joint Applicants' study of "duplicative processes" that are inherent in operating the two distinct companies with one group of employees meets the threshold of Merger Standard (a)(iii). Mr. Rooney details expected savings by employees as well as savings in outside services.[23] With respect to dollars spent on outside services such as financial audits, load forecasts, depreciation studies, rate design studies and legal services, Mr. Rooney estimates $500,000 a year in savings. Internally, the Joint Applicants expect an annual savings of 1200 labor-hours from over one-hundred duplicative processes.[24] I agree with Mr. Rooney's assessment that the labor savings is an opportunity-cost where management would redirect that labor toward other productive endeavors. The Joint Applicants state that despite the savings in labor-hours, they do not anticipate laying off employees.[25]

Q. Does the Transaction satisfy Merger Standard (a)(iii)?

A. Yes I believe it does.

[23] Rooney Direct p. 11-12.
[24] Rooney Direct p. 12.
[25] Lowry Direct p. 18.

Q. Did you evaluate the Transaction under Merger Standard (a)(iv)?

A. Yes. Merger Standard (a)(iv) evaluates benefits to customers that can be derived from operational synergies that can justify payment in excess of book value.

> *<u>Merger Standard (a)(iv):</u>*
> *(a)The effect of the transaction on customers, including:*
> *(iv) Whether there are operational synergies that can justify payment in excess of book value;*

Q. What did Staff's evaluation of Merger Standard (a)(iv) determine?

A. In the Transaction there is no payment in excess of book value to combine the two companies.

Q. Does the Transaction satisfy Merger Standard (a)(iv)?

A. Yes I believe it does. Because no payment is used to facilitate the merger, there is no payment in excess of book value. The Transaction satisfies Merger Standard (a)(iv) as there is no payment to net against potential savings from operational synergies.

Q. Did you evaluate the Transaction under Merger Standard (a)(v)?

A. Yes. Merger Standard (a)(v) evaluates the effect of the Transaction on customers and in particular the effect of the Transaction on existing competition.

> *<u>Merger Standard (a)(v):</u>*
> *(a) The effect of the transaction on customers, including:*
> *(v) The effect of the proposed transaction on the existing competition.*

Q. What did Staff determine regarding the Transaction's effect on this Merger Standard?

A. Staff agrees with the Joint Applicants' position that combining the two companies will not adversely affect competition. On the wholesale side, after the merger the Joint Applicants will sell power into and buy power from the integrated market operated by the SPP at prices determined in that market. This reflects the nature of the Joint Applicants' operations as they exist today. Likewise, the rates charged for their transmission services will continue to be determined by SPP tariffs and administered through the SPP. Both entities are now, and the merged company will continue to be, subject to the SPP planning process.[26] The Joint Applicants are, for all intents and purposes, owned by the same group of electric cooperatives and operated with the same employees and management teams. This will continue to be the case after the Transaction.

On the retail side, the Commission has jurisdiction over MKEC and SEPC's administration of their respective members' tariffs on the respective members' 34.5 kilovolt (kV) sub-transmission facilities. As appropriate under Kansas law, the Commission will continue to have jurisdiction over both services after the Transaction. The transaction will not impact the Commission's jurisdiction over SEPC and MKEC's jurisdictional services, to the extent Kansas law permits the exercise of such control.

Q. Does the Transaction satisfy Merger Standard (a)(v)?

A. Yes I believe it does. There should be no impact to existing competition at the retail level and should not impact competition at the wholesale level.

Q. Did you evaluate the Transaction in light of Merger Standard (b)?

A. Yes. Merger Standard (b) evaluates the Transaction's effect on the environment.

Merger Standard (b):

[26] Lowry Direct, p. 17.

(b) The effect of the transaction on the environment.

Q. What did you determine regarding the Transaction when reviewed in light of Merger Standard (b)?

A. It is Staff's opinion the Transaction will not negatively impact the environment. Combining the two existing companies and their generation assets that are operated by the same management teams is unlikely to alter the use of those assets. Stuart Lowry testifies that, "(b)oth companies [i.e. the Joint Applicants] have always strived to operate in a manner that fully complies with all environmental laws and regulations. Management expects that commitment to continue and feel the merger will have a positive effect on its ability to continue in its good environmental stewardship."[27] Given the fact that SEPC and MKEC are, in essence, operated by the same management team, the Transaction should have a neutral impact on the environment.

Q. Does the Transaction satisfy Merger Standard (b)?

A. Yes I believe it does. The Transaction should have a neutral effect on the environment.

Q. Did you evaluate the Transaction in light of Merger Standard (c)?

A. Yes. Merger Standard (c) relates to the Transaction and whether it will benefit local economies and communities in the area served by the resulting public utility.

[27] Lowry Direct, p. 18.

> <u>*Merger Standard (c):*</u>
> *(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.*

Q. What did your evaluation of the Transaction under Merger Standard (c) determine?

A. The Joint Applicants argue that the Transaction will have a beneficial impact on the state and local economies.[28] Staff agrees with the Joint Applicants' opinion, although it would be difficult to quantify positive benefits that accrue to any particular community. This Merger Standard typically comes into play to assess the costs of labor displacement that are frequently part of a merger between public utilities. As discussed above, labor displacement is not a key issue in this Transaction. As Mr. Lowry testified, the Transaction will not result in any employee layoffs. Regarding savings resulting from the Transaction, as a cooperative with transmission formula rates and sale for resale contracts based on formula derived rates, savings will accrue to the consumers of those services. Additionally, the rate stability the Joint Applicants testify will result from the Transaction can have obvious benefits to state and local economies in the service territories of the member owner cooperatives of MKEC and SEPC.[29]

Q. Does the Transaction satisfy Merger Standard (c)?

A. Yes I believe it does.

Q. Did you evaluate the Transaction in light of Merger Standard (d)?

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[28] Lowry Direct, p. 18.
[29] Rooney Direct, p. 14.

A. Yes. Merger Standard (d) evaluates a proposed transaction's effects on the jurisdiction of the Commission and whether the Commission will be able to continue effectively regulate and audit public utility operations in the state.

> *<u>Merger Standard (d):</u>*
> *(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.*

Q. What did your evaluation of the Transaction under Merger Standard (d) determine?

A. It is Staff's position that this Transaction preserves the jurisdiction of the Commission and its capacity to effectively regulate and audit the surviving entity's operations. Stuart Lowry for the Joint Applicants states that any regulatory oversight established in previous dockets and existing contracts will be preserved. Specifically to this point Mr. Lowry states, "Existing regulatory oversight by the Commission will not be altered and the Commission's capacity to effectively regulate public utilities operations will not be diminished by the merger. Any regulatory oversight established in previous dockets and existing contracts will be preserved."[30] Mr. Lowry's commitment is important and Staff asks that, to the extent permissible under Kansas law, the Commission's jurisdiction be preserved in any order authorizing this Transaction.

Q. Does the Transaction satisfy Merger Standard (d)?

A. Yes I believe it does.

Q. Did you evaluate the Transaction in light of Merger Standard (e)?

A. Yes. Merger Standard (e) focuses on a merger's effect on the shareholders of a public

[30] Lowry Direct, p. 18.

utility.

Merger Standard (e):
(e) The effect of the transaction on affected public utility shareholders.

Q. What did your evaluation of the Transaction under Merger Standard (e) determine?

A. Both SEPC and MKEC are organized as not-for-profit, membership corporations. As such, the Joint Applicants do not have "shareholders" in the sense investor-owned utilities do. Still, the Transaction combines the member equity of the two companies to become the merged company; none of the members' positions are diluted.[31] All of the members voted in favor of the merger, filed written direct testimony in support of the Transaction, and none of the members raised any negative consequences from the prospect of closing the Transaction. Staff believes the testimony of each member is strong evidence that the Transaction is fair and reasonable to the member/shareholders of both MKEC and SEPC.

Q. Does the Transaction satisfy Merger Standard (e)?

A. Yes I believe it does. At minimum, the transaction should have a neutral impact on SEPC and MKEC's member-owners.

Q. Did you evaluate the Transaction in light of Merger Standard (f)?

A. Yes. Merger Standard (f) focuses on maximizing the use of Kansas' energy resources.

Merger Standard (f):
(f) Whether the transaction maximizes the use of Kansas energy resources.

Q. What did your evaluation of the Transaction under Merger Standard (f) determine?

[31] Rooney Direct, p. 18-19. Lowry Direct, p. 19.

A. The Joint Applicants state that combining the two companies' energy resources will be beneficial to the state and the public at large.[32] Mr. Rooney cites combining the generation profiles of the two utilities as one of the merger benefits; MKEC generation relies on natural gas while SEPC generation is predominately coal. While the dispatch of a public utility's generation resources is largely determined by SPP, combining the generation fleet of MKEC and SEPC does help diversify the merging entities generation mix. Nevertheless, in Staff's view this particular Merger Standard can be difficult to quantify and assess. Still, at this time we do not see any facts that show a negative outcome for this Merger Standard.

Q. Does the Transaction satisfy Merger Standard (f)?

A. Yes I believe it does.

Q. Did you evaluate the Transaction in light of Merger Standard (g)?

A. Yes. Merger Standard (g) focuses on the Transaction's ability to reduce economic waste.

Merger Standard (g):
(g) Whether the transaction will reduce the possibility of economic waste.

Q. What did your evaluation of the Transaction under Merger Standard (g) determine?

A. The Joint Applicants state that the merger will reduce the possibility of economic waste by way of the efficiencies discussed earlier.[33] Staff agrees with the Joint Applicants.

Q. Does the Transaction satisfy Merger Standard (g)?

[32] Lowry Direct, p. 19.
[33] Lowry Direct, p. 19.

A. Yes I believe it does. Staff's position is that the Transaction meets this Merger Standard as it is likely to reduce the possibility of economic waste.

Q. Did you evaluate the Transaction in light of Merger Standard (h)?

A. Yes. Merger Standard (h) examines how the Transaction effects public safety.

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

Q. What did your evaluation of the Transaction under Merger Standard (h) determine?

A. The Joint Applicants state there will be no change to their commitment to public safety.[34] The merged company will be operated by the same professionals that have managed and operated the two companies for more than a decade. Staff believes it is reasonable to expect that the management team will continue to give the same level of attention to public safety in the future as it has in the past. In fact, a reasonable argument can be made that the merged entity will be able to commit more time and energy to safely operating its system, as labor, time and attention gained from eliminating duplicative processes will be freed up and able to be redirected to the operations of the merged entity.

Q. Does the Transaction satisfy Merger Standard (h)?

A. Yes I believe it does.

Q: Do you have any ultimate recommendations regarding the Transaction?

A. Yes. I recommend the Commission approve the merger between SEPC and MKEC.

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[34] Lowry Direct, p. 20.

Q. Does that conclude your testimony?

A. Yes.

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Adam Gatewood, being duly sworn upon his oath deposes and states that he is a Managing Financial Analyst for the Utilities Division of the Kansas Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Direct Testimony*, and attests that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Adam Gatewood
Managing Financial Analyst
State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 4 day of January, 2019.

Notary Public

My Appointment Expires: 4-28-21

NOTARY PUBLIC STATE OF KANSAS
ANN M. MURPHY
My Appointment Expires
April 28, 2021

CERTIFICATE OF SERVICE

19-SEPE-054-MER

I, the undersigned, certify that a true and correct copy of the above and foregoing Direct Testimony of Adam Gatewood was served via electronic service this 4th day of January, 2019, to the following:

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