MISSOURI PUBLIC SERVICE COMMISSION

STAFF REPORT

GREAT PLAINS ENERGY INC.,
WESTAR ENERGY INC.,
KANSAS CITY POWER & LIGHT COMPANY, &
KCP&L GREATER MISSOURI OPERATIONS COMPANY

CASE NO. EE-2017-0113

JANUARY 18, 2017
JEFFERSON CITY, MISSOURI

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I. Executive Summary

On January 4, 2017, and January 10, 2017, the Missouri Public Service Commission ("Commission") directed Commission Staff ("Staff") to submit a report ("Report") on its analysis of the Kansas Corporation Commission ("KCC") Staff ("KCC Staff") testimony and recommendation, and to include in its Report a summary of the rebuttal testimony of Great Plains Energy Incorporated ("GPE") and Westar Energy ("Westar") (collectively, "Joint Applicants").[1]

KCC Staff testimony describes the transaction as follows:

> GPE's proposal to acquire Westar will result in the two largest investor-owned electric utilities in Kansas becoming separately-owned subsidiaries of GPE. GPE will pay $8.6 billion for all of the Westar equity, while assuming $3.6 billion of Westar's debt for a transaction value of approximately $12.2 billion. Westar shareholders will receive approximately $60 per share. Each share of Westar stock will be converted into a right to receive $51 in cash plus an amount of GPE stock worth approximately $9. Therefore, the compensation to Westar shareholders will be approximately 85 percent cash and 15 percent stock, amounting to an acquisition premium of about $4.9 billion (233 percent) over book value and $2.3 billion (36 percent) over Westar's "undisturbed stock price." GPE will finance the acquisition with approximately 50 percent equity and 50 percent debt. After closing, Westar will be a wholly-owned subsidiary of GPE and Westar shareholders will own approximately 15 percent of GPE.[2]

[1] Staff received copies of Joint Applicants' testimony on January 17, 2017, so this Report only includes a summary of GPE and Kansas City Power & Light ("KCPL") witness Darrin R. Ives' rebuttal since that testimony appears to be an overview of all GPE/KCPL/Westar witness rebuttal testimony issues.

[2] *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.* Direct Testimony of Jeffrey D. McClanahan, beginning at p. 2, line 11, through p. 3, line 5. December 16, 2016.

KCC Staff witness Jeffrey D. McClanahan summarizes KCC Staff's recommendation when he states,

> As reflected in [KCC Staff's] overall recommendation, the [GPE/Westar] Joint Application for approval…does not satisfy a majority of the [KCC] merger standards. What's more, the proposed transaction would leave ratepayers, the state, and even the post-transaction entity in a worse position moving forward. In fact, this Transaction primarily promotes the interests of Westar's shareholders – due to the overcompensation they will receive – to the detriment of the public interest. Because the [KCC] uses the merger standards as guidance as to whether a transaction promotes the public interest, failure to meet the majority of the merger standards is a strong indication that the public interest will not be promoted by approving the Transaction.[3]

KCC Staff testimony references "promote the public interest" and "merger standards." This Report will explain that the Missouri merger standard and the Kansas merger standard are not the same. In fact, the Kansas merger standard sets a higher "bar" for KCC approval than the Missouri merger standard. It appears the KCC likely will not approve a merger request unless it can be shown that the proposed transaction "serves" or "promotes" the public interest; the "public interest" being primarily defined by a list of eight criteria or factors.

Staff's Report is structured to first discuss the Missouri merger standard and the KCC merger standard, then summarize the KCC Staff testimony and recommendation relative to each KCC merger standard. A summary of Darrin R. Ives rebuttal testimony on behalf of Joint Applicants is included at the end of the discussion on KCC merger standards.

While Missouri does not have merger standards as defined by the KCC, the Report will discuss, to the extent applicable, Staff's similar analysis in File No. EM-2016-0324, *In the Matter of Great Plains Energy, Inc.'s Acquisition of Westar Energy, Inc., and Related Matters* ("Merger Analysis"), and discuss the commitment(s) in the Stipulation and Agreements

[3] *Id.*, starting at p. 10, line 18, through p. 11, line 4.

("S&As") between Staff, the Missouri Office of the Public Counsel ("OPC") and GPE that address the issue(s) raised by the KCC Staff.

Staff continues to recommend that the Commission approve the Stipulations and Agreements ("S&As") that have been submitted between GPE/KCPL/GMO and Staff and GPE/KCPL/GMO and OPC as those S&As incorporate commitments the Missouri utilities have made relative to the proposed acquisition which are designed to protect the interests of Missouri ratepayers and the State.

II. Legal Analysis

The Missouri Merger Standard:

A Missouri public utility must obtain prior authorization from the Commission to sell, assign, lease, or transfer utility assets,[4] to merge or consolidate,[5] to raise capital by issuing stock, notes, or bonds, or by mortgaging property,[6] and to acquire the stock of another utility.[7] Section 393.190.1, RSMo.,[8] provides:

> No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or

[4] *See* Rule 4 CSR 240-3.110, electric utilities; Rule 4 CSR 240-3.210, gas utilities; Rule 4 CSR 240-3.310, sewer utilities; 4 CSR 240-3.405, steam heat utilities; 4 CSR 240-3.605, water utilities.

[5] *See* Rule 4 CSR 240-3.115, electric utilities; Rule 4 CSR 240-3.215, gas utilities; Rule 4 CSR 240-3.315, sewer utilities; 4 CSR 240-3.410, steam heat utilities; 4 CSR 240-3.610, water utilities.

[6] *See* §§ 393.180, 393.200, 393.210, and 393.220, RSMo.; *and see* Rule 4 CSR 240-3.120, electric utilities; Rule 4 CSR 240-3.220, gas utilities; Rule 4 CSR 240-3.320, sewer utilities; 4 CSR 240-3.415, steam heat utilities; 4 CSR 240-3.615, water utilities.

[7] *See* § 393.190.2, RSMo.; and see Rule 4 CSR 240-3.125, electric utilities; Rule 4 CSR 240-3.225, gas utilities; Rule 4 CSR 240-3.325, sewer utilities; 4 CSR 240-3.420, steam heat utilities; 4 CSR 240-3.620, water utilities.

[8] All statutory references are to the Revised Statutes of Missouri ("RSMo.") as currently revised, amended and effective.

> consolidation made other than in accordance with the order of the commission authorizing same shall be void. The permission and approval of the commission to the exercise of a franchise or permit under this chapter, or the sale, assignment, lease, transfer, mortgage or other disposition or encumbrance of a franchise or permit under this section shall not be construed to revive or validate any lapsed or invalid franchise or permit, or to enlarge or add to the powers or privileges contained in the grant of any franchise or permit, or to waive any forfeiture. * * * Nothing in this subsection contained shall be construed to prevent the sale, assignment, lease or other disposition by any corporation, person or public utility of a class designated in this subsection of property which is not necessary or useful in the performance of its duties to the public, and any sale of its property by such corporation, person or public utility shall be conclusively presumed to have been of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser of such property in good faith for value.

The lead case states:

> Before a utility can sell assets that are necessary or useful in the performance of its duties to the public it must obtain approval of the Commission. The obvious purpose of this provision is to ensure the continuation of adequate service to the public served by the utility. The Commission may not withhold its approval of the disposition of assets unless it can be shown that such disposition is detrimental to the public interest.[9]

That case relied, in turn, on an older Missouri Supreme Court case, which stated:

> The owners of this stock should have something to say as to whether they can sell it or not. To deny them that right would be to deny to them an incident important to ownership of property. A property owner should be allowed to sell his property unless it would be detrimental to the public.
>
> The state of Maryland has an identical statute with Missouri's and the Supreme Court of that state . . . said: "To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment. 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public.'"[10]

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[9] ***State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz,*** 596 S.W.2d 466, 468 (Mo. App., E.D. 1980) (citations omitted).

[10] ***State ex rel. City of St. Louis v. P.S.C.,*** 335 Mo. 448, 459-460, 73 S.W.2d 393, 400 (Mo. banc 1934).

Given that the purpose of § 393.190.1 is to ensure the continuation of adequate service to the public, the Commission typically considers such factors as the applicant's experience in the utility industry; the applicant's history of service difficulties, if any; the applicant's general financial health and ability to absorb the proposed transaction; and the applicant's ability to operate the assets safely and efficiently.[11] The Commission has sometimes said that denial of such an application requires compelling evidence on the record that a public detriment is likely to occur[12] and that the mere risk of harm to the ratepayers is a detriment to the public interest.[13]

The Commission has since determined that the applicable standard is a cost-benefit analysis:

> What is required is a cost-benefit analysis in which all of the benefits and detriments in evidence are considered. . . . Approval should be based upon a finding of no net detriment. * * * In considering whether or not the proposed transaction is likely to be detrimental to the public interest, the Commission notes that its duty is to ensure that UE provides safe and adequate service to its customers at just and reasonable rates. A detriment, then, is any direct or indirect effect of the transaction that tends to make the power supply less safe or less adequate, or which tends to make rates less just or less reasonable. The presence of detriments, thus defined, is not conclusive to the Commission's ultimate decision because detriments can be offset by attendant benefits. The mere fact that a proposed transaction is not the least cost alternative or will cause rates to increase is not detrimental to the public interest where the transaction will confer a benefit of equal or greater value or remedy a deficiency that threatens the safety or adequacy of the service. Additionally, "what constitutes the 'public interest'" is "a matter of policy to be determined by the Commission." In any proceeding on such an application, the applicant bears the burden of proof.[14]

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[11] *See* ***In the Matter of the Joint Application of Missouri Gas Energy, et al.,*** Case No. GM-94-252 (***Report and Order,*** iss'd Oct. 12, 1994), 3 Mo. P.S.C.3rd 216, 220.

[12] *See, e.g.,* ***In the Matter of KCP&L,*** Case No. EM-2001-464 (***Order Approving Stipulation & Agreement and Closing Case,*** issued Aug. 2, 2001).

[13] ***In the Matter of Aquila, Inc.,*** Case No. EF-2003-0465 (***Report & Order,*** issued Feb. 24, 2004) pp. 6-7.

[14] ***In the Matter of Union Electric Company, d/b/a AmerenUE,*** 13 MoPSC3d 266, 293 (2005); *and see* ***In the Matter of Great Plains Energy, Inc., Kansas City Power & Light Company and Aquila, Inc.,*** 17 Mo.P.S.C.3d 338, 541 (2008), "the Commission may not withhold its approval of the proposed transaction unless the Applicants fail in their burden to demonstrate that the transaction is not detrimental to the public interest, and detriment is determined by performing a balancing test where attendant benefits are weighed against direct or indirect effects of the transaction that would diminish the provision of safe or adequate of service or that would tend to make rates less just or less reasonable."

Additionally, “what constitutes the ‘public interest’” is “a matter of policy to be determined by the Commission.” In any proceeding on such an application, the applicant bears the burden of proof.[15]

To summarize: the private proprietors of a Missouri regulated utility have the right to pursue a merger unless it can be shown that the proposed transaction is detrimental to the public interest; the “public interest” being primarily defined as the continuation of adequate service to the public served by the utility.[16] In making its determination, the Commission uses a cost-benefit analysis.[17] Unless the detriments outweigh the benefits, the Commission *must* approve the transaction.[18]

The Kansas Merger Standard:

Helpfully, the KCC issued its Order on Merger Standards in Docket No. 16-KCPE-593-ACQ on August 9, 2016.[19] Therein, the KCC stated: “The Commission's central concern is whether the merger will promote the public interest.”[20] In making this determination, the KCC stated that it will consider the following criteria:

(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;

[15] *Id.*

[16] ***Fee Fee Trunk Sewer,*** *supra.*

[17] ***Union Electric,*** *supra;* ***Great Plains Energy,*** *supra.*

[18] *Id.*

[19] ***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 (***Order on Merger Standards,*** K.C.C., Aug. 9, 2016).

[20] *Id.*, ¶ 5.

(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

(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. 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.

(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.[21]

The KCC went on to note that "the enumerated criteria can be supplemented to account for the unique facts and circumstances of each docket."[22] These criteria are merely "the beginning criteria to be used when evaluating a merger application, and are to be supplemented by any other considerations that are relevant given the circumstances existing at the time of the merger proposal."[23] The stated criteria can be modified as necessary and additional criteria and considerations can be added.[24] In the final analysis, "the question is whether the public interest is

[21] *Id.*

[22] *Id.*, ¶ 6.

[23] *Id.*

[24] *Id.*, ¶ 7.

served by approving the merger as determined by the specific facts and circumstances of each case." [25]

To summarize: the private proprietors of a Kansas regulated utility evidently have no right to pursue a merger and the KCC will not permit it *unless* it can be shown that the proposed transaction "serves" or "promotes" the public interest;[26] the "public interest" being primarily defined by a list of eight criteria or factors.[27] In making its determination, the KCC appears to use a cost-benefit analysis.[28] Unless the benefits outweigh the costs, the Commission will not approve the transaction.[29]

III. KCC Merger Standards[30]

(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;

<u>KCC Staff</u>

For merger standard (a)(i), KCC Staff heavily relied on projections and forecasts provided by credit rating agencies. All of the parties involved in the transaction are financially

[25] *Id.,* ¶ 6.

[26] ***In the Matter of the Application of Oneok, Inc. for an Order Authorizing Its Plan of Reorganization,*** Docket No. 14-KGSG-100-MIS, 2013 WL 9571938 (***Order Approving the Unanimous Settlement Agreement,*** K.C.C., Dec. 19, 2013): "Therefore, upon finding the public interest will be promoted, the Commission should grant a public utility the authority to transact business in the state of Kansas." This is exactly what the Missouri Supreme Court said the PSC *cannot* require. ***City of St. Louis,*** *supra.*

[27] *Id.,* ¶ 5.

[28] *Id., passim.*

[29] *Id.,* ¶ 5; ***In Re Anadarko Nat. Gas Co.,*** Docket No. 13-BHCG-509-ACQ, 2013 WL 6096364 (***Order Approving Joint Application,*** K.C.C., Oct. 3, 2013): "To this end, the Commission must only grant a public utility the authority to transact business in the state of Kansas upon a finding that the public convenience will be promoted."

[30] Many of the merger standards are interrelated, and many of the arguments were repeated, so it was sometimes difficult to discern where KCC witnesses were changing from one condition to another. For purposes of this report, the testimony summary is placed under the merger standard that was most obviously referenced.

sound and possess investment-grade bond ratings. However, since the announcement of the transaction, the rating agencies have put the Joint Applicants under negative watch and outlook.

KCC Staff witness Adam H. Gatewood states that the result of the merger is a "utility that may not offer healthy returns to equity investors or sufficient safety for bondholders,"[31] and any increase in risk is likely to cause an increase in debt costs and a lower value on outstanding bonds. According to Mr. Gatewood, if the merged utility has difficulty attracting investors, "it will likely have problems raising capital on reasonable terms to finance future additions to its rate base, or at the very worst, problems simply continuing to provide efficient and sufficient service."[32] Mr. Gatewood explains that the credit profiles of the merged utility will decline further if either the KCC or the Commission use the consolidated corporate capital structure of GPE to set revenue requirements for Westar, Kansas City Power & Light Company ("KCPL") or KCP&L Greater Missouri Operations Company ("GMO").

Mr. Gatewood discusses the reports of several credit services regarding the transaction. He notes a June 2 report by Moody's which states that the $4.4 billion acquisition of debt will require "dividend" payments from subsidiaries in order for GPE to make interest payments on that acquisition debt since GPE has little other way to generate cash flow. Mr. Gatewood states that Moody's Credit Opinion shows that, prior to the transaction, the amount of GPE debt was about 3 percent of the consolidated company debt. With the addition of the $4.4 billion, GPE's debt will be one-third of the consolidated company debt. Mr. Gatewood summarizes his thoughts on statements by Moody's when he comments,

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[31] Direct testimony of Adam H. Gatewood, p. 7, lines 3-4. December 16, 2016.

[32] *Id.*, at page 7, lines 5-7.

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Mr. Gatewood continues with a statement by Moody's Ratings Assessment Service:

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According to Mr. Gatewood, these statements by Moody's indicate that the actions GPE has taken to acquire Westar are "indicative of a change in policy of GPE management and board of directors. In Moody's eyes, GPE is now willing to accept a greater degree of financial risk, and that policy change, in and of itself, has a negative effect on credit ratings."[35]

In its statements, S&P noted a negative outlook when referring to the "combined entity's" financial performance. "Fitch states that it views the mere closing of the merger transaction as a credit-negative event."[36] Mr. Gatewood is concerned that the Joint Applicants have not provided a plan to deleverage from acquisition debt or provided any financial forecasts beyond 2020. If the transaction is approved, GPE will have a consolidated capital structure with an equity ratio of 41% to 42% (pre-transaction equity ratio is 49% to 50%). Mr. Gatewood states that with such a limited timeframe included in the Joint Applicants' Forecast Model, one does not know if there is a plan to deleverage or continue at the higher degree of leverage.

[33] *Id.*, at page 18, lines 4-11.

[34] *Id.*, at page 18, lines 16-19.

[35] *Id.*, at page 18, lines 21-24.

[36] *Id.*, at page 12, lines 22-23.

Mr. Gatewood next discusses “financial engineering,” or GPE’s plan to as regulators to use the higher cost weighted average cost of capital (“WACC”) of the operating utilities to set rates instead of the lower cost WACC GPE has achieved through greater leverage and lower cost debt financing. “The ‘engineering’ is merely recapitalizing the utility and retaining the benefits for shareholders.”[37] Mr. Gatewood cautions that if the KCC uses the operating utility capital structure, and does not recognize the leverage of GPE’s capital structure when setting rates, GPE will have little to no incentive to deleverage. Such a capital structure will result in higher revenue requirements, which will allow the operating-utilities to pay GPE more in dividends, thus supporting the parent level debt of the transaction. Mr. Gatewood comments that capital structure will likely be a contentious rate case issue for many years, and “if the [KCC] approves this Transaction, it will practically have ‘bound’ future Commissions to using the operating-utility capital structure in order to maintain the financial health and investment grade bond ratings of Westar, KCPL, and GPE.”[38]

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[37] *Id.*, at page 20, lines 10-11.

[38] *Id.*, at page 30, lines 1-3.

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The KCC Staff asked the Joint Applicants for their view on using the GPE consolidated capital structure to set rates and received the following response:

> Yes, it is the Joint Applicants position that completion of the Transaction is largely dependent on the [KCC] not applying the GPE consolidated capital structure ratios when setting Westar's and KCPL's revenue requirements. (KCC-264)

Mr. Gatewood states that he is surprised the Joint Applicants would commit to a transaction where a successful outcome is "largely dependent" on capital structure decisions, not only from the KCC but also this Commission, since the use of a consolidated capital structure is common practice in both jurisdictions and by the Federal Energy Regulatory Commission ("FERC"). Mr. Gatewood recommends the KCC expresses its position on the appropriate capital structure in the merger docket. Mr. Gatewood states there will be very little separation between GPE and its subsidiaries because they will have the same board of directors who will set the dividend and the capitalization policies of the parent and the subsidiaries. He concludes "the parent should <u>not</u> profit from providing capital to the subsidiary at a higher cost than it incurred to obtain the capital. In some sense, recognizing the consolidated capital structure is a form of ring-fencing."[39]

<u>Staff Analysis</u>

In its Merger Analysis, Staff states the following as it relates to the transaction and previous merger conditions placed on GPE, KCPL and GMO:

- As of March 31, 2016, GPE had a consolidated common equity balance of 46% and KCPL had a consolidated common equity balance of 47%. Joint Applicant witness Kevin Bryant testified that GPE's consolidated common equity ratio is expected to be approximately 41% after completion of the permanent financing issued to fund the

[39] Id at page 41, lines 17-20.

transaction. As KCPL is not issuing any capital for purposes of the proposed transaction, its common equity ratio would not be directly impacted by the transaction financing.

- KCPL has rating agency coverage by S&P and Moody's and GPE has rating agency coverage as well as equity analyst coverage, Staff can evaluate this information to monitor GPE's and KCPL's financial ratios. Additionally, Staff has access to GPE's and KCPL's financial statements through the Commission's subscription to SNL. If Staff has any concerns about the information it analyzes or needs further explanation, it can contact and request such information from KCPL and/or GPE.
- Even if KCPL maintains separate debt and this debt is still at least investment grade, this does not mean higher capital costs will not be incurred by KCPL, and now GMO, as a result of the leverage introduced by the transaction. Based on Staff's review of rating agency feedback regarding GPE's proposed acquisition of Westar Energy, KCPL is expected to maintain its investment grade credit rating even with the increased leverage from the proposed transaction.
- Staff filed testimony in KCPL's and GMO's 2012 rate cases that demonstrated how GPE's financial support for GMO did cause KCPL to have a higher cost of debt due to shorter tenor debt being assigned to GMO and none being assigned to KCPL. The Commission did not adopt Staff's position. The complexities and motivation to financially manage GPE and its subsidiaries for GPE's shareholders best interest rather than KCPL and GMO individually, will cause Staff to continue to have this concern.
- Staff does not believe that GPE's proposed acquisition of Westar Energy will cause either company to not provide access to GPE and KCPL information, but the transaction will create many additional affiliates which in Staff's opinion will require GPE and KCPL to

provide unrestricted access to the same information concerning Westar and its companies.

- GPE's intention to take on a debt burden of $8 to $9 billion is necessarily a matter of concern to Staff because this debt may well negatively affect the Missouri ratepayers of KCPL and GMO.

As a result of Case No. EM-2001-464, Staff understood that the creation of GPE was probably for the purposes of pursuing other business investments that may impact KCPL's costs, including but not limited to its cost of capital, whether directly or indirectly. Staff's proposed conditions were intended to produce a stand-alone S&P credit rating for KCPL that was a function of KCPL's business and financial risks. If this had occurred, this would have alleviated Staff's concern about GPE's other business and financial risks potentially causing an increased cost of capital to KCPL. However, S&P has never recognized these conditions as being significant enough to allow for a consideration of KCPL's stand-alone risk for purposes of assigning KCPL a rating. S&P has consistently stated the following in its ratings assessment of KCPL and GMO: "There are no meaningful insulation measures in place that protect KCP&L from its parent and, therefore, KCP&L's issuer credit rating is in line with GPE's group credit profile of 'BBB+.'" This is significant since S&P believes KCPL has a stand-alone risk profile consistent with an 'A-' credit rating, but nonetheless assigns it a 'BBB+' credit rating due to its affiliation with GPE and GMO.

Given the above, the issuance of debt at GPE will have at least an indirect impact on KCPL and now GMO because the proposed transaction to acquire Westar Energy will result in increased financial risk for GPE on a consolidated basis, which will directly impact S&P's ratings of KCPL and GMO. Although S&P has affirmed GPE's credit ratings, and therefore all of GPE's companies, it has revised its outlook to "negative" from "stable," which simply means that if GPE's ratings were to change, it would likely be a downgrade. This type of designation is often issued when a merger or acquisition is announced and the rating is under active review. It is more likely than not that at the conclusion of the review the rating will be downgraded. GPE provided Staff with financial information showing the *pro forma* impact of the proposed acquisition on GPE's consolidated financial metrics. GPE and KCPL also discussed the projected financial impact in its testimony in the Kansas docket. According to Joint Applicant witness Kevin Bryant, GPE's funds from operations to debt (FFO/Debt) ratio will be in the range of 13% to 14%, which is much more aggressive than its historical average of approximately 16% to 17%. However, S&P projects the FFO/Debt ratio to improve to above 14% after 2018. It appears that S&P is giving significant weight to its expectation that GPE will be able to improve its FFO/debt ratio quickly.

On May 31, 2016, Moody's placed GPE on review for a possible downgrade to Baa3 (equivalent to an S&P rating of 'BBB-'). Moody's specifically mentions its concern about the impact of the $4.4 billion of holding company debt, which will cause holding company debt to go from 2% of total consolidated debt to approximately 35% of consolidated debt. Moody's indicates that it sees "the additional leverage and new capital structure complexity reducing financial flexibility across the entire corporate family." This is noteworthy considering the fact that Moody's usually gives more stand-alone consideration to operating utility subsidiaries when assigning credit ratings than does S&P. Although Moody's currently plans to assign a two-notch rating differential to KCPL (Baa1) and one notch differential to GMO (Baa2), if GPE is downgraded to (Baa3), Staff is not sure how Moody's would rate the subsidiaries if GPE is downgraded to below investment grade.

In past rate cases, KCPL and GMO had recommended the use of GPE's consolidated capital structure for ratemaking purposes for both companies. Staff had done so as well due to the fact that S&P assigned KCPL and GMO a credit rating based on the GPE consolidated capital structure and consolidated business risk. Staff considered this appropriate because it matched the cost of the capital with the risk underlying the capital structure. For example, if KCPL had a 60 percent equity ratio (more consistent with an A-rated regulated utility), but it was assigned a BBB credit rating because of its affiliation with a more leveraged GPE consolidated capital structure, KCPL would be paying debt costs consistent with a BBB capital structure rather than its per books value capital structure of 60 percent equity. Consequently, if KCPL's allowed ROR were based on a 60% equity ratio, its ratepayers would be charged for an equity-rich capital structure without the benefit of lower debt costs consistent with an A-rated capital structure. Consequently, using GPE's consolidated capital structure allowed for a matching of costs with the cost drivers, which includes leverage issued at GPE.

Staff will point out that GPE's proposed acquisition of Westar may cause this change to be even more costly to Missouri ratepayers if debt investors do not recognize KCPL's and GMO's lower risk capital structures when determining their required return on debt. Although Westar is also a pure-play regulated utility with a similar risk profile to that of KCPL and GMO, GPE proposes to issue $4.4 billion of debt at the holding company level, which will cause GPE's consolidated common equity ratio to be around 40 percent rather than the approximate 50 percent shown on KCPL's and GMO's books. GPE, KCPL and GMO have $1.77 billion of debt maturing in approximately the next 5 years. Because GPE had issued debt on behalf of GMO, Staff would expect that this GPE debt would be refinanced with debt issued at the subsidiary level, but Staff has not confirmed this. Because this $1.77 billion of debt will be refinanced under a weaker GPE consolidated capital structure and S&P assigns KCPL and GMO credit ratings based on this weaker consolidated capital structure, then the cost of this subsidiary-specific debt will be higher than if GPE had a consolidated capital structure similar to its subsidiaries. The higher cost of debt that is a function of the more leveraged capital structure will be applied to a less risky capital structure, causing Missouri ratepayers to pay higher capital costs than they would normally pay if KCPL and GMO were truly viewed by investors as stand-alone entities. Absent rating-agency-recognized ring-fencing of GPE's Missouri subsidiaries, which Staff believes can only be ensured if the company collaborates with rating agencies through its own initiatives, Staff does not know how to provide the Commission assurance that KCPL and GMO ratepayers will not pay higher capital costs as a result of the proposed transaction and possibly suffer impaired ability to raise reasonably-priced capital due to unforeseen events.

<u>Relevant S&A Commitments</u>

The S&A with Staff, in summary,[40] provides the following financing conditions:

- GPE, KCPL and GMO shall maintain separate capital structures; separate Corporate Credit Ratings and debt; separate revolving credit facilities and commercial paper, if any; separate preferred stock, if any. Neither KCPL nor GMO shall guarantee the debt of the other, or of GPE, or of any of GPE's other affiliates. Neither KCPL nor GMO shall pledge their respective stock or assets as collateral for obligations of any other entity.
- KCPL and GMO have indicated their intent to utilize their respective utility-specific capital structure in general rate case filings after the close of the transaction, with supporting documentation of the reasonableness of that structure. KCPL or GMO shall

[40] The S&A provisions are not repeated in their entirety in this Report; however, the summary is not intended to imply a change in the provisions.

provide evidence demonstrating that the transaction has not resulted in a downgrade to that utility's Corporate Credit Rating that exists at the time the general rate case is filed compared to the Corporate Credit Rating of that utility that existed as of May 27, 2016. If such a Corporate Credit Rating downgrade resulting from the transaction exists, KCPL or GMO will provide evidence demonstrating that Missouri customers are held harmless from any cost increases resulting from such a downgrade.

- In the event KCPL or GMO should have its respective Standard & Poor's ("S&P") Corporate Credit Rating downgraded to below BBB- as a result of the transaction, the affected utility commits to file notice with the Commission within five business days of such downgrade with various supporting documentation. In the event KCPL or GMO's affiliation with GPE or any of its affiliates is the reason for the downgrade to below BBB-, KCPL and/or GMO shall pursue additional legal and structural separation, if necessary, from the affiliate(s) causing the downgrade and the impacted utility shall not pay a common dividend without Commission approval or until the Corporate Credit Rating has been restored.
- Neither KCPL nor GMO shall seek an increase to the cost of capital as a result of the transaction or their ongoing affiliation with GPE and its affiliates other than KCPL/GMO. Any net increase in the cost of capital they seek shall be supported by various documentation.
- Nothing shall restrict the Commission from disallowing such capital cost increases from recovery in KCPL or GMO's rates.

(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;

KCC Staff

Ms. Ann Diggs states that if the KCC Staff were recommending approval of the transaction, it would recommend Kansas jurisdictional ratepayers share in transaction savings through annual bill credits; that assurances provided by the Joint Applicants related to the preservation of the KCC's jurisdiction be incorporated in the KCC's order, and the KCC require Westar and KCPL to file updated cost allocation manuals ("CAMs") within 60 days of the transaction. GPE established a savings estimation team to answer the question: "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?"[41] (Emphasis added by Ms. Diggs) The savings estimation team was provided initial net savings estimate targets of $50 million, $100 million and $130 million, respectively, for calendar years 2018-202. The net savings as estimated by the savings estimation team were: ** ______________________________ ** respectively, for calendar years 2018-2020.

According to Ms. Diggs, "Joint Applicants have clearly stated that their proposed ratemaking treatment allows them to retain approximately ** __________ ** of savings, due to regulatory, lag, which will be used to help pay for various transaction and transaction related costs incurred in 2016 and 2017."[42] Ms. Diggs questions why savings estimates were provided to the savings estimation team "other than to influence the identification and range of estimated savings results either from being too risky in order to support a potential bid price, or keeping savings conservative in order to limit the potential sharing of savings with ratepayers."[43] Ms.

[41] Direct Testimony of Ann Diggs, p. 14, lines 8-11. December 16, 2016.

[42] *Id.*, at p. 16, lines 22-25.

[43] *Id.*, at p. 17, lines 2-5.

Diggs further questions why the team was provide with any estimates instead of tasking it with independently identifying and estimating transaction-related savings and costs, suggesting the process "erodes the credibility of the preliminary savings estimate results which the Commission must rely on to determine if the proposed transaction is in the public interest."[44]

Ms. Diggs then compares the current savings analysis process with the estimation process in the Aquila acquisition docket, stating the Aquila process included more teams and a common understanding from both KCPL and Aquila management and employees. In contrast, Ms. Diggs describes the current analysis process as conducted within a short deadline prior to GPE's final bid with limited Westar data. Ms. Diggs states, "Due to the self-imposed time restrictions in this case, this important element of management and employee involvement from both GPE and Westar into the savings estimation process was not possible. Timing restrictions further prohibited the savings estimation team from using relevant Westar data, such as cross-mapping KCP&L and Westar employee positions by department, which could have increased the credibility of the savings estimation results. Joint Applicants are essentially relying on GPE's preliminary due diligence analysis, and did not perform a more thorough and reliable savings estimation analysis."[45] Ms. Diggs identified examples of Westar-specific data that was not considered in the Joint Applicants' Transaction savings analysis, including: differences in Westar and KCPL employee salary and benefit levels and differences in job organization and functions. The results of the preliminary savings analysis are "efficiency targets" as KCPL and Westar explore savings in the on-going integration process. Ms. Diggs notes, "the results will not be available in time for the [KCC] to consider in determining the effect of the proposed

[44] *Id.*, at p. 17, lines 10-12.

[45] *Id.*, at p. 25, lines 1-8.

Transaction on consumers,"[46] She concludes, "The KCC and Kansas customers deserve more than vague inferences that savings will be achieved."[47]

Ms. Diggs also reviewed the Joint Applicants' calculations for such things as transaction-related labor savings of Shared Services, reaching the same conclusions. She notes KCC Staff identified errors in the Joint Applicants' calculations of estimated transaction savings which, if adjusted, would reduce net savings by $7.6 million in the Shared Services area, and by $14.2 million if applied to all functional areas.[48]

Justin T. Grady further discusses the transaction relative to merger standard (a) (ii). He states, "GPE has agreed to pay $1.70 for every dollar of Westar's rate base and $2.30 for every $1 of Westar's book equity."[49] Mr. Grady discusses the Guggenheim Securities Financial Analysis presented in the Final Proxy Statement. He includes a table presenting previous merger and acquisition ("M&A") transactions, and concludes, "GPE's agreement to pay 24.4 times the next calendar year earnings for Westar Equity is the highest priced transaction on the table, 13.4% higher than Algonquin's equivalent multiple paid for Empire earlier this year."[50] According to Mr. Grady, Guggenheim presented two other measures of primary valuation analyses – a Discounted Cash Flow ("DCF") Analysis and a Peer Group Trading Analysis. "In both cases, the valuations that Guggenheim derived using these methods were below the $60/share GPE has agreed to pay."[51] Based on various calculations, Mr. Grady states, "in order to support a purchase price (or valuation) higher than $54.46/share, you would have to assume

[46] *Id.*, at p. 31, lines 8-9.

[47] *Id.*, at lines 20-21.

[48] *Id.*, beginning at p. 48, line 18, through p. 49, line 2.

[49] Direct Testimony of Justin T. Grady at p. 10, lines 5-6. December 16, 2016.

[50] *Id.*, at p. 15, lines 2-5.

[51] *Id.*, at p. 17, lines 13-14.

higher cash flows for Westar than represented in the official forecast, or an even lower required return."[52] Mr. Grady also discusses other valuation and financial analyses performed by Guggenheim and notes, "Interestingly, while Guggenheim does not consider these analyses to be material to the rendering of its opinion, the Transaction Premiums Paid Analysis is the only valuation analysis of all those performed by Guggenheim that supports a purchase price at or above $60/share."[53] Guggenheim performed the following:

> ** ______________________________
> ______________________________
> ______________________________
> __________
>
> ______________________________
> ______________________________ *[54]

The Final Proxy Statement describes the Goldman analysis of the Historical Stock Trading range of Westar compared to the $60/share merger consideration, presented as follows:

- A premium of 36.1% to the closing price of $44.08/share for Westar common stock as of March 9, 2016;
- A premium of 13.4% to the closing price of $52.92/share for Westar common stock as of May 27, 2016; and
- A premium of 8.2% to the 52-week intraday trading price high of $55.47/share for Westar common stock as of May 27, 2016

Joint Applicant witness Kevin Bryant refers to these premiums when explaining why GPE believes the premium it agreed to pay is reasonable compared to other recently announced transactions.[55] Mr. Grady does not agree these analyses demonstrate reasonableness of the purchase price because some of the M&A transactions include natural gas retail distribution

[52] *Id.*, beginning at p. 18, line18, through p. 19, line 2,

[53] *Id.*, at p. 19, lines 10-13.

[54] *Id.*, at p. 20, lines 13-23.

[55] *Id.*, at p. 22, lines 12 -20.

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businesses; the best unaffected stock price to measure against the transaction is $39.51, the closing price on November 3, 2015, a date unaffected by merger speculation; other transactions such as the Fortis/ITC transaction were included at full weight despite obvious differences; even with all the non-applicable entities removed, Mr. Grady calculates the average premium of unaffected stock price as 28.9%. Mr. Grady states the only all-electric transaction that is similar to the GPE/Westar transaction is the recent Algonquin/Empire transaction. KCC Staff testified that transaction did not meet the KCC's merger standards without significant rate concessions to overcome deficiencies. Mr. Grady identifies additional deficiencies in Goldman's analyses, stating, the "differential between GPE's expectation of allowed equity returns in Westar's rates, compared to the real cost of equity (required return on equity) estimated by Goldman, is the most significant contributing factor for GPE's decision to pay nearly $5 billion more for Westar's equity than it is allowed to recover through rates."[56]

Mr. Grady discusses Goldman's DCF values on Westar's stand-alone operations without the effects of efficiencies noting that the per share values are from $11.79 to $14.01 higher than the DCF values calculated by Goldman. When multiplied by an expected 143.3 million outstanding shares, the result is a net present value ("NPV") of synergies of $1.68 billion to $2.01 billion. Mr. Grady states, "That is an enormous amount of assumed net present value benefit to present stockholders associated with net non-fuel operating and maintenance (NFOM) savings of approximately $356 million over the first three and a half years". He notes the savings number is prior to sharing any cost savings with ratepayers or prior to paying any taxes on the savings.[57] Mr. Grady identifies two flaws to the analysis: (1) It is illogical to assume savings would be retained forever without sharing with ratepayers and inconsistent with GPE's stated

[56] *Id.*, at p. 30, lines 6-10.

[57] *Id.*, at p. 31, lines 3-12.

plans; and, (2) It is illogical to assume the costs savings would be free from income tax liability.[58] Mr. Grady says the KCC should be concerned because the $4.9 billion of Goodwill that GPE plans to record on its books would require an annual evaluation to determine whether its value has become impaired. If impaired (book value exceeds fair value), Mr. Grady notes that GPE would be required to write-down the asset, resulting in an immediate hit to the equity balance and potentially resulting in significant negative financial ramifications. Mr. Grady observes, "Even if all of the operational synergies that the Joint Applicants expect to occur as a result of this Transaction were achieved, the NPV of those operational synergies doesn't come anywhere close to justifying GPE's payment of a nearly $5 billion premium in excess of Westar's book value … GPE's response to [KCC] Staff and intervenor discovery in this Docket and GPE's direct testimony confirms that neither the purchase price, nor the purchase price over book value, is directly tied to cost savings anticipated by GPE."[59] Mr. Grady cites an excerpt from Joint Applicant witness Mr. Bryant's direct testimony, which states,

> GPE developed the offer price based on the 'premiums paid in recent regulated utility transactions' and then used a combination of Enovation's savings analysis and various other assumptions to evaluate the impacts on both GPE's and Westar's customers as well as GPE's existing shareholders.[60]

Finally, Mr. Grady notes that Mr. Bryant, in supplemental direct testimony "admits … the amount of the acquisition premium and the savings resulting from the merger result from different sources and are driven by different factors."[61] Mr. Grady concludes that there is no financial or economic analysis that justifies the payment of almost $5 billion over book value of Westar's equity based on an expectation that savings will result from the transaction, and

[58] *Id.*, at p. 32, lines 11-16.

[59] *Id.*, beginning at p. 41, line 14, through p. 42, line3.

[60] *Id.*, at p. 46, lines 23-27.

[61] *Id.*, at p. 47, lines 15-17.

surmises that there are only two explanations for such a result: (1) the buyer expects to create additional cash flows by cutting costs, increasing revenues, etc. than the seller expects to generate on its own; or (2) the buyer's expected cost of capital is much less than is allowed in rates of the utility being acquired.[62] Mr. Grady states that GPE's plan will only work if the KCC does not recognize the lower cost debt when setting Westar's rates in future cases, which would be a change in KCC ratemaking practices. Mr. Grady references several highly confidential equity analyst reports to support his thesis that GPE plans to use low cost holding company debt to purchase Westar equity at a premium, thereby realizing a windfall profit of approximately ** _____ ** million per year after interest expense incurred for the transaction is paid.[63] Further, the transaction will garner GPE a net positive cash flow of approximately ** ___ ** million a year that will flow to shareholders "that GPE plans to retain by objecting to the [KCC's] recognition of the existence of this debt in Westar and KCPL ratemaking proceedings."[64]

Mr. Grady also performs an analysis changing Goldman's assumptions to those applicable in Westar's most recent rate case. For instance, modifying the WACC results in a $1.6 billion equity value less that Goldman's DCF calculation. Based on this additional analysis, Mr. Grady, notes, "[I]f Goldman believed that Westar's cost of equity was anywhere near its regulatory-authorized return on equity, its calculations of Westar's intrinsic value would not be near as high as supported in its valuation and financial analysis of GPE's Board. Likewise, if GPE believed its real cost of equity was anywhere close to Westar's authorized return on equity

[62] *Id.*, at p. 48, lines 14-19.

[63] *Id.*, at p. 61, line 20.

[64] *Id.*, beginning at p. 66, line 19, through p. 67, line 2.

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of 9.35%, it should have never been willing to pay $60/share for Westar. In fact, it would not have been willing to pay more than $46.45/share for Westar."[65]

Next, Mr. Grady reviews GPE's expectations related to net operating losses ("NOL"). In response to a KCC data request, GPE indicates it expects the transaction to affect the timing of the utilization of regulated and non-regulated NOLs and tax credits. Mr. Grady notes that GPE's ability to utilize NOLs two years earlier than expected would have a worth of about $10.98 million of NPV. KCC Staff recommends splitting this value 50/50 with ratepayers and shareholders.[66]

KCC Staff witness Scott Hempling describes the "acquisition premium" and the "control premium." He defines the "control premium" as "the excess of GPE's purchase price over Westar's pre-acquisition stock value."[67] Much of Mr. Hempling's testimony indicates Westar viewed the purchase price of the transaction as more important than customer benefit. According to Mr. Hempling, "GPE and Westar bargained over price, cash ratio, break-up fees, Board membership, and headquarters location, but they never bargained over consumer benefits."[68] In citing the Proxy Statement, Mr. Hempling identifies factors considered by Westar, including the "Westar Board's belief that the merger will create a leading utility company with a broader customer base"; "The fact that both Westar and [GPE] own well-known and respected brands and share a strong commitment to high-quality customer service, innovative energy efficiency programs, environmental stewardship, reliability and safety"; and, the "Westar Board's belief that the merger should over time generate cost savings and operating efficiencies."

[65] *Id.*, at p. 72, lines 6-12.

[66] *Id.*, beginning at p. 79, line 26, through p. 80, line 6.

[67] Direct Testimony of Scott Hempling, p. 14, lines 22-25. December 16, 2016.

[68] *Id.*, at p. 24, lines 24-26.

Mr. Hempling notes "these statements are 'beliefs' not commitments … what is missing: studies of customer benefits."[69] Mr. Hempling recognizes GPE and Westar obtained "fairness" opinions, but states that the opinions are to verify that the price is "fair" to shareholders, not the benefits to customers. However, Mr. Hempling acknowledges that it is reasonable to assume Westar projected some benefit to customers. "But the central, dominant, determinative factor – Westar's sole reason for seeking and choosing an acquirer – was value to shareholders, not performance for customers."[70]

Mr. Hempling also discusses the auction process, noting Westar's top officers will receive an estimated $43.7 million from the transaction based on their various rights to Westar stock. He quotes the Proxy Statement, which explains that executive compensation for Westar "is designed 'to strongly align the interest of our officers with those of our shareholders.'"[71] Mr. Hempling recognizes that if the merged company operates sub-optimally, there may be lost sales and regulatory penalties that would reduce shareholder return and executive compensation, but again states the decision-makers did not make customer benefits a focus of the transaction.

At page 33, line 3, Mr. Hempling is asked "What is a public utility's obligation to its customers?" He responds, "[I]f regulation does not replicate the discipline of effective competition – their rates will not be 'just and reasonable' and their service will not be 'efficient and sufficient' all as required by Kansas law."[72] This is another theme of Mr. Hempling's testimony, as he comments that Westar caused its customers "opportunity cost harm" (the transaction displaces some other action that would have produced more benefits to the public),

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[69] *Id.*, at p. 25, lines 11-26.

[70] *Id.*, at p. 26, lines 15-18.

[71] *Id.*, at p. 32, lines 12-13.

[72] *Id.*, at p. 33, lines 18-21.

because the Joint Applicants "guarantee zero benefits" for the customer.[73] In order to obtain customer benefits, Mr. Hempling suggests the competitive auction should have "auditioned" bidders based on benefits, then should have had finalists bid on price. In that way, "customer benefit would have prevailed over price."[74] Mr. Hempling states, "Whatever fiduciary duty the Westar Board has to maximize its shareholders' wealth is constrained by its Kansas law obligation to provide the most cost-effective service to its customers. That is the obligation the Westar Board violated when it bid out its franchise based on highest possible price rather than best possible performance … A utility must serve its customers cost-effectively. The [KCC] must set rates that give the utility an opportunity to earn a reasonable return on its prudent investment in assets used and useful in serving the public. These two obligations – the utility's and the {KCC's] – align shareholder interest and customer interest."[75]

Mr. Hempling claims that a market in which a monopoly can sell its franchise for profit to the buyer promising to pay the highest price is a "distorted" market. To avoid this problem, the selling utility must run the competition based on benefits to customers, and if there is a control premium, customers must receive a portion of that premium.[76] Mr. Hempling then discusses acquisition debt of 3.86% as compared to its authorize ROE of 9.35%, noting that if GPE can finance $3.7 billion of Westar equity at 3.95%, but earn a return of 9.35%, GPE will have a large profit – the reason GPE is willing to pay the premium. This concept is known as "double-leveraging" because debt is at both the holding company level and the utility level. This is also similar to the "financial engineering" discussed by Mr. Gatewood and explained above.

[73] *Id.*, at p. 34, line 19.

[74] *Id.*, at p. 35, lines 12-13.

[75] *Id.*, at p. 39, lines 1-5 and 21-24.

[76] *Id.*, at p. 41, lines 13-24.

The gain is realized, not by risk-taking, but by financial arrangements. Mr. Hempling concludes, “There is, therefore, no necessary reason why Westar shareholders are entitled to the portion of the premium associated with the value.”[77] Mr. Hempling continues that adding to the value of double-leveraging is the low level of interest rates, quoting Joint Applicant witness Ruelle “…[U]tilities are trading at pretty high values. The reason for that are low interest rates.”[78] Mr. Hempling continues that low interest rates do not represent shareholder risk-taking or executive decision-making.

Mr. Hempling states that when Westar needs to invest in new plant, it has the exclusive opportunity to make profit-causing investments that could be attractive to GPE, but it is “government protection from competition, not Westar’s merits, that creates this opportunity for gain. Again, Mr. Hempling states that there is no reason why Westar shareholders should receive a benefit from that gain.[79]

Switching to economies of scale, Mr. Hempling arrives at the same conclusion – combining offices does not take special management skill or shareholder risk so there is no reason for Westar shareholders to keep the full control premium. Similarly, he states that sharing “best practices” is not a reason to reward Westar shareholders because a failure by Westar to use best practices is cause for a [KCC] investigation into imprudence. Mr. Hempling states that when an acquirer improves performance, the benefit is not a result of the merger, but because the acquirer substitutes higher-quality practices for lower-quality practices … an improvement in management oversight that should have occurred without the merger. In this case, since the

[77] *Id.*, at p. 45, lines 15-16.

[78] *Id.*, at p. 46, lines 13-15.

[79] *Id.*, at p. 48, lines 5-9.

KCC has jurisdiction over both merging companies, Mr. Hempling states the KCC can order the companies to share best practices without the merger.

Mr. Hempling states that what GPE is actually purchasing for a premium is a "franchise" – the right to provide a government-regulated service free from competition. He recommends a 50-50 sharing with ratepayers as the logical treatment.

Mr. Hempling questions whether savings projections were influenced by "deal-making." He states, "the savings evaluation team's estimates could have suffered from optimism bias – a desire to 'make things work out.'"[80] He urges the KCC to keep this possibility in mind, but continues that the Joint Applicants "did stress that '[n]o one on the Enovation and GPE savings estimate team was advised, urged, or influenced to identify anything other than achievable savings to justify the bid price.'"[81]

Mr. Hempling also questions the benefits of the transaction, noting that Joint Applicant witness Mr. Terry Bassham identifies a key benefit as creating a financially stronger company, better suited to meet the needs of customers and communities in Kansas. Mr. Hempling states that when asked to describe shortfalls in Westar's performance that support these benefits, "Mr. Bassham avoided the question."[82] Mr. Hempling recognizes the KCC has not required savings commitments in order to consider savings values, but recommends the KCC condition benefit recognition on benefit commitment to induce performance consistent with effective competition and to protect the public interest.

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[80] *Id.*, at p. 93, lines 23-24.

[81] *Id.*, at lines 25-27.

[82] *Id.*, at p. 94, lines 10-11.

Staff Analysis

Most of the large utilities regulated by the Commission are owned by holding companies that also own subsidiaries engaged in unregulated businesses. This situation creates a danger that the holding company will seek to maximize the profits of its unregulated enterprise by shifting its costs to the regulated business, thereby subsidizing it at the ratepayers' expense. The Commission has promulgated rules governing affiliated transactions in the electric, gas, steam heat and refrigeration industries. The Missouri Supreme Court stated that the Commission's rules are:

> a reaction to the emergence of a profit-producing scheme among public utilities termed "cross-subsidization," in which utilities abandon their traditional monopoly structure and expand into non-regulated areas. This transaction gives the Joint Applicants an opportunity to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers. The centerpiece of the Commission's affiliate transaction rule is the "asymmetrical pricing standards" designed to prevent improper subsidization of unregulated activities by ratepayers:
>
> > A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if—
> >
> > 1. It compensates an affiliated entity for goods or services above the lesser of—
> >
> >   A. The fair market price; or
> >   B. The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or
> >
> > 2. It transfers information, assets, goods or services of any kind to an affiliated entity below the greater of—
> >
> >   A. The fair market price; or
> >   B. The fully distributed cost to the regulated electrical corporation.

The asymmetrical pricing standards have been characterized as "in essence, a simple prohibition to all utilities against providing a financial advantage to their affiliates[.]"[83] Their purpose is to "prevent regulated utilities from subsidizing their non-regulated operations ... and provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities." A presumption that costs of transactions between affiliates were prudent is inconsistent with these rules.[84]

The current allocation methodology used by KCPL to allocate shared costs among KCPL and other Great Plains Energy business units, as documented in the Great Plains Energy Cost Allocation Manual filed annually with the Commission, will be utilized. That is, KCPL's allocation of its shared costs will be expanded to include Westar in the allocation. Currently, KCPL employees operate GPE and all of its affiliates. In the case in which GPE acquired Aquila, Inc., KCPL and Aquila obtained a limited variance to the Commission's affiliate transactions rule, 4 CSR 240-20.015 (2)(A), 1 and 2, to provide information, assets, goods, or services at cost to, and receive information, assets, goods, or services at cost from GMO, and not consider fair market price in those transactions.

<u>Relevant S&A Commitments</u>

The S&A with Staff, as summarized, provides:

- The goodwill arising from the transaction will be maintained on the books of GPE and is therefore not expected to negatively affect KCP&L or GMO's cost of capital; however, if such goodwill becomes impaired other than as a result of a Commission order and such impairment negatively affects KCPL or GMO's cost

[83] ***State ex rel. Atmos Energy Corp. v. PSC,*** 103 S.W.3d 753, 763 (Mo. banc 2003).

[84] ***Office of Public Counsel,*** *supra,* 2013 WL 3894953, at 6.

of capital, all net costs associated with the decline shall be excluded from the determination.

- For the first five years after closing, GPE shall provide Staff and OPC its annual goodwill impairment analysis.
- KCPL and GMO agree to comply with the Commission's affiliate transaction rules.
- No later than six months after the closing of the transaction but no less than two months before the filing of a general rate case for either KCPL or GMO, KCPL and GMO will file updates to their existing CAMs.

The S&A with OPC, in summary, adds:

- GPE, KCPL and GMO shall agree to an independent third party management audit of their corporate cost allocations and affiliate transaction protocols. The Staff, OPC and company will develop a Request for Proposal ("RFP") for Commission approval. The same entities will select the winning bid, subject to approval by the Commission if the decision is not unanimous. GPE, KCPL and GMO shall collectively provide $500,000 dollars, funded below the line (and not recovered in rates), for the audit. Any additional expense required by the Commission, will be split 50/50 between ratepayers and shareholders.

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

<u>KCC Staff</u>

Mr. Gatewood discusses standard (a)(iii) as part of his financial discussion, stating "consumers should receive the befits of a cost reduction whether it is labor efficiencies or a lower cost of capital."[85] He states that a higher equity ratio will result in higher cost to ratepayers because equity capital is riskier than debt, thus requiring a higher return. He explains that when a utility subsidiary depends on a parent company for equity capital it becomes difficult to determine how the subsidiary is financed. The equity capital is assigned to the subsidiary through a book entry at the discretion of the parent, and it does not have to reflect the capitalization of the parent. According to Mr. Gatewood, "[I]f regulators merely accept the subsidiary's capital structure without reviewing the capital structure of the parent, it will result in a windfall to the parent company's shareholders … an unnecessary cost paid by ratepayers … that fails to reflect the much lower true cost of capital for the utility."[86] Mr. Gatewood estimates cost reductions from the difference in parent and capital structures in the range of $90 million to $136 million – the higher estimate reflecting the economic benefit GPE "hopes" to retain each year by not passing on the savings to consumers and the lower estimate representing the minimum amount of savings that should be returned to consumers so they receive benefit of a higher debt ratio. Should the KCC approve the transaction, Mr. Gatewood recommends the KCC Staff use the weighted average cost of debt of the consolidated company and the consolidated company capital structure so the consumers receive savings from the lower cost debt.

Ms. Diggs also discusses ratepayer benefits (or lack thereof) as they related to savings that flow to customers. According to Ms. Diggs, the Joint Applicants used results from GPE's estimated transaction analysis as inputs into a financial model to estimate annual savings of efficiencies achieved, retained and shared with ratepayers each year from 2017 through 2020. She summarizes concerns with the modeling as follows:

[85] Gatewood, p. 36, lines 1-2.

[86] *Id.*, at p. 37, lines 6-13.

- ** ____ **

- The actual Gross Efficiencies and costs to achieve used in the financial model were provided by GPE's preliminary savings estimation team. [KCC] Staff discussed its concerns with these estimates in the preceding sections of my testimony. So I will just add here for reference that [KCC] Staff found the underlying savings estimates not to be sufficient or credible, and recommended the KCC not rely on the savings estimates in making their determination of whether this transaction is in the public interest.

- ** ____ **

- A review of the calculations supporting the results in the above chart clearly show the advantage Joint Applicants enjoy in this scenario. By controlling the timing of rate cases after the Transaction, they are able to effectively control the amount of achieved efficiencies they are allowed to retain through regulatory lag. For example, in the year 2020, Joint Applicants are estimating achieved efficiencies of $172 million. Including costs to achieve, Kansas ratepayers can expect to receive ** ______________________________ ** And this disparity is occurring as savings from Westar's and KCP&L's post-transaction general rate cases are being fully flowed through to ratepayers. If [KCC] intervention is needed at some point to require an audit due to overearning, Joint Applicants can continue overearning while the regulatory process takes its course. Yet Joint Applicants continue to argue their proposed plan is fair to consumers because they are receiving benefits that they would not have received absent the transaction.[87]

Ms. Diggs states that if KCC Staff were recommending approval of the transaction, it would recommend the KCC require KCPL and Westar to issue bill credits to Kansas jurisdictional ratepayers annually until rates from utility's next general rate case become

[87] Diggs, starting at p. 52, line 12, through p. 54, line 14.

effective. Ms. Diggs recommends the annual bill credits reflect a 50-50 sharing of the ** ___ ______________________ **[88] as identified in Joint Applicant work papers as an equitable solution.

KCC Staff witness Casey Gile discusses quality of service. Witness Gile states that Kansas statutes require all public electric utilities provide "sufficient and efficient service to their customers (K.S.A. 66-101b)." Gile suggests that if the KCC relies upon quality of service benefits, it should establish performance goals for the post-merger utility to ensure all benefits are achieved. According to Gile, Westar South (former Kansas Gas and Electric area); Westar North (former Kansas Power and Light area) and KCPL Kansas operations all have readily identifiable reliability metrics. Average performance over the last five years shows large differences between the areas with KCPL Kansas performing the best. Gile states the merger should not disadvantage one set of customers over another – KCPL Kansas customers should not be penalized with relaxed standards, while a potentially unattainable goal should not be set for the Westar areas. Gile suggests the customer and the KCC should be able to compare past performance of each utility with the post-merger companies. If the transaction is approved, KCC Staff proposes reliability standards for each of the three operating areas, with a goal of reaching one overall performance target five years after the merger. Gile references the financial concerns raised in the testimony of other KCC Staff witnesses, continuing, "Because of this risk, we are concerned that financial pressures may force GPE and the operating utilities to defer maintenance and system improvements in order to pay debt and/or reserve cash for shareholder's returns."[89] Gile recommends penalties be assessed for failure to meet reasonable performance thresholds. As an example, Gile references the GPE acquisition of Aquila, Inc. (07-KCPL-1064-

[88] *Id.*, at p. 55, Line 11.

[89] Direct Testimony of Casey Gile, p. 9, lines 13-15. December 16, 2016.

ACQ) where the parties agreed to a maximum penalty equivalent to 100 basis points of the return on equity ("ROE") for KCPL's Kansas operations. Non-performance was defined as "any performance below 70% of the pre-merger average performance metrics."[90] For this transaction, Gile recommends a maximum non-performance penalty of "25 basis points of the ROE for each company's most recent rate case," which would result in a $3.5 million penalty for KCPL and $11.1 million for Westar.[91] The recommended amount of penalty would be weighted based on the number of customers in each operating area, with the maximum annual penalty not exceeding 25 basis points of the pre-acquisition ROE based on each company's most recent rate case.

Staff Analysis

In its Merger Analysis, Staff notes, the "not detrimental to the public interest" standard requires a cost-benefit analysis. Based on information known at this time, Staff is unaware of any benefits that the proposed transaction will confer on the Missouri ratepayers of KCPL or GMO.

Employee reductions among Missouri regulated utilities have previously had some negative impacts upon operations. Management decisions to both reduce call center staffing and use outsourcing resulted in diminished service quality to Missouri customers. While outsourcing specific operational functions may not lead to poorer service, outsourcing that is not managed effectively by regulated utilities and which has resulted in less qualified and less trained workers and resulted in high-turnover, etc., can and has certainly led to service quality reductions. Significant proposed merger savings have been addressed in testimony filed with the KCC including $65 million during the first full year after closing and $200 million in the third full year after closing. Such savings may come from many sources and may or may not be realized, but undoubtedly savings will include a reduction in employee headcounts. Testimony filed by

[90] *Id.*, at p. 11, lines 8-9.

[91] *Id.*, at lines 12-16.

Mr. Bassham indicates that he anticipates headcount savings resulting from the elimination of "overlapping administrative, management and support positions" . . . and "if natural attrition is not sufficient, GPE may consider targeted voluntary staffing reduction programs where it makes sense." But further in his testimony he states, "some level of involuntary severance may occur as this is typically unavoidable in transactions of this nature."[92]

Relevant S&A Commitments

The S&A with Staff, in summary, contains the following provisions related to ratemaking:

- Goodwill associated with the premium over book value of the assets paid for the shares of Westar stock ("Acquisition Premium") will be maintained on the books of GPE. The amount of any acquisition premium paid for Westar shall not be recovered in retail rates. Nothing shall preclude any party to the S&A from taking a position regarding the ratemaking measures and adjustments necessary to ensure no impact from the acquisition premium on rates.
- Neither KCP&L nor GMO will seek direct or indirect recovery or recognition in retail rates of any acquisition premium through any purported acquisition savings "sharing" adjustment (or similar adjustment).
- If any party to any KCPL or GMO general rate case proposes to impute the cost or proportion of the debt GPE is using to finance the transaction to either KCPL or GMO for purposes of determining a fair and reasonable return, then KCPL and GMO reserve the right to seek recovery of the acquisition premium.
- Transaction costs include, but are not limited to, those costs relating to obtaining regulatory approvals, development of transaction documents, investment banking

[92] Direct Testimony of Terry Bassham page 10.

costs, costs related to raising equity incurred prior to the close of the transaction, payments required to be paid to employees who invoke severance payment agreements, and communication costs regarding the ownership change. Neither KCPL nor GMO will seek either direct or indirect recovery of any transaction costs through any purported acquisition savings "sharing" adjustment (or similar adjustment).

- If any party to any KCPL or GMO general rate case proposes to impute the cost or proportion of the debt GPE is using to finance the transaction to either KCP&L or GMO for purposes of determining a fair and reasonable return for either utility, then KCPL and GMO reserve the right to seek recovery of transaction costs.
- Transition costs are those costs incurred to integrate Westar under the ownership of GPE and include capital and non-capital costs. If requested, and approved by the Commission, on-capital transition costs can be deferred. If recovery is sought, KCPL and GMO will have the burden of proving that the recoveries of any transition costs are just and reasonable and that the costs provide benefits to Missouri customers.
- GPE commits that retail rates for Missouri KCPL and GMO customers shall not increase as a result of the transaction.

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

<u>KCC Staff</u>

Mr. Drabinski summarizes reductions in staffing and their effect on operation and maintenance ("O&M") reductions for generation, transmission and distribution ("T&D"). Once generating unit retirements are implemented, staff "will be reduced by

** ___ ** FTE's (Full Time Equivalents). Likewise T&D Staffing will decrease by ** ___ ** FTEs; Supply Chain staffing will decrease by ** __ ** FTEs, and Customer Service related activities will decrease by ** __ ** FTEs."[93] "Once all changes are implemented, generation O&M will be reduced by ** ___ ** and T&D O&M expenses will be reduced by ** ___ **."[94] Most of the supply chain merger savings are a result of a reduction in employees. Mr. Drabinski maintains the savings could be achieved without the merger since both Westar and GPE are "large, sophisticated utilities with experienced and well managed procurement and contract management departments."[95]

Mr. Hempling comments that Joint Applicants state they have not "asked" customers to pay the acquisition premium, but indicates they will collect the premium from customers "without asking" by: (1) "having Westar charge rates based on equity-level returns when part of Westar's equity will be funded by lower-cost debt"; (2) "using Westar's profit to extract value from GPE's net operating losses"; and, (3) keeping merger-related savings for themselves between rate cases, rather than passing them through to customers";[96] thus, allowing GPE shareholders to recover the premium implicitly. He further explains that if GPE absorbed the premium, it would still cause problems because it would require GPE to issue more stock and take on more debt, which would weaken its financial profile. Further, if the premium was funded entirely with equity, it would like require more frequent rate cases and cost-recovery mechanisms due to the pressure on GPE's earned equity returns, making it more difficult for GPE to raise equity capital. Mr. Hempling states, "GPE can recover its premium only if we

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[93] Direct Testimony of Walter P. Drabinski, p. 6, lines 10-13. December 16, 2016.

[94] *Id.*, at p. 8, lines 6-7.

[95] *Id.*, at p. 86, lines 12-15.

[96] Hempling, at p. 69, lines 13-18.

sever rates from true economic cost. Never in a competitive market, but only in a government-protected monopoly market, could we ever sever prices from economic reality" – and according to Mr. Hempling, that is exactly what Joint Applicants propose.[97] In other words, rates that are set based on debt costs are rates based on cost of service. Requiring recovery of the premium because a premium was paid is setting rates based on a gain the seller wanted to receive, not setting rates based on the cost of service. Mr. Hempling recommends the KCC allocate the control premium (the excess of GPE's purchase price over market value) between shareholders and ratepayers based on their contribution to the economic value that underlies the premium. In lieu of being able to identify that benefit, he suggests the split be 50-50, with a rebuttable presumption that each group would have the burden to demonstrate its contribution was more than 50 percent.[98]

Switching to synergies, Mr. Hempling notes that the synergies claimed are not quantifiable, are incapable of being tracked, and lack the ability to be proven or to provide accountability. Mr. Hempling states that savings were identified by GPE and its consultants without full data or joint meetings with managers of both companies. He also states there is an absence of executive accountability because Mr. Bassham has made no public decision about management changes, responsibilities related to savings, or accountabilities. In response to a KCC Staff DR, the Joint Applicants respond it is, "expected that [GPE] senior executives involved in reviewing and approving Transaction-related benefits will have substantial responsibility for achieving those benefits post-closing."[99]

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[97] *Id.*, at p. 71, lines 3-10.

[98] *Id.*, at p. 74, lines 15-17.

[99] *Id.*, at p. 92, lines 2-3.

Joint Applicants claim the new entity will be larger, thus providing benefit. Mr. Hempling observes that there is range of size that will result in cost-effective performance, but challenges this claim as lacking evidentiary value. Ultimately, he states, the KCC should ask: "Will this Transaction produce for customers the best possible benefit-cost ratio, compared to alternative actions the utility could take?" because, "[w]hen regulation protects a utility from competition, it must compensate by inducing the utility to perform as if it were subject to competition".[100] In this transaction, Mr. Hemphill states GPE is obtaining control of Westar's franchises and Westar shareholders are getting a $2.3 billion control premium, but Westar's customers are guaranteed nothing; thus, from the customers' perspective, the benefit-cost ratio does not serve the public interest.[101] Further, the longer the time between rate cases, and the more cost reductions the companies make between those rate cases that are not included in previously set rates, the greater the savings the utility will realize. Mr. Hempling recommends the KCC determine "reasonably expected benefits," then limit the premium recovery to that amount.[102]

Staff Analysis

In its Merger Analysis, Staff raised concerns with synergies claims noting GPE does not have the necessary resources and personnel to provide managerial services and oversight to Westar Energy as it has no employees. All employees reside with KCPL, a regulated utility that does the majority of its business in Missouri. KCPL's employees are already fully occupied in operating KCPL, GMO and GPE. Staff fears that tasking these employees with, first, the acquisition and integration of Westar and, second, the operation of Westar, would necessarily

[100] Id., at p. 101, lines 19-25.

[101] Id., at p. 102, lines 5-9.

[102] *Id.*, beginning at p. 106, line 22, through p. 107, line 2.

result in a loss of operational efficiency and the subsidization of GPE's acquisition by Missouri ratepayers.

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

KCC Staff

Dr. Glass provides an analysis of the effect of the transaction on competition in the wholesale electricity market. He states that KCC Staff's lone concern in this area is that a generation plant closing to produce savings might create transmission congestion, which would then raise local electricity prices. Therefore, if the transaction is approved, KCC Staff recommends the KCC require GPE to obtain KCC approval of all plant closings.

Mr. Drabinski identifies 10 units as planned for retirement post-merger, four units that were scheduled for retirement pre-merger are no longer identified, and three units not scheduled for retirement pre-merger were added. He recognizes the Southwest Power Pool ("SPP") currently has over-capacity and individual companies have over-capacity that will need to be addressed whether the merger is approved or not. Using 2015 data shows "about 5.6 million mWh of energy will be removed from production, while reducing the average life of the fleet by two years."[103] In response to a KCC Staff DR, GPE indicated it was not aware of any SPP study analyzing the impact of the retirements.

Mr. Hempling discusses competition from the perspective of "across-the-fence rivalry," a rivalry that exists between two adjacent utilities to continuously improve performance to avoid unfavorable comparisons, and "benchmark competition" which exists when two companies that are similar become a valid basis for judging the performance of each other. According to Mr. Hempling, the transaction will eliminate both benchmarking and rivalry, reducing the pressure to

[103] Drabinski, at p. 31, lines 10-12.

perform. Mr. Hempling suggests the KCC could identify best practices of each and then order their adoption by both with penalties for non-compliance, resulting in consumer benefits without the merger.

Since customers have no choice, Mr. Hempling suggests the logical sequence is for the government to choose the competitor that will best serve customers. To do this, the State's needs must be defined, then the characteristics of companies that will meet those needs must be defined, then create a procedure to attract companies to the state. If the KCC addresses these steps, utilities will better understand what merger partners to seek. Mr. Hempling claims that Westar's lack of understanding allowed it to choose GPE in a competition where price was the dominating factor. Mr. Hempling states that, "Given the statutory requirement of 'efficient and sufficient service,' the [KCC] has the power to fix this problem … [by] defining the types of companies it wishes to see providing utility service, and specifying the ingredients in merger transactions that align merging parties' interests with the public interest."[104] He continues by noting the "Proxy Statement makes clear that Westar is very attractive, not only to GPE but to others. With the focus then on the customer, let the bidding begin."[105] Therefore, Mr. Hempling recommends the KCC clarify its merger policy, which was first established in 1991, where mergers were largely limited by law to adjacent companies. Since the federal Public Utility Holding Company Act ("PUCHA") has now been repealed, any company can acquire another company.

<u>Staff Analysis</u>

Staff has no input on the effect the transaction will have on wholesale competition, and does not typically compare Missouri utilities to like utilities in other states.

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[104] Hempling, at p. 120, lines 7-11.

[105] *Id.*, at lines 13-15.

<u>Relevant S&A Commitments</u>

While the S&As do not directly address this merger standard, KCPL and GMO are required to obtain Commission approval of plant closings pursuant to Chapter 22[106] of the Commission's rules and § 393.190.1.[107]

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

<u>KCC Staff</u>

Mr. Drabinski indicates that his analysis did not demonstrate there was any impact on the environment in Kansas since all of the units proposed for retirement meet current Clean Air Act compliance, with some units recently undergoing "major and costly upgrades."[108] He continues that many of the planned retirements identified as providing savings from accelerated retirement were already planned for retirement, and would likely have occurred absent the merger.

<u>Staff Analysis</u>

Staff has no opinion as to whether the transaction will affect 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. 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.

<u>KCC Staff</u>

KCC Staff witness Robert H. Glass discusses the effect of the transaction on state and local economies through loss of wages, salaries and benefits for the Kansas economy, GPE's plans to reduce electric rates, and savings that will flow to shareholders. He ultimately concludes, "The net effect of three of these channels is a negative impact on the Kansas

[106] Relating to Integrated Resource Planning.

[107] Requiring Commission authority to transfer assets.

[108] Drabinski, at p. 11, line 20.

Economy."[109] The projected savings from the transaction are generated from eliminating jobs. Dr. Glass concludes that positions that are eliminated will be permanently lost to the state and local labor markets since people who lose technical utility jobs in Kansas will have a difficult time trying to find similar jobs in Kansas and have a better chance finding jobs outside of Kansas. He notes a possible exception is Johnson County.

Dr. Glass discusses three "channels" where the savings will impact the economy of Kansas. A reduction in wages, salaries and benefits will flow through as a direct reduction in demand for goods and services. Lower electric rates will free up consumer income for expenditures on other items, which will result in increased demand. The portion of savings that will go to shareholders that live in Kansas will result in additional consumption that will also raise demand for products. Dr. Glass provides the following analysis:

> GPE has 2020 estimates for labor savings deflated to 2016 dollars, thus all of the following discussion will be done in 2016 dollars. Total 2020 labor savings is ** ______** million with approximately ** _____ ** million coming from Kansas. So, the reduction in Kansas demand due to the labor savings is ** _____ ** million. GPE estimates sharing ** ______ ** million with Kansas ratepayers via lower rates. That leaves ** ______ ** million that goes to shareholders. Assume that 2% of GPE shareholders will be Kansans after the Transaction, which is probably a high estimate, then the amount for Kansas shareholders is ** _____ ** million. Thus, the total savings returned to Kansans is ** ______ ** million.

Dr. Glass comments that since the savings will not be completely shared with ratepayers and only a small proportion of GPE's shareholders like in Kansas, the transaction will result in a net loss to Kansas and have a negative effect on the economy. Dr. Glass provides a history of the Kansas economy since 1940, noting the Kansas economy response to "external shocks." In other words, the Kansas economy does not tend to sustain growth, but grows when there is an event such as the World War II armament build up or the Russian wheat deal in the 1970s. He explains

[109] Glass, at p. 3, lines 10-12.

[110] *Id.*, beginning at p. 9, line 9, through p. 10, line 3.

the Kansas labor market has performed relatively weakly since 2000; local labor markets in Kansas have experienced difficulties compared with the national trend and the Kansas utility labor market has lost jobs over the past 25 years, except for a brief period in the early 2000s, which peaked in 2010. He also discusses that Kansas has increasingly become an economy of lower wage jobs relative to the United States, and that Kansas has not recovered from the 2007 recession nearly as well as the US as a whole.

Mr. Drabinski states that "reducing staff in T&D, Customer Service and Supply Chain departments hurts local economies by removing the salaries [ ] associated with ** ___ ** well-paying jobs."[111] However, he comments the Joint Applicants have not made any commitments regarding the location (Kansas or Missouri) of those job reductions.

Staff Analysis

While Staff did not perform a similar analysis of the impact of the transaction on Missouri or the KCPL/GMO service area, Staff has performed economic analyses in all recent electric rate cases. Relevant to this Report, Staff provided the following economic analysis in its Cost of Service Report in KCPL's pending rate case, Case No. ER-2016-0258.

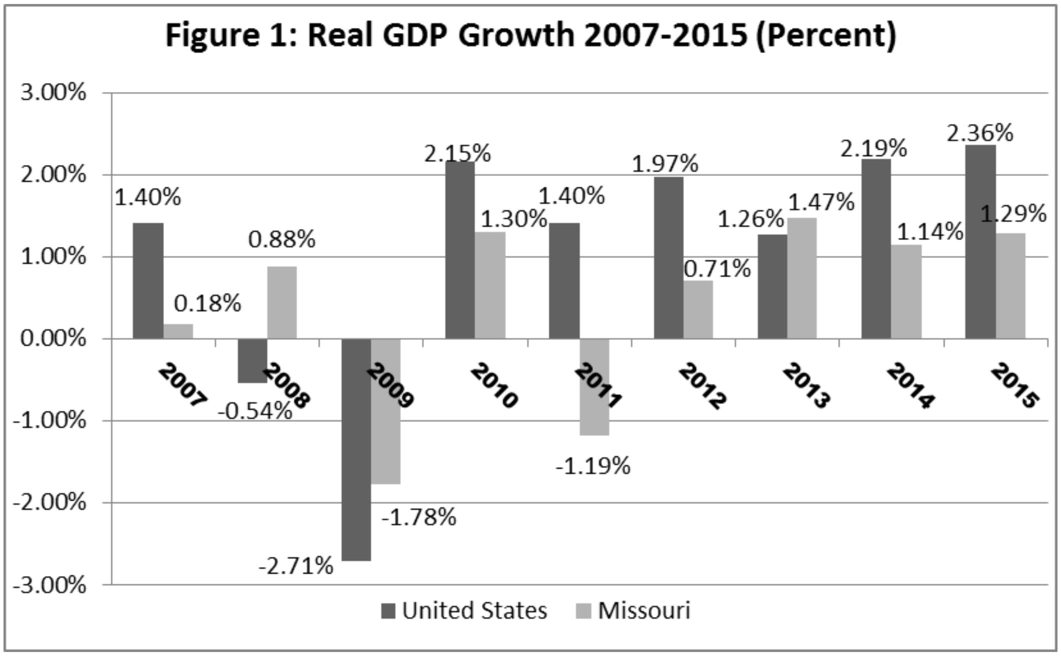
Economic Considerations

The indicators of Missouri's general economic condition, specifically of the Missouri counties[112] that compose the service area of KCPL, indicate that moderate growth continues. Figure 1 below shows that the real gross domestic product ("GDP") growth of Missouri has averaged less than one percent (1%) per year from 2010 to 2015. Preliminary 2015 data had

[111] Drabinski, at p. 12, lines 11-13.

[112] According to Appendix 3 of KCPL's application, which includes the minimum filing requirements, and KCPL's current tariff, KCPL serves a total of 13 counties.

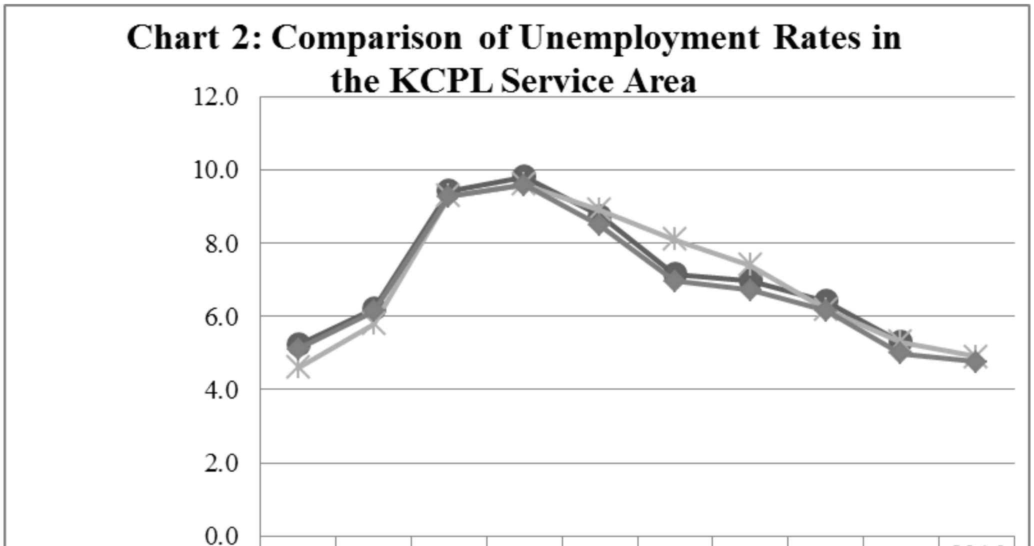
shown a robust year-over-year growth rate at 2.80 percent, but subsequent revisions lowered the growth to only 1.29 percent.



Despite a low GDP growth rate, Figure 2 shows that the annual unemployment rate levels for Missouri, including the preliminary 2016 levels, are below the pre-recession levels, but the unemployment rate for the U.S. rate has yet to reach the pre-recession lows. [113] The combined unemployment rate for all of the Missouri counties that KCPL serves tends to be 0.2 to 0.3 percent above Missouri's overall unemployment rate.[114]

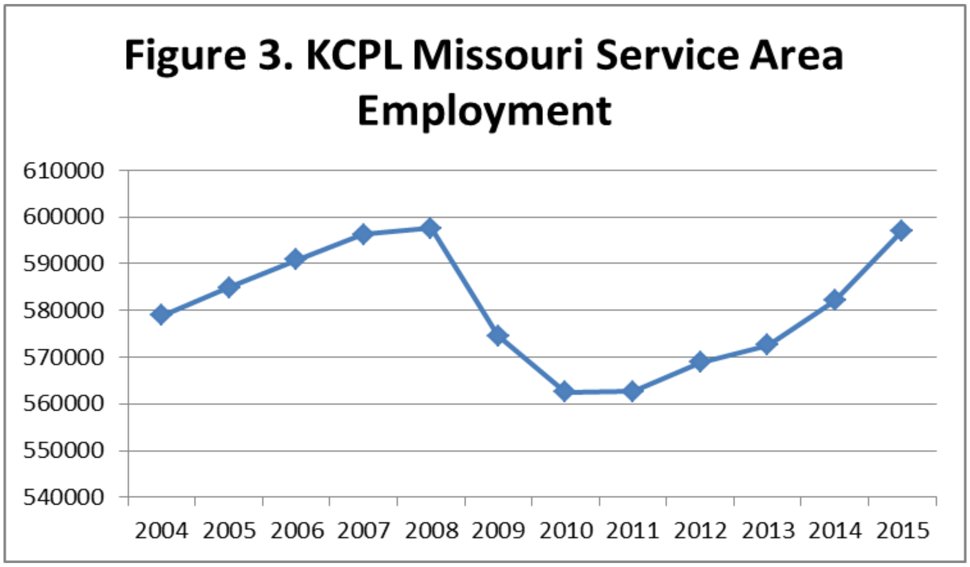
[113] According to the National Bureau of Economic Research, the recession began in December 2007 and ended in June 2009.

[114] The county level unemployment data is unavailable for 2016.



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 (P)
KCPL	5.2	6.2	9.4	9.8	8.8	7.2	7.0	6.4	5.3	
United States	4.6	5.8	9.3	9.6	8.9	8.1	7.4	6.2	5.3	4.9
Missouri	5.1	6.1	9.3	9.6	8.5	7.0	6.7	6.2	5.0	4.8

Some economists have expressed concern that the unemployment rate statistic has not accurately reflected a lower labor-force participation rate. Figure 3 shows the number of employed persons in KCPL's Missouri service area is near the pre-recession peak. While not correcting for population growth, Figures 2 and 3 together show that the employment situation in Missouri continues to improve.



In addition to examining the status of the current economy, economic forecasters also examine economic data that have a history of leading, lagging, or coinciding with changes in the broader economy to anticipate future economic conditions. The current economic outlook from a variety of economic forecasters has been cautious. For instance, the American Institute for Economic Research's ("AIER")[115] most recent version of Business Cycle Conditions (November 2016) shows that 58 percent of the leading indicators are evaluated as expanding.[116] Under AIER's method, consistent evaluations above 50 percent suggest a low probability of recession over the next six to 12 months. This was the second month that was evaluated above 50 percent after six months in a row where the evaluation was at or below 50 percent. AIER states, "[W]e do not believe there is enough evidence to suggest the

[115] American Institute for Economic Research. (09NOV16). "Business Conditions Monthly." https://www.aier.org/sites/default/files/Documents/Research/pdf/BCM_November2016.pdf (15NOV16).

[116] AIER uses 24 indicators in total – 12 leading indicators are a measurable economic factor that tend to change ahead of a turning point in the broader economy, six coincident indicators that tend to change at roughly the same time as a change in the broader economy, and six lagging indicators that tend to change after a turning point in the broader economy. AIER recently revised its list of indicators, details of which can be found at https://www.aier.org/revising. A leading indicator evaluated as expanding means that the change in that indicator is historically correlated with future economic growth.

economy is on a significantly different path. Consequently, we still believe the results over the past nine months are consistent with overall slow growth and continued economic expansion."[117]

Figure 4, below, provides a comparison of the increase in average weekly wages for the counties in the Missouri KCPL service area, Consumer Price Index ("CPI"), Producer Price Index ("PPI"),[118] and KCPL's electric rates. From 2007 to 2015, the Missouri counties in the KCPL service area collectively experienced a 17.62% increase in average weekly wages. This was slightly lower than the overall Missouri compounded increase in average weekly wages of 18.03% and about 3% above the CPI increase. During that same time period, KCPL filed six rate cases[119] which increased overall electric rates for customers served by KCPL by approximately $283.1 million, or a cumulative total of 57.69%, as shown in Table 1. However, KCPL has also experienced inflationary pressure, illustrated by a 10.31% increase in the PPI for Industrial Commodities from 2007 to 2015.[120] KCPL is currently requesting an additional $90.1 million — a 10.77% increase in permanent rates.[121] From 2007 to 2015, the increase in average weekly wages for Missouri counties in the KCPL service area is about one-fourth of the increase in electric rates for KCPL customers. If KCPL receives its requested 10.77% increase, the increase in average weekly wages would

[117] American Institute for Economic Research. (09NOV16). "Business Conditions Monthly." https://www.aier.org/sites/default/files/Documents/Research/pdf/BCM_November2016.pdf (15NOV16).

[118] The PPI represents the Producer Price Index for Industrial Commodities which includes textile products and apparel, hides, skins, leather and related products, fuels and related products and power, chemicals and allied products, rubber and plastic products, lumber and wood products, pulp, paper and allied products, metals and metal products, machinery and equipment, furniture and household durables, nonmetallic mineral products and transportation equipment.

[119] Case Nos. ER-2006-0314, ER-2007-0291, ER-2009-0089, ER-2010-0355, ER-2012-0174, and ER-2014-0370.

[120] Detailed information on KCPL's expenditures and revenues can be found later in this report.

[121] Since some of the proposed increase in permanent rates is currently collected in the fuel adjustment clause, the apparent proposed increase on customers is approximately $62.9 million or 7.52%.

be less than one-fifth of the increase in electric rates, but this does not include any increase in average weekly wages for 2016, which is currently unavailable.

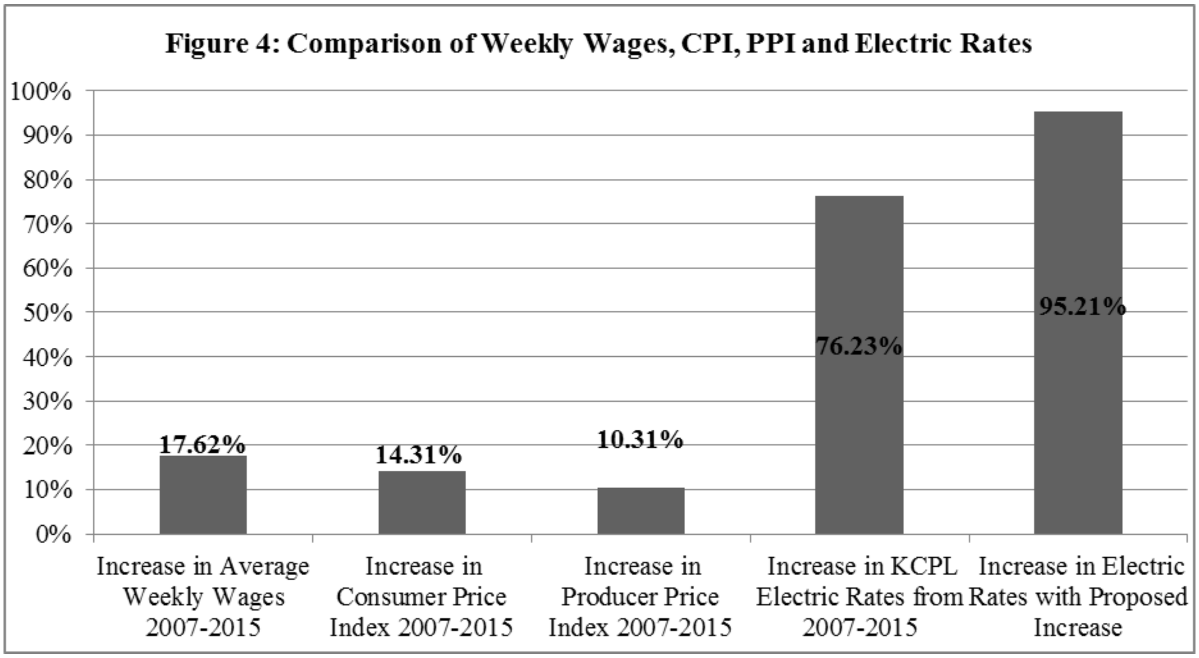


Table 1: KCPL Rate Case History 2007 - 2016

Case Number	Effective Date	Dollar Value	Percent Increase
ER-2006-0314	1-Jan-07	$50,616,638	10.46%
ER-2007-0291	1-Jan-08	$35,308,914	6.50%
ER-2009-0089	1-Sep-09	$95,000,000	16.16%
ER-2010-0355	4-May-11	$34,817,199	5.25%
ER-2012-0174	26-Jan-13	$67,390,893	9.64%
ER-2014-0370	29-Sep-15	$89,671,644	11.76%
Total Dollars		$372,805,288	
Total Compounded Increase			76.23%
ER-2016-0285	(Proposed)	$90,076,613	10.77%
Total with Proposed		*$462,881,901*	*95.21%*

Relevant S&A Commitments

- Pursuant to the S&A with Staff, GPE's corporate headquarters will remain at 1200 Main Street in Kansas City, Missouri, after the transaction closes. GPE has also committed in the acquisition agreement to maintain the current Westar headquarters at 818 Kansas Avenue in Topeka, Kansas, for GPE's Kansas headquarters after closing. While transaction-related efficiencies will result in lower employee headcount in both Missouri and Kansas post-closing, GPE expects to achieve such transaction-related efficiencies in a generally balanced way across both states.

The S&A with OPC, in summary, states:

- In their first general rate case filed after the closing of the Transaction, KCPL and GMO shall provide direct testimony explaining the employment metrics related to the number of full time employees and the average turnover rate along with any material changes to those metrics since the closing of the transaction, including, transaction related labor and all labor related efficiency savings that KCPL and GMO propose to flow through to the benefit of customers in the form of rates that are lower than they would have been absent the transaction.
- KCPL shall not effect an involuntary reduction in workforce or involuntary retirement program due to the transaction which results in a reduction in its Missouri-based workforce of greater than 20 percent for a period of three years.
- GPE is committed to maintaining its corporate headquarters in Kansas City, Missouri, and shall honor all terms and conditions of the existing lease for its headquarters office located at 1200 Main Street in Kansas City, Missouri, which

expires in October 2032. Headquarters is defined as the location serving as the managerial and administrative center of GPE in Kansas City, Missouri.

- No later than thirty days after the closing of the transaction, and for the succeeding nine years, GPE will provide $50,000 to each of six Community Action Agencies. These funds are provided to each agency with the express purpose of the creation of an additional position(s) to enable further low-income weatherization deployment at a recommended spend level of $50,000 per year over a ten-year period. Any excess funds can be allocated to certain categories at the agencies' discretion.
- KCPL and GMO commit to an annual in-person meeting with each of the local Community Action Agencies for the next five years at GPE's headquarters in Kansas City, Missouri, with extended invitations to (at least) the Commission Staff and OPC to discuss progress to date including Strengths, Weaknesses, Opportunities, and Threats to KCP&L and GMO's low-income population.

(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.

KCC Staff

Mr. Gatewood agrees with the Joint Applicants that the transaction does not change the KCC's jurisdiction or legal authority to regulate the post-acquisition utility, but states, "the financial weakness highlighted by the ratings agencies will likely leave the [KCC] fewer options ... that is regulators will be compelled to adopt practices that they might not otherwise adopt – to provide a higher stream of revenue to the utility – to support the parent company's new debt."[122]

[122] Gatewood, p. 43, lines 16-18, and p. 44, lines 14-16.

Ms. Diggs agrees that with the assurances the Joint Applicants make in the application, the KCC's jurisdiction to regulate and audit the public utility operations will be preserved, but also agrees that the transaction will "impart additional burdens and complexities to effectively regulate and audit Westar's utility operations"[123] and add risk to Westar's Kansas ratepayers, "given the multi[-]jurisdictional and multi[-]utility allocation issues…that don't exist today."[124] Ms. Diggs recommends that if the KCC approves the transaction, it include the assurances that are set out in the application as part of its order.

Mr. Hempling explains that for any major infrastructure job, there could be multiple entities willing to compete. He states, "The [KCC] specifically, and the state generally, should not be in a position where they feel pressured to use government powers to block market entry by efficient competitors, just to protect a company that took on too much debt."[125] He expresses concern that if the KCC were to order GPE to bid such projects out, it will face arguments that it is endangering GPE's bond ratings. Such actions will create tension between GPE's debt and the KCC's ability to be flexible.

Staff Analysis

In Staff's opinion, the transaction will not affect the Commission's jurisdiction to effectively regulate GPE's Missouri operations. As discussed elsewhere, and as explained by KCC Staff, the transaction may add complexities to rate cases.

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[123] Diggs, at p. 60 lines 6-8.

[124] *Id.*, at lines 10-11.

[125] Hempling, at p. 66, lines 16-20.

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

<u>KCC Staff</u>

Mr. Grady states that it is unlikely the transaction will benefit GPE shareholders, noting that while GPE's offer for Westar increased by $2 billion from October 2015 through May 2016, the net asset it was purchasing only increased $107 million. A DR response model shows:

> GPE's financial model now predicts a ** ____________________________ ____ ** So in other words, before even closing this Transaction, GPE is ** ______________ ____ ________ *

<u>Staff Analysis</u>

Staff does not have an opinion as to the effect of the transaction on Westar shareholders. As explained elsewhere, should the transaction affect the valuation of GPE stock or KCPL/GMO capital structure, there may be an effect on GPE shareholders.

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

<u>KCC Staff</u>

Mr. Drabinski reviewed the efficiencies of the planned retirements noting some of the units have "reasonable heat rates and rank[ ] high within the fleet."[127] Mr. Drabinski reviews projected savings associated with the retirements, and notes the Joint Applicants have not identified or quantified any stranded costs for the selected units even though remaining book value will need to be addressed. Based on the most recent rate cases, net book value would produce ** _____ ** million in annual revenue requirement for KCPL and ** ______ **

[126] Grady, at p. 88, lines 2-5.

[127] Drabinski, at p. 28, lines 21-22.

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million in annual revenue requirement for Westar, not including depreciation expense.[128] Mr. Drabinski suggests the GPE analysis performed related to net savings associated with power plants is "too simplistic for a merger of this size and complexity."[129] He states that when "units are retired, the generation that was produced through economic dispatch must be replaced by the next most expensive source … a spreadsheet showing that these costs start at over ** ___ ** million per year and rise to over ** ___ ** million per year within ten years. KCC Staff was unable to project lost revenue for the KCPL and GMO units. The increase in fuel costs would be borne by ratepayers.[130] Mr. Drabinski notes that costs associated with staffing reductions m may not have been included, replacement costs have not been fully included and costs for dismantling the units have not yet been developed. KCC Staff performed an analysis and determined, that when all costs for retiring the units are considered, "the costs are almost ** __ ** times that of the GPE savings estimates."[131]

Mr. Drabinski concludes "there is a great deal of uncertainty, hesitation and disagreement as to exactly what will occur with the generation fleet post-merger. No analysis similar to an Integrated Resource Plan (IRP[)], has been performed, no system stability and transmission analysis has been performed, there has been no detailed analysis of stranded costs treatment, losses from energy and capacity sales, or impact to the economy of Kansas".[132] Mr. Drabinski suggests the KCC consider whether any projected savings attributed to retirements are actually merger-related.

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[128] *Id.*, at p. 38, line 7.

[129] *Id.*, at p. 40, lines 11-12.

[130] *Id.*, beginning at p. 40, line 13, through p. 41, line 4.

[131] *Id.*, at p. 45, line 2.

[132] *Id.*, beginning at p. 2, line 19, through p. 14, line 4.

Mr. Drabinski also completed an analysis of T&D integration noting the two companies have similar engineering standards from the standpoint of design, which will allow both companies to deploy material and methods and there should be no impediment to meeting reliability standards. He expresses concerns with staffing cuts, especially since Westar previously proposed a significant increase in capital expenditures (“CAPEX”) for T&D in order to improve reliability. He also raises concerns related to a reduction in the Westar vegetation management program since vegetation management issues continue to contribute to the number and duration of outages for Westar customers. Mr. Drabinski indicates the proposed reductions in vegetation management will likely lead to increased outages, and recommends the reduction in spending be eliminated from the merger savings estimates. Westar also has an Electric Distribution Grid Resiliency Program (“EDGR”).

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The KCC approved a one-year trial project. The report on results of the program has not yet been completed, yet there is no mention of EDGR in the merger application, but GPE testimony indicates a significant decrease in CAPEX spending by Westar, and Mr. Drabinski raises concerns as to how this corresponds to the Joint Applicants’ commitment to increase customer service and reliability. When reviewing the Joint Applicants proposed T&D post-merger spending, Mr. Drabinski raises concerns with the assumptions. He notes while the KCPL and Westar systems are similar in age, the make-up of the systems is different; thus, the more

[133] *Id.*, at p. 61, lines 15-19.

you need to spend to maintain a more complex system. He asserts that a more appropriate analysis would have been to look at individual line segments as wells as mean time to failure for key components, pole inspections and thermal imaging inspections. Mr. Drabinski recommends a system-wide assessment be performed to determine what expenditures are needed and where. He ultimately questions whether the KCC should give any weight to capital expenditure reductions since, "The capital expenditure budget of these utilities is entirely within the discretion of their management and the Boards of Directors …. Therefore, I believe the [KCC] should find that the capital expenditures related savings estimates are entirely too speculative and imprecise to be given any weight in evaluating whether a merger or acquisition is in the public interest."[134]

Mr. Drabinski provides a discussion of the Westar and KCPL reliability profiles, noting that SAIFI ("System Average Interruption Frequency Index") and SAIDI ("System Average Interruption Duration Index") for KCPL have been "significantly" better than for Westar, while CAIDI ("Customer Average Interruption Duration Index") is higher for KCPL due to the way it is calculated.[135] Mr. Drabinski recommends two additional performance measures: MAIFI ("Momentary Average Interruption Frequency Index") that represents the system-wide average number of momentary outages per year; and, CEMMI-10 ("Customers Experiencing Multiple Momentary Interruptions in excess of 10").[136]

<u>Staff Analysis</u>

In reviewing the highly confidential chart of planned retirements, Staff identified some changes in potential planned retirements, pre-merger and post-merger, related to Missouri

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[134] *Id.,* beginning at p. 86, line 12, through p. 87, line 7.

[135] *Id.,* at p. 71, lines 7-9.

[136] Mr. Drabinski proposes several merger conditions covering approximately 9 pages of testimony so they will not be repeated here, but can be found beginning at p. 88 of the public version of his Direct Testimony.

operations. Missouri has a robust IRP planning process. KCPL filed its last triennial compliance filing on April 1, 2015, in Case No. EO-2015-0254 and its last annual update on March 15, 2016, in Case No. EO-2016-0232. GMO filed its last triennial compliance filing on April 1, 2015, in Case No. EO-2015-0252 and its last annual update on March 15, 2016, in Case No. EO-2016-0233. Chapter 22 of the Commission's Rules requires the utility to file notice with the Commission of any significant changes to its IRP within 60 days of its determination that the utility's business plan or acquisition strategy has become materially inconsistent with the preferred resource plan, or its determination that that the preferred resource plan or acquisition strategy is no longer appropriate.[137]

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

<u>KCC Staff</u>

Dr. Glass discusses merger standards (f) and (g) together since, from an economic perspective, the concepts are mirrored. He reviews the standards relative to the closing of one of the Kansas plants identified for closing. Dr. Glass recommends that if the KCC approves the transaction, it require GPE to seek KCC approval prior to any plant closings.

Mr. Hempling states that Westar shareholders may hope to sell at a gain, but their hope is not supported by a government commitment, which only grants Westar the right to provide service in return for "just and reasonable" rates. Therefore, the government owes Westar nothing if its "hopes" turn to "disappointment." He describes this as "economic waste" – compensating shareholders for disappointment when they have already been compensated for their investment – a violation of merger standard (g).[138]

[137] Rule 4 CSR 240-22.080(12).

[138] Hempling, at p. 59, lines 13-21.

Staff Analysis

Staff has no opinion on whether the transaction will cause economic waste. KCPL/GMO are required to seek Commission approval prior to closing regulated electrical utility plant. The Commission has a robust IRP process, which allows the Commission, Staff, and interested stakeholders to monitor the utilities' long-term plans.

(h) What impact, if any, the transaction has on the public safety.

KCC Staff

Witness Gile identifies three metrics the KCC Staff believes should be included with reliability metrics: Call center answered call rate; response time to an outage; and Customer Information Statistics. Gile expresses concern that consolidation of the utilities will lead to personnel reductions and logistics problems as operating centers are combined, which could impact responsiveness of the remaining call centers or response times for service personnel to reach outage sites. As discussed under merger standard (a) (iii), if the transaction is approved, the KCC Staff recommends a penalty if performance declines. As such, Gile recommends the KCC require the post-merger company, KCC Staff and other interested parties file an agreement that provides expected details of compliance.

Mr. Drabinski discusses the information technology systems, and concludes they are made up of a "patchwork" of various mainframe and distributed technologies that, if integrated into a cohesive system will enable the merged company to "maximize the utilization of business, financial and operational data," but will require a "significant investment of time and resources."[139]

[139] Drabinski, at p. 75, lines 14-16.

Mr. Drabinski also states that an integrated CIS would potentially allow for economies of scale in call centers, but would require the development of consistent policies and procedures for customer interface. "In response to a data request the merger savings were based on the presumption that 'GPE is ** ________________________________ ** CIS platform, while Westar ** ___________________________________ **[140] Mr. Drabinski notes there is no real change in the current level of customer service related to customer offices and call center operations and indicates the level of customer service could be enhanced by the new CIS platform. He also notes the consolidation of the CIS platforms could provide enhanced services at a reduced cost. However, Mr. Drabinski states, "these minimal savings and service enhancements are not sufficient to justify [KCC] approval of the proposed transaction"[141] because the enhanced service will be realized whether the merger moves forward or not. Mr. Drabinski recommends the KCC Staff and the companies work together to develop a reporting format, including performance metrics.

Staff Analysis

There are a number of factors that place regulated utility service quality at risk during merger or sale cases. Transitions may place additional pressure on the utilities being combined due to the merging of different processes, practices, systems, procedures, cultures, organizational structures, and workforces. Transitions may require that previous focus be shared with determining how to combine two separate systems into one, often with additional pressures of expected efficiencies or synergies and cost savings. New or different ways of operating, while determined to be desirable, may disrupt or disturb stability, security of systems, operations or staffs. In addition, natural human resistance to change should not be discounted. Among the

[140] *Id.*, at p. 80, lines 2-4.

[141] *Id.*, at p. 79, lines 17-19.

greatest factors that place regulated utility service quality at risk during merger or sale cases are the financial constraint concerns and the desire or need to reduce costs. Mergers and sales can result in strong incentives to reduce costs in order to realize savings driven by the need to compensate for high acquisition premiums and the assumption of new debt to fulfill synergy commitments and expectations and others commitments. Such cost-cutting incentives may cause the deferral of system maintenance and facility upgrades and may also result in the termination of well-trained and experienced workforces whose development, training and expertise has been paid for by ratepayers.

Cost reductions may also result in the outsourcing of functions previously performed in-house that, if not managed and controlled effectively, can result in reductions in service. Cost-cutting can further result in the deferral of filling positions created by normal attrition. Ensuring that mergers are not detrimental to the public interest should include consideration and evaluation of such factors. Staff has considerable information about KCPL and GMO's service quality that it has obtained through a variety of means over many years. Staff has obtained service quality information concerning: formal case work including rate, merger, investigation, and complaint cases; comprehensive customer service reviews; service quality reporting of both companies which encompasses the companies' call center performance (including their use of call deferral technology), meter reading including estimated reads, reliability metrics including SAIDI, CAIDI, SAIFI and MAIFI; customer complaint and comment data as well as operational information obtained through regular quarterly service quality meetings with the companies.

The metric information the Staff currently receives from the companies has indicated performance that the Staff considers to be within an acceptable range for those specific service indicators. As part of its Merger Analysis, Staff sent data requests seeding information related to the above. GPE's responded: (1) . . . KCP&L has only performed the due diligence phase of the Westar transaction and as part of that due diligence phase has evaluated service related data (provided as part of our response to DR 21). Transition planning and next steps are yet to be developed. (2) However, based on the results of the Aquila integration, KCP&L believes that we have a credible track record and proof of our ability and willingness to effectively integrate companies without negatively impacting our quality of service. We will pursue a similar approach with the Westar integration and expect no significant negative customer impacts. While Staff understands that KCPL does not have all details of the merger completed, such unknown critical operational plans are cause for concern regarding Missouri regulated operations.

Relevant S&A Commitments

The S&A with Staff, in summary, provides:

- KCPL and GMO will meet or exceed the customer service and operational levels currently provided to their Missouri retail customers.
- As GPE undertakes the process of integrating Westar, KCPL and GMO, fundamental principles have been adopted to ensure the availability of adequate resources, including but not limited to personnel, equipment and systems, that will enable a smooth transition to ownership and operation of Westar by GPE.

The S&A outlines several monthly, quarterly, and periodic meetings or reporting/access to records for Staff, OPC and the Commission, both before and after the transaction closes, to address such things as call center performance, performance metrics, staffing changes.

IV. Summary of Joint Applicant Rebuttal Testimony

On January 17, 2017, Staff received copies of Joint Applicants' rebuttal testimony, which responds to KCC Staff issues discussed above. GPE/KCPL witness Darrin R. Ives provides an overview of Joint Applicants' position in rebuttal testimony, so Mr. Ives' testimony is summarized here. In his rebuttal testimony, Mr. Ives responds to what he characterizes as primary, yet valid, criticisms of the transaction; summarizes GPE's compliance with the KCC merger standards; and, presents a set of merger conditions (*see Exhibit A*) that "collectively ensure that the Transaction will benefit customers and protect them from potential harm due to the financing structure or relationship of Westar and KCPL with GPE or its affiliates."[142]

Mr. Ives identifies three major concerns raised by KCC Staff and intervenors to the KCC proceeding: (1) the method of financing will harm customers and limit the KCC's ability to ensure just and reasonable rates; (2) GPE has agreed to pay a purchase price that is too high; and, (3) GPE is attempting to collect a portion of the acquisition premium through rates. In response to concern 1, GPE has proposed 43 conditions to address "ring-fencing" of customers, including general conditions, financing, ratemaking, accounting, affiliate transactions and CAM, quality of service, and parent company conditions. In response to the other concerns, GPE provides rebuttal testimony addressing the issues and explaining how some of the proposals are not relevant or are contrary to positions in other proceedings. Mr. Ives states that proposals presented by Mr. Hempling are "unprecedented, impractical, and/or would completely destroy the value of the Transaction"[143] since they are largely designed to terminate the transaction. Mr. Ives cites the following benefits of the transaction:

[142] Rebuttal Testimony of Darrin R. Ives on behalf of GPE and KCPL at p. 1, lines 19-21.

[143] *Id.*, at p. 8, lines 17 and 18.

- Reduction in future rate increases as a result of flowing through 100 percent of merger savings to customers through the normal rate making process;
- An electric company that continues to be a local, regional entity with ties to the communities and a major vested interest in the economic well-being of Kansas;
- A company with a continued physical presence in Topeka and Wichita;
- Little to no involuntary lay-off of employees;
- Continued level of good quality of service to all customers;
- Reduction in economic waste;
- A positive impact on the environment through an electric provider that has been and will continue to be actively involved in renewable generation and demand-side management("DSM")/energy efficiency ("EE") programs;
- No impact on the credit ratings of the utility companies; and a parent company that will maintain its investment grade credit rating.[144]

Merger Standard (a)

Merger standard (a) addresses, generally, the effect of the transaction on the consumer. Mr. Ives summarizes that GPE uses a low-cost financing mix to maintain the credit quality of all of its utility operating companies and to maintain investment grade ratings at GPE, and does not request to include the acquisition premium or related financing costs in rates. According to Joint Applicant witnesses, debt financing "enables" the transaction, and ultimately the benefits to customers. Mr. Ives notes that components of the financing plan have already been completed, and "[i]t is apparent that sophisticated investors…do not share the concerns expressed by certain parties."[145] Joint Applicant outside expert witnesses explain that debt financing is typical for a transaction of this nature, and that issuance of debt by the parent is to the benefit of consumers since risk is borne by the shareholders. They also dispute a KCC Staff statement about capital structure, noting that commissions have a long-standing practice of establishing rates based on the utility operating company structure as opposed to a consolidated capital structure.

[144] *Id.*, at p. 10, lines 3-15.

[145] *Id.*, at p. 16, lines 12-13.

In response to KCC Staff statements that the purchase price is not fair, Joint Applicant witnesses discuss recent KCC merger precedent, stating that it demonstrates the KCC has not historically ruled on the reasonableness of the purchase price of a transaction, but only addressed issues related to the acquisition premium as it relates to utility requests to recover the premium in rates. Since GPE is not requesting recovery in rates, Mr. Ives states that this issue is not relevant to the case. Joint Applicant witnesses also present rebuttal testimony that "point[s] out certain flaws in Mr. Grady's analyses, demonstrating that the analyses performed by the Joint Applicants and their experts show that the purchase price is reasonable,"[146] while also discussing the reasonableness of the purchase price and the competitive auction and the many financial analyses evaluated by GPE and its financial advisor to determine the appropriate purchase price.

In response to KCC Staff concerns with the quantification of benefits from the transaction, Joint Applicant witnesses provide rebuttal testimony to demonstrate that the quantification of benefits from the transaction was conducted properly and "the level of confidence of GPE's management around the sufficiency of savings has grown[] due to the more detailed integration planning work performed…since June 2016."[147] Joint Applicant witnesses explain that the achievability of savings has been confirmed and plans are being readied for execution.[148]

<u>Merger Standard (b)</u>

Merger standard (b) concerns the effect of the transaction on the environment. Mr. Ives discusses that KCPL has been a leader in efforts to promote energy efficiency and renewable resources.

[146] *Id.*, at p. 20, lines 18-20.

[147] *Id.*, at p. 22, lines 9-11.

[148] *Id.*, at lines 12-13.

Merger Standard (c)

Merger standard (c) is the standard related to the effect on state and local economies and to communities in the area served by the merged utility. Mr. Ives notes that Joint Applicant witnesses respond to these concerns by describing the significance of various commitments in this area. Mr. Ives references Mr. Bassham's testimony on this issue, which "explains that 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."[149]

Merger Standard (d)

Merger standard (d) relates to whether the transaction will preserve the jurisdiction of the KCC. Mr. Ives states that it is "uncontroverted" that as a subsidiary of GPE, Westar's utility operations will be regulated by the KCC and will continue to operate as a jurisdictional public utility in Kansas under its current Certificate of Public Convenience and Necessity and Kansas law. He continues by explaining that after the transaction, Westar's service area will not change, assets utilized for the provision of regulated electric utility service will continue to be owned by Wester, and services will continue to be provided by Westar under its existing rates, rules, regulations and tariffs.[150]

Mr. Ives states that concerns of KCC Staff witness related to elevated leverage at GPE, which will limit the KCC's authority, are speculative since the risk is on shareholders, not ratepayers and multiple witnesses have demonstrated the financing is reasonable. As indicated above, Mr. Ives states that Joint Applicant witnesses explain that it is not a precedent of the KCC to use a consolidated capital structure when setting rates and that the KCC is not "obligated to bail out the financial condition of the parent company or the utility," explaining that the KCC has

[149] *Id.*, at p. 29, lines 13-16.

[150] *Id.*, at p. 30, lines 14-22.

"tools" to address concerns without shifting any consequences of a weakened utility to customers.[151] Mr. Ives states that GPE has proposed ring-fencing commitments to insulate customers from any potential negative impact from the transaction caused by higher leverage at the parent company level. In response to Mr. Hempling's discussion of "benchmark competition," Mr. Ives states the KCC has the ability to use industry benchmarking studies to evaluate the utilities.

Merger Standard (e)

Merger standard (e) relates to the effect of the transaction on shareholders. Mr. Ives notes that many of the issues raised under merger standard (e) are actually related to other merger standards, which have already been addressed. Joint Applicant witnesses "emphasize" that GPE and Westar shareholders are sophisticated and have relied on sound analyses and recommendations when unanimously approving the transaction.

Merger Standard (f)

Merger standard (f) is an analysis as to whether the transaction maximizes Kansas energy resources. Mr. Ives explains the KCPL IRP process, noting plant retirements and associated costs are part of that process. If the transaction is approved, the IRP process will be expanded to include Westar, and no plants will be retired without fully vetting them through the IRP process. Under the IRP process, if a plant retirement is deemed necessary, the IRP process, according to Mr. Ives, would reflect the most efficient use of resources.

[151] *Id.*, at p. 31, lines 4-16.

Merger Standard (g)

Merger standard (g) discusses economic waste. Mr. Ives discusses how Joint Applicant rebuttal testimony demonstrates the transaction will increase productivity, thereby reducing economic waste. He cites Joint Applicant witness Hall's rebuttal testimony, which states, "lower electricity rates help all impacted Kansas businesses increase their productivity and help all Kansas households have greater purchasing power for items other than electricity."[152]

Merger Standard (h)

Merger standard (h) addresses impacts of the transaction on public safety. Mr. Ives states that Joint Applicants respond to testimony related to concerns with Westar's vegetation management program, commenting that cost reductions in that area are not related to safety but to efficiencies in how the vegetation management program is staffed, managed and executed. He notes that the intended efficiencies will not result in fewer trees being trimmed or increased outages or hazards.

In response to KCC Staff comments related to staffing and call center concerns, Joint Applicants explain that both call centers will continue to operate with the same emphasis on customers and will continue to be staffed 7x24x365 for emergency calls.

Finally, in response to KCC Staff discussions related to quality of service metrics and recommendations that penalties be imposed for not meeting standards, Mr. Ives states that "quality of service metrics are not specifically provided for under the Merger Standards. While this is a fundamental priority of the Joint Applicants and will continue to be so post-Transaction, there is no basis or support for the positions taken by Mr. Gile [and intervenors] in this regard." Mr. Ives comments that KCC Staff's recommended service quality standards are "unprecedented

[152] *Id.*, at p. 37, lines 7-9.

and unwarranted" and are inconsistent with KCC Staff recommendations previously approved by the KCC. "The result of Staff's recommended service quality standards is to unreasonably increase the probably that significant penalties will be incurred" and the penalties are designed to continue indefinitely as opposed to terminating after a showing of no service decline…. While [GPE] can appreciate the need to assure that the Transaction does not reduce service quality, perpetuating a more expensive and burdensome level of regulation indefinitely is not conducive to efficient regulation for the long term and cannot be considered to be in the public interest."[153]

Mr. Ives concludes by stating that Joint Applicants' responses to concerns raised by other parties and the addition of new merger commitments the Joint Applicants put forward, "the positive impact this Transaction will have on the public interest is abundantly clear" and he urges the KCC to approve the request. He continues, "This Transaction meets all industry standards for being consistent with the public interest, and is fully consistent with the KCC's merger approval guidelines."[154]

V. Any Conclusions/Recommendations/Additional Comments

Staff continues to recommend the Commission approve the Stipulations and Agreements that have been submitted between GPE/KCPL/GMO and Staff and GPE/KCPL/GMO and OPC as those S&As incorporate commitments the Missouri utilities have agreed upon relative to the proposed acquisition and those commitments are designed to protect the interests of Missouri ratepayers and the State.

[153] *Id.*, at p. 39 lines 5-23.

[154] *Id.*, at p. 40, lines 3-9.

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New**[1]	**Responsiveness to Staff/ Intervenor Testimony**[2]
Applicability of Commitments and Conditions			
These conditions[3] are presented as a package. Changes to any individual condition may require changes to other conditions. The conditions will remain in force and effect for the time period specified in the condition or if no time period is specified in perpetuity and in all cases unless otherwise approved by the KCC.			
General Conditions			
1	GPE intends to maintain its corporate headquarters in Kansas City, Missouri and GPE shall honor all terms and conditions of the existing lease for its headquarters office located at 1200 Main in Kansas City, Missouri, which expires in October 2032. GPE has also committed in the Merger Agreement to maintain the current Westar Topeka downtown headquarters building at 818 South Kansas Avenue in Topeka, Kansas for GPE's Kansas headquarters. GPE shall honor all terms and conditions of the existing lease for the Westar headquarters building, which expires in April 2023.	Expanded	Responsive to testimony of Staff and other intervenors regarding impacts on Kansas, local communities, and local economies, as well as workforce reductions.

[1] This column identifies whether the proferred condition is: **existing –** i.e., was proferred by the Joint Applicants initially in the Joint Application, Exhibit B, and the Direct Testimony of Darrin Ives, pp. 12-13; **expanded –** i.e., a condition initially proferred by the Joint Applicants has been expanded in response to Staff or intervenor concerns; or **new –** i.e., is being proferred by the Joint Applicants for the first time in response to Staff or intervenor concerns.

[2] This column identifies ways in which the proferred conditions are responsive Staff and intevernor testimonies. This column is meant to be illustrative and not exhaustive. "Responsive" means the condition is intended to respond to the identified topic/category. For cases where the Joint Applicants' condition reflects a specific condition proposed by an intervenor, greater detail is provided. "No change" indicates that the condition has not been materially revised from what the Joint Applicants initially proferred, recognizing that the initial conditions reflect the Joint Applicants' effort to proactively address expected concerns.

[3] Though the terms "condition" and "commitment" may have slightly different meanings, for the sake of simplicity, this exhibit generally uses the term "condition" to refer to Joint Applicants' proferred conditions and commitments.

Exhibit A

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
2	Upon completion of the Transaction, GPE will add one current Westar board member to the board of directors of GPE.	New	Responsive to tesimony of Staff and intervenors regarding GPE's Board of Directors.
3	GPE has committed to continue charitable giving and community involvement in the Westar service territory at levels equal to or greater than Westar's 2015 levels for a minimum of five (5) years following Transaction close.	Expanded	Responsive to testimony of Staff and other intervenors regarding impacts on Kansas, local communities, and local economies.
4	Honor all existing collective bargaining agreements.	Existing	No change
5	Maintain existing compensation levels and benefits of Westar employees for two years after the closing of the Transaction.	Existing	No change
6	While 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 expects to achieve such Transaction-related efficiencies in a generally balanced way across both states. Additionally, GPE shall not effect 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.	Expanded	Responsive to testimony of Staff and other intervenors regarding impacts on Kansas, local communities, and local economies, as well as workforce reductions.
7	Make best efforts to achieve desired staffing reductions through natural attrition.	Existing	No change
8	Consider targeted voluntary staffing reduction programs if natural attrition is not sufficient. Where severance is unavoidable, honor, and in some cases enhance, Westar's employee severance package.	Existing	No change
9	Maintain and promote all low-income assistance programs consistent with those in place at all operating utility companies prior to the	Existing	No change

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New**[1]	**Responsiveness to Staff/ Intervenor Testimony**[2]
	Transaction		
	Financing and Ring-Fencing Conditions		
10	***Separate capital structures***: GPE, KCP&L and Westar shall maintain separate capital structures to finance the activities and operations of each entity unless otherwise authorized by the Commission. Unless the Commission authorizes otherwise, GPE, KCP&L and Westar shall maintain separate Corporate Credit Ratings, and separate debt so that neither GPE, KCP&L nor Westar will be responsible for the debts of each other or their other affiliated companies. GPE, KCP&L and Westar shall also maintain adequate capacity under revolving credit facilities and commercial paper, if any, which capacity may be administered on a combined basis provided that pricing is separated by entity and there are neither cross-default provisions nor provisions under which KCP&L or Westar guarantee the debt obligations of any GPE affiliate. GPE, KCP&L and Westar shall also maintain separate preferred stock, if any. KCP&L and Westar plan to use reasonable and prudent investment grade capital structures. KCP&L and Westar will be provided with appropriate amounts of equity from GPE to maintain such capital structures. GPE shall maintain consolidated debt of no more than 70 percent of total consolidated capitalization. KCP&L's debt shall be maintained at no more than 65 percent. GPE commits that Westar's debt shall also be maintained at no more than 65 percent. GPE commits that Westar and KCP&L will not make any dividend payments to the parent company to	Expanded	This reflects KEPCo witness Dismukes' proposed commitments 1 and 1a.[4] This also reflects Mr. Dismukes proposed commitment 9, with one modification being that that the Joint Applicants specify debt level at no more than 65 percent for dividend payments to the parent company, rather than Mr. Dismukes' proposal of at least 40 percent equity level. This also reflects BPU witness Lesser's suggested "restrictions" (ii) and (iii)[5] and KIC witness Gorman's recommended condition related to capital structures, though Mr. Gorman recommends an equity ratio of 50 percent.[6]

[4] Dismukes Direct Testimony, Exhibit DED-2. All references to Mr. Dismukes apply to this same exhibit.
[5] Lesser Direct Testimony, p. 114.
[6] Gorman Direct Testimony, p. 23.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	the extent that the payment would result in an increase in either utility's debt level above 65 percent of its total capitalization, unless the Commission authorizes otherwise.		
11	***Separation of assets***: GPE commits that KCP&L and Westar will not comingle their assets with the assets of any other person or entity, except as allowed under the Commission's Affiliate Transaction statutes or other Commission order. GPE commits that KCP&L and Westar will conduct business as separate legal entities and shall hold all of their assets in their own legal entity name unless otherwise authorized by Commission order. GPE, KCP&L and Westar affirm that the present legal entity structure that separates their regulated business operations from their unregulated business operations shall be maintained unless express Commission approval is sought to alter any such structure. GPE, KCP&L and Westar further commit that proper accounting procedures will be employed to protect against cross-subsidization of GPE's, KCP&L's and Westar's non-regulated businesses, or GPE's other regulated businesses in Kansas or its regulated businesses in other jurisdictions by Westar's Kansas customers.	Expanded	This reflects Mr. Dismukes' proposed commitments 1a, 2, and 7. This also reflects Mr. Gorman's recommended "ring fencing structure" 3.[7]
12	***Other Separation:*** Neither KCP&L nor Westar shall guarantee the debt of the other, or of GPE, or of any of GPE's other affiliates, or otherwise enter into make-well or similar agreements, unless otherwise authorized by the Commission. Neither KCP&L nor Westar shall pledge their respective stock or assets as collateral for obligations of any other entity,	Expanded	This reflects Mr. Dismukes' proposed commitments 3, 3a, 3b, and 4. This also reflects Mr. Gorman's recommended "ring fencing structure" 3.[8]

[7] Gorman Direct Testimony, p. 25.
[8] Gorman Direct Testimony, p. 25.

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New**[1]	**Responsiveness to Staff/ Intervenor Testimony**[2]
	unless otherwise authorized by the Commission. Neither KCP&L nor Westar will include, in any debt or credit instrument of Westar and KCP&L, any financial covenants or default triggers related to GPE or any of its affiliates.		
13	***Use of utility-specific capital structure:*** KCP&L and Westar intend to utilize their respective utility-specific capital structure in general rate case filings subsequent to the close of the Transaction. In such filings, KCP&L or Westar (as applicable) shall provide (a) evidence demonstrating that the Transaction has not resulted in a downgrade to that utility's Corporate Credit Rating that exists at the time the general rate case is filed compared to the Corporate Credit Rating of that utility that existed as of May 27, 2016, or (b) if such a Corporate Credit Rating downgrade resulting from the Transaction exists at the time the general rate case is filed, evidence demonstrating that Kansas customers are held harmless from any cost increases resulting from such a downgrade, and (c) evidence supporting the reasonableness of using the utility-specific capital structure of KCP&L or Westar in determining a fair and reasonable rate of return for the applicable utility.	Expanded	This reflects Mr. Dismukes' proposed commitments 1b and 6. This also reflect Mr. Gorman's recommended condition 3. related to credit rating.[9]
14	Credit rating downgrade: In the event KCP&L or Westar should have its respective Standard & Poor's ("S&P") or Moody's Corporate Credit Rating downgraded to below BBB- or Baa3, respectively, as a result of the Transaction, KCP&L and/or Westar (the "Impacted Utility") commits to file: i. Notice with the Commission within five (5) business days of such downgrade;	Expanded	This reflects and adds to Mr. Dismukes' proposed commitment 1c.

[9] Gorman Direct Testimony, p. 21.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	ii. A pleading with the Commission within sixty (60) days which shall include the following: • Actions the Impacted Utility may take to raise its S&P or Moody's Corporate Credit Rating to BBB- or Baa3, respectively, including the costs and benefits of such actions and any plan the Impacted Utility may have to undertake such actions. If the costs of returning Westar and/or KCP&L to investment grade are above the benefits of such actions, Westar and/or KCP&L shall be required to show and explain why it is not necessary, or cost-effective, to take such actions and how the utility(s) can continue to provide efficient and sufficient service in Kansas under such circumstances; • The change, if any, on the capital costs of the Impacted Utility due to its S&P or Moody's Corporate Credit Rating being below BBB- or Baa3, respectively; and • Documentation detailing how the Impacted Utility will not request from its Kansas customers, directly or indirectly, any higher capital costs incurred due to a downgrade of its S&P or Moody's Corporate Credit Rating below BBB- or Baa3, respectively; iii. File with the Commission, every forty-five (45) days thereafter until the Impacted Utility has regained its S&P or Moody's Corporate Credit Rating of BBB- or Baa3, respectively or above, an updated status report with respect to the items required in paragraph 4(c)(ii) above. iv. If the Commission determines that the decline of the Impacted Utility's S&P or Moody's Corporate Credit Rating to a level below BBB- or Baa3, respectively, has caused its quality of service to decline, then the Impacted Utility shall be required to file a plan with the Commission detailing the steps that will be taken to restore service		

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	quality levels that existed prior to the ratings decline. v. In the event KCP&L's or Westar's affiliation with GPE or any of GPE's affiliates is the reason for KCP&L's or Westar's respective S&P or Moody's Corporate Credit Rating to be downgraded to below BBB- or Baa3, respectively, KCP&L and/or Westar shall pursue additional legal and structural separation, if necessary, from the affiliate(s) causing the downgrade, and the Impacted Utility shall not pay a common dividend without Commission approval or until the Impacted Utility's S&P or Moody's Corporate Credit Rating has been restored to BBB- or Baa3, respectively, or above. vi. If KCP&L's or Westar's respective S&P or Moody's Corporate Credit Rating declines below BBB- or Baa3, respectively, as a result of the Transaction, the Impacted Utility shall file with the Commission a comprehensive risk management plan that assures the Impacted Utility's access to and cost of capital will not be further impaired. The plan shall include a non-consolidation opinion if required by S&P or Moody's.		
15	***<u>Cost of capital</u>:*** Neither KCP&L nor Westar shall seek an increase to their cost of capital as a result of the Transaction or KCP&L's and Westar's ongoing affiliation with GPE and its affiliates after the Transaction. Any net increase in the cost of capital that KCP&L or Westar seek shall be supported by documentation that: (a) the increases are a result of factors not associated with the Transaction or the post-Transaction operations of GPE or its non-KCP&L and non-Westar affiliates; (b) the increases are not a result of changes in business, market, economic or other conditions caused by the Transaction or the post-Transaction operations of GPE or its non-KCP&L and non-Westar affiliates; and (c) the increases are not a result of changes in the risk profile of KCP&L or Westar caused by the Transaction or the post-	Expanded	This reflects Mr. Dismukes' proposed commitment 6.

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New**[1]	**Responsiveness to Staff/ Intervenor Testimony**[2]
	Transaction operations of GPE or its non-KCP&L and non-Westar affiliates. The provisions of this section are intended to recognize the Commission's authority to consider, in appropriate proceedings, whether this Transaction or the post-Transaction operations of GPE or its non-KCP&L and non-Westar affiliates have resulted in capital cost increases for KCP&L or Westar. Nothing in this condition shall restrict the Commission from disallowing such capital cost increases from recovery in KCP&L or Westar's rates.		
16	***Goodwill:*** The goodwill arising from the Transaction will be maintained on the books of GPE and is therefore not expected to negatively affect KCP&L's or Westar's cost of capital; however, if such goodwill becomes impaired other than as a result of a Commission order and such impairment negatively affects KCP&L's or Westar's cost of capital, all net costs associated with the decline in the Impacted Utility's credit quality specifically attributed to the goodwill impairment, considering all other capital cost effects of the Transaction and the impairment, shall be excluded from the determination of the Impacted Utility's rates. For the first five (5) years after closing of the Transaction, GPE shall provide Staff and CURB its annual goodwill impairment analysis in a format that includes spreadsheets in their original format with formulas and links to other spreadsheets intact and any printed materials within thirty (30) days after the filing of GPE's Form 10 Q for the period in which the analysis is performed, as well as all supporting documentation. Thereafter, this analysis will be made available to Staff and CURB upon request.	Expanded	This provides greater detail regarding the Joint Applicants' commitment not to seek recovery of goodwill, i.e., the acquisition premium, in rates, which is also proposed in Mr. Dismukes' proposed commitment 11.
	Ratemaking, Accouting, and Related Conditions		
17	Each utility will file a general rate case in Kansas no later than January 1, 2019.	New	This responds to testimony regarding the timing of rate cases.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
18	For ratemaking purposes, Westar and KCP&L agree to the use of an actual utility-specific capital structure with an equity share of no less than 45 percent and no more than 53 percent; provided, however, that Westar and KCP&L may petition the Commission for relief from this condition for reasons not related to the Transaction and the Commission may grant such relief, to the extent it chooses to do so, based on a finding of good cause.	New	This commitment builds upon Mr. Dismukes' proposed commitment 10, except that Mr. Dismukes proposes an equity share of no less than 40 percent (rather than 45 percent, as the Joint Applicants propose).
19	Transition costs are those costs incurred to integrate Westar under the ownership of GPE and include integration planning and execution, and "costs to achieve." Transition costs include capital and non-capital costs. Non-capital transition costs can be ongoing costs or one-time costs. KCP&L's and Westar's non-capital transition costs, which shall include but not be limited to severance payments made to employees other than those required to be made under change of control agreements, can be deferred on the books of either KCP&L or Westar to be considered for recovery in KCP&L and Westar future rate cases. If subsequent rate recovery is sought, KCP&L and Westar will have the burden of proof to clearly identify where all transaction costs are recorded and of proving that the recoveries of any transition costs are just and reasonable as their incurrence facilitated the ability to provide benefits to its Kansas customers. Such benefits may be the result of avoiding or shifting costs and activities.	Expanded	This provides greater detail regarding the treatment of transition costs, which is addressed in Mr. Dismukes' proposed commitments 14, 14a, 14b. This also reflects Mr. Gorman's recommended condition 4. related to transition costs.[10]
20	Goodwill associated with the premium over book value of the assets paid for the shares of Westar stock (referred to herein as "Acquisition Premium") will be maintained on the books of GPE. The amount of any	Expanded	This provides greater detail regarding the Joint Applicants' commitment not to seek recovery of goodwill, i.e., the acquisition premium, in rates, as

[10] Gorman Direct Testimony, p. 21.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	Acquisition Premium paid for Westar shall not be included in the revenue requirement of KCP&L or Westar in future Kansas rate cases, unless otherwise ordered by the Commission. Neither KCP&L nor Westar will seek direct or indirect recovery or recognition in retail rates of any Acquisition Premium through revenue requirement in future rate cases; provided, however, that if any party to any KCP&L or Westar general rate case proposes to impute the cost or proportion of the debt GPE is using to finance the Transaction to either KCP&L or Westar for purposes of determining a fair and reasonable return for either utility, then KCP&L and Westar reserve the right to seek, in any such rate case, recovery and recognition in retail rates of the Acquisition Premium.		is proposed in Mr. Dismukes' proposed commitement 11.
21	Transaction costs include, but are not limited to, those costs relating to obtaining regulatory approvals, development of transaction documents, investment banking costs, costs related to raising equity incurred prior to the close of the Transaction, severance payments required to be made by change of control agreements, and communication costs regarding the ownership change with customers and employees. Transaction costs shall be recorded on GPE's books. Neither KCP&L nor Westar will seek either direct or indirect recovery or recognition in retail rates of any Transaction costs through its revenue requirement in future rate cases; provided, however, that if any party to any KCP&L or Westar general rate case proposes to impute the cost or proportion of the debt GPE is using to finance the Transaction to either KCP&L or Westar for purposes of determining a fair and reasonable return for either utility, then KCP&L and Westar reserve the right to seek, in any such rate case, recovery and recognition in retail rates of transaction costs.	Expanded	This provides greater detail regarding the treatment of transaction costs, which is addressed in Mr. Dismukes' proposed commitments 11, 11a, and 11b.

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New[1]**	**Responsiveness to Staff/ Intervenor Testimony[2]**
22	KCP&L's and Westar's fuel and purchased power costs shall not be adversely impacted as a result of the Transaction.	New	This is responsive to testimony of Staff and other intervenors regarding customer rate impacts.
23	GPE commits that retail rates for KCP&L and Westar customers shall not increase as a result of the Transaction.	New	This is responsive to testimony of Staff and other intervenors regarding customer rate impacts.
24	The return on equity capital ("ROE") as reflected in Westar's and KCP&L's rates will not be adversely affected as a result of the Transaction. GPE agrees the ROE shall be determined in future rate cases, consistent with applicable law, regulations and practices of the Commission.	New	This is responsive to testimony of Staff and other intervenors regarding customer rate impacts.
25	Provided the actual utility-specific capital structure is used to set rates for KCP&L and Westar, GPE, KCP&L and Westar commit to uphold the principle that their future costs of service and rates will be set commensurate with the financial and business risks attendant to each affiliate's regulated utility operations and that they will not oppose, in either a regulatory proceeding or by judicial appeal of a Commission decision, the application of this principle.	Expanded	This reflects Mr. Dismukes' proposed commitment 13.
26	GPE commits that in future rate case proceedings, KCP&L and Westar will support their assurances provided in this document with appropriate analysis, testimony, and necessary journal entries fully clarifying and explaining how any such determinations were made.	New	This formalizes GPE's intention with regard to demonstrating compliance with these commitments.
	Affiliate Transactions and Cost Allocations Manual (CAM) Conditions		
27	KCP&L and Westar commit that they will file with the Commission within sixty (60) days of closing of the Transaction an executed copy of all additional relevant Affiliate Service Agreements related to the Transaction, pursuant to K.S.A. 66-1402.	New	This addresses testimony of Staff and others regarding affiliates and enabling effective regulation by the KCC.

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New**[1]	**Responsiveness to Staff/ Intervenor Testimony**[2]
28	GPE, KCP&L and Westar each expressly recognize that each represents an "Affiliated Interest" under K.S.A. 66-1401, 66-1402, and 66-1403. These statutes confer certain jurisdiction on the Commission regarding access to books and records, submission of contracts, review of affiliate transactions detail, etc.	New	This addresses testimony of Staff and others regarding affiliates and enabling effective regulation by the KCC.
29	KCP&L and Westar will be operated after close of the Transaction in compliance with the Commission's affiliate transaction rules as set forth in K.S.A. 66-1401, *et seq.*, and in compliance with the affiliate rules adopted in the Commission's December 3, 2010 Order in Docket No. 06-GIMX-181-GIV ("06-181 Order"), or will obtain any necessary variances from such rules, and the Commission's August 7, 2001 Order in Docket No. 01-KCPE-708-MIS ("01-708 Order").	New	This addresses testimony of Staff and others regarding affiliates and enabling effective regulation by the KCC.
30	GPE and its subsidiaries commit that all information related to an affiliate transaction consistent with the affiliate statutes and the Commission's 06-181 and 01-708 Orders in the possession of GPE will be treated in the same manner as if that information is under the control of either KCP&L or Westar.	New	This addresses testimony of Staff and others regarding affiliates and enabling effective regulation by the KCC.
31	GPE and its subsidiaries shall seek recovery of intercompany charges to their regulated utility affiliates in their first base rate proceedings following the closing of the Transaction at levels equal to the lesser of actual costs or the costs allowed related to such functions in the cost of service of their most recent rate case prior to the closing of the Transaction, as adjusted for inflation measured by the Gross Domestic Product Price Index. Billings for common-use assets shall be permitted consistent with GPE's current practices.	New	This reflects Mr. Dismukes' proposed commitment 15.
32	Joint Applicants shall maintain separate books and records, system of accounts, financial statements and bank accounts for Westar and KCP&L. The records and books of Westar and KCP&L will be maintained under	Expanded	This reflects Mr. Dismukes' proposed commitements 16, 16a, 16b.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	the FERC Uniform System of Accounts ("USOA") applicable to investor-owned jurisdictional electric utilities, as adopted by the Commission.		
33	The Transaction is the subject of a variance request currently before the Missouri Public Service Commission ("MPSC") and an order is expected from the MPSC no later than April 24, 2017. GPE and KCP&L commit to pursue this variance from the provisions of Missouri Affiliate Transaction Rule 4 CSR 240-20.015 and endeavor to have such variance in place by Transaction close. The variance will provide for goods and services transactions between KCP&L, GMO and Westar to occur at cost except for wholesale power transactions, which will be based on rates approved by the Federal Energy Regulatory Commission ("FERC"). Within thirty (30) days of the issuance of a final MPSC order in that proceeding (Case No. EM-2016-0324), KCP&L and Westar will cause to be filed in this docket a copy of the final order.	New	This addresses testimony of Staff and others regarding affiliates and enabling effective regulation by the KCC.
34	KCP&L and Westar agree to meet with Staff and CURB no later than sixty (60) days after the closing of the Transaction to provide a description of its expected impact on the allocation of costs among GPE's utility and non-utility subsidiaries as well as a description of its expected impact on the cost allocation manuals ("CAMs") of KCP&L and Westar. No later than six (6) months after the closing of the Transaction but no less than two (2) months before the filing of a general rate case for either KCP&L or Westar, whichever occurs first, KCP&L and Westar agree to file updates to their existing CAMs reflecting process and recordkeeping changes necessitated by the Transaction.	Expanded	This reflects and expands upon Mr. Dismukes' proposed commitement 16g.
35	GPE, KCP&L and Westar will maintain adequate records to support, demonstrate the reasonableness of, and enable the audit and examination of all centralized corporate costs that are allocated to or directly charged to KCP&L or Westar. Nothing in this condition shall be deemed a	New	This addresses testimony of Staff and others regarding enabling effective regulation by the KCC.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	waiver of any rights of GPE, KCP&L or Westar to seek protection of the information or to object, for purposes of submitting such information as evidence in any evidentiary proceeding, to the relevancy or use of such information by any party.		
	Quality of Service Conditions		
36	Commencing with the beginning of the first full calendar year after closing, KCP&L and Westar will provide electric service reliability and call center service that meets or is better than the performance metric thresholds set forth in the schedules KTN-1, KTN-2, KTN-3.[11] If KCP&L or Westar fail to meet a particular performance metric threshold, then penalties will apply in accordance with the these schedules and provisions.[12] KCP&L and Westar will report quarterly on its performance relative to these service metrics beginning with the first full calendar quarter following Transaction close. If KCP&L or Westar perform without penalties on any metric for three consecutive years, then the reporting and penalty provisions for that metric for that utility will terminate.	Expanded	This reflects several elements of recommendations put forth by Staff witness Gile[13] and CURB witness Harden[14], with some modifications.
	Access to Records		
37	KCP&L and Westar shall provide Staff and CURB with access, upon reasonable written notice during working hours and subject to appropriate confidentiality and discovery procedures, to all written information provided to common stock, bond or bond rating analysts which directly or	New	This addresses testimony of Staff and others regarding enabling effective regulation by the KCC.

[11] Noblet Rebuttal Testimony, Schedules KTN-1, KTN-2, KTN-3.
[12] *Ibid.*
[13] Gile Direct, pp. 10-16.
[14] Harden Direct, pp. 9-10.

No.	Joint Applicants' Proferred Merger Commitments and Conditions	Existing, Expanded or New[1]	Responsiveness to Staff/ Intervenor Testimony[2]
	indirectly pertains to KCP&L or Westar or any affiliate that exercises influence or control over KCP&L, Westar or GPE. Such information includes, but is not limited to, common stock analyst and bond rating analyst reports. For purposes of this condition, "written" information includes, but is not limited to, any written and printed material, audio and video tapes, computer disks, and electronically stored information. Nothing in this condition shall be deemed a waiver of any entity's right to seek protection of the information or to object, for purposes of submitting such information as evidence in any evidentiary proceeding, to the relevancy or use of such information by any party.		
38	GPE, KCP&L and Westar shall make available to Staff and CURB, upon written notice during normal working hours and subject to appropriate confidentiality and discovery procedures, all books, records and employees as may be reasonably required to verify compliance with KCP&L and Westar's CAM and any conditions ordered by this Commission. GPE, KCP&L and Westar shall also provide Staff and CURB any other such information (including access to employees) relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over KCP&L or Westar; provided that any entity producing records or personnel shall have the right to object on any basis under applicable law and Commission rules, excluding any objection that such records and personnel of affiliates; (a) are not within the possession or control of either KCP&L or Westar or (b) are either not relevant or are not subject to, the Commission's jurisdiction and statutory authority by virtue of, or as a result of, the implementation of the proposed Transaction.	New	This reflects Mr. Dismukes' proposed commitement 16c.

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New[1]**	**Responsiveness to Staff/ Intervenor Testimony[2]**
39	KCP&L and Westar shall provide Staff and CURB access, upon reasonable request, the complete GPE Board of Directors' meeting minutes, including all agendas and related information distributed in advance of the meeting, presentations and handouts, provided that privileged information shall continue to be subject to protection from disclosure and KCP&L and Westar shall continue to have the right to object to the provision of such information on relevancy grounds.	New	This addresses testimony of Staff and others regarding enabling effective regulation by the KCC.
40	KCP&L and Westar will maintain records supporting its affiliated transactions for at least five (5) years. Within six months of the close of the merger, Joint Applicants will provide to the Commission Staff detailed journal entries recorded to reflect the transaction and the provisions of this Agreement. The Joint Applicants shall also provide the final detailed journal entries to be filed with the Commission no later than 13 months after the date of the closing. These entries must show, and shall include but not be limited to, the entries made to record or remove from all utility accounts any acquisition premium costs or transaction costs.	New	This reflects Mr. Dismukes' proposed commitement 16d.
Parent Company Conditions			
41	GPE and Westar commit to reaffirm and honor any prior commitments made by Westar to the Commission to comply with any previously issued Commission orders applicable to Westar or its previous owners except as otherwise provided for herein.	New	This affirms GPE's and Westar's intentions to honor all prior commitments.
42	Parent acknowledges that its utility subsidiaries (existing and proposed) need significant amounts of capital to invest in energy supply and delivery infrastructure (including, but not limited to, renewable energy resources and other environmental sustainability initiatives such as energy efficiency and demand response programs) and acknowledges that meeting these capital requirements of its utility subsidiaries will be	Existing	No change

No.	**Joint Applicants' Proferred Merger Commitments and Conditions**	**Existing, Expanded or New**[1]	**Responsiveness to Staff/ Intervenor Testimony**[2]
	considered a high priority by Parent's board of directors and executive management and that Parent's access to capital post-transaction will permit it and its utility subsidiaries to meet their statutory obligation to provide sufficient and efficient service.		
43	GPE will provide to the KCC Staff its integrated resource plan (IRP) within 30 days of its filing in Missouri.	New	This addresses several of the conditions proposed by Staff witness Drabinksi and will ensure the timely provision of information regarding generation plant closure.[15]

[15] Drabinski Direct Testimony pp. 88-91.