BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

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

Direct Testimony
of
Scott Hempling

Before the
Utilities Division
Kansas Corporation Commission

December 16, 2016

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Direct Testimony of Scott Hempling

On Behalf of
Utilities Division
Kansas Corporation Commission

I.
Qualifications and Overview

A. Qualifications

Q. State your name, position and business address.

A. My name is Scott Hempling. I am the President of Scott Hempling, Attorney at Law LLC. My business address is 417 St. Lawrence Drive, Silver Spring, Maryland 20901.

Q. Describe your employment background, experience and education.

A. I began my legal career in 1984 as an associate in a private law firm, where I represented municipal power systems and others on transmission access, holding company structures, nuclear power plant construction prudence and producer-pipeline gas contracts. From 1987 to 1990 I was employed by a public interest organization to work on electric utility issues. From 1990 to 2006 I had my own law practice, advising public and private sector clients—primarily state regulatory commissions, and also municipal systems, independent power producers, consumer advocates, public interest organizations and utilities—with an emphasis on electric utility regulation.

From October 2006 through August 2011, I was Executive Director of the National Regulatory Research Institute (NRRI). Founded by the National Association of Regulatory Utility Commissioners, NRRI is a Section 501(c)(3) organization, funded primarily by state utility regulatory commissions. During my tenure, NRRI's mission was to provide research that empowered utility regulators to make decisions of the

highest possible quality. As Executive Director, I was responsible for working with commissioners and commission staff at all 51 state-level regulatory agencies to develop and carry out research priorities in electricity, gas, telecommunications and water. In addition to overseeing the planning and publication of over 80 research papers by NRRI's staff experts and outside consultants, I published my own research papers, advised contract clients (including state commissions, regional transmission organizations, private industry and international institutions), and wrote monthly essays on effective regulation.

In September 2011, I returned to private practice to focus on writing books and research papers, providing expert testimony, and teaching courses and seminars on the law and policy of utility regulation. I am an adjunct professor at Georgetown University Law Center in Washington, D.C., where I teach two seminars: "Monopolies, Competition, and the Regulation of Public Utilities"; and "Regulatory Litigation: Roles, Skills and Strategies." Students study the legal fundamentals in class, then apply that learning, under my supervision, in practicums at state and federal regulatory agencies.

I have represented and advised clients in diverse state commission cases, and in federal proceedings under the Federal Power Act of 1935 and the Public Utility Holding Company Act of 1935. The latter proceedings took place before the Federal Energy Regulatory Commission (FERC), the Securities and Exchange Commission (SEC), and U.S. courts of appeals. I have participated in 17 merger proceedings—as an attorney advising litigating party, as an advisor to a regulatory commission or as an expert witness.[1] I have testified many times on electric industry matters before Congressional

[1] These proceedings include: Toledo Edison and Cleveland Electric Illuminating (1985); PacifiCorp and Utah Power & Light (1987-88); Northeast Utilities and Public

and state legislative committees.

During the period 1990–2006, I was an outside advisor to this Commission, in three roles: (1) assisting the litigation staff in merger and restructuring cases, either as an internal advisor or a litigation attorney; (2) advising the Commissioners during deliberations and assisting in drafting opinions; and (3) acting as outside counsel in proceedings before the Federal Energy Regulatory Commission. On two or three occasions since 1990, I have presented internal seminars on electricity law and policy to the Commissioners and staff.

My book on utility law, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, was published by the American Bar Association in 2013. This is the first volume of a two-volume treatise, the second of which will address the law of corporate structure, mergers and acquisitions. My book of essays, *Preside or Lead? The Attributes and Actions of Effective Regulators*, was published by NRRI in 2010. I published a second, expanded edition in 2013. I have written several dozen articles on utility regulation for publication in trade journals, law journals and books; and taught electricity law seminars to attendees from all fifty states and all industry sectors. I have spoken or taught at many industry conferences or

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Service of New Hampshire (1990-91); Kansas Power & Light and Kansas Gas & Electric (1990-91); Northern States Power and Wisconsin Electric Power Co. (1992); Entergy and Gulf States (1995); Potomac Electric Company and Baltimore Gas & Electric (1997-98); Carolina Power & Light and Florida Power Corp (1999); Sierra Pacific Power and Nevada Power (1998-99); American Electric Power and Central and Southwest (2001); Union Electric and Central Illinois Light Company (2001); Exelon and Constellation (2011-12); Entergy and International Transmission Company (2013); Exelon and PHI Holdings (2014-15) (before the commissions in Maryland and the District of Columbia); Iberdrola and United Illuminating (2014); Macquarie and Central Louisiana Electric Company (2015); and NextEra and Hawaiian Electric Industries (2015-16).

seminars in the United States, and in Australia, Canada, England, Germany, India, Italy, Jamaica, Mexico, New Zealand, Nigeria, Peru and Vanuatu. As a subcontractor to the U.S. Department of State, I have advised the six nations of Central America on the regulatory infrastructure necessary to accommodate and encourage cross-national electricity transactions.

I received a B.A. *cum laude* from Yale University in 1978, where I majored in Economics and Political Science and in Music. I received a J.D. *magna cum laude* from Georgetown University Law Center in 1984. I am a member of the Bars of the District of Columbia and Maryland.

My resume is attached to this testimony as Exhibit SH-1. More information is available at www.scotthemplinglaw.com.

Q. Have you provided testimony in prior regulatory proceedings?

A. Yes, before the following fora: Louisiana Public Service Commission, Hawaii Public Utilities Commission, Connecticut Public Utilities Regulatory Authority, District of Columbia Public Service Commission, Maryland Public Service Commission, Mississippi Public Service Commission, U.S. District Court for Minnesota, Illinois Commerce Commission, California Public Utilities Commission, Minnesota Public Utilities Commission, U.S. District Court for Wisconsin, New Jersey Board of Public Utilities, Indiana Utility Regulatory Commission, North Carolina Utilities Commission, Wisconsin Public Service Commission, Texas Public Utilities Commission and the Vermont Public Service Board. These proceedings are listed on my resume.

Q. On whose behalf are you submitting this testimony?

A. The Utilities Division of the Kansas Corporation Commission (referred to herein as "KCC Staff").

Q. What information did you review in preparing this testimony?

A. I reviewed the Application and accompanying testimony, the Proxy Statement filed by GPE with the Securities and Exchange Commission, Kansas's public utility statutes, various Kansas court and Commission decisions provided to me by counsel, and various discovery responses.

B. Description of the Transaction

Q. Describe the parties to this Transaction.

A. In this Transaction, Great Plains Energy (often referred to herein as "GPE"), a holding company owning public utilities and other businesses, seeks to acquire 100% of the stock of Westar. After closing, Westar would be a wholly-owned subsidiary of GPE.

Applicants describe GPE as owning the following "direct and indirect subsidiaries with significant operations":

> Kansas City Power & Light Company (referred to as "KCP&L") is an integrated, regulated electric utility that provides electricity to customers primarily in the states of Missouri and Kansas. KCP&L has one active wholly-owned subsidiary, Kansas City Power & Light Receivables Company.
>
> KCP&L Greater Missouri Operations Company (referred to as "GMO") is an integrated, regulated electric utility that provides electricity to customers in the state of Missouri. GMO also provides regulated steam service to certain customers in the St. Joseph, Missouri, area. GMO has two active wholly-owned subsidiaries, GMO Receivables Company and MPS Merchant Services, Inc. (referred to as "MPS Merchant"). MPS Merchant has certain long-term natural gas contracts remaining from its former non-regulated trading operations.

> GPE Transmission Holding Company, LLC, which owns 13.5 percent of Transource Energy, LLC, is a company focused on the development, ownership and operation of competitive electric transmission projects.[2]

Applicants describe Westar as follows:

> Westar is the largest electric utility in Kansas. Westar provides electric generation, transmission and distribution services to approximately 700,000 customers in Kansas. Westar provides these services in central and northeastern Kansas, including the cities of Topeka, Lawrence, Manhattan, Salina and Hutchinson. Kansas Gas and Electric Company, Westar's wholly-owned subsidiary, provides these services in south-central and southeastern Kansas, including the city of Wichita.[3]

Q. Describe the Transaction in general terms.

A. I summarize here information on total Transaction value, payment to Westar shareholders, financing of the Transaction, and structure and ownership of the post-acquisition entity.

Total Transaction value: The Transaction value is about $12.2 billion. GPE will pay $8.6 billion for all of Westar's equity, while assuming all $3.6 billion of Westar's debt.[4]

Payment to Westar shareholders: Westar shareholders will receive approximately $60 per share. Each share of Westar stock will be converted into a right to receive $51.00 in cash, plus an amount of GPE stock worth approximately $9.00 (subject to a 7.5% collar based upon the Great Plains Energy common stock price at the time of

[2] Great Plains Energy, Inc., Form DEFM14A (Aug. 25, 2016) (hereinafter referred to as "Proxy Statement") at 8.

[3] Proxy Statement at 9. Unless stated otherwise, when I refer to "Westar" I am referring to the two utilities being acquired: Westar and KG&E.

[4] Joint Application at ¶ 8. The total consideration given to Westar shareholders in the Transaction will vary slightly based on the volume-weighted average trading price of Great Plain Energy Stock at closing.

the closing).[5] The compensation to Westar shareholders is therefore about 85% cash and 15% stock. This compensation amounts to an acquisition premium $2.3 billion (36%) over Westar's "undisturbed stock price."[6]

Financing: GPE will finance its purchase of Westar with approximately 50% equity and 50% debt."[7]

Post-acquisition entity: After closing, Westar will be a wholly-owned subsidiary of GPE. Westar shareholders will own about 15% of GPE's stock.[8]

[5] Joint Application at ¶ 8.

[6] Bryant Supp. at 8 (Attachment A to Joint Applicants' Motion for Leave to File Supplemental Direct Testimony, November 2, 2016). The 36% figure for the control premium is a conservative figure. In the Proxy Statement (at 86) is a table presenting various merger premia supplied by Guggenheim Securities for presentation to the Westar Board in conjunction with Guggenheim's fairness opinion. This table shows that the premium (purchase price over market value) was 36.1% over the March 9, 2016, price and 51.9% over the November 3, 2015, price. Asked about these numbers in KCC-384, Applicants responded as follows:

> November 3, 2015, is the date that in the early stages of the process best represented the unaffected price of Westar's stock; that is the date when the Westar stock price was not impacted by merger speculation. On November 3, 2015, Westar released earnings and had an earnings call, after which the possibility of an acquisition became a topic of speculation in the market, thus affecting the stock price. Westar's stock price was further impacted after a Bloomberg news story on March 10, 2016, which leaked that a sale process was underway. Thus, the second benchmark for Westar's unaffected stock price is March 9, 2016, the trading day prior to the Bloomberg story.

[7] Bassham Direct at 3.

[8] Bryant Direct at 7.

C. Executive summary

Q. Which Commission standards do you address?

A. Of the standards stated in the Commission's Order of August 9, 2016, my testimony addresses the following:

(a) The effect of the Transaction on consumers, including:

(ii) reasonableness of the purchase price, including whether the purchase price was reasonable in light of the savings that can be demonstrated from the merger and whether the purchase price is within a reasonable range;

(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.

(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.

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

Q. Summarize your testimony.

A. This Transaction does not comply with the Commission's standards. Specifically:

1. The purchase price is not "reasonable in light of the savings that can be demonstrated from the merger...." Standard (a)(ii).

2. The "ratepayer benefits resulting from the Transaction" cannot be quantified in a manner that makes Applicants accountable. Standard (a)(iii).

3. The "operational synergies [do not] justify payment of a premium in excess of book value...." Standard (a)(iv).

4. The Transaction will adversely affect existing and future competition. Standard (a)(v).

5. The Transaction will reduce the Commission's future capacity to advance the public interest. Standard (d).

6. Because the purchase price is not based on the production of customer benefits, it will not "reduce the possibility of economic waste"; rather, it will cause economic waste. Standard (g).

I explain these conclusions in Parts II through V.

Part II: The $2.3 billion control premium (the excess of purchase price over undisturbed market value), paid by GPE exclusively to Westar shareholders, conflicts with the public interest. The control premium results from Westar running a competition won by the contestant offering the highest price, with customer benefit only incidental. The premium overcompensates Westar shareholders because (a) its value is grounded in factors unrelated to their risk-taking or their executives' decision-making; and (b) it exceeds the legally required compensation they already have received due to this Commission's lawful rate-setting.

Adding to the public interest detriment is the large acquisition debt GPE would incur to buy Westar's equity at a premium. To pay off that debt, GPE would keep rates above costs plus reasonable profit. This plan contradicts Applicants' claim that their Transaction is the "best" for customers and that they will not recover the premium from customers. That same debt will constrain the Commission's future decisions, by making GPE less able to weather declines in revenue. Those declines could occur if the Commission or Legislature decides to attract new businesses to Kansas by offering them roles in expanding and modernizing Kansas's electricity infrastructure.

The size of the premium—and the accompanying GPE debt—is reason enough to reject this Transaction. But if the Commission grants approval, it still should address the overcompensation. It can do so by allocating the control premium (the excess of purchase price over market value) between shareholders and customers according to their contribution to the premium's value. Only that way will the Transaction, and Commission policy, align acquisition decisions with the principles of economic efficiency and fiscal conservatism.

Part III: Applicants' estimated savings do not satisfy the public interest standard. The estimates are in the hundreds of millions; but unlike the guaranteed premium of $2.3 billion, the commitments to savings equal zero. Thus Applicants take no risk that the outcome will match the advertising. They identify no executives whose careers, or even compensation, depend on success. They talk of "economies of scale" and "best practices." But economies of scale are inherent in a product's cost function; they are not caused by managerial skill. And best practices are prudent practices—what we expect of any utility, with or without a merger.

Part IV: Unless the Commission acts affirmatively, the allocation of merger savings between shareholders and customers will be controlled by GPE. Applicants intend to withhold savings from consumers by using regulatory lag. That device advantages Applicants over the Commission, to the extent they control the information about cost and the timing of rate cases. Indeed, they have limited the Commission's options already, because the size of the premium—and the debt GPE will take on to pay it—assumes that Applicants can exploit that advantage. So if the Commission decides to

allocate savings differently from Applicants' expectations, they will complain of financial weakening—and may have a point.

Part V: GPE and Westar are each other's most formidable competitor. Benchmarking—the comparison of similar companies—provides the information regulators need to assess performance and assign consequences. Adjacent rivals seek continuously to outperform each other. Eliminating benchmarks *and* rivalry weakens the pressure to perform. This Transaction does exactly that.

Part VI: Rejecting this Transaction is not enough, because I respectfully suggest there is a gap in the Commission's merger policy. To find the best companies, the Commission first should define Kansas's needs, then describe the types of companies that can most cost-effectively satisfy those needs. Once merger applicants understand the Commission's priorities, they will organize their competitions and their transactions to serve those priorities. The result will be transactions that compensate shareholders reasonably, but that put consumers first. In a capitalist system, whether a market is regulated or unregulated, that is the right result.

Q. Will the Commission's rejection of this Transaction deprive consumers of benefits?

A. Not if the Commission uses this Transaction as an opportunity to distinguish transactions that serve the public interest from those that do not. Applicants might argue that opposing the Transaction creates an obstacle to rate reductions. That argument would be misleading, in at least two respects.

First, Applicants do not promise a rate reduction; they assert (without proving or committing) that the Transaction will reduce future rate increases. Because they make no

promise, they take no risk of breaking a promise. A claim without commitment is mere advertising—like ads for car wax that promise the shiniest car.

Second, my testimony does not find fault with a GPE-Westar merger *per se*; it finds fault with this Transaction—how it was chosen and priced. Applicants' own narrative, as quoted in my testimony, makes clear that GPE was chosen through a Westar-designed auction in which the dominant criterion was gain to Westar shareholders. Benefit to customers was literally an afterthought. By designing the auction this way, applicants who might have offered more to customers than GPE, but who were less willing or able to incur debt to do so, had no chance to compete. If Applicants truly want the best for customers, let the competition focus on what is best for customers. If GPE can win that competition, then most of this Transaction's negatives are removed.

I argue that the right transaction is the one that embodies economic efficiency and fiscal conservatism. Applicants argue that the right transaction is the one that pays Westar shareholders the greatest gain. This difference in principle gives the Commission a clear choice.

II.
The $2.3 billion control premium, paid by GPE exclusively to Westar shareholders, conflicts with the public interest

Q. Explain the organization of this Part II.

A. This Part II explains that GPE and Westar, in agreeing to a control premium of $2.3 billion, acted in conflict with the public interest. After defining and distinguishing "acquisition premium" and "control premium" (Part II.A), I explain that the control premium reached $2.3 billion because Westar's priority was highest offer price (Part II.B). By seeking highest price rather than best performer, Westar violated its obligation to its customers (Part II.C). I then explain the multiple reasons why the control premium overcompensates Westar shareholders, relative to the normal profit that flows from investing in a state-franchised public utility (Part II.D).

The premium also harms the Commission, because GPE's acquisition debt—$4.4 billion[9]—will limit the Commission's future options (Part II.E). GPE has said it will not seek to place the premium in rates, but that statement is a half-truth: Westar would recover the premium from ratepayers by charging rates that exceed reasonable cost and reasonable profit. Even a true commitment to non-recovery—which GPE does not make—leaves other harms unremedied (Part II.F).

Finally, I explain that if the Commission approves the Transaction, the only way to avoid overcompensation to shareholders and harm to customers is to allocate the control premium between shareholders and ratepayers based on their relative contributions to its value.

[9] *See* SEC Form DEFM14A, Definitive Proxy Statement, filed August 25, 2016, with the Securities and Exchange Commission.

A. The meaning of "acquisition premium" and "control premium"

Q. Explain and distinguish the concepts of "acquisition premium" and "control premium."

A. Westar shareholders will each receive $51 in cash and about $9 in GPE stock. The full purchase price, therefore, is $60 per share. The total compensation to Westar is $2.3 billion (36%) above Westar's "undisturbed" market value of $44.08 per share.[10]

In utility acquisition cases, participants sometimes use the term "acquisition premium" to refer to either of two different amounts: the excess of purchase price over book value, or the excess of purchase price over market value. In this testimony I distinguish those amounts as follows: The excess of purchase price over book value is the full acquisition premium. It consists of two layers defined by three dollar figures. The three dollar figures, starting from the bottom, are:

1. Westar's book value
2. Westar's undisturbed stock value
3. GPE's total purchase price

The two layers that make up the full acquisition premium are, therefore:

1. The lower layer: the excess of Westar's pre-acquisition stock value over Westar's book value

2. The upper layer: the excess of GPE's purchase price over Westar's pre-acquisition stock value.

I will refer to the upper layer as the "control premium," because it is what GPE is paying to acquire control of Westar's utility franchises. As stated, the control premium here is

[10] Undisturbed market value means Westar's stock price on March 9, 2016, the day before news leaked of a potential purchase of Westar. See Bryant Dir. at 11; Bryant Supp. Dir. at 8. While the $51.00 cash payment is fixed, the amount of GPE stock ultimately paid to Westar shareholders is subject to a 7.5% collar based on GPE's stock price at closing.

$2.3 billion, or 36% above Westar's undisturbed market price. For reasons I will discuss shortly, when determining ratepayers' appropriate share of the premium the focus is on the control premium.[11]

B. The control premium is $2.3 billion because the Westar Board sought the highest price

Q. What role did Westar play in influencing the size of the premium?

A. The undisputed facts produce two indisputable conclusions. First, Westar's Chief Executive Officer and Board of Directors took the actions they deemed necessary to get Westar shareholders the highest price possible. Second, the emphasis on price dominated all other considerations. The customer interest and the public interest were incidental—relevant only to ensure that the highest-price purchaser won regulatory approval.

The proof appears in GPE's own narrative, excerpted in Appendix A.[12] That narrative confirms that "[t]he Transaction is the result of a competitive process."[13] That competitive process was designed to achieve the Westar Board's central goal: "to provide long-term value to [Westar] shareholders."[14] Here is the short version, excerpted from the Proxy Statement:[15]

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[11] GPE's purchase of Westar includes not only Westar's Kansas electric retail operations, but also its non-utility businesses and its FERC-jurisdictional businesses (transmission and wholesale sales). The premium relevant to the instant proceeding is the portion attributable to Westar's Kansas electric retail business only.

[12] The full narrative appears in the Proxy Statement.

[13] Bassham Direct at 3.

[14] Proxy Statement at 52.

[15] All emphases are added by me.

By early 2015, Westar's CEO Mark Ruelle had informed his Board that "terms may have been shifting ***in favor of shareholders of selling companies*** in utility transactions announced in the last half of 2014 and first few months of 2015. Specifically, he noted that, in these transactions, there seemed to have been a greater willingness of buyers to take regulatory risk, and they reflected stronger price/earnings multiples and ***robust takeover premia***."[16]

During this period, Mr. Ruelle had informed GPE and others that Westar "was not for sale." But he did have conversations with officials of GPE and other companies that expressed interest in buying Westar.[17]

During that same period, Mr. Ruelle told Mr. Bassham [GPE's CEO] that if Westar "were to pursue a consolidating transaction, management would be more likely to recommend the route of ***being acquired at a premium***" (as opposed to being the acquirer or merging as equals).[18]

At its retreat in August 2015, Westar's Board authorized Mr. Ruelle to "gather additional information from inquiring companies, including with respect to value and regulatory risk, without making any commitments regarding any strategic transactions."[19]

In September 2015, Mr. Bassham told Mr. Ruelle that "while Great Plains Energy still remained very interested in a potential transaction, Great Plains Energy ***was not contemplating a valuation in the range of then recently announced industry transactions***."[20]

At that time, Mr. Ruelle "advised Mr. Bassham that any business combination transaction would have to be structured as a purchase of Westar ***at a premium to market prices***...."[21]

In late September 2015, "Bidder B" described to Mr. Ruelle a possible transaction with a ***25% premium*** above the then-current trading price of Westar's common stock.[22]

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[16] Proxy Statement at 52.

[17] Proxy Statement at 52.

[18] Proxy Statement at 52.

[19] Proxy Statement at 53.

[20] Proxy Statement at 54.

[21] Proxy Statement at 54.

> On October 2, 2015, GPE's Board authorized Mr. Bassham to discuss with Mr. Ruelle a preliminary proposal based on ***a premium of 20%- 25%*** over Westar's current stock price, with the price payable ***70% in Great Plains Energy common stock and 30% in cash***...."[23]
>
> At its meeting of Oct. 22, 2016, the Westar Board reviewed "relative valuations of utilities, generally, and how future changes in interest rates and economic activity ***could affect values***. Also discussed were possible approaches to ascertaining ***potential value Westar might obtain*** for its shareholders should it consider a strategic transaction."[24]
>
> At its special meeting of November 19, 2015, the Westar Board heard a briefing on, among other things, "factors that could affect the ***market for [utility] stocks*** in the future," including the ***prices of recent utility mergers and acquisitions***. Mr. Ruelle said "it might be possible to ***achieve value for shareholders that would exceed the value that could reasonably be expected to be achieved if Westar were to continue to pursue its long-term stand-alone strategic plan***."[25] At this time, the Westar Board emphasized that "in addition to ***the price to be received*** by Westar's shareholders, other important factors would be the ***type of consideration and certainty of value*** to be received by Westar shareholders, the ability of the counter-party in any such transaction to demonstrate that the ***transaction would be in the public interest and be able to obtain the necessary regulatory approvals***, the counter-party's ability to obtain any necessary financing for the transaction and ***any commitments that the counterparty would be willing to make with respect to Westar's customers and employees, as well as the communities served by Westar***."[26]
>
> The Westar Board then "concluded that it should determine if it would be possible to negotiate a transaction that would be ***more favorable to Westar's shareholders*** than Westar's long-term stand-alone strategic plan. ... [T]he Westar Board authorized Mr. Ruelle to approach Bidder A. ... The Westar Board selected Bidder A because ... Bidder A would likely have the desired characteristics described above."[27]

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[22] Proxy Statement at 54.

[23] Proxy Statement at 54.

[24] Proxy Statement at 55.

[25] Proxy Statement at 55-56.

[26] Proxy Statement at 56.

[27] Proxy Statement at 56-57.

After the December Westar Board meeting, Bidder A dropped out.[28]

"On December 10, 2015, Bidder C told Mr. Ruelle "it saw a preliminary indication of value of ***potentially $50 per share, in cash***, subject to due diligence and other customary contingencies...."[29]

"On February 2, 2016, Bidder B noted [to Mr. Ruelle] that since October ***Westar's stock price had increased significantly***, as had the prices of many other stocks of electric utility companies; accordingly, his company ***would consider changes in its preliminary indication of value*** and potentially consider changing the consideration to ***all cash***...."[30]

On the same day, Mr. Ruelle called Mr. Bassham, who reiterated Great Plains Energy's continuing interest as well."[31]

On February 11, 2016, Mr. Ruelle asked Mr. Bassham to provide GPE's "current view on the ***price Great Plains Energy would be willing to pay*** in a potential acquisition, and to what extent Great Plains Energy would be willing to provide ***additional certainty with respect to the value*** of the consideration payable in the potential acquisition, by ***increasing the cash portion*** of the consideration and potentially providing a collar with respect to the stock portion of the consideration. Mr. Ruelle advised Mr. Bassham that ***Westar had a preference for cash consideration***, but was open to stock consideration as well."[32]

On February 18, 2016, the GPE Board authorized Mr. Bassham to offer Mr. Ruelle "***a premium of 20%*** over the current market price, with a ***consideration mix of 50% Great Plains Energy common stock and 50% cash*** with the potential to include a collar with respect to the stock consideration." Mr. Bassham did so.[33]

In its meeting on February 22, 2016, the Westar Board "concluded that to ***ascertain maximum potential value***, it wished to solicit indications of interest

[28] Proxy Statement at 57.

[29] Proxy Statement at 57.

[30] Proxy Statement at 57.

[31] Proxy Statement at 57.

[32] Proxy Statement at 57.

[33] Proxy Statement at 57-58.

from several potential counter-parties….No decision to pursue a strategic transaction was made."[34]

"Following this meeting, Guggenheim Securities contacted Great Plains Energy, Bidder B and ***14 other companies*** regarding a possible transaction. Of these, Great Plains Energy, Bidder B and 7 others entered into confidentiality and standstill agreements. ..."[35]

On March 15, 2016, Westar management decided "not to grant Bidder C permission to contact other potential investors because it was concerned that doing so would increase the risk that additional market rumors would develop, ***which could serve to discourage more capable bidders*** from continuing to evaluate a possible transaction. This decision was also based in part on the view that Bidder C likely had ***fewer opportunities to create synergies*** from a transaction and ***would not be able to make a compelling case to regulators*** that a transaction was in the public interest."[36]

On March 29, 2016, the GPE Board authorized management to "submit a first round indicative proposal, the terms of which would include an acquisition of Westar by Great Plains Energy priced in the range of ***$53-$55 per share, with a consideration mix of 35% Great Plains Energy common stock and 65% cash*** which would include fully committed financing for the cash portion of the purchase price and with the potential to include a collar with respect to the stock consideration, and would potentially express interest in evaluating Westar senior management and the potential for Westar representation on the Great Plains Energy Board following the closing."[37]

"On April 5, 2016, the deadline set by Westar for submission of preliminary indications of interest, Great Plains Energy, Bidder B and the 3 other companies with which Westar had held management calls submitted preliminary non-binding indications of interest. The 3 additional companies are referred to as Bidders D, E and F. Great Plains Energy indicated that it might be willing to acquire Westar for a price of ***$54.50 per share*** of Westar common stock, with the consideration being ***65% cash and 35% Great Plains Energy common stock***. Bidder B's proposal indicated a price of ***$50.50 per share with consideration being 50% cash and 50% common stock*** of Bidder B. Bidder D proposed a price range of up to ***$55.11 per share in cash*** on a fully-diluted basis. Bidder E proposed acquiring

[34] Proxy Statement at 58.

[35] Proxy Statement at 58.

[36] Proxy Statement at 58-59.

[37] Proxy Statement at 59.

Westar for ***$53.00 per share consisting of 33% cash and 67% common stock*** of Bidder E, and Bidder F said that it might be willing to acquire Westar for ***$52.00 per share in cash***."[38]

On April 11, 2016, the Westar Board "decided to seek definitive proposals from all five companies that had submitted indications of interest, including Great Plains Energy....[A] representative of Guggenheim Securities provided feedback regarding Great Plains Energy's initial proposal that ***Westar would prefer a bid with a larger proportion of the consideration consisting of cash***."[39]

"On May 19, 2016, Bidder B indicated to Guggenheim Securities that it had determined not to submit a bid to acquire Westar."[40]

On May 23, 2016, GPE "submitted a proposal to acquire Westar for a price of ***$58.25 per share, with 85% of the consideration being in cash and 15% in Great Plains Energy common stock***....Bidder D proposed to acquire Westar for a price of between ***$54.00 and $56.00, with 45% of the consideration being in cash and 55% being in common stock*** of Bidder D.... Bidder E proposed to acquire Westar for a price of ***$51.00 per share with 80% of the consideration in common stock of Bidder E and 20% in cash***.... Bidder F provided an oral indication of continued interest, stating that it would be interested in acquiring Westar for a purchase price of ***$52.00 per share in cash***, but that it would require additional time to obtain committed financing and negotiate a definitive merger agreement."[41]

"In reviewing the bids that had been received, the Westar Board noted that ***the price proposed by Great Plains Energy was higher than the upper end of the price range proposed by the next highest bidder***, Bidder D, and represented an ***implied 36% premium*** to the closing price of Westar common stock on March 9, 2016, the day before an article was published stating that Westar was seeking acquisition proposals. The Westar Board also noted that the consideration proposed by Great Plains Energy was 85% cash and 15% Great Plains Energy common stock, that the Great Plains Energy proposal included ***some protection for the value of the stock portion of the consideration*** in the form of a collar on the price of Great Plains Energy common stock, that Great Plains Energy had obtained committed financing for its proposal and that the proposed form of merger agreement submitted by Great Plains Energy was more favorable to

[38] Proxy Statement at 59.

[39] Proxy Statement at 59.

[40] Proxy Statement at 61.

[41] Proxy Statement at 61.

Westar than the form of merger agreement submitted by Bidder E because, among other things, Bidder E's proposal did not contain a reverse break-up fee and provided that Westar ***would bear more regulatory risk*** than under the Great Plains Energy proposal. After extensive discussion, the Westar Board instructed Mr. Ruelle, with assistance from Guggenheim Securities and Baker Botts, to negotiate with Great Plains Energy and Bidder D with respect to their proposals ***to attempt to obtain their best and final bid terms***. The Westar Board did not specify the specific terms that it wished to see changed in either of the bids, but it did indicate that the ***value of the consideration to be received by Westar shareholders, the mix of cash and stock to be received by Westar shareholders and the probability that a closing would occur, including the likelihood that regulators would find the transaction to be in the public interest and thereby gain regulatory approval***, were important factors that it would consider. ..."[42]

"After the meeting, Guggenheim Securities called representatives of Goldman Sachs and Bidder D to inform them that the Westar Board would like them ***to consider improving the terms of their proposals*** and that they should submit their best and final proposals as soon as possible. Guggenheim Securities further indicated that Westar and the Westar Board would review the totality of the bid terms and that the value of the consideration to be received by Westar shareholders, consideration mix and certainty of closing, including the ability to obtain regulatory approvals, were all important terms to the Westar Board."[43]

"On May 26, 2016, in a telephone conversation with Guggenheim Securities, Bidder D indicated that it was ***prepared to increase the amount of its bid to $56.00 per share and possibly more***, with the mix of consideration, comprising $25.00 in cash with the remainder in common stock of Bidder D. Bidder D indicated that it would be able to increase its bid even further if it were able to find additional sources of value following further diligence on Westar."[44]

"Also on May 26, 2016, … Guggenheim Securities and Baker Botts reviewed certain adjustments to the terms of the merger agreement proposed by Great Plains Energy that Westar sought, including changes to the termination fees potentially payable by the parties, in particular, (i) increasing the fee payable by Great Plains Energy if the Merger were not completed as a result of failure to obtain required regulatory approvals, (ii) ***decreasing the fee payable by Westar if it were to terminate the merger agreement under circumstances in which another company had made a superior proposal to acquire Westar***,…."[45]

[42] Proxy Statement at 62.

[43] Proxy Statement at 62.

[44] Proxy Statement at 62.

[45] Proxy Statement at 62-63.

"Later that day, Goldman Sachs, as directed by GPE, told Guggenheim Securities that GPE was willing to accept all of the changes to the merger agreement proposed by Baker Botts. In the course of the conversation, the representative of Guggenheim Securities advised the representative of Goldman Sachs that ***the purchase prices proposed by each of the two final participants in the process were close, and that Great Plains Energy should consider that in conveying its best and final proposal*** to Guggenheim Securities....Great Plains Energy sent Westar a revised bid letter ***increasing its price to $60.00 per share***. The consideration mix remained 85% cash and 15% Great Plains Energy stock with a 7.5% collar on the price of Great Plains Energy's common stock."[46]

"Later in the day on May 27, 2016, Mr. Bassham and Mr. Ruelle … agreed that the terms should include Great Plains Energy offering one of the Westar Board members a seat on the Great Plains Energy Board…."[47]

"Mr. Ruelle's decision was based on the price and other terms proposed by Great Plains Energy as well as his judgment that it was ***unlikely that Westar would be able to obtain as high or a higher price from any of the other bidders within the next few days***, and that if Westar did not act quickly to execute a merger agreement with Great Plains Energy, the opportunity to enter into a transaction with Great Plains Energy ***on the terms then proposed*** could be lost."[48]

"After considering the proposed terms of the merger agreement [and other factors]..., the Great Plains Energy Board determined that the merger, including the issuance of shares of Great Plains Energy common stock as contemplated by the merger agreement, was advisable and ***in the best interests of Great Plains Energy and its shareholders***."[49]

"Also on May 29, 2016, ... Management, Guggenheim Securities and Baker Botts updated the Westar Board with respect to the ***improved terms of the bids***, including that Great Plains Energy had ***agreed to increase its price*** and had agreed to changes to the merger agreement requested by Westar. ... The Westar Board noted that ***the indicative price of $60.00 per share of Westar common stock proposed by Great Plains Energy was $4.00 higher than the price then proposed by Bidder D***, that Bidder D had indicated that it might be able to increase its price further but that there was ***no assurance that Bidder D would***

[46] Proxy Statement at 63.

[47] Proxy Statement at 63.

[48] Proxy Statement at 63-64.

[49] Proxy Statement at 64.

> ***increase its price and that any price increase if it did occur could be less than $4.00 per share***. The Westar Board also noted that Great Plains Energy had obtained fully committed financing for the cash portion of its proposal. Guggenheim Securities informed the Westar Board that the indicative price of $60.00 ... represented ... a ***multiple of projected earnings consistent with or favorable to recent utility acquisition agreements*** included in the comparable transactions reviewed by Guggenheim Securities. ... Finally, the Westar Board also considered that Westar would have the right to terminate the merger agreement in order ***to accept an alternative acquisition proposal upon satisfaction of certain conditions, including payment to Great Plains Energy of a fee of $280 million***. The Westar Board also considered that Great Plains Energy had agreed to maintain Westar's corporate headquarters in Topeka, Kansas, which might contribute to a finding by regulators that the transaction would be in the public interest."[50]
>
> At its May 29, 2016 meeting, the Westar Board "unanimously determined that the merger was in the ***best interests of Westar and its shareholders***...."[51]

C. By seeking the highest price rather than the best performer, Westar undermined its obligations to its customers

1. Westar viewed purchase price as dominant, customer benefit as incidental

Q. Is there evidence that in choosing an acquirer, Westar viewed purchase price as more important than customer benefit?

A. Yes. From the foregoing excerpts, seven points emerge:

1. Westar's desire to remain a stand-alone utility, stated at the outset, diminished as the price offers rose.

2. The dominant focus in the discussions, internally at Westar and GPE as well as between the companies, was always price and certainty of the value (the latter point represented by the ratio of cash to total consideration).

3. GPE's offer began (Oct. 2, 2015) with a premium of 20-25% over market price and a cash-to-stock ratio of 30-70. The final offer had a premium of 36% over market value and a cash-to-stock ratio of 85-15. The purchase price GPE agreed to was the one "necessary to win the competitive bidding process...."[52]

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[50] Proxy Statement at 64-65.

[51] Proxy Statement at 65.

[52] Response to KCC-218.

4. As Westar bargained for a higher price and more cash, GPE's acquisition debt necessarily rose.

5. Confirming the centrality of price was Westar's insistence on reserving the right to terminate the agreement with GPE if Westar were offered by someone else a higher price—but not more consumer benefits.

6. Westar's expert advisors were expert in valuing the deal for shareholders, not in assessing benefits for customers.

7. Other bidders were invited, specifically to move the prices up, not to increase customer benefits.

8. Mentions of customers and the public interest are rare, and usually only in the context of assessing whether an offer would get regulatory approval. Nowhere, ever, did the Board ask the question: Which is the best company for Kansas ratepayers?

So we have two types of evidence—affirmative and negative. The affirmative evidence is that the Transaction arose from a competition based explicitly on highest price.

Then there is the absence of evidence. At no point in the narrative, ever, did Mr. Ruelle demand of bidders any customer benefits. Or even ask. Nor did the Westar Board ever require Mr. Ruelle to do so. Or even discuss the issue. GPE and Westar bargained over price, cash ratio, break-up fees, Board membership, and headquarters location, but they never bargained over consumer benefits. Never once did Westar say to GPE, "We need $1 billion in guaranteed customer benefits or the deal is off." Such a demand would conflict with Westar's real goal— highest possible price. Because Westar never bargained for a commitment to consumer benefits, Applicants make no commitment to consumer benefits.

The Merger Agreement has 80 pages of single-spaced prose— dense, detailed and thorough. More pages flow from the two "fairness opinions" (Annex C (GPE) and Annex D (Westar)). All this effort—thousands of words typed, billions of dollars

negotiated—solely to ensure that both sets of shareholders receive benefits that protect them from transactional disappointment. But for the utility customers, Applicants negotiated nothing. If this Transaction's real purpose was to lower costs and improve performance, one would expect Westar to have extracted something from GPE. The record shows nothing.

Q. Are you saying that Westar gathered no information about possible customer benefits?

A. No, I am not. The Proxy Statement (at pp. 78-79) lists factors considered by the Westar Board. Those factors include:

> The Westar Board's belief that the merger will create a leading utility company with a broader customer base than Westar on a stand-alone basis and the operational expertise, scale and financial resources to meet the region's future energy needs.
>
> The fact that both Westar and Great Plains Energy 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.
>
> The Westar Board's belief that the merger should over time generate cost savings and operating efficiencies through consolidation and integration of certain functions.

But these statements are "beliefs," not commitments. And notice what is missing: studies of customer benefits. Westar admits that no members of its Board, and no members of its executive team, considered (a) any "studies of economies of scale in the generation, transmission, distribution or marketing of electric service"; or (b) any "studies of whether prior electric utility mergers and acquisitions actually achieved the savings their supporting witnesses said would result."[53] The quoted language is from my

[53] See Westar's response to KCC-210.

question to Westar. The answer to whether such studies were considered by Westar was "no." Westar could only cite Mr. Ruelle's long career in the industry, which "confirmed to him that many utility combinations can indeed result in significant savings of various types, and that companies having pursued such opportunities have generally satisfied those companies' ex ante opinions." Such loose, general, self-supporting impressions are an inadequate substitute for the rigorous study warranted by this $12.2 billion Transaction, not to mention an under-oath appearance before an expert commission. Furthermore, the heading above these statements is "**Strategic Rationale: Shareholder Value**"—signaling that Westar viewed these factors as benefitting the shareholders. That these factors might also benefit customers is a possibility, yes; but Applicants have done nothing to make it a reality. Certainty of customer benefits was not the purpose.

Consider the converse: If the two companies had bargained over customer benefits and made them certain, but had only "beliefs" about shareholder gain without a commitment, would there be a Merger Agreement? The question answers itself.

It's reasonable to assume that Westar did enough review of GPE to project 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.

Q. Didn't each of GPE and Westar obtain a "fairness" opinion from its respective financial advisor?

A. Yes, but the purpose of a "fairness" opinion is to verify that the price is "fair" to shareholders; it says nothing about benefits to customers. Thus:

> Goldman Sachs' [GPE's advisor] opinion addresses only the fairness from a financial point of view, as of the date of the opinion, of the merger

> consideration to be paid by Great Plains Energy for each outstanding share of Westar common stock pursuant to the merger agreement.[54]

Guggenheim Securities (Westar's advisor) stated: "Based on and subject to the foregoing, it is our opinion that, as of the date hereof, the Merger Consideration is fair, from a financial point of view, to the holders of Westar Common Stock (excluding shares owned by Westar as treasury stock, shares that are owned by a wholly owned subsidiary of Westar, or shares that are owned directly or indirectly by Great Plains or Merger Sub)."[55]

Q. Besides running a competition based on price, how else did Westar reveal that purchase price took priority over customer benefit?

A. Westar reserved the right to walk away from GPE in favor of a "superior" proposal from someone else. Section 8.01(c)(i) of the Merger Agreement provides:[56]

> (c) Termination by the Company. The Company shall have the right to terminate this Agreement: (i) in the event that the Company Board has made a Company Adverse Recommendation Change with respect to a Superior Company Proposal and shall have approved, and concurrently with the termination hereunder, the Company shall have entered into, a Company Acquisition Agreement providing for the implementation of such Superior Company Proposal, so long as (1) the Company has complied in all material respects with its obligations under Section 5.03(c) and (2) the Company prior to or concurrently with such termination pays to Parent the Company Termination Fee in accordance with Section 8.02(b)(ii) and the termination pursuant to this Section 8.01(c)(i) shall not be effective and the Company shall not enter into any such Company Acquisition Agreement until Parent is in receipt of the Company Termination Fee; provided, however, that the Company shall not have the right to terminate this Agreement under this Section 8.01(c)(i) after the Company Shareholder Approval is obtained at the Company Shareholders Meeting;

Section 5.03(f)(ii) in turn defines "Superior Company Proposal":

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[54] Proxy Statement at 72.

[55] Proxy Statement, Appendix D at 4.

[56] In this passage "Company" refers to Westar, and "Parent" refers to GPE.

> "Superior Company Proposal" means a bona fide written Company Takeover Proposal (provided that for purposes of this definition, the applicable percentage in the definition of Company Takeover Proposal shall be "50.1%" rather than "20% or more"), which the Company Board determines in good faith, after consultation with outside legal counsel and a financial advisor, and taking into account the legal, financial, regulatory, timing and other aspects of such Company Takeover Proposal, the identity of the Person making the proposal and any financing required for such proposal, the ability of the Person making such proposal to obtain such required financing and the level of certainty with respect to such required financing, and such other factors that are deemed relevant by the Company Board, is *more favorable to the holders of Company Common Stock* than the transactions contemplated by this Agreement (after taking into account any revisions to the terms of this Agreement that are committed to in writing by Parent (including pursuant to Section 5.03(c)).

(emphasis added). The focus is on Westar's shareholders. Westar could exercise this right even if the Superior Company Proposal would produce a merger less likely to produce the benefits about which Westar has only "beliefs."[57]

KCP&L described this provision as "commonplace in merger agreements for public companies, permit[ting] the members of the board of directors to satisfy their fiduciary obligations under state law."[58] This straightforward answer reveals the problem. Of course a corporate board may not disregard fiduciary obligations imposed

[57] This technical language is restated in the Proxy Statement (at 17), explaining that the merger agreement may be terminated by Westar—

> in the event the Westar Board has made an adverse recommendation change with respect to a superior proposal, in each case as defined in the merger agreement, and the Westar Board has approved and entered into, concurrently with the termination, an acquisition agreement, as defined in the merger agreement, providing for the implementation of such superior proposal, so long as Westar has complied with certain obligations under the merger agreement and prior to or concurrently with such termination, pays to Great Plains Energy the applicable termination fee; provided that Westar shall not have the right to terminate the merger agreement after the approval of the Merger proposal has been obtained….

[58] Response to KCC-238.

by state law. But as I will explain in Part II.C.2 below, that fiduciary obligation imposed by that other state's law is subject to obligations imposed by Kansas law. And Kansas law, as this Commission has applied it to mergers, requires an acquisition to promote the public interest. The public interest does not allow a government-protected utility to sell on terms that maximize its gain and make customer benefits incidental.

Q. What about GPE's claim that efficiencies were the "primary driver"?

A. Mr. Ives (Direct at 14) asserted that "[c]reating efficiencies is the primary driver of the Transaction." His testimony cannot be reconciled with the facts.

If customer savings were Applicants' primary objective, there would be no control premium. On identifying GPE as the most cost-effective acquirer (assuming Westar designed its search to do so, which it did not), Westar would simply have agreed to merge without demanding a premium—because if the acquirer had to pay a premium it would have to reduce the benefits to consumers to pay off its acquisition debt.[59] That is not what happened. The Proxy Statement makes clear that *from nearly the very beginning*, Westar did not want a merger of equals; it wanted a premium.[60] Instead of simply

[59] In this sentence I used the term "merge" loosely, for purposes of brevity. In a true merger, the shareholders of GPE and Westar would become shareholders in the new combined company, each shareholder receiving a number of shares roughly reflecting the market value of her stock. A different form of non-premium coupling would have taken the form of the acquisition proposed here: Westar becoming a subsidiary of GPE, with Westar shareholders receiving GPE shares in exchange for their Westar shares. In either coupling, there need be no premium if benefit to customers was the Transaction's "primary driver."

[60] See Proxy Statement at 52 (Ruelle tells Bassham Westar was "ambivalent" about a merger of equals; "management would be more likely to recommend the route of being acquired at a premium"); *id.* at 53 (describing similar conversation with Bidder B); *id.* at 54 (Ruelle tells Bassham that "Westar did not view a business combination transaction structured as a merger of equals favorably,... [and that] any business

agreeing to merge with GPE, Westar held out for a premium—and higher and higher premia as the offers came in. Holding out for a premium meant being willing to kill a transaction—a transaction Westar now claims is the "best" for customers—unless Westar received a premium sized to its desire. That is not the behavior of someone who views the Transaction's "driving force" as "creating efficiencies." It is more the behavior of a child who refuses to do his chores unless he is paid. Even if the child had some legal ability to refuse, he could not say he has put his chores first.

Attempting to justify the premium, Mr. Bryant says that the cost savings would not be "available to customers without the Transaction."[61] His logical error should now be clear. It may be true that the savings are not available without the Transaction. *But it is not true that a transaction could not happen without the premium.* The Transaction was not "available" without the premium only because Westar refused to do a transaction without a premium. Westar put its shareholders before its customers. Anyone who testifies otherwise is departing from the facts.

In fact, Mr. Bryant concedes the point. He insists the customers' savings share is "fair relative to the benefit Westar shareholders will experience as a result of the acquisition premium being paid" (Supp. Direct at 4). How odd to use the term "fair," where a company with a government-protected monopoly, with an obligation to serve its customers cost-effectively, stands ready to block a customer-effective transaction unless its shareholders receive the maximum gain; and where GPE, having been forced by

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combination transaction would have to be structured as a purchase of Westar at a premium to market prices").

[61] Supp. Direct at 4.

Westar to pay for that gain, now intends to recover its payment by keeping Westar's rates above cost plus reasonable profit[62]—thereby reducing "customers' savings share."

Mr. Bryant then asserts that allowing GPE to keep savings to pay for the premium is "more than fair" because "customers incur no cost [other than reasonable transition costs] to receive [their share of] these benefits...."[63] When Mr. Bryant says "customers incur no cost," he ignores opportunity cost: the cost savings Westar denies its customers when it refuses to merge unless its shareholders get a gain—a gain that comes at customers' expense. If blocking savings to customers can be "more than fair to customers," we have abandoned the premise that supports Westar's government-protected franchise: its continuing statutory obligation to provide "efficient and sufficient" service by minimizing its costs.

Mr. Bryant acknowledges that Westar would deny savings to consumers (as I will explain in Part II.F). He defends that result as "more than fair to customers" because "GPE shareholders bear all the risk of receiving a fair return on their investment."[64] There is some truth to that statement, as GPE shareholders do bear risk. But that risk—for which GPE competed vigorously—exists only because Westar insisted on the premium. That insistence caused GPE to pay the high purchase price that creates its risk. So if the question is whether it is proper for Westar to withhold customer savings unless

[62] As I will explain in Part II.F

[63] Supp. Direct at 8.

[64] Supp. Dir. at 8.

it receives a premium, Mr. Bryant's statement is circular. It assumes the appropriateness of a premium whose appropriateness is the very issue to determine.

Q. In designing the auction and determining the outcome, were Westar's decisionmakers influenced by the form of their executive compensation?

A. I don't know. I do know that if executive compensation did play a role, it was not to make customer benefits more important than shareholder gain. Westar's top officials (Ruelle, Greenwood, Somma, Irick, Akin, Banning, Bridson and Kongs) will receive an estimated total of $43.7 million in gain from this Transaction, as a result of their various rights to Westar stock.[65] More generally, the compensation for Mr. Ruelle and his executive team does not depend on benefits to customers. As described in the Proxy Statement (at pp. 19-32), executive compensation at Westar is designed "to strongly align the interest of our officers with those of our shareholders" (*id*. at 19). The focus is on "total shareholder return" for Westar as compared to other companies (*id.* at 20). The terms of executive compensation make no mention of operational performance or customer satisfaction.

I am not suggesting that Westar's executive compensation is indifferent to customers. If the company operates suboptimally, there can be lost sales and regulatory penalties, both of which can reduce total shareholder return and therefore executive compensation. But that fact does not change this reality: In this acquisition, Westar's compensation scheme did nothing to cause decisionmakers to make customer benefits the focus of the Transaction.

[65] See Confidential Response to KCC-208, which lists each individual and their current stock holdings. The dollar figure is an estimate based on $60 per unit or share. The value of actual gain could of course differ from that amount.

2. By subordinating customer benefit to purchase price, Westar violated its obligation to its customers

Q. What is a public utility's obligation to its customers?

A. In Kansas, each utility receives government protection from retail competition. In return, the utility must serve all its customers using the most cost-effective practices, and at the lowest feasible cost. Consider these precedents:

1. A utility must "operate with all reasonable economies."[66]

2. A utility has an obligation to serve at "lowest feasible cost."[67]

3. A utility must use "all available cost savings opportunities...as well as general economies of management."[68]

These standards replicate pressures of a company subject to effective competition. If that company did not "operate with all reasonable economies," serve at "lowest feasible cost" and use "all available cost savings opportunities," it would lose its customers to companies that did. If Kansas utilities do not meet these standards—if 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.

[66] *El Paso Natural Gas Co. v. Federal Power Commission*, 281 F.2d 567, 573 (5th Cir. 1960).

[67] *Potomac Elec. Power Co. v. Pub. Serv. Comm'n of the D.C.*, 661 A. 2d 131, 137 (D.C. 1995).

[68] *Midwestern Gas Transmission Co. v. E. Tenn. Natural Gas Co.*, 36 FPC 61, (1966), *aff'd sub nom. Midwestern Gas Transmission Co. v. Federal Power Commission*, 388 F.2d 444 (7th Cir. 1968).

Q. In making the dominant selection criterion purchase price rather than customer benefits, did Westar's Board honor its obligation to its customers?

A. No. Westar caused its customers harm—what economists call "opportunity cost harm." "[T]he opportunity cost of an item—what you must give up in order to get it—is its true cost."[69] In the context of utility acquisitions, opportunity cost harm occurs if the transaction displaces some other action that would produce more benefits to the public.

In competitive markets, companies that make suboptimal decisions do not succeed. This principle applies to all decisions—hiring employees, buying fuel, and signing billion-dollar merger agreements. Disregarding this principle in utility mergers produces outcomes inconsistent with competitive performance.

And that is what happened here. Westar's Board organized a competition in which the dominant criterion was purchase price. Choosing the acquirer offering the highest price means not choosing the acquirer offering the most customer benefit (unless coincidentally the former and the latter companies are the same). The resulting loss of benefit is opportunity cost—economic harm. To be indifferent to the opportunity cost is to allow the merging companies to gain benefits while causing customers to incur costs. That is not a competitive market outcome and it is not a public interest outcome.

But that is the outcome here, because Applicants guarantee zero benefits. Had Westar based the competition on customer benefits, there would not be guaranteed benefits of zero. There would be guaranteed benefits equal to *the maximum benefits that the most cost-effective coupling could produce, less whatever profit from the transaction*

[69] Krugman, P. R., and R. Wells, *Microeconomics:* Third Edition (Macmillan 2012).

was necessary to make each company better off with the merger than without. What those benefits would be, we have no idea—because Westar's preoccupation with price has denied us the competition that would have revealed them. So when Westar offers "beliefs" instead of guarantees (as I will discuss in Part III below), the Commission cannot make the comparison necessary to find that this Transaction is in the customers' best interest. That evidentiary gap is Westar's fault, and it is fatal.

Consider the alternative. Westar's Board could have sought and screened acquirers based on customer benefits. Then it could have caused the screened-in contestants to compete, with currency being commitments to Westar's customers. Then, and only then, the Westar Board could have induced the surviving competitors to compete on price. Running the competition that way—first auditioning bidders based on benefits, then having the finalists bid on price— customer benefit would have prevailed over price. Westar had it backwards.

Q. What about Applicants' statement that this Transaction is "best" for all?

A. Applicants state that this Transaction is "the best possible outcome for the State of Kansas, its communities, customers served in Kansas by Westar and KCP&L, and the Commission, as well as Westar and GPE shareholders."[70] This statement is neither factual nor logical. It is not factual because Westar sought and compared bidders based primarily on price. Consumer benefit was only incidental—its consideration consisting merely of Westar verifying that GPE would satisfy the Commission's minimum

[70] Application at 4.

standards. Westar has known of GPE for decades. If from a customer perspective GPE was truly the best acquirer, there was no reason for Westar to seek bids from others.[71]

And the statement is not logical because its premise—that the interests of shareholders and customers are aligned—is wrong. In an effectively competitive market, those interests are aligned because if shareholders seek too much profit, the company's prices will rise or its quality will decline, causing customers to shop elsewhere. An acquisition of a utility monopoly does not occur in a competitive market, so there is no necessary alignment of shareholder and customer interests.

So the claim of "best" is neither factual nor logical. Nor is it provable, because Westar never held a competition to see what acquirer (or non-acquisition scenarios) would be "best" for consumers. We don't know what benefits might have emerged. To claim that the Transaction is the "best" is puffery—inappropriate for a serious evidentiary proceeding like this one.

Q. Isn't seeking the highest price what everyone expects profit-maximizing sellers to do?

A. Yes, in competitive markets. But in competitive markets the asset seller's desires are disciplined by the need to keep its costs reasonable to avoid losing customers. Consider the sale of an apartment building, in a city with plenty of apartment vacancies. The interests of the building seller, building buyer and renters are aligned. The building seller will demand the highest possible price, but the buyer will resist paying a price above what she predicts she can recover as she competes for tenants in the competitive rental

[71] Indeed, once the Westar Board authorized Mr. Ruelle to approach a single long-term bidder, Mr. Ruelle's first call went not to GPE but to Bidder A. See Proxy Statement at 56-57. Why not go directly to GPE?

market. So the building buyer will pay a premium no greater than the new economic value she believes she can create as the new owner. That new economic value is a public interest benefit. In that market, competition injects discipline. That discipline ensures that an acquisition contest run by the seller, based on highest possible price, can produce a public interest result.

Monopoly utility service is not like competitive apartment rentals. The customers who depend on their utility's monopoly distribution service cannot shop elsewhere. So the interests of asset seller, asset purchaser and the ultimate consumer are not aligned. That non-alignment produces a conflict between the asset seller and the ultimate consumer—between Westar and its utilities' customers. Holding out for the highest price produces an outcome different from holding out for the best performer—unless by coincidence they happen to be the same company.

Applying this reasoning to the acquisition premium: Where competition for the customer is effective competition, a premium is routine and legitimate because the shareholder interest and customer interest are aligned. If the acquirer faces effective competition in its ultimate product market, it will pay no more for the target company than what it predicts it can recover by pricing competitively, *i.e.*, setting prices high enough to cover its costs and yield a reasonable profit, but not so high as to lose customers to competitors. In the context of regulated monopolies, the acquirer does not risk losing customers to competitors, so the interests of shareholders and customers are not aligned. Westar resolved the shareholder-customer conflict by maximizing shareholder benefit while guaranteeing zero customer benefit.

Q. But doesn't regulation replicate the forces of competition?

A. That is its purpose in theory. But in practice, there are problems. Regulation, like competition, has imperfections. In the merger context, one imperfection is the asymmetry of information. If information were perfect, a regulatory staff could establish now, for the post-merger Westar, performance standards equivalent to what a competitive market would have produced. Then the Commission could hold Westar to those standards, with the consequence of non-compliance being loss of customers. But that scenario is unrealistic, for two reasons. First, the regulatory staff does not have that information.[72] Second, Kansas statutes do not authorize the Commission to allow customers to buy electricity from others should Westar's post-merger performance fall below Commission standards. So in the merger context regulation cannot, as a practical matter, replicate competitive market outcomes. For that reason, treating the acquisition premium as an ordinary occurrence is an error.

Q. Didn't the Westar Board have a fiduciary duty to maximize its shareholders' wealth?

A. I assume so, based on the statutory law of its incorporation state. But a board's fiduciary duty is always subject to other legal duties. Otherwise, companies could, without legal consequence, violate tax laws, trade laws or environmental laws, all in the name of complying with a fiduciary duty to maximize profit. Rights and obligations under corporate law are always subject to rights and obligations under substantive utility law.

[72] *See, e.g.*, Department of Justice/Federal Trade Commission Horizontal Merger Guidelines at section 10 ("[Merger] efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms.").

Applying that principle here: 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.

Westar treats its fiduciary obligation to shareholders as a constraint on its public utility obligation to customers. That view makes Westar's decision (to base the competition on shareholder gain rather than customer benefit) a constraint on the Commission's decision (on whether to approve a transaction that fails to maximize customer benefit). Westar has it backwards: Westar's fiduciary obligation is constrained by its statutory obligations to customers and the public interest. The Commission determines the constraints arising from substantive utility law; then Westar seeks acquirers consistent with those constraints. By finding that auctions dominated by price rather than benefit fail the public interest test, the Commission will signal that the franchise is a privilege to be earned through performance, not an asset to be bought with dollars.

Q. The Commission's prior merger decisions did not require the target company to prove it selected the acquirer that was best for customers. Are you asking the Commission to "change the rules mid-game"?

A. No, because my position does not change the rules; it applies the rules. A utility must serve its customers cost-effectively. The Commission 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 Commission's—align shareholder interest and customer interest. There is no rule guaranteeing

shareholders an opportunity to earn a return exceeding a reasonable return, or to cause customers opportunity cost by receiving a premium rather than providing customer benefits.

Would it have been better had the Commission, prior to this Transaction, made this point explicitly? Yes. But the rule has always existed implicitly, in the utility's unambiguous, undisputed obligation to minimize its customers' costs. And the rule exists within the Commission's merger standard (a)(ii). A purchase price cannot be "reasonable" if it reflects a decision to put shareholder and ratepayer interests in opposition, creating debt in the holding company not for purposes of investing in customer benefits but for purposes of providing target shareholders unearned gain.

Westar will likely argue that by now recognizing this principle explicitly, the Commission will be denying Westar shareholders a gain they expected when they purchased Westar stock. That argument misses the fundamental difference between investing dollars in public utility assets and betting dollars in the stock market. Westar has invested its shareholders' money in utility assets. The Commission has set lawful rates that authorize a fair return on the book value of assets. If the Commission finds the control premium to be overcompensation (as I discuss in Part II.D below), then allocates it appropriately between Westar's shareholders and its customers, the utilities' rates will still be lawful because they will give the utility a reasonable opportunity to recover its prudent costs along with an appropriate return. The Commission has never promised shareholders an opportunity to earn more than the authorized return on investment in utility assets. Nor has the Commission ever promised shareholders any particular return

on their investment in utility stock. That shareholders bet their money on a different outcome is not the Commission's legal concern.

In sum: For the Commission to require Westar, in seeking and choosing acquirers, to find the best performer for consumers does not conflict with any regulatory obligation to shareholders. There is, therefore, no "changing the rules mid-game"—at least not for any game relevant to public utility regulation. What would "change the rules of the game" would be to allow a utility board, whose franchise obligation requires putting customers first, to ignore that obligation just because it sees an opportunity to sell the franchise for a gain.

Q. If the problem is target companies choosing acquirers for the wrong reason, how can the Commission fix the problem?

A: A market in which a utility with a state-protected monopoly can sell its franchise for profit, to the buyer promising to pay the highest price, is a distorted market.

There are two ways to fix the problem. The first way is the negative way: Disapprove acquisitions whose origins lie in unnecessary shareholder-customer conflict, such as when the target company runs a competition based on purchase price rather than customer benefit. But this is only a partial solution, because it has the Commission saying "no" without explaining how it would say "yes."

The second way is the positive way: Eliminate the conflict by requiring that in seeking prospective acquirers, the utility must run the competition based on benefits to customers. Necessarily accompanying that policy is this rule: If there is a control premium (the excess of purchase price over market price), customers must receive a portion commensurate with their contribution to its value. I discuss this concept in Part II.G.

Each of these two approaches will disappoint those Westar shareholders who bet on the Commission's approving the Transaction and allowing them to keep the control premium. But the Commission's obligation is not to honor shareholder bets on acquisitions; it is to authorize sufficient returns on investments in utility service, and then to enforce the utility's obligation to serve—an obligation that, as in a competitive market, puts customers first.

This reasoning fits well within the Commission's merger standards (a)(ii), (a)(iv) and (g). In competition generally, in regulation generally, and in just and reasonable ratemaking specifically, customer interests and shareholder interests are aligned—as long as those interests are legitimate. Customers need a utility whose financial condition is sufficiently strong to attract capital on reasonable terms. Shareholders need customers who are satisfied with their quality of service and the rates they pay. Just and reasonable rates satisfy both interests. There may be differences of opinion over methodologies and standards—differences that exist among customer groups as well as between customers and shareholders. But at bottom, the legitimate interests are aligned. The acquisition premium paid here creates a misalignment. It reflects Joint Applicants' intent to set shareholders against ratepayers—to pay a purchase price determined not by the value of the transaction to consumers but by the gain-seeking goals of Westar shareholders. Such conflict cannot be consistent with the "reasonableness" criterion of Commission standard (a)(ii). And because the purchase price was determined by auction among buyers rather than analysis of customer savings, it violates the requirement of Commission standard (a)(iv), that there be operational synergies that justify payment of the premium. Finally, a transaction between monopolies, neither one disciplined by competition for the

consumer, where the seller is seeking a price unrelated to the benefits it provides the consumers, is untethered from the goal of economic efficiency, necessarily violating Commission standard (g)'s requirement that the transaction "reduce the possibility of economic waste." Using dollars to pay Westar's gain rather than investing them prudently in needed infrastructure is the definition of "economic waste."

D. The control premium overcompensates Westar shareholders

Q. Describe the organization of this subsection.

A. Applicants would allocate the entire control premium to Westar shareholders. Allowing them to do so would commit a multi-billion-dollar error, for four main reasons. First, the five key contributions to the premium's value do not derive from Westar shareholders' risk-taking or Westar management's decision-making (Part II.D.1). Second, through Commission-set rates, Westar shareholders already have received their appropriate compensation. Any portion of the control premium is extra compensation (Part II.D.2). Third, Westar's franchise is a privilege bestowed by Kansas to serve the public; it is not Westar's asset to sell for profit (Part II.D.3). Fourth, legal ownership of Westar stock does not mean legal entitlement to the control premium (Part II.D.4). These four concerns lead to the same conclusions, regarding the Commission's merger standards, that I explained at the end of Part II.C. Overcompensation violates the reasonableness standard because it misallocates economic benefit between ratepayers and shareholders (standard (a)(ii)), divorces purchase price from synergies (standard (a)(iv)), and by channeling dollars to passive shareholder gain rather than active efficient investment causes economic waste (standard (g)).

1. The five key contributions to the premium's value do not derive from Westar shareholders' risk-taking or Westar management's decision-making

Q. Introduce the relationship between shareholder gain and economic value.

A. When markets are efficient and when competition is effective, gain goes to those who create economic value. Shareholders deserve gain when they take risks to improve their company, and when their company's executives take actions that increase quality or lower costs.

In the proposed Transaction, the Westar shareholders' gain is the $2.3 billion control premium. KCC Staff Witness Grady explains that GPE's willingness to pay that premium can be linked to at least four factors. As I discuss next, none of these factors is attributable to risk-taking by Westar shareholders or managerial actions by Westar executives.

a. GPE expects to earn equity-level returns on investment financed with lower-cost debt

Q. Explain why the gain from financing equity purchase with debt owes nothing to Westar shareholders.

A. To finance its purchase of $8.6 billion in Westar equity, GPE plans to borrow $4.4 billion, with the rest of the purchase financed by issuing new stock (to Westar shareholders and to the public). Debt is, of course, less costly than equity because its risk to investors is lower: The borrower has a contractual obligation to pay back the principal with interest; the stock issuer normally has no obligation to pay the stock buyer anything. The anticipated interest rate on this acquisition debt is 3.86%.[73] Westar's most recent

[73] This figure is derived using the $170 million interest costs and $4.4 billion new debt. See Direct Testimony of Kevin Bryant.

authorized return on equity approved by the Kansas Corporation Commission is 9.35%.[74] If GPE can finance $3.7 billion of Westar's equity at 3.95% but earn on that equity 9.35%, its financial planners will have produced a large profit.[75] The anticipation of that profit is one reason why GPE is willing to pay the premium. (Financial analysts describe this action as "double-leveraging," because there is debt at both the holding company level and the utility level. They also call it "financial engineering," because the profit comes not from physical improvements but from financial arrangements.)

This profit is solely the result of two factors: the traditional differentiation financial markets make between interest cost and equity cost, and an expectation of the Commission's willingness (at least as anticipated by GPE) to apply an equity-level return to equity purchased with debt. Neither of these factors owes its origins to risk-taking by Westar shareholders or managerial decision-making by Westar executives. Indeed, ratepayers are the source of this gain because they pay the rates that are not being lowered to reflect the lower debt cost. The profit does not reflect improvement in business operations. There is, therefore, no necessary reason why Westar shareholders are entitled to the portion of the premium associated with this value.

[74] See Docket No. 15-WSEE-115-RTS. The case was settled with a pre-tax return on equity. The 9.35% figure can be derived from the settlement number. The settlement can be found at http://estar.kcc.ks.gov/estar/ViewFile.aspx/S20150806151046.pdf?Id=06892f1c-caa8-491c-88f3-ea58aba56f61. This same number was used in a Westar Investor Presentation of August 2016.

[75] The $3.7 billion of equity is attributable to Westar's Kansas-jurisdictional and FERC-jurisdictional businesses. KCC Staff Witness Grady develops this point in more detail.

My purpose at this point is not to criticize double-leveraging as an acquisition strategy, nor to advise the Commission on whether to authorize equity-level returns on equity financed with debt. (This issue is discussed by Staff Witnesses Grady and Gatewood.) My point is more specific: to demonstrate that the portion of the premium attributable to double-leveraging does not reflect value created by Westar shareholders.

Adding to the value of double-leveraging is the current low level of interest rates. What goes for home buyers goes for utility acquirers. When interest rates are low, a home buyer will be willing to pay more for a house (or buy a larger house) than she would when interest rates are high. Similarly, a corporate acquirer will be willing to pay more for a utility during a low-interest period than during a high-interest period. That factor also contributes to the premium, as Mr. Grady explains. Indeed, Mr. Ruelle saw opportunity in the fact that low interest rates were causing higher utility acquisition prices. As Mr. Ruelle testified:

> ... [U]tilities are trading at pretty high values. The reason for that is low interest rates. That meant that the value for our shareholders is good, and that with a combination could be even better, yet there were assurances that a buyer could finance the transaction on acceptable terms. Maybe those conditions will persist, maybe they won't, but we felt it important to capture those advantages.

Ruelle Direct at 16. Like double-leveraging itself, low interest rates owe nothing to Westar shareholders' risk-taking or Westar executives' decision-making.

b. GPE expects Westar's actual return to exceed GPE's required return

Q. Explain why GPE's expectation of actual returns exceeding its required return does not entitle Westar shareholders to a premium.

A. A second contributor to the acquisition premium, as Mr. Grady explains, is GPE's expectation that actual returns earned by Westar (and thus accruing to GPE) will exceed

GPE's "required returns." By "required return" I mean that return viewed by GPE as high enough to persuade it to invest in Westar rather than put its money elsewhere. The source of this return is, of course, Westar's existing rate base, to which the Commission applies an authorized return. As with double-leveraging, this factor owes nothing to decisions made or actions taken by Westar shareholders or executives. To the extent this factor contributed to the premium, then, Westar shareholders have no necessary entitlement to it. And again, the source of this value is the ratepayers' payment of rates that produce an actual return exceeding GPE's required return.

GPE's expectation that actual returns will exceed required returns is not limited to Westar's current rate base. GPE also saw value in the potential for adding to Westar's rate base. In GPE's July 2016 presentation to investors, under the heading "Compelling Strategic Rationale" are these items:

"Increased access to attractive rate-based growth opportunities"

"Ability to invest aggressively in transmission assets"

And under the heading "Significant Targeted EPS [Earnings per Share] Accretion" is this item: "Incremental investment opportunities: Transmission, Renewables, Energy efficiency."[76] So part of the premium Westar shareholders would receive is attributable to GPE's valuation of that profit potential from these activities. Additionally, if GPE sees future rate base growth as justification for buying Westar's equity at a premium, then GPE necessarily is assuming that the return on that future capital investment will exceed the cost of its investment capital.

[76] Great Plains Energy Investor Presentation, filed with the SEC as Form 425 (filed June 7, 2016).

These factors are not an appropriate basis for Westar shareholders' receiving the control premium, for at least two reasons. First, GPE's opportunity to grow Westar's rate base exists because decades ago Kansas granted Westar an exclusive franchise—an event unrelated to the merits of Westar's current management or the risk-taking of Westar's current shareholders. When Westar needs new distribution, transmission or generation, Westar has, at least under current practice, the automatic and exclusive opportunity to make the profit-causing investments that GPE values. It is government protection from competition, not Westar's merits, that creates this opportunity for gain.[77] There is no clear reason why Westar shareholders should receive that gain.

From that reasoning, a second problem arises. GPE is betting literally billions that Westar's future infrastructure will be provided by Westar—that because it has government protection from competition today it will have that protection in the future. Who says? Constructing or repowering generation, and extending or "hardening" transmission and distribution—these are activities carried out competently by dozens of other companies, in the United States and elsewhere. Customers benefit when major projects are undertaken by the most qualified companies. Why should GPE assume that Westar will always be the preferred provider of these services—that Kansas government will always intervene in the market to protect Westar from competition, to block those who seek to bring benefits to Kansas? Or why should Westar assume, immodestly, that

[77] *See Order on Merger Application, in the Matter of Application of Western Resources, Inc. and Kansas City Power & Light*, Docket No. 97-WSRE-676-MER, at para. 10 (Sept. 28, 1999) (describing the Retail Electric Suppliers Act, K.S.A. 66-1,170 *et. seq.* as "divid[ing] the state into exclusive territories" and thus creating a "legislatively mandated monopoly").

should Kansas someday open its doors more widely to companies seeking to compete in the State, that Westar will always come out the winner? GPE is betting that by paying the premium it will get a government-protected right to avoid competition—a bet that assumes this Commission will block that competition. Consistent with its obligation to advance the public interest, the Commission should correct GPE's misimpression. It is not the purpose of government to protect companies—even Kansas companies—from the normal business pressures. (It is true that Kansas statutes prohibit retail competition. But the activities I have described here are not about retail competition—they include building and maintaining the infrastructure necessary to retail service regardless of whether there is retail competition.)

In short, GPE's expectation that actual returns will exceed required returns—which Mr. Grady shows is a contributor to the control premium—has no necessary roots in Westar's merits; instead, it has roots in a mistaken assumption that state government will protect Westar from competition.

c. "Economies of scale" and "best practices" are attributable to factors external to Westar's performance

Q. Explain why "economies of scale" and "best practices" are not appropriate justifications for Westar shareholders to retain all of the $2.3 billion control premium.

A. GPE has asserted that the Transaction will reduce Westar's costs due to savings from "economies of scale"[78] and "best practices."[79] GPE intends to retain the resulting savings between rate cases, rather than pass them through to ratepayers as they occur. The ability

[78] *See, e.g.*, Application at para. 19.

[79] *See, e.g.*, Kemp Direct Testimony at 25.

to retain these savings is one reason for GPE's willingness to pay a premium to Westar shareholders. But as discussed next, neither economies of scale nor best practices results from any Westar action other than ordinary utility performance. Therefore there is no justification for Westar shareholders to receive extraordinary gain.

Economies of scale: For a given product or operation, economies of scale exist when the per-unit cost declines as output increases. This cost function—the mathematical relationship of cost to quantity—is inherent in that product or operation; it does not result from managerial skill. If a bakery's per-loaf cost is lower when it produces 1000 loaves per day rather than 200 loaves per day, that cost is lower not because the bakery used more skill or took more risk but because it increased its inputs (floor size, oven size, staff size, volume of flour and sugar purchased) or used existing fixed costs more intensively. To use a common example in mergers, if the shareholder relations function can be carried out just as effectively by a single office rather than the pre-existing two offices, it does not take special management skill or shareholder risk to notice that fact, lay off the redundant employees and sell off the redundant equipment. The savings are inherent in the function—whose per-unit cost declines as output grows. (Management might need to incur costs to execute the increase in production, but that effort or cost will be recovered through rates as "transition cost.") If the shareholder relations office costs $1 per shareholder for each company separately, but only $0.65 per shareholder when the two companies join, it is because the computer and staff and headquarters space in one company are capable of serving both companies' shareholders. This fact is not the result of risk-taking or skill. Because economies of scale are not attributable to Westar's efforts, they are not a legitimate basis for Westar shareholders to

keep the full control premium. If this is a situation in which neither shareholders nor ratepayers can claim to be the cause of the savings, the logical treatment is a 50-50 sharing, as I will explain in Part II.G.

Best practices: Best practices are simply prudent practices. They are the activities that any successful competitor, and any prudent utility, must engage in to retain its customers. Hiring consultants, sharing ideas with peers, attending professional conferences, overseeing contractors, recruiting capable managers and employees, compensating based on merit: all these activities are "best practices" expected of any company. If Westar is failing to use such practices now, it makes no sense to reward Westar shareholders with a premium just because GPE will inject those practices. A failure by Westar to use best practices is cause for a Commission investigation into Westar's imprudence, not a basis for rewarding Westar shareholders.

One could argue that some reward for economies of scale and best practices should go to Westar shareholders, to encourage voluntary mergers that benefit customers. (This argument would first need to confront the counter-argument that just as a company in a competitive market must find and use all sources of efficiencies, including merging, so must a utility. Any other treatment would cause "waste," prohibited by Commission merger standard (g).) If so, that reward should be some percentage of the improvements that derive uniquely from the merger, as opposed to savings that the target company could produce without the merger. Even more logical would be to award the premium not solely to Westar shareholders but also to the individual employees who make the efficiencies possible.

I reiterate my earlier point: In an effectively competitive market (which regulation strives to emulate), new entrants can replicate the savings and lower the prices, thus causing the savings to shift from the sellers to the customers. It is only GPE's and Westar's protection from competition that allows the utility to keep these savings derived from economies of scale or best practices. That protection from competition arises from government policy, not from a strong market position earned by hard work, special skill or risk-taking. Economies of scale and best practices do not justify Westar shareholders' receiving the control premium.

d. GPE would use Westar's profit to extract value from GPE's net operating losses

Q. Explain how GPE's net operating losses relate to the acquisition premium.

A. KCC Staff Witness Grady explains GPE's expectation that Westar's profitability will enable GPE to monetize $400 million in net operating losses incurred by GPE's non-utility subsidiaries. He asserts that part of the control premium can be attributable to this factor.

As with the other three contributors to the premium, this one owes nothing to Westar shareholders' risk-taking or Westar management's decision-making. The net operating losses themselves arise from business decisions (suboptimal ones, I assume) made by GPE executives or the predecessor of the non-utility companies.

e. Westar's value to GPE owes more to Kansas government decisions than to Westar management's actions

Q. Explain how Westar's value to GPE is related to Kansas government decisions rather than Westar's merits.

A. In the preceding five subsections, I explained that GPE's willingness to pay the control premium (and Westar's ability to demand it) is, with minor possible exceptions, not based

on Westar shareholders' risk-taking or Westar management's decision-making. One therefore must infer that Westar's value to GPE lies in Westar's franchise—its government-granted, exclusive right to provide an essential service, free from direct competition, in return for monthly customer payments. Those monthly payments, like the franchise itself, are established by government based on relatively predictable principles that guarantee the utility a reasonable opportunity to earn a fair return on prudent investment. It is that franchise—that right to provide a government-regulated service free from competition—that GPE is buying with the premium.

Here is another way to understand the point. When GPE buys 100% of Westar stockholders' shares, GPE is actually buying two things: the Westar utilities' assets and the Westar utilities' franchises. Today, the assets sit on Westar's books at book value. After the acquisition, those assets will remain on the books at book value (a necessary result of not putting the acquisition premium into rate base). Because in Kansas utility regulation rates and profits are based on book value, we can assume that the value to GPE of these bare assets (*i.e.*, the assets separated from the franchise) is book value. If the value of the bare assets is only book value, then GPE is paying the premium—the portion of the purchase price exceeding book value—for something else. That something else is the franchise—the exclusive, government-protected right to sell a necessary service within a defined geographic territory. GPE is paying Westar shareholders a premium to get control of the franchises. (Consider this: If the Commission or the Legislature, prior to GPE's committing to pay a control premium, had declared that the utilities' exclusive franchises would no longer be exclusive, would GPE have offered the same control premium? Unlikely.)

But a franchise is not a private good, like a refrigerator or a television set. A franchise is a government-granted right—the right to be the sole provider of a government-defined service in a government-defined service territory. The franchise was not created by the shareholders; it was created by government. Therefore the franchise right is not a private good owned by the shareholders; it is a public license granted by the government. Yet Westar proposes to treat its franchises like a private good, to be sold to the highest bidder.

Having concluded that GPE is paying a control premium to get control of Westar's franchises, how does GPE's motivation relate to Westar's compensation? What GPE is buying with the control premium is a value created by government and ratepayers, not by Westar shareholders. To allow them to keep the premium is overcompensation. And as I have already explained, overcompensation violates the reasonableness requirement of merger standard (a)(ii), disconnects the premium from synergies (contrary to the requirement of merger standard (a)(iv)), and causes economic waste in violation of merger standard (g).

2. Through Commission-set rates, Westar shareholders already have received their appropriate compensation; the control premium is overcompensation

Q. Explain the connection between the compensation Westar shareholders receive through rates and the gain they would receive from the control premium.

A. A utility has a legal right to compensation. That legal right comes from two sources: the statutory standard of "just and reasonable"; and the Constitutional standard, inscribed in the Fifth Amendment's Takings Clause (as applied to the states through the Fourteenth Amendment's Due Process Clause), stating that "nor shall private property be taken without just compensation."

In cost-based ratemaking, regulators set rates that give the utility a reasonable opportunity to recover its expenses, pay off its debt on time, pay the contractually required interest on that debt, and still have enough revenue to provide a return on equity prudently invested in the utility business—that return being sufficient to compensate investors for their risks. As Justice Brandeis has stated, in famous language repeated over the decades:

> The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.[80]

The phrase "capital embarked in the enterprise," Justice Brandeis explained, is the money invested in assets that serve the public, *i.e.*, book value, otherwise known as rate base:

> The adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors involved in rate controversies which are now shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable. The rate base would be ascertained as a fact, not determined as a matter of opinion. It would not fluctuate with the market price of labor, or materials, or money.[81]

When a commission sets cost-based rates, utility shareholders receive the compensation required by statute and Constitution. That compensation is what Westar shareholders have received from this Commission's lawful decisions (with judicial review available should shareholders feel aggrieved).

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[80] *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 290 (1923) (Brandeis, J., concurring).

[81] 262 U.S. at 307-08. For additional discussion of this point, see Scott Hempling, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction* at 104-05 (American Bar Association 2013).

If the compensation from cost-based rates is sufficient compensation, then the control premium necessarily is extra compensation—overcompensation. It does not represent "capital embarked in the [public utility] enterprise," *i.e.*, funds invested in assets used to provide public utility service. The control premium represents what GPE is willing to pay Westar shareholders to get control of Westar's franchise. Because the control premium does not represent investment in utility service assets, Westar shareholders have no legally protected expectation to receive it. Expectations of a premium arise from shareholders betting on the stock market, not utilities investing in public service assets. The regulatory obligation, and the legitimate shareholder expectation to which that obligation applies, relate only to the latter. Rate base is where government honors its obligations; stock value is where shareholders bet their money.

Q. What about the argument that the premium paid here was consistent with the premium paid in other transactions?

A. Mr. Bryant states that the premium "is in line with that paid in other recent deals."[82] From this statement, I assume Joint Applicants will argue that Westar shareholders are entitled to keep the premium. There are two problems with this statement and the argument. First, the statutory standard is not "in line with other deals"; the standard is "efficient and sufficient" service. If in these "other deals" the target company did what Westar did—violate its obligation to act cost-effectively by standing ready to scrap a cost-effective deal unless it got the maximum gain (as I explained in Part II.C.2 above)—these "other deals" are poor models for this Commission to replicate.

[82] Supp. Dir. at 3.

Second, Mr. Bryant's statement separates price from product, making it meaningless. Joe says to Mary: "I paid $200 for my plane ticket." Mary says: "So did I." This equality of price, and the conversation, tell us nothing unless we know where each person flew, from where, at what time of the year and for what purpose, and how far in advance they bought their ticket. Mergers are not commodities, to be compared based only on price.

3. Westar's franchise is a privilege bestowed by Kansas to serve the public; it is not Westar's asset to sell for profit

Q. Explain the connection between the franchise privilege and the control premium.

A. Westar shareholders do not own the franchise. The franchise is a set of rights granted by the government, and a set of obligations undertaken by the utility. The right is the right to provide legally defined services, protected from competition, under legally defined constraints, in return for legally defined compensation. The "value" of the franchise right necessarily depends on those legally defined parameters. To assume, as Westar apparently does, that "value" includes the value of selling the franchise right for gain, is to reason in a circle, *i.e.*, to assume the answer to the question at issue. That question—whether Westar's "right" includes the right to keep the control premium—is for the Commission to answer. The answer cannot be that Westar is entitled to keep the gain because there is value from keeping the gain. That is the essence of circular reasoning.

If Westar shareholders were to insist on a "right" to the control premium, their reasoning likely would distill to this syllogism:

1. Westar shareholders are entitled to the value of the franchise.

2. The value of the franchise includes the gain from selling control of the franchise to a bidder selected by Westar based on the highest price offer.

3. Therefore, Westar shareholders are entitled to the gain from selling control of the franchise to GPE.

This distillation reveals the problem. Step 1 cannot be correct just because Westar says so. Step 1 can be correct only if the Commission decides it is correct. Because the franchise was created by the State, not Westar, and because the power to grant and condition the franchise is with the Commission, not Westar, the decision on who gets the value of the franchise is a decision for the Commission, not for Applicants.

And the decision must be this: The value of the franchise right is defined by the State, because the right is created by the State. The franchise is not the utility's private property. It is not like the land under my house—land I bought, land I own, land I risked buying so that I could get gain when I sold it. Here, the "land" granted to Westar is the privilege to provide electric service in defined areas within Kansas. That privilege does not include a right to sell the privilege for gain. It may well be that GPE views that privilege as a profit opportunity, and is thus willing to pay a premium for it. But GPE's desire does not become Westar's gain.

Those are the problems with Step 1 of the syllogism. Step 2 suffers from both circularity and substance. As I have explained, Step 2 is circular because the value of the franchise includes the gain from selling control only if the Commission allows the selling shareholders to keep the gain—and that is the very question we are trying to determine. The substantive problem is the assumption that we would measure the "value" of a franchise based on what the acquirer is willing to pay for it. That willingness to pay will depend on whether the Commission allows the selling utility to insist on and receive the premium. If the Commission decides that the incumbent is not entitled to a premium,

then the acquirer will not need to pay a premium—unless the Commission demands a premium for the state or the customers.

To view the control premium as the Westar shareholders' to keep is to treat Westar's franchise like a McDonald's franchise: a business opportunity bought at one price, owned by the buyer and then resold at a higher price. Westar's right to serve Kansas customers is not like a McDonald's franchise.

Denying Westar shareholders this gain will cause them disappointment. But shareholder disappointment matters legally only if the state has made some kind of commitment, the breach of which caused that disappointment. There is no evidence that Kansas ever promised Westar shareholders the opportunity to sell out for a gain.

In granting a franchise, the state grants the utility a right to engage in a particular activity: selling the obligatory services that are the subject of the franchise. Other than this right to sell obligatory service, the government has given nothing else. Westar shareholders may have *hopes* of selling at a gain. But those hopes are not supported by any government commitment, because the sole government action here was to grant Westar the right to provide the obligatory service in return for "just and reasonable" rates. And because such hopes are only hopes, government owes the shareholders nothing when those hopes turn to disappointment. To compensate shareholders for mere disappointment, when they have already been compensated justly for their utility's investment, is to divert dollars from those who earn to those who complain. That is the definition of economic waste—a violation of merger standard (g).

4. Legal ownership of Westar stock does not mean legal entitlement to the control premium

Q. What about the argument that Westar shareholders are legally entitled to the premium because they are the legal owners of Westar's stock?

A. This argument, like the previous one, is circular. The word "entitled" implies a legal right. There is no legal right unless the statute or Commission creates one. The Commission has never promised Westar it could keep the gain from a control premium.

This argument also imports, incorrectly, a non-regulated market concept into a regulated market context. In a non-regulated market, the acquirer's willingness to pay the premium, and the target's expectation of a premium, are both disciplined by competitive market forces. (See my discussion of the apartment market in Part II.C.2 above.) Those forces limit the acquirer's ability to recover its acquisition cost. In our regulated utility market, that discipline is not as strong. Yes, the regulator can (and should) disallow the premium from rates. But if by paying the premium the acquirer suffers financially, and if the state's health is linked to the acquirer's health (due to the acquirer's monopoly status), the regulator may feel it has no choice but to allow some recovery of the premium, either directly or indirectly.

If it were literally true that shareholders are entitled to *any* appreciation on stock value, then Westar shareholders could demand, and GPE might be willing to pay, $10.3 billion instead of the current $2.3 billion. And if shareholders were legally entitled to any appreciation, the Commission would have to approve the Transaction, regardless of how high was the acquisition price. But that is not the law—or the Commission's merger standards, such as standard (a)(iv), tying the premium to synergies. Because there is no legally protected expectation to receive a control premium, the Commission is free

to reject an acquisition because of the control premium. (Such a policy would achieve several public interest goals, such as (1) preventing transactions that burden the acquirer with debt or the acquirer's shareholders with stock dilution, and (2) discouraging target companies from seeking acquirers based on the prospect of gain rather than the prospect of reduced costs and improved service.) And if the Commission can reject a merger because there is a control premium, it can approve a merger subject to a condition that there be no control premium, or that any control premium be allocated between shareholders and customers based on their relative contributions to the value of the franchise whose control is the reason for the premium (as I discuss in Part II.G below). Shareholders are not "entitled" to be free of a regulator's public interest decisions.

The "legal ownership" argument also assumes, incorrectly, that the franchise is a private good to which the shareholders have "title." This argument again imports unregulated market practices into a regulated utility market. In an unregulated market, one with no government intervention, buyers and sellers trade freely. They are entitled to the value of that to which they have title. If you want what I own, you must pay me what I want for it—its full value. But in utility regulation, legal ownership does not always entitle the owner to full value. Otherwise, utilities with monopolies could charge whatever price the market could bear, thereby earning full value. That is not how regulation works. When utility shareholders volunteer to enter a government-regulated market, they necessarily accept that regulation can affect value. That has been the law since medieval times, memorialized today in the landmark case of *Munn v. Illinois*, 94 U.S. 113, 126 (1877). There the Court stated that when someone

> devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be

> controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to the control.

What shareholders spend to buy stock is constitutionally distinct from what the utility spends to acquire utility assets. When the state grants Westar the franchise privilege, Westar undertakes an obligation to serve. To fulfill that obligation, Westar must invest in the necessary assets. In imposing this obligation to invest, the state has "taken" private property for which the Constitution requires "just compensation." Thus the just compensation relates to the utility's investment in utility assets. The shareholder's decision to buy stock is an entirely different matter. The decision to buy stock is not an obligation imposed by government to ensure the public is served; the decision to buy stock is a voluntary act made by the purchaser to increase his wealth. The stockholder is not "entitled" to any government protection of that decision, other than the expectation that, as Justice Brandeis explained, rates would be set to ensure a reasonable opportunity to earn a fair return on prudent utility investment.

In sum, this argument—that the legal ownership of the stock entitles the stockholders to the control premium—conflates what they own (the company and its assets) with what they do not own (the government-granted franchise). The franchise is not theirs to sell.

E. GPE's control premium debt will limit the Commission's future options

Q. Describe the organization of this subsection.

A. Prior subsections discussed the control premium from Westar's perspective. Westar shareholders do not deserve the premium because unlike shareholders in an unregulated

company, they played no clear role in creating its value. Now I will discuss the premium from GPE's perspective.

To buy Westar, GPE will issue $4.4 billion in debt and issue nearly that amount in new equity. To earn a return on that equity and to pay off that debt, GPE needs to grow its earnings. That need is GPE's private pecuniary need. But that private need becomes a matter of public interest concern if GPE's financial pressures affect the performance of Westar and KCP&L within Kansas.

Applicants assert, correctly, that the Transaction does not affect the Commission's legal authority. But they do not, and cannot, promise that, if approved, the acquisition will not affect the Commission's *practical* authority: its ability to guide Kansas's electric industry toward the most cost-effective future. In this subsection I explain how GPE's acquisition debt could constrain the Commission's practical authority in two ways: by limiting the Commission's decisions on Westar's earnings and its investment risks; and by constraining the Commission's efforts to open Kansas's commercial doors to others. My discussion will show that the transaction fails merger standard (d): "[w]hether the proposed transaction will preserve the jurisdiction of the KCC and the capacity of the KCC to effectively regulate and audit public utility operations in the state.

1. GPE's acquisition debt will constrain the Commission's decisions on Westar's earnings and its investment risks

Q. Explain the connection between GPE's acquisition debt and the Commission's future decisions on Westar's earnings and its investment risks.

A. I have explained that the premium is attributable in part to GPE's expectations that GPE will earn equity-level returns on debt financing, and Westar will bring GPE returns exceeding GPE's required returns. See Parts II.D.1.a and II.D.1.b., respectively.

In a regulated monopoly setting, when earned returns exceed required or authorized returns the result is economic waste—a violation of merger standard (g).[83] In that situation, customers would pay more for utility service than they would in a competitive market. That extra cost leaves them less disposable income to purchase more valuable goods, whether cars, books or clothes—all contributors to economic growth. Meanwhile, the recipients of the excess returns will be rewarded for reasons other than economic merit—thus inviting them to invest in other ventures lacking economic merit. The utility shareholders will be better off, but at the expense of the state's economy: extraction instead of expansion.

The Commission can avoid this result—by moving gradually to set authorized returns that track required returns, and by monitoring actual returns to keep them aligned with authorized returns, where the returns reflect the sources of capital actually used. But once GPE incurs its acquisition debt there will be pressure—from rating agencies, lenders, stockholders and GPE management—to set authorized returns based not on proper capital market theory and actual capital costs but on GPE's own needs—its acquisition-induced needs. The Commission can avoid this pressure by not allowing an acquisition that creates conflict between GPE's own interests and Kansas's broader interests.

[83] *See Order*, *In the Matter of Complaint of Farmland Industries, Inc.*, Docket No. 02-MAPP-160-COM, para. 67 (Jan. 31, 2005) (stating that "[u]se of the adjective 'efficient' to modify 'service' in K.S.A. 66-1,217 is evidence of the Legislature's intent to require a common carrier to provide service in a way that allows transportation for public use with a minimum amount of waste or unnecessary effort").

This reasoning applies as well to the continuing conversation in the regulatory field about the use of surcharges, riders and adjustment clauses. Each of these devices is a departure from traditional cost-based ratemaking. In traditional cost-based ratemaking, the revenue requirement and the resulting rates are based on predictions about costs and sales. Shareholders and customers bear the risk that actual costs and sales will vary from the predictions. The goal is always to allocate that risk in a way that strikes a cost-effective balance between minimizing the cost of capital (which rises with risk) and maximizing the utility's incentive to act prudently (which creates benefits for consumers).

There are numerous ways to "skin this cat"—numerous ways to allocate risks between shareholders and customers. My purpose is not to advise the Commission on their merits. My purpose, rather, is to emphasize that once the Commission approves an acquisition for which the acquirer incurs large debt, it will face pressure to reallocate risks from shareholders to customers, regardless of the effects on economic efficiency.

2. GPE's acquisition debt will constrain the Commission's and Legislature's future efforts to provide business opportunities for others

Q. Explain the connection between GPE's acquisition debt and regulatory and legislative efforts to encourage new companies to provide services in Kansas.

A. Applicants state (Application at 16) that "[u]nder the Kansas Retail Electric Supplier's Act, KSA 66-1,170 *et. seq.*, retail electric competition is not permitted, thus the Transaction will not result in any adverse effect on retail competition in Kansas." This statement, technically true, misses the broader question: Will this Transaction reduce future business opportunities in Kansas's electric industry? The answer is yes. Each opportunity for entry by a company other than GPE will make earnings less secure for GPE. Given GPE's high acquisition debt, the Commission will face pressure to protect

GPE from competition by others, including companies that can perform more cost-effectively. This concern applies to two categories of entrants, discussed next.

a. Investors in generation, transmission and distribution

Westar will need investments in generation, transmission and distribution facilities. It will need to create new facilities and repower or improve existing ones.

GPE is paying the premium in part to exploit these opportunities. "Increased access to attractive rate-based growth opportunities" is among the Transaction's "compelling strategic rationales."[84] But on this issue, GPE's interests and the Commission's duties conflict. GPE's interest is to profit from building and rebuilding Kansas's electricity infrastructure. The Commission's duty is to ensure that electricity prices are just and reasonable. That duty means always finding the most cost-effective solutions. There is no reason to assume that every time Kansas needs new or refurbished generation, transmission or distribution, GPE will be the best alternative. As with all government-related procurement, the job should go the most cost-effective supplier. That is the path the Commission must pursue. My point should not be confused with advocacy for retail competition, which is not permitted by Kansas statute. My point is that for any major infrastructural job, there could be many companies eager to come to Kansas to compete for the role. The Commission 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. It is issues like this that make so relevant to this Transaction merger standard (d). The

[84] Form 425 at 6 (June 7, 2016).

Commission should avoid approving transactions that will constrain its practical ability to act in the future.

And that is the problem arising from GPE's acquisition debt. If the Commission orders GPE to bid out particular investments, or plans to disallow GPE costs that exceed those of a more efficient supplier, it will face arguments that it is endangering GPE's bond ratings—bond ratings at risk because of the acquisition debt. Such arguments—made more likely by GPE's acquisition debt—puts GPE's needs ahead of the Commission's duties. This conflict provides no public interest gain. It diminishes the Commission's flexibility at a time when it needs more flexibility.

b. Providers of solar, wind, storage and distribution services

Today, Kansas's electric customers buy a uniform electricity product from a single supplier. Elsewhere, electricity customers large and small are gaining access to new distribution technologies. New companies are offering thermostat controls, time-of-use pricing and renewable energy packages. Consumers are self-supplying with solar panels. Neighborhood-level microgrids and customer-shared supply arrangements are under discussion. Aggregators of "demand response" are offering to pay consumers to use less, creating load-shifting behaviors that can displace higher-cost generation. Consumers are finding ways to lower their costs and raise their comfort.

Around the United States, these technological and market developments are stimulating discussion of regulation's central question: What market structures—what mixes of competition, monopoly and regulation—will produce the most customer-

responsive array of distribution services at reasonable cost? Such questions have become prominent in Maine, New York and elsewhere.[85]

I do not suggest that the Commission must mimic New York or Maine or should pick any of these paths, either in this proceeding or ever. But its continuing duty is to ensure "efficient and sufficient service" to customers. New technologies mean that "efficient and sufficient" service might be provided more cost-effectively by diverse suppliers. And so to address these possibilities objectively, the Commission cannot assume that GPE has a lock on all future opportunities. Other companies might provide these new services more cost-effectively. But that lock is what GPE will bet on when it incurs its acquisition debt. And so we have tension, again, between GPE's acquisition debt and the Commission's need for future flexibility.

In the distribution space, Westar is the gatekeeper. It controls physical distribution (sometimes called the "last mile"), meter data and interoperability protocols.[86] Its cooperation will be essential to bringing diversity to Kansas's electricity

[85] Maine is exploring whether to appoint a "smart grid coordinator"; New York is examining the possible roles for a "distribution system platform provider." *See Investigation into Need for Smart Grid Coordinator and Smart Grid Coordinator Standards*, Maine Public Utilities Commission Docket Number 2010-267; and *Order Adopting Regulatory Policy Framework and Implementation Plan*, Case 14-M-0101 (N.Y. Pub. Serv. Comm. Apr. 24, 2014). Both jurisdictions are examining whether this new service provider can be an entity other than the incumbent utility.

[86] *See* Johann Kranz and Arnold Picot, *Toward an End-to-End Smart Grid: Overcoming Bottlenecks to Facilitate Competition and Innovation in Smart Grids* (National Regulatory Research Institute 2011), available at http://www.energycollection.us/EnergyRegulators/TowardEndEnd.pdf. This study details how an incumbent utility can use its control over the "last mile," meter data and interoperability protocols to block entry by competitors into the evolving distribution space.

future. At the same time, Westar and GPE have a natural economic incentive to discourage developments that could displace their current investments and current roles. That incentive will be enlarged by GPE's acquisition debt.

The Commission needs to preserve its options—such as the option of giving diverse companies the chance to bring their skills to Kansas. Approving this acquisition, given the premium and GPE's $4.4 billion debt incurred to pay it, heads in the opposite direction.

F. GPE's commitment to place no premium in rates—a half-truth—does not remove the premium's harms

Q. Is GPE's commitment to place no premium in rates a real commitment?

A. No. Mr. Bryant (Direct at 22) says that "we have not asked customers to pay for the acquisition premium." True—Applicants have not "asked"; they will collect part of the premium from customers without asking, by: (a) having Westar charge rates based on equity-level returns when part of Westar's equity will be funded by lower-cost debt (as explained in Part II.D.1.a above); (b) using Westar's profit to extract value from GPE's net operating losses (as explained in Part II.D.1.e above); and (c) keeping merger-related savings for themselves between rate cases, rather than passing them through to customers (as explained in Part II.D.1.d above). So in evaluating the value (and candor) of Applicants' commitment, we must distinguish what is stated from what is not. GPE will not seek to recover the premium explicitly, *i.e.*, by placing it into Westar's rate base. But GPE shareholders will recover part of the premium implicitly, by charging rates exceeding reasonable cost. The effect is the same: Customer payments will help pay for the premium.

Q. If GPE truly committed not to recover the premium in rates, would your stated concerns about the premium go away?

A. No. Even if GPE absorbed the premium fully, the premium still would cause problems. Paying the premium requires GPE to issue more stock and take on more debt—weakening its financial profile before it has produced a dollar of savings. That debt burden will constrain the Commission's future options, as Part II.E explained. Even if the entire premium was funded with equity, the pressure on GPE's earned equity returns would likely require more frequent rate cases and additional cost-recovery mechanisms (thereby reducing its incentive to perform efficiently), while making it more difficult for GPE to raise equity capital.

Then there is the problem of the market distortion. Part II.D.1 explained that Westar shareholders would receive the control premium without having created commensurate value. To approve a wealth transfer unsupported by value is to support, and stimulate, market behavior that undermines economic efficiency. It creates a mismatch of risk and reward, a gap between performance and compensation. It invites mergers based on who can pay the highest price rather than who can create the most value. It is no overstatement to say that Applicants are asking the government to undermine the principles of cost-effective capitalism. The Commission should decline.

Q. Mr. Ives stated that if Applicants cannot receive equity-level returns on equity purchased with debt, they might seek explicit recovery of the premium. How do you respond?

A. To purchase 100% of Westar's equity, GPE will finance half the cost with debt. (See Part II.D.1.a above.) KCC Staff Witness Gatewood recommends that when setting Westar's rates, the Commission should recognize the consolidated capital structure of GPE, as that is the true cost of capital supporting all of the GPE subsidiaries, instead of allowing GPE

to use a subsidiary-specific capital structure with the higher authorized returns normally applied to equity. Anticipating (and opposing) that recommendation, Mr. Ives warned that if GPE cannot recover the premium indirectly (by applying equity-level returns to equity financed with debt, thus having Westar earn returns exceeding the actual cost of capital), it must have the option of recovering the premium directly (by putting the premium into rates).[87]

Understand Mr. Ives's concession: GPE can recover its premium only if we 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. But severing is what Mr. Ives wants, under either of his proposed methods:

1. Applying an equity return to equity purchased with debt means rates will exceed true cost—a result unsustainable in an effectively competitive market.

2. Putting an acquisition premium directly in rate base departs from economic reality as well. It is one thing to allow recovery of an acquisition premium to the extent of savings produced by the acquisition. Facing such a ceiling, those who negotiate the premium are disciplined by economic reality—the presence of economic benefits. But putting the premium into rate base—not because it reflects actual benefits but *just because it was paid*—removes the discipline.

By relating his need to recover the premium to the debt incurred to pay it, he is acknowledging that the premium's size is rooted in the leveraging GPE used to finance it. That is the definition of "financial engineering"—purchasing a company at a premium reflecting the artificial substitution of government-set equity returns for actual debt costs, rather than a premium reflecting the true economic value produced (which is what we would have if the recovery of the premium were based on true cost reductions).

[87] Supp. Direct at 12.

The Commission has seen this problem before. Its 1991 merger opinion reasoned that where the purchase price was designed to win the bid, its connection to savings is "tenuous." The Commission there stated that (a) the "evidence is clear that KPL made the $32/share offer in an effort to win the bid for KGE," and (b) "it was clear that regardless of the offer price per share, the potential savings from the combined operations identified by Applicants would not change." In such a situation the "offer price has a very tenuous relationship to the savings identified by Applicants." The Commission therefore tied the recovery of the acquisition premium to the benefits realized by ratepayers.[88]

Mr. Ives wants to "match the recovery of the use of funds with such a request to utilize the source of funds in setting retail rates."[89] He is mixing apples and oranges. The "source of funds" used to buy half of Westar's equity is debt. So in "setting retail rates" we should recognize the cost of that debt—because that cost is the cost incurred to serve the customers who pay those rates. The "use of funds," in contrast, is the use of funds to pay the control premium. GPE is paying the control premium not merely to produce savings for customers. If all GPE were buying was the chance to produce merger savings, the acquisition price should have been lower, for GPE is simply replacing Westar shareholders as the owner of Westar. GPE paid more than market price—$2.3 billion more—because GPE wanted more than the opportunity to produce savings, and because Westar wanted more than a new owner to serve its customers. GPE wanted

[88] *Order, In the Matter of the Application of Kansas City Power & Light Company for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric*, Docket Nos. 172,745-U et al. at 48-49 (Nov. 15, 1991).

[89] Supp. Direct at 12.

control of Westar's utility franchises, while Westar wanted to extract the maximum gain from GPE's desire for control.

Setting rates based on true debt costs rather than artificial equity costs is simply setting rates based on cost of service. But requiring recovery of the premium merely because the premium was paid is not setting rates based on cost of service; it is setting rates based on what the seller of a monopoly wanted to receive in gain from the buyer of a monopoly. Putting the premium in rate base departs from rates based on cost of service—and thus from the statutory ""just and reasonable"" standard.

For all these reasons, I cannot reconcile this transaction with merger standard (a)(iv), which tests reasonableness of acquisition premium in light of the merger savings.

G. Any control premium should be allocated between shareholders and ratepayers based on their contributions to its value

Q. What is the purpose and organization of this subsection?

A. As structured, this Transaction does not promote the public interest. It will not promote the public interest unless (and this is not the sole problem to solve) the Commission allocates the control premium appropriately. Applicants would allocate the premium100% to Westar shareholders. They provide no rationale to support this asymmetry. I recommend the Commission allocate the control premium between shareholders and ratepayers according to each group's contribution to the economic value that underlies the premium. (Part II.G.1). I then explain why allocating the premium based on economic value is consistent with Westar shareholders' legitimate expectations (Part II.G.2).

1. Allocating the premium based on economic value created, not incumbent monopoly status, is required by the public interest

Q. What is the appropriate treatment of the control premium?

A. The Commission should allocate the control premium consistently with the public interest. In the context of Kansas utility regulation, the public interest is in efficient and sufficient service. Efficiency requires rewarding those who create value, not those who happen to have the status of incumbency. Therefore:

1. The Commission should allocate the control premium between Westar shareholders and Westar ratepayers, according to each group's relative contribution to the premium's value.

2. In determining this allocation, there should be, for evidentiary purposes, a rebuttable presumption that each group's relative contribution is 50-50. I do not suggest that the right answer is likely to be 50-50. I mean that each group should have an equal evidentiary burden to demonstrate that its contribution value was greater than 50%. This approach contrasts with Applicants' proposal, which is a *conclusive* presumption, without any evidence, that the Westar shareholders should receive 100%.

3. Upon the Commission's final determination of the contribution by ratepayers, the post-acquisition entity shall pay that amount to Westar's customers according to a procedure specified by the Commission.

Q. Is your recommendation for allocating the control premium consistent with general precedent dealing with "gain on sale"?

A. Yes. This solution is a straightforward application of a long-standing principle in economics and regulatory law: Benefits should follow burdens, compensation should reward performance. Commissions apply this principle frequently when they allocate the gain on sale of an asset used for utility service. When a generating asset has been in a utility's rate base, and the utility then sells that asset for a price above the asset's net book value, the gain goes (or should go) to ratepayers. The gain goes to ratepayers because the asset's prior presence in rate base means that ratepayers have borne the asset's cost.

Benefit follows burden. Conversely, when an asset that has not been in rate base is sold at a gain, the gain goes to shareholders because they bore the economic burden. Benefit follows burden.[90]

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[90] In *Democratic Central Comm. of the District of Columbia v. Washington Metropolitan Area Transit Comm'n*, the court stated:

> Ratepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they patronize. It is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service. This entitlement extends, not only to reductions in investment attributable to physical wear and tear (ordinary depreciation) but also to those occasioned by functional deterioration (obsolescence) and by exhaustion (depletion). . . .[Since customers] have shouldered these burdens, . . . it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and waste occurring in service, should benefit in instances where gain eventuates—to the full extent of the gain.

485 F.2d 786, 808–11, 822 (D.C. Cir. 1973) (footnotes omitted); *id.* at 808 ("[I]f the land no longer useful in utility operations is sold at a profit, those who shouldered the risk of loss are entitled to benefit from the gain."). *See also Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd. 6283, 6295 ¶¶ 113–14 (Sept. 17, 1987) (order on reconsideration) (observing that "[t]he equitable principles identified in [*Democratic Central Committee*] have direct application to a transfer of assets out of regulation that produces gains to be distributed," and requiring "that ratepayers receive the gains on assets when the market value of the assets exceeds net book cost."); *N.Y. Water Serv. Corp. v. Pub. Serv. Comm'n of N.Y.*, 12 A.D.2d 122, 129 (N.Y. App.Div. 1960) (allocating gain on sale to ratepayers when ratepayers bore the risk of a loss in value of the assets); *N.Y. State Elec. & Gas*, Case No. 96-M-0375, 1996 N.Y. PUC LEXIS 671, at *8 (N.Y. Pub. Serv. Comm'n Nov. 19, 1996) (memorandum opinion) (reserving the net gains on the sale of land for ratepayers is "equitable and reasonable"); N.*Y. Tel. Co. v. N.Y. Pub. Serv. Comm'n*, 530 N.E.2d 843 (N.Y. 1988) (ratepayers entitled to benefits on sale of yellow pages advertisements).

But see Bd. of Pub. Util. Comm'rs v. N.Y. Tel. Co., 271 U.S. 23 (1926) ("Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for the convenience or in the funds of the company.").

The gain-on-sale-of-asset analogy applies here because it exemplifies the principle that value goes to those whose economic contribution produced the value. In citing this precedent, I am not suggesting that the ratepayers' burden-bearing in the context of a generating asset sold at a gain is itself analogous to the ratepayers' contribution to the control premium.

Q. Is your recommendation for allocating the control premium consistent with Kansas precedent dealing with "gain on sale"?

A. Yes. My recommendation is consistent with the principles articulated in *Kansas Power & Light v. State Corp. Commission of Kansas*, 5 Kan.App.2d 514, 528-29 (Kan. Ct. App. 1980). There the Court of Appeals said that in allocating capital gain between shareholders and ratepayers, the Commission "should consider" these guidelines:

1. "The risk of loss of investment capital."

2. "Contribution by the ratepayers to the value of the property, such as maintenance, upkeep and improvements."

3. "Financial integrity of the company, and the effect of the allocation on the price of the stock and the ability of the company to attract adequate capital."

4. "Increases in the value of the property due to inflation."

5. "Increased value of the property due to improvements in the neighborhood of the facilities sold as a result of special assessments ... which were paid in whole or in part by the ratepayers."

Kansas Power & Light dealt with the sale of physical property. Here we deal with the sale of franchise control, because franchise control is what GPE is buying. That difference affects the applicability of the five criteria. Thus:

1. *"[R]isk of loss of investment capital":* Whereas in *Kansas Power & Light* the utility invested money in the building, Westar did not invest money to buy its franchise. So with respect to the franchise whose control GPE is buying, Westar never risked a loss of investment capital. Westar did

invest money to build its physical facilities, but it has been compensated for that investment through rates lawfully set by the Commission. In any event, GPE is paying the control premium not to buy Westar's physical facilities but to buy ultimate control of Westar's franchise (and thus the stream of earnings from that franchise). Westar's physical facilities will remain owned by Westar.

2. *"[C]ontribution by the ratepayers to the value of the property...."*: The value of the franchise stems from the income earned when its holder sells electricity at Commission-set rates. That value exists because of Kansas government policy (protecting the utility from retail competition) and customers' continuous payments (set by the Commission to comply with statutory and constitutional law, so that whatever costs Westar reasonably incurs, its customers must pay).

3. *"Financial integrity of the company"*: The reference to "the company" here is to the selling company—here, Westar. Westar's financial integrity is assured, to the extent of statutory and constitutional law, by the rates set by this Commission. The control premium paid by GPE is unrelated to Westar's financial integrity.

4. *"Increase in the value of the property due to inflation"*: Unlike a building, the franchise right has no original cost to which inflation would apply. I suggest, therefore, that in the control premium context, this factor is not relevant.

5. *"Increased value of the property due to improvements in the neighborhood of the facilities sold"*: As with inflation, since what is being sold here is not physical facilities, this factor is not relevant.

I do not intend my application of *Kansas Power & Light* to require allocation of the entire control premium to ratepayers. The Court's criteria signal that gain on sale does not go automatically to ratepayers or shareholders, but rather should be allocated based on contribution to the value of what is being sold. That is precisely the principle I recommend.

Q. Based on your principle for allocating the control premium, are you recommending a specific allocation at this time?

A. No. The Commission will need to determine the relative contribution made by shareholders and ratepayers. I did explain, in Part II.D.1, five reasons why the value GPE

sees in buying Westar is not attributable to Westar shareholders' risk-taking or Westar management's decision-making. Those five reasons were:

1. GPE expects to earn equity-level returns on investment financed with lower-cost debt.

2. GPE expects Westar 's actual return to exceed GPE's required return.

3. "Economies of scale" and "best practices" are attributable to factors external to Westar's performance.

4. GPE would use Westar's profit to extract value from GPE's net operating losses.

5. Westar's value to GPE owes more to Kansas government decisions than to Westar management's actions

In contrast, logic and facts point to some of the value of the control premium being attributable to ratepayers. That logic is as follows:

1. GPE is paying the control premium to get control of the Westar utilities' franchises.

2. The value of those franchises is due to their stable source of revenue.

3. That source of revenue is stable because of the Kansas government decision to (a) make the utilities' retail franchise exclusive, and (b) require that customers wanting electric service pay rates set by the government based on principles that provide Westar a reasonable opportunity to earn a fair return. Ratepayers have no choice but to pay those rates.

In short, Westar's value to GPE owes much to Kansas government decisions and ratepayer choicelessness. Westar may respond by saying that shareholders provide the capital that enables Westar to provide that service. That statement is true, but omits the relevant point: Shareholders are compensated for their contribution through Commission-set rates that include a fair return on equity. I elaborate on this point in Part II.G.2 below.

The foregoing considerations are only a beginning point. If the Commission wishes to approve a restructured transaction that can promote the public interest, it should invite the parties to offer more facts and arguments supporting their position on contribution to the value underlying the premium. And in situations where both parties have arguments of equal value, I recommend that the Commission rebuttably presume that the relative contribution to the franchises' value, as between shareholders and ratepayers, is 50-50. Then the rebuttable presumption does the work. If facts rebutting the presumption do not emerge, the presumption becomes the result.

KCC Staff Witness Grady applies my approach. He identifies the sources of value that GPE sees in Westar, then allocates the entire premium to each of these sources according to their relative values. Then for each source, he allocates the associated portion of the premium between shareholders and ratepayers according to their contribution. For some sources he finds that the entire value comes from ratepayers; for other sources he recommends a 50-50 split. My approach—allocating the premium according to value contributed—allows Applicants to argue for a different result. In this way, the Commission can base the allocation on economic and financial facts, rather than on government-granted incumbency.

Q. Why does your allocation analysis focus on only the control premium rather than the entire acquisition premium?

A. In Part II.A, I defined the "acquisition premium" as the total difference between GPE's purchase price and Westar's book value. I explained that the acquisition premium thus defined has two layers. The lower layer is the excess of market value over book value. The upper layer is the excess of GPE's purchase price over market value. I labeled the upper layer the "control premium."

My allocation proposal addresses only the upper layer—the control premium. The lower layer—the excess of market value over book value—has nothing to do with the acquisition because it pre-dated the acquisition. It reflects the common tendency for utility stock to trade at levels exceeding book value. The control premium, in contrast, reflects new value GPE seeks to gain by taking control of Westar's franchise. Since the value to GPE of controlling the franchise results from the combination of government-granted monopoly and government-mandated rates, there is no clear reason why this value should go to Westar shareholders.

2. Allocating the premium based on economic value created is consistent with Westar shareholders' legitimate expectations

Q. How will you organize this subsection?

A. I expect Westar to argue that any limit on its shareholders' portion of the control premium violates their legal rights. This argument fails, for three reasons. First, Westar shareholders have already received their legally required compensation—just and reasonable rates set by the Commission. Second, because Westar shareholders have received their legally required compensation, keeping the control premium is overcompensation. Third, the franchise is a privilege Kansas bestowed on Westar to serve the public interest; it is not an asset Westar can sell to advance its private interest.

a. Westar shareholders have already received their legally required compensation—just and reasonable rates set by the Commission

Q. In the utility context, what is the legally required compensation to shareholders?

A. The Fifth Amendment's Takings Clause provides, among other things, that "nor shall private property be taken for public use, without just compensation."[91] In the context of utility investments, "just compensation" is the reasonable opportunity to earn a fair return on the prudent investment made by the utility in assets necessary to serve the public. Recall from Part II.D.2 Justice Brandeis's famous explanation:

> The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.[92]

Westar shareholders receive this constitutionally required compensation when the Commission sets rates based on the net book value of prudent utility investment in assets used to provide service. Their legitimate expectations of Kansas regulation have been satisfied.

b. Because Westar shareholders have received their legally required compensation, keeping the control premium is overcompensation

Q. If Westar shareholders receive just compensation through their rates, how should the Commission characterize the control premium?

A. If fair return on prudent rate base is the legally required compensation, then the control premium is necessarily extra compensation—overcompensation. The control premium does not represent "capital embarked in the [public utility] enterprise," *i.e.*, funds invested

[91] The Fifth Amendment applies to the states through the Fourteenth Amendment's Due Process Clause.

[92] *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 290 (1923) (Brandeis, J., concurring).

in assets used to provide public utility service. It represents the gain Westar shareholders want for selling GPE the right to control Westar's state-granted franchises. Because the control premium does not represent investment in utility service assets, it falls outside the constitutionally required compensation. Westar shareholders have no constitutionally protected expectation to receive it.

If the control premium does not represent utility assets, what is it? Recall what the control premium is—the excess of purchase price over market price. The control premium represents the speculative increase in value prospective acquirers see when they circle around a target. Justice Brandeis's formulation, applied by courts and commissions for decades, says nothing about protecting speculation in stock price. Rate base is where government honors its obligations; stock price is where shareholders bet their money. The dollars shareholders spend to buy stock are therefore constitutionally distinct from the dollars a utility spends to acquire utility assets. Only the latter dollars—dollars associated with utility service rather than acquirers' speculation—deserve constitutional protection.

When Kansas granted Westar the franchise privilege, Westar undertook an obligation to serve. To fulfill that obligation, Westar invested in utility assets. In imposing this obligation to invest, Kansas has "taken" private property for which the Constitution requires "just compensation." From this logic, we see that the just compensation relates to the utility's investment in utility assets. The shareholder's decision to buy stock, in contrast, is not an obligation imposed by government to serve the public; the decision to buy stock is a voluntary act made by stock buyers to increase their wealth. In the utility regulatory context, stockholders do not receive any

government protection of that wealth—let alone an increase in "value" arising solely from an acquirer's desire to buy control of the franchise.

A reader may wonder why I focus on the control premium (the excess of purchase price over market price) rather than the full acquisition premium (the excess of purchase price over book value). The lower portion of the full premium (the excess of market price over book value) preceded the merger and thus was not caused by the merger. It would be illogical to allocate to ratepayers, as a condition of approving a merger, a pot of dollars unrelated to the merger. That is why, for purposes of allocating the premium, I focus only on the control premium portion of the full premium. My reasoning is confined to allocating the premium. It is not in conflict with the Commission's decision to review, under merger standard (a)(iv), the relationship between synergies and the full premium.

Q. Companies routinely sell their businesses to others and pocket the gain. What's the difference?

A. To argue that regulators owe shareholders the control premium is to misapply a non-regulated market concept to a regulated market context. In a non-regulated market, the acquirer's willingness to pay the premium, and the target's expectation of a premium, are both disciplined by competitive market forces. And since in an unregulated market the target company receives no government protection, the target's value to acquirers can be attributed to real economic value created by their coupling (assuming the acquisition is not motivated by anticompetitive intent and does not have anticompetitive effect). Under those facts, the target shareholders have every reason to demand and keep the premium. But in a regulated utility market, those factors are not present.

Q. Where does your analysis leave the Commission?

A. Because there is no legally protected expectation to receive a control premium, the Commission is free to limit that premium—or to require that the target company share the premium with its customers. Such a policy would not only allocate the premium according to who created the value; it would have two other benefits directly relevant to this Transaction. It would (1) discourage excess premia that burden the acquirer with debt or its shareholders with stock dilution, and (2) discourage target companies from seeking acquirers based on shareholder gain rather than customer service.[93]

Q. Will this policy disappoint Westar shareholders?

A. I assume so. But shareholder disappointment matters legally only if the state government made some kind of commitment, the breach of which caused that disappointment. Kansas regulation has never promised Westar shareholders they could keep the gain from selling the franchise. When Kansas granted Westar a franchise to provide electric service, it created a right in Westar to receive just compensation for its costs in providing that service. But the franchise right does not include the right to profit from selling that right. Westar shareholders may have *hopes* for additional profit beyond the profit from selling electricity. But hopes are not legal entitlements.

[93] As I noted in Part II.A above, GPE's purchase of Westar includes not only Westar's Kansas retail business but also its FERC-jurisdictional business. The control premium allocated by this Commission, therefore, would be the Kansas-jurisdictional share of the $2.3 billion control premium.

c. The franchise is a privilege Kansas bestowed on Westar to serve the public interest; it is not an asset Westar can sell to advance its private interest

Q. How does the nature of a franchise mesh with your analysis?

A. A franchise right is a right granted by the government: in this situation, the right to provide government-defined services under government-defined terms, accompanied by government-guaranteed protections from competition and in return for legally defined compensation. The franchise's value to utility shareholders flows from the right to charge rates set by the Commission.

Because the franchise is a right created, defined and conditioned by government, it is not the utility's private property. It is not like the land under my house—land I bought, land I own, land I risked buying so that I could get gain when I sold it. Here, the "land" granted to Westar is the privilege to provide electric service in Kansas. That privilege does not translate into a right to sell the privilege for gain. GPE views that privilege as a profit opportunity, one worth buying at a premium. But GPE's desire does not become Westar's gain.

* * *

Q. Summarize your conclusions in this Part II, relating to the acquisition premium.

A. The $2.3 billion control premium is inconsistent with the public interest. It results from a competition based on greatest gain to shareholders. Customer benefit was only incidental, making the payment inconsistent with merger standard (a)(iv), which requires a connection between premium and synergies. The purchase price overcompensates Westar shareholders because (1) its value flows from factors unrelated to their risk-taking or their executives' decision-making, and (2) it exceeds the legally required compensation

they already have received from ratepayer payments. That overcompensation alone violates the reasonableness principle embedded in the Commission's merger standards.

Adding to the public interest detriment is the GPE's $4.4 billion acquisition debt. To pay off that debt, GPE would keep rates above costs plus reasonable profit—a plan in conflict with Joint Applicants' claim that they will not recover the premium from customers. That same debt will constrain the Commission's future decisions, by making GPE less able to weather declines in revenue—a concern of merger standard (d)—should the Commission or Legislature decide to attract new businesses to Kansas by offering them roles in expanding and modernizing Kansas's electricity infrastructure.

The size of the premium—and the accompanying GPE debt—is reason enough to reject this Transaction. But if the Commission grants approval, it still should address the overcompensation. It can do so by allocating the control premium (the excess of purchase price over market value) between shareholders and customers according to their contribution to the premium's value. Only that way will the Transaction, and Commission policy, align acquisition decisions with the principles of economic efficiency and fiscal conservatism.

III.
The claimed savings do not satisfy the public interest standard

Q. How do you organize your discussion of the merger benefits asserted by Applicants?

A. Benefits matter to a merger because of their relationship to costs. An acquisition whose benefit-cost ratio is lower than alternatives (including no acquisition) wastes economic resources, and therefore is contrary to the public interest.[94] This reasoning carries out the Commission's merger standards (a)(ii), (a)(iv) and (a)(g)—all aiming to ensure that prices paid for companies, and actions taken by the post-merger companies, focus on creating efficiencies and avoiding waste.

In comparing benefits to costs, which benefits should count, and how should they be compared to costs? I answer that question in the following five subsections:

1. Synergies are legitimate merger benefits—if backed by commitments and allocated properly between shareholders and customers (Part III.A)

2. "Best practices" are not merger benefits if they are attainable without a merger (Part III.B)

3. An increase in size does not guarantee improvement in service or reduction in cost (Part III.C)

4. Cash payouts to win support are not merger benefits (Part III.D)

5. This Transaction's benefit-cost ratio favors Applicants while disfavoring their customers (Part III.E)

[94] *See Order, In the Matter of Complaint of Farmland Industries, Inc.*, Docket No. 02-MAPP-160-COM, para. 67 (Jan. 31, 2005) (holding that "the term 'efficient' [in K.S.A. 66-1,217] can also refer to acting in a manner that exhibits a high ratio of output to input").

A. Synergies are legitimate merger benefits—if backed by commitments and allocated properly between shareholders and customers

Q. How do you define merger synergies?

A. Merger synergies are benefits created because two companies operate more effectively together than apart. The benefits can take the form of decreases in cost or increases in quality. When a winter-peaking utility merges with a summer-peaking utility, or a renewables-heavy utility merges with a gas-heavy utility, or two companies share resources to reduce overhead expenses, these actions can reduce cost or increase quality. Synergies can flow from economies of scale, scope or integration. Because synergies are caused by the merger and are unavailable without the merger, they qualify, potentially, as a merger benefit. I say "potentially" because, as I discuss next, a commission should not count synergies not backed by commitments.

Q. Should synergies count as a merger benefit if they are not backed by commitments?

A. No. The purpose of utility regulation is to establish standards for performance, then hold the utility accountable for its performance. To credit claims without accountability conflicts with that purpose. For the Commission to find claims of synergies credible, Applicants must provide (1) specific metrics, (2) a binding (*i.e.*, not rhetorical) commitment to achieve them, and (3) a plan for achieving them. The prerequisite for credibility is accountability.

Without this information and these commitments, the Commission would only be guessing. Its guesses would not be credible because the Commission is an outsider to the merging companies. It has neither the internal data on which synergy claims are based, nor the legal power to hold specific individuals accountable. Moreover, this situation is prone to excess optimism—for when one company is about to get control of a multi-

billion-dollar monopoly franchise and the other company is about to receive a 36% control premium, who wouldn't make claims optimistically—especially if one need not back up the claims with commitments? As the Commission has stated: "Although the Applicants may be in the best position of projecting what synergies might be achieved through merger of their operations, they obviously have every reason to present overly optimistic estimates of the benefits of the merger."[95]

But that is where we are here: claims without metrics, plans, commitments or accountability.

Contrast a new purchased power agreement or a new generating unit. No utility proposes these things without presenting year-by-year data showing the benefit-cost ratio over the agreement's or unit's lifetime—and *comparing that benefit-cost ratio to all feasible alternatives*. Those numbers, accompanied by alternative scenarios and sensitivity studies, are presented by specific witnesses—witnesses whose reputations (along with the utility's finances) are at stake. The utility's contracts with its vendors will assign accountability for performance shortfalls. Yet in this $12.2 billion merger, its proponents commit to nothing.

In competitive markets, things work differently. Had GPE been required to compete for the privilege of serving Kansas's customers, it would have dropped the self-praise and vagueness; it would have committed to the benefits it now only describes. The Commission then could have compared those commitments to alternatives, just as it does

[95] *Order, In the Matter of the Application of Kansas City Power & Light Company for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric*, Docket Nos. 172,745-U et al., at p.59 (Nov. 15, 1991).

when it reviews a proposed purchased power agreement or generating unit. And if the Commission chose GPE, the Commission then could hold GPE to its commitments: The Commission would attach to its approval conditions that made GPE accountable for its claims. Competition for the customer produces accountability to the customer. But as we know from the Proxy Statement (see Part II.B above), Westar designed this competition not to benefit the customer but to benefit its shareholders. That is why we have, now, claims without benefits—leaving us unable to confirm compliance with merger standard (a)(iv), that the synergies justify the premium.

Q. Besides the lack of commitments, are there are other problems with synergy claims?

A. Yes. Synergies are unquantifiable, and therefore incapable of tracking, proof and accountability. As the Maryland Public Service Commission has stated:

> [P]rojections of benefits through synergies, 'shared services' or 'best practices' are inherently speculative and, to the extent they materialize, will likely benefit ratepayers only as 'forgone requests for rate relief,' which we have previously held to be too intangible to qualify as a benefit under PUA sec. 6-105 [*i.e.*, Maryland's merger statute, which requires benefits from the acquisition].[96]

Q. In this specific Transaction, are there factors that reduce the likelihood of the claimed benefits?

A. Yes, there are several factors. The first factor is the absence of methodical, mutually accountable planning based on hard data. It appears that the savings estimates were developed by GPE unilaterally. Thus during the negotiations, "[n]o specific data or

[96] *In the Matter of the Merger of Exelon Corporation and Constellation Energy Group*, Order No. 84698 (Feb. 17, 2012), 2012 Md. PSC LEXIS 12 at text accompanying note 356.

quantifications of savings were provided to the Westar board."[97] Furthermore, GPE's savings consultants "did not have access to Westar executives in that time period, other than indirect access through the descriptions by GPE executives of the management briefings by Westar that they attended."[98] Savings specific to this Transaction were identified and estimated by GPE and its consultant, based on data Westar (the company looking for a gain) placed in its "data room." (GPE had opportunities to request certain types of data.[99]) There were no joint meetings at which managers of both companies questioned each other's assumptions about savings, or methodically assessed the magnitude, likelihood and timing of various types of savings. There were meetings, but according to Westar, "[n]one of these 'ordinary course' due diligence meetings with Great Plains were specifically to identify cost savings."[100]

The second factor is the absence of executive accountability. The acquisition "will require changes in the structure of the executive management team compared to the structure of those teams as they currently exist at GPE and Westar Energy today."[101] But Mr. Bassham has made no public decision about those changes. He has made no decision about which executives and managers will be responsible for producing the savings. Nor

[97] Response to KCC-221.

[98] Response to KCC-252.

[99] Response to KCC-252.

[100] Response to KCC-211. See also the Missouri Settlement Part E.2 at 12: "The planning process for the integration of KCP&L, GMO and Westar began with the formation of integration teams in July 2016 and is currently under way. As such, detailed plans regarding post-closing operations and organizational structure are under development and not currently available."

[101] Response to KCC-217.

has he decided how they will be held accountable in terms of compensation or employment. It is merely "expected that [GPE] senior executives involved in reviewing and approving Transaction-related benefits will have substantial responsibility for achieving those benefits post-closing."[102] Note the passive voice ("it is expected"—by whom?) and the absence of names associated with specific responsibilities.

Mr. Kemp—a consultant to GPE, with no authority over anyone—testified that "GPE senior executives ... took ownership for achieving the targeted benefits."[103] "Took ownership" is a business buzz-phrase, never defined by Mr. Kemp.[104] In discovery, we asked GPE to

> explain precisely how executive management will be held accountable, and how consequences will be assigned, to those who have taken ownership for achieving the targeted benefits;

and to

> explain the career consequences, in terms of compensation or promotion, that are associated with taking ownership….

The response was uninspiring. GPE displayed no plans or even ideas, saying only that "[t]his would be decided on a case-by-case basis."[105] Whether the estimates would have

[102] Response to KCC-212, 213.

[103] Kemp Direct at p.18.

[104] Indeed, Mr. Kemp used precisely the same phrase—"took ownership" for achieving the targeted benefits—when testifying before the Missouri Public Service Commission in favor of the merger of KCP&L and Acquila. *See*, *In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc., for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, Case No. EM-2007-0374, 2008 Mo. PSC LEXIS 693; 266 P.U.R.4th 1 at para. 261 n.371 (July 1, 2008).

[105] Response to KCC-213.

been more "conservative" if each executive faced explicit career consequences for failing to achieve the estimated savings, Mr. Kemp could not, or would not, say, because an answer would be only "conjecture."[106] This is pure evasion. Accountability causes conservatism.

The third factor relates to whether the savings projections were influenced by the deal-making. Enovation (GPE's savings consultant) was asked what information the savings team had, at various points in time, about the bid prices the "deal team" was considering. Mr. Kemp responded as follows:

> The Enovation team was not privy to the bid price analyses conducted by the GPE deal team, and was only aware in very general terms of the range of bid prices that were being considered. They were not aware of any changes in that range during the time period of the savings estimation process. As stated in Mr. Kemp's testimony, the over-riding question the Enovation team was charged to answer was: *Are the reasonably achievable savings sufficient to meet the targets for making a competitive bid while maintaining GPE's financial and operational health and producing significant long-term benefits for customers and shareholders? Those targets were communicated to the Enovation and GPE savings estimation team in the form of annual minimum targets for aggregate net savings in the 2017-2020 period*, and were not related explicitly to GPE's bid price for Westar.[107]

Given targets to meet, the savings evaluation team's estimates could have suffered from optimism bias—a desire to "make things work out." From a distance I cannot tell if there was bias, but this possibility should be on the Commission's mind. Mr. Kemp 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."

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[106] Response to KCC-257.

[107] Response to DR-254 (emphasis added).

And as to whether "the savings estimation team was influenced to pursue higher risk areas of savings to justify a higher bid price, the answer is no. The guidance from GPE's senior management on the level of acceptable risk (low), and conversely the level of conservatism in the estimates (high), was consistent during the savings estimation process."[108]

A fourth factor is the vagueness of the benefits themselves. Mr. Bassham asserted (Direct at p.7) that "[o]ne of the key benefits of this Transaction is that it creates a financially stronger company that is better suited to meet the needs of customers and communities in Kansas,..." But asked to describe the shortfalls in Westar's performance that support his view that the combined company would be better suited, Mr. Bassham avoided the question.[109]

Q. Is your recommendation, that savings be recognized only to the extent of Applicants' commitment, consistent with Commission precedent?

A. No. I recognize that the Commission has not required commitments to savings as a prerequisite for counting savings. In its 1991 Merger Order, for example, the Commission related recoverability of the premium to "reasonably determinable benefits which they can with some certainty expect from the Transaction."[110] I respectfully recommend that in light of Applicants' control of the information and any applicant's

[108] *Id.*

[109] See Response to KCC-216. Asked to describe the shortfalls, he (or whoever wrote his answer) illogically referred to a prior answer, which was: "No, 'better suited' means 'better suited than either Great Plains Energy (GPE) or Westar Energy on a stand-alone basis.'"

[110] *Order, In the Matter of the Application of Kansas City Power & Light Company for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric*, Docket Nos. 172,745-U et al., at pp.60-61 (Nov. 15, 1991).

natural tendency toward optimism—also recognized by the Commission—conditioning benefit recognition on benefit commitment induces the discipline necessary for performance consistent with the pressures of effective competition and with protection of the public interest.

To summarize: The savings are estimates, they are not based on joint meetings, there are no commitments, everyone has "ownership" but no one has been assigned responsibility. On this soft foundation, Westar has demanded, and GPE has agreed to pay, a control premium of $2.3 billion and now seeks to justify a $4.9 billion acquisition premium (Bryant's Supplemental at 6). The Commission should credit only commitments, not aspirations. Otherwise we get advertising instead of accountability. And we get asymmetry: GPE receives control of Westar's franchise and Westar shareholders receive the $2.3 billion premium, while Westar ratepayers receive only the possibility of benefits.

Q. Does the existence of a synergy benefit mean that Westar shareholders should keep the gains associated with the benefit?

A. No. Recall from Part II.D that just because a benefit is made possible by the merger does not mean the benefit is attributable to management skill or investor risk-taking. Economies of scale, for example, result from a cost function associated with a particular product or service. As I explained in Part II.D.1.d, a product's cost function—how its cost varies with size—is inherent in that product. Yes, it takes management effort to convert that cost function into a benefit, but management will get paid for its effort through charges to ratepayers. The savings from the cost function, therefore, are not necessarily for Westar to keep. So when Applicants propose to recover GPE's control premium by depriving ratepayers of some portion of the savings (the portion that remains

with shareholders due to regulatory lag), they are crediting themselves with benefits they did not create. The more logical approach for savings attributable to a cost function is to split them 50-50, because neither shareholders nor ratepayers had a hand in creating them.

B. "Best practices" are not merger benefits if they are attainable without a merger

Q. Should the Commission treat the introduction of "best practices" as a merger benefit that justifies the control premium?

A. No. Best practices should not be treated as a merger benefit if those best practices could be implemented without a merger. When an acquirer improves the target's performance, this benefit arises not because two operations mesh but because the acquirer substitutes higher-quality practices for the target's lower-quality practices. The benefit is attributable not to the merger but to the improvement in management oversight.

Suppose the target company was using quill pens and Roman numerals. When the acquirer introduces computers, the benefit arises not from the meshing of operations but because incompetence was replaced with competence. The target company has improved, but that improvement could have—and should have—occurred without the merger. The target could have hired new managers or consultants, learned from peers, attended professional conferences, or raised internal standards by sharpening its recruitment and compensation policies. Or the regulator could have induced the improvements by penalizing the incompetence.

Attributing to a merger benefits that can occur without the merger conflicts with economic efficiency. The reason for merger benefits is to justify merger costs—such as the high purchase price, half of which will be paid for by debt GPE will bear. When "benefits" used to justify costs are savings the utility should be achieving anyway, then

the Transaction is causing costs without causing true benefits. Causing costs that exceed benefits is the opposite of economic efficiency. Consider the logical perversion: The worse the target's pre-merger performance, the more "benefits" the merger will purport to produce. And the more benefits the merger purports to produce, the higher the premium the acquirer can justify. The illogic should be obvious: The poorer the target's performance, the higher its shareholders' gain.

"Best practices" are, by definition, practical, not imaginary. They are not some secret formula; they are available to the intelligent and entrepreneurial. And so they are available without the acquisition; they are not properly attributable to the acquisition. In a competitive market, a company has no choice but to use best practices. A utility receiving protection from competition similarly should have no choice. Using best practices is part of the obligation to provide "efficient and sufficient service."

Indeed, because the Commission has jurisdiction over both companies, it can order each to share its best practices with the other (with appropriate compensation for the effort involved). There is no need for a merger to make this collaboration happen. Collaboration is the interaction of real people who want the best for the customers. If Westar and GPE are led by executives who intend to hide their best practices unless they get their merger, let such individuals acknowledge their narrowness now. Until then, the Commission is free to assume, and should assume, that the necessary collaboration can occur without a merger. Best practices are not a merger benefit.

Q. Do other jurisdictions reject merger benefits not uniquely attributable to the merger?

A. Yes. Applying the Communications Act of 1934, the Federal Communications Commission has rejected non-merger benefits repeatedly: "[T]he claimed benefit must

be transaction- or merger-specific. This means that the claimed benefit 'must be likely to be accomplished as a result of the merger but unlikely to be realized by other means that entail fewer anticompetitive effects.'"[111] That principle was applied by the FCC Staff to the proposed merger of AT&T and T-Mobile. The Staff rejected benefits that the applicants claimed would result from "the adoption of each company's best business practices, including customer service best practices . . . because the improvement of specific business functions by either AT&T or T-Mobile could be achieved absent the proposed transaction."[112]

In the antitrust context, the Department of Justice and the Federal Trade Commission disregard benefits achievable without a merger. Their *Horizontal Merger Guidelines* (2010) states (at Section 10): "The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects." See also *id.* at n.13: "The Agencies will not deem efficiencies

[111] *AT&T, Inc. & Bellsouth Corp.*, 22 FCC Rcd at 5761 (*quoting EchoStar/DirecTV Order*, 17 FCC Rcd 20,559, 20,630 (2002) (*citing Ameritech Corp. & SBC Communications Inc.*, 14 FCC Rcd 14,712, 14,825 (1999) ("Public interest benefits also include any cost saving efficiencies arising from the merger if such efficiencies are achievable only as a result of the merger")); *Comcast Corp.*, 17 FCC Rcd 23,246 (2002) (Commission considers whether benefits are "merger-specific").

[112] *Applications of AT&T Inc. and Deutsche Telekom Ag for Consent to Assign or Transfer Control of Licenses and Authorizations*, WT Docket No. 11-65, Staff Analysis and Findings 6 241 (2011), available at http://www.wirelessestimator.com/publicdocs/ATT-TMO-FCC.pdf. The FCC Staff's document is not an official Commission document; nor was it part of the official record in the named Docket. It was a draft report prepared by the Staff and released to the public by the FCC Chairman. No FCC order was issued in this proceeding, because the merger applicants withdrew their proposal.

to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing."

Some state commissions have adopted a similar policy. In its decision rejecting the proposed merger of Southern California Edison and San Diego Gas & Electric, the California Commission rejected the applicants' claimed labor savings. Given the smaller utility's (SDG&E's) growth, "some of the efficiencies SDG&E might realize by merger into Edison may be achieved if SDG&E remains independent and becomes larger."[113] And when a merger applicant offered ratepayers 90% of the net proceeds from divesting a fossil fuel plant, the New York Commission disregarded this "benefit" because the Commission had full authority to determine the proceeds' disposition without any merger.[114]

C. An increase in size does not guarantee improvement in service or reduction in cost

Q. Applicants argue that Kansas will benefit because the new entity will be larger than either Westar or KCP&L. Please comment.

A. The argument lacks any evidentiary value. Certainly there is some range of company sizes, some sweet spot, within which performance will be more cost-effective than in company sizes above and below that range. That statement is true of all businesses; it is the inevitable, unsurprising result of economies of scale. But at some size point

[113] *SCEcorp, Southern California Edison Co. & San Diego Gas & Electric Co.*, Decision No. 91-05-028, 1991 Cal. PUC Lexis 253, at *25.

[114] *GPE, S.A., Energy East Corp., New York State Electric & Gas Corp. & Rochester Gas & Electric Corp.*, Case 07-M-0906, 2008 N.Y. PUC Lexis 448, at *10. See also GPE-Constellation Merger, Order No. 84698, 2012 Md. PSC Lexis 12, at *162-163 (finding the possibility of utility's adopting its post-merger affiliates' business practices "too intangible to qualify as a benefit").

economies of scale diminish, and then exhaust. What that size point is for utilities, and for GPE, Westar or the combined GPE-Westar, Applicants do not say. They offer no evidence on whether, or how, the merged company's size (or any utility's size) is causally related to performance. They give us no evidence about where the sweet spot is. They could have offered statistical studies to prove their point, but they did not. (I assume that the cost of such studies would be less than the $90 million break-up fee.[115]) Lacking statistical studies, they at least could have offered anecdotal evidence comparing small utilities like Madison [Wisconsin] Gas & Electric with large utilities like Pacific Gas & Electric. They did not. The argument on "size" is mere advertising—possibly true, possibly false, but in no way resembling substantial evidence.

D. Cash payouts to win support are not merger benefits

Q. What if Applicants offer money to various social service organizations—is that a merger benefit?

A. No. Financial offers unrelated to the acquisition transaction arise from merger strategy rather than merger execution. They become available not because two companies have combined to make operations more efficient, but because the acquirer is willing and able to open its wallet to gain support. Treating such payments as "merger benefits" favors acquirers who have those extra resources, over alternative acquirers who have fewer resources but more merit. Such offers distract attention from the real question: whether the purchase of one company by another is an efficient use of resources. A student should get an "A" for excelling at her schoolwork, not for planting flowers in the schoolyard.

[115] See Ex. 1 to the Application (GPE Form 8-K, Dec. 3, 2014) at 2.

Finally, counting such offers as merger benefits causes intergenerational discrimination, because the benefits flow only to some citizens—usually current ones—while the merger's risks fall on all customers, including future ones. Discrimination by a monopoly provider is precisely what regulation is supposed to prevent. Treating its fruits as a merger benefit does exactly the opposite.

E. This Transaction's benefit-cost ratio favors Applicants while disfavoring their customers

Q. For the benefits that deserve to be counted, how should regulators determine if their value justifies the Transaction's costs?

A. An acquisition can satisfy the public interest only if it promises an appropriate level of benefits in relation to its costs. When a rational person makes an investment (costs), she seeks the highest possible return (benefits) relative to other investments of comparable risk. A prospective acquirer of a utility has the same goal: to achieve a benefit-cost ratio at least as high as the most attractive alternative investment of comparable risk. The same goes for consumers. Someone buying a car seeks the highest possible value relative to the cost.

This same principle applies to regulatory evaluation of utility acquisitions. The Commission should ask the same question investors (and consumers) ask: Will this Transaction produce for customers the best possible benefit-cost ratio, compared to alternative actions the utility could take? This question repeats the principle that regulation always applies to utilities: Having received protection from competition, a utility must perform as if it were subject to competition; it must provide its customers the best possible benefit-cost ratio. When regulation protects a utility from competition, it must compensate by inducing the utility to perform as if it were subject to competition.

That means assuring that a transaction offering biggest-bang-for-buck to the target and its acquirer provides comparable benefit to the utility's customers.

This Transaction fails that standard. To understand why, one need only contrast what Applicants are obtaining for themselves with what they are offering their customers. GPE is obtaining control of Westar's franchises. Westar shareholders are getting the $2.3 billion control premium. Those two "gets" are guarantees. But Westar's customers are guaranteed, literally, nothing. That asymmetry of outcome speaks more clearly than any sentence in Applicants' submission: From the customers' perspective, this Transaction's benefit-cost relationship does not serve the public interest.

* * *

Q. Summarize your reasoning and recommendations in this Part III, relating to merger savings.

A. This Transaction promises the Westar shareholders a control premium of $2.3 billion, but promises the customers zero. Thus Applicants take no risk that the outcome will match the advertising. They identify no executives whose careers, or even compensation, depend on success. They talk of "economies of scale" and "best practices." But economies of scale are inherent in a product's cost function; they are not caused by managerial skill. And best practices are prudent practices—what we expect of any utility, with or without a merger. A transaction that commits to no savings cannot be reconciled with merger standards (a)(ii) and (a)(iv).

IV.
Unless the Commission acts affirmatively, the allocation of merger savings between shareholders and customers will be controlled by GPE

Q. In allocating merger savings between shareholders and ratepayers, what are the Commission's role and options?

A. Assuming a restructured Transaction meets the Commission's standards, and assuming that it produces real savings, the Commission will need to allocate those savings between shareholders and customers. Under cost-based ratemaking, rates ideally equal reasonable costs (plus reasonable profit) at all points in time. Applying that principle here (assuming it were practical to do so) would mean that 100% of the savings would go to the customers. If instead the Commission froze rates at their pre-merger levels, then 100% of the savings would go to the shareholders. Those are the two poles. Within them, the Commission could allocate some specific percentage of the savings to each group.[116]

In practice, allocating savings with precision is impossible, for at least two reasons. First, distinguishing which cost reductions were uniquely due to the merger (*i.e.*, they could not have occurred without the merger) requires speculation, especially after the first few years. Second, a schedule of rate reductions that accurately tracks cost reductions as they occur is difficult as well.[117]

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[116] A separate question then is how to allocate the resulting customer share among the various customer categories—Westar customers, KG&E customers and GPE customers (and on to the various tariff categories), but that question is a traditional revenue allocation task arising in all rate cases. I will not address it here.

[117] As the Commission held in its 1991 Merger Order, rejecting Applicants' proposed tracking system:

> The basis of the proposed system is the determination of the costs that would have been incurred on a stand-alone basis had KPL and KGE remained stand-alone entities. This would effectively require the

So the Commission faces a dilemma. It must allocate merger savings somehow, but it lacks a reliable method for doing so. Designing a method is the province of experts in costs and cost tracking. I am not such an expert. I will explain, however, that if the Commission does not act affirmatively, it cedes control over allocation to Applicants. I address these points in the following three subsections:

a. Applicants' approach—allocating by regulatory lag—means allocating without regulatory principle

b. GPE has limited the Commission's allocation options already

c. The Commission should allocate merger savings based on relative contribution

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> Commission to make a finding regarding the service and revenue requirement levels for utility companies that ceased to exist. The Commission would be in a position of taking into account any and all events, technological, economic, natural phenomena or otherwise, in determining revenue requirement levels for nonexistent companies. The Commission refuses to head down the path in which it will be required to engage in guesswork regarding nonexistent companies to determine savings from the merger. Nor can the Commission ignore the subjectivity inherent in Applicants' proposal for identifying savings events. The expense and time needed to track, quantify and audit the thousands of savings events that Applicants anticipate they will identify would represent a substantial cost which would diminish the benefits of the merger. Furthermore, the time and effort of staff audits and Commission proceedings regarding the tracking system is administratively unworkable and undesirable given the Commission's limited resources.

Order, In the Matter of the Application of Kansas City Power & Light Company for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric, Docket Nos. 172,745-U et al., at pp.73-74 (Nov. 15, 1991).

A. Applicants' approach—allocating by regulatory lag—means allocating without regulatory principle

Q. Explain how Applicants would allocate merger benefits by means of regulatory lag.

A. At any point in time, the utility rates in effect are the only lawful rates. They are lawful even if actual costs and sales have deviated from the projections on which the rates are based. This principle is known as the "filed rate doctrine."[118] Those deviations are normal and expected, because projections are never perfect. A commission can address those deviations by changing the rates, but that change must be prospective only, due to the prohibition against retroactive ratemaking.[119] (A commission can avoid the prohibition against retroactivity if it has (a) established, in advance, some version of a "true-up clause," or (b) given advance notice that the rates in effect are to be treated as "interim and subject to refund.")

Given these principles, if costs drop before a commission lowers the rates (a difference in time known as "regulatory lag"), the utility keeps the difference. At the next rate case, those cost reductions will be reflected in new prospective rates. But if Applicants can control the information about cost reductions and the timing of rate cases, they will control the amount of merger savings they keep. The longer the period between rate cases, and the more cost reductions made between rate cases (and not reflected in the previously set rates), the greater the savings kept by the utility.

What I have just described is the method Applicants propose for allocating merger cost reductions between shareholders and customers. This method gives them maximum

[118] See my *Regulating Utility Performance: The Law of Market Structure, Pricing and Jurisdiction* at Chapter 9 (American Bar Association 2013).

[119] *Id.* at Chapter 8.

control relative to the Commission. For they will have, internally, all the detailed projections for cost reductions, and the actual cost reductions as they occur. They can use the projected cost data to determine the cost levels that support new rates. They can use the actual cost data to determine how long to wait before proposing rates. Both those determinations will affect how much of the savings they keep.

Q. Explain the disadvantages, to the Commission and consumers, of allocating merger savings by means of regulatory lag.

A. In theory, the Commission can try to replicate Applicants' knowledge by conducting audits and rate case discovery, thereby helping to detect any Applicant effort to rely on test year costs that it knows will decline during the rate year. But it is unlikely that the Commission's moderately sized (but immoderately hard-working) staff will match Applicants' mastery. The Commission can control the timing of rate cases, to reduce the gap in time during which Applicants can keep savings. But the Commission's staff size and other duties will limit the frequency of those rate cases.

By using regulatory lag as the allocation method, therefore, Applicants will have an advantage over the Commission. But more importantly, allocating savings by means of regulatory lag lacks any regulatory principle for deciding who deserves the financial benefit arising from savings. It does not reflect a 50-50 decision, a 90-10 decision or any decision. With respect to the actual percentage allocation, it is opaque.

I recommend against any approach that leaves the Commission in the dark. In its 1991 merger order, the Commission determined "reasonably expected benefits" of $312

million (net present value), then limited the recovery of the premium to that amount.[120] If the Commission approves this Transaction, it should act similarly here.

B. GPE has limited the Commission's allocation options already

Q. Does Applicants' regulatory lag approach to allocating merger savings limit the Commission's options?

A. Yes. The "regulatory lag" method will be opaque to the Commission, but not to Applicants. Before agreeing to the $12.2 billion cost, GPE must have estimated the value of the savings it would keep, taking into account the cost to achieve the savings, the timing of the savings and timing of the rate cases (between each rate case, savings created would equal savings kept). Otherwise it could not have known that the benefits to its shareholders would justify the cost.

With these estimates and plans, Applicants are already ahead of the Commission. They have projected what they will keep and how they will keep it. To believe otherwise is to believe that GPE would spend $8.6 billion for Westar's equity and take on $3.6 billion in Westar debt without a full plan for making that investment pay off. If GPE has no estimates and has no plans, then its acquisition is based on speculation—reason alone to reject this Transaction.

Not only are Applicants ahead of the Commission; they also have limited the Commission's allocation options. As just explained, GPE's decisions to pay a specific price and incur specific debt are premised on retaining a specific amount of savings. If

[120] *Order, In the Matter of the Application of Kansas City Power & Light Company for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric*, Docket Nos. 172,745-U et al., at p. 61 (Nov. 15, 1991) (allowing amortization over 40 years, without carrying charges).

the Commission now requires a different allocation, Applicants will respond predictably: "The Commission has rattled the bond markets by making debt repayment less certain." Or, "The Commission has reduced GPE's stock value by causing earnings expectations to fall below those assumed by the purchasers of the new stock." Or, "The Commission has 'threatened' a transaction that the financial markets expected to occur." Such arguments do not address the merits of the Commission's chosen allocation; they merely express irritation at having a private arrangement, one reached without the Commission's involvement, upset by the Commission's public interest decision.

So that is the state of play: Applicants intend to allocate a specific amount of savings to the shareholders, but have not shared that information with the Commission. That allocation of merger savings is based not on public interest criteria but on ensuring that the premium demanded by Westar can be paid by GPE. The allocation will occur through Applicants' unilateral decisions on the timing of transition costs and the timing of rate cases. In short, the allocation will be driven by acquisition debt rather than by Commission policy. The merger finance tail will wag the merger policy dog. That is not a public interest result.

C. The Commission should allocate merger savings based on relative contribution

Q. How should the Commission allocate merger savings?

A. Applicants' approach would cause the Commission to cede authority over rates. The Commission instead should declare its own principle. The logical principle is the one I

recommended for allocating the control premium[121]: Allocate the merger savings based on relative contribution to those savings.

To clarify: I do not mean that the same percentages used to allocate the premium should be used to allocate the savings. The Commission might decide that the premium is allocated 100% to the customers because, as explained in Part II.D above, none of the reasons GPE likely has for paying the premium are attributable to value created by Westar. But the Commission might find that a particular cost reduction would not have occurred but for special Applicant effort—in which case a greater than 50% share can go to the shareholders. Where, in contrast, the savings are not attributable to any special effort, such as the savings from economies of scale and "best practices" I discussed in Part II.D.1.c, we can default to 50-50—as a means of getting the premium recovered[122]. What is common between the two allocation efforts—premium and savings—is not the numbers but the principle: Allocate benefits to benefit-producers.

And as with the premium, if the evidence on benefit-producers is absent or inconclusive, the Commission can apply a default presumption of 50-50—a rebuttable presumption that shareholders and ratepayers contributed equally. So where a particular

[121] In Part II.G.

[122] To be clear, outside the merger premium context, mere application of economies of scale or "best practices" is the utility's obligation, imposed in return for granting it an exclusive franchise. Those savings go to customers 100%. Otherwise a utility would have an incentive to resist creating savings unless it received an "incentive." Such behavior would never work in a competitive market; it has no place in a regulated setting.

category of savings has no obvious author (such as those from economies of scale[123]), the Commission can allocate it 50-50.

I explained in Part IV.B that GPE premised its purchase price in part on its ability to control the allocation of benefits. With the Commission controlling the allocation, Applicants will need to reduce that purchase price. Doing so will reduce the gain to Westar shareholders. If Applicants choose instead to drop the Transaction, we will know that the main motivation (at least Westar's) was not serving the customers but getting gain. The Commission should not feel pressured by the prospect of withdrawal to approve a Transaction built on such a premise.

* * *

Q. Summarize your conclusions for this Part IV, relating to allocation of merger savings.

A. Applicants intend to control the allocation of merger savings between shareholder and ratepayers, by using regulatory lag. Because Joint Applicants control the information about cost and the timing of rate cases, the regulatory lag device advantages them over the Commission. Once GPE has incurred the $4.4 billion debt to pay the premium, Applicants will argue against any allocation different from what they assumed, on grounds of weakened finances. To avoid being backed into that corner, the Commission must establish the allocation now, before GPE incurs its debt. That allocation should track the logic of the control premium: Savings go to those who create them; but if the savings result from natural conditions rather than special effort, the allocation is 50-50.

[123] As explained in Part II.D.1.d, economies of scale come to reflect a product's function rather than any entity's innovation, risk or effort.

V.
By eliminating "across-the-fence rivalry" and "benchmark competition," this acquisition reduces Applicants' accountability

Q. What have Applicants said about the acquisition's effects on competition?

A. Citing Kansas's ban on retail electricity competition, Applicants insist that "the Transaction will not result in any adverse effect on retail competition in Kansas." (Application at 16.) That single sentence completes Applicants' treatment of competition. This bare treatment ignores merger standard (a)(v), relating to a transaction's effect on existing competition.

That four merging monopolies would downplay the effects on competition is unsurprising. But this Commission knows better. Even in markets controlled by monopolies, competition of some sort either exists or is possible:

> Competition between utilities is not limited to competition for retail competition. Competition between utilities may include wholesale competition, inter-fuel competition between electric and natural gas utilities, and competition for new load....
>
> ... KPL and KGE compete with one another on a variety of levels. First, they compete for new retail load. This type of competition is regional and national, and sometimes international....While KPL is not in a completely free competitive market and regulation's primary purpose is to act as a substitute for competition, it is clear that competition in the utility industry is increasing....Although KPL is a regulated utility, it competes with other utilities for the sale of power to large customers and for the sale of gas to intermediate and large customers. KPL also competes with other utilities for capital, labor and customers.[124]

The merger of Westar and GPE would eliminate each company's most formidable potential rival. This Part V first describes the power of competitive rivalry and

[124] *Order, In the Matter of the Application of Kansas City Power & Light Company for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric*, Docket Nos. 172,745-U et al., at pp.32-33 (Nov. 15, 1991).

benchmark competition, then explains how the Commission can deploy that power to fulfill its duty—achieving "efficient and sufficient service" for Kansas customers.

A. Competitive rivalry pressures monopolies to perform

Q. Describe the concepts of "across-the-fence rivalry" and "benchmark competition," and how these market features pressure utility monopolies to perform.

A. "Across-the-fence" rivalry exists when two adjacent utilities continuously improve their performance to avoid unfavorable comparisons by regulators and consumers who know them both. Benchmark competition, rivalry's close cousin, exists when two companies are sufficiently similar that the performance of one company becomes a valid basis for judging the other.

Effective regulation is informed regulation. Benchmarks provide the information regulators need to assess performance and assign consequences. If we eliminate benchmarks, we reduce information; if we reduce information, we reduce the effectiveness of regulation. Eliminating a rival means eliminating rivalry. Eliminating benchmarks *and* rivalry weakens the pressure to perform. Dynamic efficiency—the increase in performance that arises from the urge to improve—diminishes.

Benchmark competition assists consumers as well as regulators. Customers in adjacent territories talk to each other. Comparing experiences, they use that information to make relocation decisions, to write letters to the editor, to pressure their regulators to order improvements, to oppose unnecessary rate increases, even to replace the utility with a better performer. When customers observe that nearby utilities differ in prices or performance, they react in at least three ways:

> [1] Existing customers who are facing other pressures to relocate, such as plant modernization or expansion, may select a site within the area served by the preferred utility. [2] New customers, without an existing location

> in either service area, will make the same election. These will include residents who may be accommodated by housing or commercial development in areas of the service territory which admit such expansion. [3] Finally, existing consumers with neither the opportunity nor means to relocate will take their complaints to the management of the utility deemed to charge excessive rates or deliver inferior service.[125]

Independent companies expecting to be judged in these ways will work to outdo each other; otherwise, they risk losing existing and future customers or suffering regulatory penalties. A merger eliminates independence. The incentive to outperform disappears.

Loss of benchmark competition was among the reasons the California Commission rejected the proposed merger between Southern California Edison and San Diego Gas & Electric. The Commission found that due to those two companies' longstanding rivalry, the public was "advantaged by the presence of proximate comparative data": data that spurred SDG&E to study the reasons for its higher rates. The Commission concluded that "the loss of SDG&E as a regulatory comparison is an adverse unmitigable impact of the proposed merger," diminishing the Commission's "ability to regulate the merged utility effectively."[126]

[125] *SCEcorp, Southern California Edison Co. & San Diego Gas & Electric Co.*, Decision No. 91-05-028, 1991 Cal. PUC LEXIS 253, at *236-37 & n.68, *238, *262.

[126] *Id.* See also *AT&T, Inc. & BellSouth Corp.*, 22 FCC Rcd 5662, at 5755 para. 188 (expressing concern that mergers reduce benchmarks, especially concerning "introduction of new technologies and services"), citing *GTE Corp. & Bell Atlantic Corp*., 15 FCC Rcd 14,032, 14,101-03 paras. 132-137 (2000), and *SBC Communications Inc. & Ameritech Corp.*, 14 FCC Rcd 14,712, at 14,770-80 paras. 125-143 (1999).

B. Avoiding the acquisition preserves these powerful tools

Q. Explain how the Commission can use competitive rivalry to carry out its public interest duties.

A. GPE and Westar's adjacency allows the Commission to make continuous comparisons. The Commission can say to Westar, "GPE's distribution costs are $X per mile lower than yours—why?" Or it can say to GPE, "Westar's outages are 20% less frequent and of 30% shorter duration than yours—why?" Done carefully, assertively and publicly, with consequences for shortcomings, these comparisons will cause the companies to compete. Instead of companies competing to pay more gain to departing shareholders, we will have companies competing to bring more benefits to consumers.

With the pressure produced by comparisons, "best practices" will be shared without the merger. The Commission can identify the best practices of each, then order their adoption by the other, with penalties for non-compliance. Should either company resist, there can be only two reasons:

1. The company wants to withhold the collaboration without the merger so that it can claim the collaboration as a benefit of the merger.

2. The company wants to withhold the collaboration so that the other company will remain less efficient. By looking better in comparison, the withholding company will increase its chances of winning the Commission's favor in rate cases, in attracting new customers and in retaining existing customers.

Each reason is cynical, unbecoming of a company that cares about its customers. The Commission should assume that its utilities are eager to please the Commission, therefore eager to share best practices. With rivalry and benchmarks, consumer benefits can flow without a merger.

* * *

Q. Summarize your conclusions in this Part V, relating to competition.

A. GPE and Westar are each other's most formidable competitor. Benchmarking—the comparison of similar companies—provides the information regulators need to assess performance and assign consequences. Adjacent rivals seek continuously to outperform each other. Eliminating benchmarks *and* rivalry weakens the pressure to perform. This Transaction does exactly that.

VI.
A public interest acquisition policy first defines the state's needs, then attracts the companies best able to satisfy those needs

Q. Describe the purpose and organization of this Part VI.

A. Few things matter more to a state than deciding who should control the electricity infrastructure, and who should have the privilege to produce and deliver the diverse electric services that support the state's economy.

In Kansas, as in most places, those decisions are made initially by government, because utility acquisitions do not occur in a "free market." In a competitive market, sellers and buyers have choices. Sellers can choose their products and their customers; buyers determine their needs and choose their suppliers. The Kansas retail utility market is different. Customers have no choice but to buy from the utility that government has chosen for them. So in making that initial decision—choosing who controls our electricity infrastructure—government must do what competitive markets do: choose the competitor that will serve customers the best. The logical sequence is to define the State's needs, describe the characteristics of companies best suited to serve those needs, then create a procedure that attracts those companies to the State. I discuss those three steps next.

A. Defining Kansas's needs

Q. How might the Commission go about defining Kansas's needs?

A. To attract the companies best suited to supply Kansas's needs, the first step is to define those needs, by answering questions like these:

1. Given the new technologies becoming available to diversify supply and help consumers manage demand, what are the products and services that consumers need?

2. For each of these products and services, what types of companies will provide them most cost-effectively?

3. For those products and services, which types of markets—monopoly markets or competitive markets—are most appropriate?

4. What statutory authority, rules and regulatory resources will the Commission need to induce performance excellence and prevent inappropriate behavior that harms consumers or stifles competition (for those markets where competition is appropriate)?

5. What consequences must the Commission be authorized and prepared to impose on those who fail to get the message that the priority is the public interest?

B. Defining the most attractive companies

Q. How might the Commission go about defining the characteristics of the most attractive companies?

A. Once the State has defined its needs, it can describe the types of companies best able to satisfy those needs. Those policies should address two characteristics of the utility's corporate family: (a) business activities; and (b) internal financial arrangements. The purpose of these policies is to prevent conflict between, and ensure alignment of, the companies' profit goals and its customer obligations.

1. Business activities

Q. In the area of a holding company system's business activities, what are the potential sources of conflict?

A. A stand-alone utility, serving a single local territory and affiliated with no other business, experiences no conflict because its sole business is its regulated business. The potential for conflict grows as the utility's business activities expand. Expansion may be in terms of geography or type of business.

Geographic expansion (merging with utilities serving other areas, whether nearby or remote) can benefit customers if there are increasing economies of scale; it can hurt customers if operations are impaired by managerial remoteness or diseconomies of scale.

Type-of-business expansion (merging with companies that sell services, whether utility or non-utility services, to third parties or to the utility itself) is a two-edged sword: Non-utility affiliates can support a utility (as might a subsidiary experienced in acquiring land or supply fuel); or distract it (like affiliates buying banks and hedge funds, or engaging in businesses whose interest in high generation prices conflicts with the utility's interest in low generation prices).

Q. What types of conflicts can arise?

A. There are at least three types. The first is management distraction stemming from non-utility investments. Failures force management to spend time saving or selling the losers; successes spur management to find more winners.

The second is affiliate abuse, of two types: (a) The utility affiliate overpays the non-utility for services, and (b) the non-utility affiliate underpays the utility affiliate for services. These improper transactions harm customers by raising the utility's price above the level necessary to cover prudent cost and reasonable profit. They also harm competition by granting affiliates unearned advantages.

The third risk is a weakened utility. When non-utility affiliates fail, the holding company is tempted to draw dividends from the utility or reduce equity flows to the utility (the holding company being the utility's sole source of equity). And because utilities are capital-intensive, their assets are attractive collateral for third-party loans to the failing affiliates.

In a utility's corporate family, there should be at all levels, from the holding company CEO to the substation repair team, a single focus: the utility's performance for the consumer. When presented with a proposed acquisition, therefore, a commission should ask: Will ultimate control be exercised by individuals whose full focus and professional priority is on service to utility customers? Or will control be exercised by companies and executives whose objectives conflict with the consumer interest?

2. Financial structures

Q. In the area of a holding company system's financial structure, what are the regulatory concerns?

A. Financial structure involves the ratio of equity to debt, the types of entities that hold the equity and debt, what recourse they have to utility assets, and which business activities get priority when capital is scarce. There are two main risks. First, when a utility's holding company finances acquisitions with debt, the repayment obligations will tempt the holding company to divert cash from the utility or to limit equity injections into the utility. Second, when a non-utility affiliate fails, investors view the holding company as more risky. Their response will be to raise its finance costs—and possibly require utility assets as collateral for their loans.

C. Attracting the companies

Q. How does the proposed Transaction square with your recommendations?

A. If the Commission has identified the State's needs, and described the company types able to satisfy those needs, its utilities will understand better what merger partners to seek.

Westar lacked that understanding. Westar chose GPE in a competition where price was dominant, quality only an incident. If the competition had been based on Kansas's needs rather than Westar shareholders' gain, GPE's offer would have been its

vision for the mix of goods and services that best suits the State. And it would have offered real commitments rather than aspirations. Because Westar's Board lacked the understanding that the Commission now needs to create, this Transaction guarantees a $2.3 billion control premium to Westar shareholders but guarantees nothing for Westar's customers. For that reason alone, this Transaction deserves rejection.

But rejection without more leaves a gap in guiding future merger transactions. Given the statutory requirement of "efficient and sufficient service," the Commission has the power to fix this problem. It can do so by applying the reasoning in this Part VI: 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. Then it will be clear, to both entities, that any future applicant must show why it, above any other company, deserves the extraordinary privilege of controlling a government-granted, exclusive franchise to serve the State's citizens. 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.

Conclusion

Q. Summarize your recommendations to the Commission.

A. This Transaction does not promote the public interest. It satisfies two private interests. It satisfies GPE's interest in adding two more utility monopolies to its two-monopoly holding company system, giving it government-protected access to two large streams of earnings and the chance to grow those earnings by expanding and modernizing electricity infrastructure without having to compete for that role. And it satisfies Westar's interest in finding the one acquirer that would pay the highest gain to Westar shareholders while

winning regulatory approval. The record evidence, from the mouths of the two CEOs and certified statements to the Securities and Exchange Commission, show unambiguously that the public interest, especially the consumer interest, was incidental. This Transaction, one set of monopolies acquiring another, did not emerge from the discipline of competitive forces, where the competition is about who can best serve the public interest. That fact alone makes this Transaction unworthy of approval.

But there is much more. GPE would take on $4.4 billion in debt to pay a $2.3 billion, 36% control premium. The control premium overcompensates Westar shareholders, for two reasons. First, its value is grounded in factors unrelated to their risk-taking or their executives' decision-making: GPE's expectation of earning equity returns on debt investment, its expectation of earning actual returns exceeding required returns, GPE's intent to keep merger savings whose creation are not the result of either utility's skill, and the ability to monetize net operating losses on the books of GPE's non-utility affiliates. Second, the premium vastly exceeds the legally required compensation Westar shareholders already have received due to this Commission's lawful rate-setting.

These factors would be enough reason to reject the merger, even if GPE were using retained earnings to make the buy. But GPE will be borrowing $4.4 billion, all to buy the equity of a company that needs no buyer to operate competently. Put bluntly, GPE is going into debt for no public interest reason. To pay off that debt, GPE intends to use its control of information and rate case timing to prevent this Commission from passing to ratepayers billions in savings from "economies of scale" and "best practices" —two categories in which it would use its control of information to keep rates above costs plus reasonable profit. By making GPE less able to weather declines in revenue,

that same debt will put pressure on the Commission and the Legislature to place GPE's private financial condition ahead of the Kansas's public needs, when it comes time to decide whether to open Kansas's doors to new businesses seeking to expand and modernize the state's electricity infrastructure.

All these factors support—indeed require—rejecting this Transaction. If somehow the Transaction can be freed of its flaws—a logical impossibility unless it emerges from a truly competitive process in which the competition is to serve the public rather than pay Westar shareholders—the Commission will need to address the overcompensation. It can do so by allocating the control premium (the excess of purchase price over market value) between shareholders and customers according to their contribution to the premium's value. Only that way will the Transaction, and Commission policy, align acquisition decisions with the principles of economic efficiency and fiscal conservatism.

GPE and Westar are each other's most formidable competitor. Benchmarking—the comparison of similar companies—provides the information regulators need to assess performance and assign consequences. Adjacent rivals seek continuously to outperform each other. Eliminating benchmarks *and* rivalry weakens the pressure to perform. This Transaction does exactly that.

Finally, I recommend that the Commission clarify its merger policy. The policy's origins date from an era different from today's. The 1991 merger whose approval first produced the policy occurred in an era where nearly the only mergers permitted by law were mergers of adjacent companies. With the 2005 repeal of the federal Public Utility Holding Company Act, now any company can acquire any other company. There are no

restrictions on geographic remoteness or type-of-business mixing. This new world has caused an acceleration of mergers, leading to a consolidation of electric infrastructure ownership unguided by competitive discipline or regulatory clarity. The high merger premium in this Transaction (which Joint Applicants justify by referencing, circularly, high merger premia in other transactions) is a likely result of this consolidation trend. The Commission can no longer hope that transactions emerging from the current forces will satisfy the public interest. In this proceeding, the Commission can gain insights about how to align its policies with the current forces so that transacting parties' actions will be aligned with the public interest.

Rejecting this Transaction will not deprive Kansas customers of future merger savings. Rejecting the Transaction, coupled with clarifying current policy, will open the door to better transactions that will produce more savings—because transacting parties will be focusing on the public rather than on themselves.

Q. Does this conclude your Direct Testimony?

A. Yes.

Appendix A: Excerpts from the Proxy Statement

"The Westar Board and senior management of Westar regularly review and evaluate Westar's strategies as part of their ongoing efforts to provide long-term value to shareholders, taking into account economic, competitive, regulatory and other conditions, as well as historical and projected industry trends and developments. As part of these reviews, the Westar Board and senior management of Westar also periodically consider and evaluate potential options and alternatives designed to enhance shareholder value, including, from time to time, potential strategic transactions."[1]

"From time to time in 2014 and early 2015, Mr. Mark Ruelle, Westar's Chief Executive Officer, apprised the Westar Board at its regular meetings of recently announced utility strategic transactions along with his sentiment that the nature of some of these transactions might suggest a shift from historical precedents regarding valuations and transaction terms. Specifically, Mr. Ruelle noted that terms may have been shifting in favor of shareholders of selling companies in utility transactions announced in the last half of 2014 and first few months of 2015. Specifically, he noted that, in these transactions, there seemed to have been a greater willingness of buyers to take regulatory risk, and they reflected stronger price/earnings multiples and robust takeover premia. He indicated that he did not see a reason for Westar to deviate from its long-term stand-alone strategy, but that he felt it important to apprise the Westar Board of what may be important shifting trends, which were perhaps different from what they were familiar with based on earlier discussions."[2]

"In early 2015, after reading the first of several published analyst reports speculating as to Westar's potential interest as a seller, Mr. Bassham contacted Mr. Ruelle and indicated that, while not wanting to press the issue, should the Westar Board ever be interested in discussing a potential strategic transaction, he wanted Mr. Ruelle to know that the Great Plains Energy Board had potential interest in discussing the merits of a business combination with Westar. Mr. Ruelle, while indicating that Westar was not for sale, agreed to have dinner with Mr. Bassham to discuss their perspectives on the industry as the two returned from the same industry conference. During this dinner in March 2015, the two discussed their respective views about the business environment and the industry, generally, along with trends affecting both companies. Mr. Ruelle reiterated that Westar was not for sale, and his prior public statements about business combinations, generally, including his beliefs that if the Westar Board were to consider a business combination, it would be less likely to be a premium acquirer; that it would likely be ambivalent regarding a merger of equals or other similar form of transaction; and that if it were to pursue a consolidating transaction, management would be more likely to recommend the route of being acquired at a premium."[3]

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[1] Proxy Statement at 52.

[2] Proxy Statement at 52.

[3] Proxy Statement at 52.

"The Chief Executive Officer of another utility company, referred to as "Bidder A", called Mr. Ruelle in the spring of 2015. He indicated that his company had kept apprised of Westar's business and circumstances, that it thought well of Westar and its management, and that if the Westar Board ever considered pursuing a business combination, he believed his company would be a good fit. Mr. Ruelle responded that Westar was not for sale, but that he would discuss Bidder A's interest with the Westar Board. Bidder A's Chief Executive Officer did not share any thoughts on valuation, but indicated the general nature of a potential transaction by reference to another recent industry transaction familiar to both of them. In that transaction, a buyer had purchased a company for cash and paid a premium of approximately 20% over the market price of the seller's common stock immediately prior to the announcement of the transaction."[4]

"In summer 2015, Mr. Bassham again reiterated to Mr. Ruelle his company's potential interest in combining with Westar, should Westar decide to pursue that strategy. Mr. Ruelle noted that the Westar Board would be meeting in late August, 2015 and that he would share with the Westar Board Great Plains Energy's potential interest in discussing the merits of a possible business combination."[5]

"In recent years, the Chief Executive Officer of another company, referred to as "Bidder B," had on occasion in conversations with Mr. Ruelle mentioned Bidder B's interest in exploring the possibility of a business combination, should Westar ever decide it was interested in exploring such a transaction. Those casual, infrequent conversations included a conversation in the spring of 2015."[6]

"In the summer of 2015, Bidder B's Chief Executive Officer called Mr. Ruelle and reiterated Bidder B's possible interest in a transaction and asked if Mr. Ruelle would be willing to meet to hear Bidder B's view of the potential merits of a business combination. The two met in Kansas City in August, 2015. Mr. Ruelle reiterated that while Westar was not for sale, he was willing to hear Bidder B's thoughts on the merits of a possible business combination and would be willing to share those ideas with the Westar Board later that month. During the meeting Bidder B's Chief Executive Officer shared his views on the "industrial logic" of a business combination and Bidder B's view of Westar as a good strategic fit. There was no discussion of value, consideration or potential structure of any possible transaction. Mr. Ruelle reiterated his prior public statements about potential business combinations, including his beliefs that, should the Westar Board ever consider a business combination, Westar would be less likely to be a premium acquirer; that it might be ambivalent about a merger of equals; and that if it were to consider a

[4] Proxy Statement at 53.

[5] Proxy Statement at 53.

[6] Proxy Statement at 53.

consolidating transaction, management would be more likely to recommend the route of Westar being a premium seller."[7]

"On August 25 through 27, 2015, the Westar Board held its customary annual strategic planning meeting. Among topics of discussion were trends in the industry, including the nature of M&A activity. As part of that discussion, Mr. Ruelle reported the earlier expressions of interest and discussions described above. The Westar Board concurred that, based on the information presented to date, Westar should continue to pursue its long-term strategy, but advised that Mr. Ruelle could gather additional information from inquiring companies, including with respect to value and regulatory risk, without making any commitments regarding any strategic transactions."[8]

"On September 3, 2015, Bidder B's Chief Executive Officer called Mr. Ruelle to discuss industry issues, and also reiterated Bidder B's continued interest in exploring a possible business combination. Mr. Ruelle reiterated that Westar was not for sale but said that he would be willing to hear more detail regarding what Bidder B might have in mind, specifically with regard to value, structure and the ability to consummate a transaction in the public interest, as without such information, there would be nothing more to share with the Westar Board. The two agreed to continue their discussions when Bidder B's Chief Executive Officer had additional information to share."[9]

"Following a trade association meeting in September 2015, Mr. Bassham and Mr. Ruelle shared a ride to the airport. At the airport the two visited about their earlier conversations and, after Mr. Ruelle noted that Westar was not for sale, he said he was willing to hear what Great Plains Energy wished to share with the Westar Board in terms of its potential interest. Mr. Bassham indicated that while Great Plains Energy still remained very interested in a potential transaction, Great Plains Energy was not contemplating a valuation in the range of then recently announced industry transactions. The two agreed to continue their conversations and met again later in September, at which meeting Mr. Ruelle reiterated to Mr. Bassham that Westar was not for sale, but that Mr. Ruelle was willing to listen to a proposal. Mr. Ruelle confirmed that Westar did not see itself as a buyer and that Westar did not view a business combination transaction structured as a merger of equals favorably, based on the anticipated benefits to Westar shareholders. Mr. Ruelle advised Mr. Bassham that any business combination transaction would have to be structured as a purchase of Westar at a premium to market prices, and that both the premium and the certainty of closing the transaction would be important to Westar's consideration of any proposal made by Great Plains Energy. Mr. Bassham

[7] Proxy Statement at 53.

[8] Proxy Statement at 53.

[9] Proxy Statement at 53-54.

advised Mr. Ruelle that he would discuss the matter with the Great Plains Energy Board."[10]

"At the request of Bidder B's Chief Executive Officer, Mr. Ruelle met again with him on September 29, 2015 in Kansas City. Bidder B's Chief Executive Officer again reiterated his views as to the industrial logic and other benefits of a potential business combination. He further provided a non-binding, rough approximation of value, subject to conducting diligence and other customary contingencies and qualifications. He stated the preferred structure from Bidder B's point of view would be a combination of stock and cash, with the majority of the consideration being in stock. The preliminary indication of value was a premium of approximately 25% to the then-current trading price of Westar's common stock. The market closing price of Westar's common stock on September 28, 2015 was $37.87. Mr. Ruelle thanked Bidder B's Chief Executive Officer for his interest, reiterated that Westar was not for sale, and said that he would share this information with the Westar Board in October, but that the Westar Board had made no decision to proceed toward a potential strategic transaction."[11]

"On October 2, 2015, the Great Plains Energy Board held a special telephonic meeting.... Following discussion and review, the Great Plains Energy Board authorized Mr. Bassham to discuss a preliminary proposal with Mr. Ruelle that would be based on an acquisition of Westar by Great Plains Energy at a premium of 20% 25% over the current market price of Westar's shares of common stock, with consideration payable 70% in Great Plains Energy common stock and 30% in cash...."[12]

"On October 4, 2015, Mr. Bassham called Mr. Ruelle to check in to possibly continue their earlier conversations. Mr. Ruelle told him that the Westar Board had made no decision to proceed toward a potential strategic transaction. The two agreed to meet again so that Great Plains Energy could clarify its preliminary thoughts on value, certainty of value, structure and ability to consummate a potential transaction should Westar decide to go down that path. Mr. Ruelle and Mr. Bassham met on October 7, 2015 in Lawrence, Kansas. Mr. Bassham shared his thoughts about a possible business combination in terms of cost savings opportunities, value, structure and the ability to consummate a transaction that would be in the public interest. He indicated that Great Plains Energy would consider a mix of consideration consisting of 70% Great Plains Energy common stock and 30% cash, and a premium in the range of 20-25% to the then-current price of Westar's common stock. The market closing price of Westar's common stock on October 6, 2015 was $38.17. Mr. Ruelle agreed to share that information with the Westar Board later in October."[13]

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[10] Proxy Statement at 54.

[11] Proxy Statement at 54.

[12] Proxy Statement at 54.

[13] Proxy Statement at 54-55.

"At a regular meeting of the Westar Board on October 22, 2015, at which members of senior management were present, Mr. Ruelle reported to the Westar Board on the contacts and conversations described above. The Westar Board discussed the current environment for mergers and acquisitions in the utility industry, including transactions announced in 2015, and the potential implications for Westar. Topics of discussion included the relative valuations of utilities, generally, and how future changes in interest rates and economic activity could affect values. Also discussed were possible approaches to ascertaining potential value Westar might obtain for its shareholders should it consider a strategic transaction."[14]

"Following discussions regarding those respective firms' interest and ability to represent Westar, on November 11, 2015 Guggenheim Securities, LLC ("Guggenheim Securities") was retained as financial advisor to Westar to advise the Westar Board concerning merger and acquisition matters, including the potential sale of Westar. Guggenheim Securities was selected based on the firm's extensive expertise and experience in the industry and its understanding of macro issues affecting the industry, as well as being free from conflicts of interest. In November 2015, Westar also retained Baker Botts L.L.P. ("Baker Botts") to provide the Westar Board with legal advice concerning potential mergers and acquisitions."[15]

"On October 23, 2015, executives with an investment fund focused on infrastructure investment, referred to as "Bidder C," met with Mr. Ruelle and Mr. Somma to introduce themselves and their organization, and to express an interest in discussing a possible business combination with Westar should Westar decide to pursue a business combination. Mr. Ruelle and Mr. Somma listened to them, indicated that Westar was not for sale and thanked them for expressing their interest. Mr. Ruelle explained that if Bidder C had a particular sense of value, structure and other matters it thought important for Westar to know, he would share that with the Westar Board, if they wished."[16]

"On October 30, 2015, Bidder B's Chief Executive Officer called Mr. Ruelle to check in about possibly pursuing their previous conversations. Bidder B's Chief Executive Officer reiterated his company's interest, and noted that his earlier preliminary indication of value might be subject to favorable adjustment, if Bidder B were given access to confidential information about Westar. Mr. Ruelle thanked Bidder B's CEO for his company's continuing interest, but indicated that the Westar Board had not made a decision to proceed down the path toward a possible strategic transaction."[17]

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[14] Proxy Statement at 55.

[15] Proxy Statement at 55.

[16] Proxy Statement at 55.

[17] Proxy Statement at 55.

"A special meeting of the Westar Board was held on November 19, 2015. Members of the senior management of Westar and representatives of Guggenheim Securities and Baker Botts also attended the meeting. At the meeting, Baker Botts provided the Westar Board with information regarding its fiduciary duties, and the Westar Board received a presentation from Guggenheim Securities discussing, among other things, current market conditions for the stock of regulated utility companies, factors that could affect the market for those stocks in the future and recent developments with respect to mergers and acquisitions of electric and gas utility companies. Guggenheim Securities also discussed the prices and other key terms of several recently announced transactions in the industry. Mr. Ruelle informed the Westar Board that in his view there might have been a change in the environment for transactions involving electric and gas utilities, and that it might be possible to achieve value for shareholders that would exceed the value that could reasonably be expected to be achieved if Westar were to continue to pursue its long-term stand-alone strategic plan. Mr. Ruelle's belief was based in part on the presentation made by Guggenheim Securities, which had noted that recent strategic utility transactions were characterized by, among other things, improving regulatory support for transactions, proactivity of acquirers to initiate transactions, strong offer prices and robust takeover premia. The presentation from Guggenheim Securities also noted that, at the time, utilities were trading above long-term average price/earnings multiples. The Westar Board expressed its interest in learning more and instructed management to have Guggenheim Securities present more specific information about possibilities were Westar to consider being acquired, and to also compare and contrast that outcome with alternative strategies at the Westar Board's next meeting."[18]

"At a regular meeting of the Westar Board on December 9, 2015, at which members of Westar senior management and representatives of Guggenheim Securities and Baker Botts were present, Guggenheim Securities provided additional information to the Westar Board regarding the current environment for mergers and acquisitions. Among other things, Guggenheim Securities provided the Westar Board with an update regarding Westar's recent stock price performance, factors that could affect Westar's share price performance in the future and potential strategic alternatives that might be available to Westar, including remaining a stand-alone company, acquiring one or more additional regulated utility companies, expanding Westar's non-utility growth platform, entering into a merger of equals or similar transaction with another utility company or entering into a corporate transaction that would result in a change of control of Westar. Guggenheim Securities also provided the Westar Board with information regarding the financial multiples and other metrics in recent merger and acquisition transactions involving regulated utility companies, a potential range of values for Westar on a stand-

[18] Proxy Statement at 55-56.

alone basis under alternative future scenarios and a potential range of values that Westar might be able to achieve in a strategic corporate transaction."[19]

"Following the Guggenheim Securities presentation, the Westar Board discussed the factors that would affect its view of any potential transaction and how the Westar Board might determine what type of transaction might be available to Westar. The Westar Board concluded that in addition to the price to be received by Westar's shareholders, other important factors would be the type of consideration and certainty of value to be received by Westar shareholders, the ability of the counter-party in any such transaction to demonstrate that the transaction would be in the public interest and be able to obtain the necessary regulatory approvals, the counter-party's ability to obtain any necessary financing for the transaction and any commitments that the counterparty would be willing to make with respect to Westar's customers and employees, as well as the communities served by Westar."[20]

"Following this discussion, the Westar Board concluded that it should determine if it would be possible to negotiate a transaction that would be more favorable to Westar's shareholders than Westar's long-term stand-alone strategic plan. In order to determine if such a transaction might be possible, while still preserving the confidentiality of any discussions, the Westar Board determined that it would be advisable to approach a single long-term bidder in the first instance. Consequently, the Westar Board authorized Mr. Ruelle to approach Bidder A, which had previously approached him to express interest in pursuing a transaction, to inquire whether Bidder A might be interested in discussing a potential acquisition of Westar. The Westar Board selected Bidder A because of the Westar Board's belief that if it were interested in pursuing a transaction, a transaction with Bidder A would likely have the desired characteristics described above. The Westar Board did not discuss any specific price at which it would or would not be prepared to enter into a transaction and no decision was made to seek to sell the company in a change of control transaction."[21]

"Following the Westar Board meeting on December 9th, and in accordance with the authorization of the Westar Board, Mr. Ruelle called the Chief Executive Officer of Bidder A and told him that the Westar Board had authorized him to respond to Bidder A's inquiry earlier in the year, to ascertain whether Bidder A had continuing interest, and if so, what it might have in mind regarding potential value, structure and ability to consummate a transaction in the public interest. ... Bidder A subsequently responded later in January that it had concluded that it was not interested at this time in continuing

[19] Proxy Statement at 56.

[20] Proxy Statement at 56.

[21] Proxy Statement at 56-57.

discussions with Westar regarding a potential transaction, given other internal investment opportunities for its available capital...."[22]

"On December 10, 2015, representatives from Bidder C came to Westar again for a previously scheduled meeting with Mr. Ruelle and Mr. Somma. At that meeting, Bidder C reiterated its interest and further indicated that were Westar to engage with Bidder C, it saw a preliminary indication of value of potentially $50 per share, in cash, subject to due diligence and other customary contingencies. The market closing price of Westar's common stock on December 9, 2015 was $41.05."[23]

"On February 2, 2016, in advance of the regularly scheduled February meeting of the Westar Board, Mr. Ruelle called and spoke with Bidder B's Chief Executive Officer by telephone. Bidder B's Chief Executive Officer reiterated his company's interest in potentially exploring a transaction. He noted that since October Westar's stock price had increased significantly, as had the prices of many other stocks of electric utility companies; accordingly, his company would consider changes in its preliminary indication of value and potentially consider changing the consideration to all cash. He indicated that his company had engaged advisors and was prepared to move promptly. On the same day, Mr. Ruelle called Mr. Bassham, who reiterated Great Plains Energy's continuing interest as well."[24]

"On February 11, 2016, Mr. Ruelle contacted Mr. Bassham by telephone regarding the proposal made by Great Plains Energy in October 2015. Mr. Ruelle requested that Great Plains Energy provide its current view on the price Great Plains Energy would be willing to pay in a potential acquisition, and to what extent Great Plains Energy would be willing to provide additional certainty with respect to the value of the consideration payable in the potential acquisition, by increasing the cash portion of the consideration and potentially providing a collar with respect to the stock portion of the consideration. Mr. Ruelle advised Mr. Bassham that Westar had a preference for cash consideration, but was open to stock consideration as well."[25]

"On February 18, 2016, the Great Plains Energy Board held a regularly scheduled meeting, which included a review of the potential Westar acquisition transaction....Representatives of Goldman Sachs reviewed its preliminary financial analyses of a potential transaction. Following discussion of a potential transaction, including with respect to the consideration payable, the associated financing requirements and the potential use of a purchase price collar among other items, the Great Plains

[22] Proxy Statement at 57.

[23] Proxy Statement at 57.

[24] Proxy Statement at 57.

[25] Proxy Statement at 57.

Energy Board authorized Mr. Bassham to convey an updated proposal to Mr. Ruelle. The terms of the updated proposal would include an acquisition of Westar by Great Plains Energy priced at a premium of 20% over the current market price, with a consideration mix of 50% Great Plains Energy common stock and 50% cash with the potential to include a collar with respect to the stock consideration. Following this meeting, Mr. Bassham called Mr. Ruelle to convey Great Plains Energy's updated proposal."[26]

"At a Westar Board meeting on February 22, 2016, at which members of Westar senior management and representatives of Guggenheim Securities and Baker Botts were present, Mr. Ruelle updated the Westar Board regarding developments since the previous meeting as described above. Following this, Guggenheim Securities updated the Westar Board regarding recent developments relating to three transactions involving regulated electric and gas companies that had been announced since the Westar Board's last meeting, including the valuations and other key terms of those transactions. Guggenheim Securities also provided the Westar Board with information about several potential counter-parties that might be interested in discussing a possible transaction with Westar. Following Guggenheim Securities' presentation, the Westar Board discussed whether it made sense to continue to explore the possibility of a potential transaction, and if so, what would be the best way to proceed. Among other things, the Westar Board discussed whether it would be better to approach one party at a time, a limited number of potential counter-parties or a broader group as part of a more formal process. After discussion, the Westar Board concluded that to ascertain maximum potential value, it wished to solicit indications of interest from several potential counter-parties in order to gauge their level of interest in a potential strategic transaction with Westar and instructed management and Guggenheim Securities to identify a list of potential counter-parties and to contact them to determine their level of interest in a strategic transaction. No decision to pursue a strategic transaction was made."[27]

"Following this meeting, Guggenheim Securities contacted Great Plains Energy, Bidder B and 14 other companies regarding a possible transaction. Of these, Great Plains Energy, Bidder B and 7 others entered into confidentiality and standstill agreements with Westar that contained substantially the same terms, including standstill provisions. The parties that entered into confidentiality and standstill agreements were provided with a confidential information package that included information regarding Westar, including its 2016 internal financial forecast. This forecast was the same forecast provided to Guggenheim Securities for purposes of its fairness opinion. Westar's management team also held conference calls with Great Plains Energy, Bidder B and 5 of the other companies to discuss Westar's business and financial condition as well as its anticipated results of operations as reflected in its forecast. The other two companies that had signed confidentiality agreements decided not to schedule management due diligence calls.

[26] Proxy Statement at 57-58.

[27] Proxy Statement at 58.

Representatives of Westar and Guggenheim Securities also held follow-up calls with three of the bidders after the calls with Westar management to discuss financial issues and Westar's forecasts in more detail."[28]

"On March 15, 2016, Bidder C submitted a letter to Guggenheim Securities indicating that Bidder C believed that it could develop an attractive proposal to acquire Westar. Bidder C indicated that in order to develop a proposal, it would need Westar's permission to contact 4 or 5 other investors who would have to join together to make a proposal. After discussion with Guggenheim Securities, members of Westar's senior management determined not to grant Bidder C permission to contact other potential investors because it was concerned that doing so would increase the risk that additional market rumors would develop, which could serve to discourage more capable bidders from continuing to evaluate a possible transaction. This decision was also based in part on the view that Bidder C likely had fewer opportunities to create synergies from a transaction and would not be able to make a compelling case to regulators that a transaction was in the public interest."[29]

"On March 29, 2016, the Great Plains Energy Board held a regularly scheduled meeting, which included an update with regard to Great Plains Energy's participation in the Westar sale process. .... Following discussion, the Great Plains Energy Board authorized Great Plains Energy management to submit a first round indicative proposal the terms of which would include an acquisition of Westar by Great Plains Energy priced in the range of $53-$55 per share, with a consideration mix of 35% Great Plains Energy common stock and 65% cash which would include fully committed financing for the cash portion of the purchase price and with the potential to include a collar with respect to the stock consideration, and would potentially express interest in evaluating Westar senior management and the potential for Westar representation on the Great Plains Energy Board following the closing."[30]

"On April 5, 2016, the deadline set by Westar for submission of preliminary indications of interest, Great Plains Energy, Bidder B and the 3 other companies with which Westar had held management calls submitted preliminary non-binding indications of interest. The 3 additional companies are referred to as Bidders D, E and F. Great Plains Energy indicated that it might be willing to acquire Westar for a price of $54.50 per share of Westar common stock, with the consideration being 65% cash and 35% Great Plains Energy common stock. Bidder B's proposal indicated a price of $50.50 per share with consideration being 50% cash and 50% common stock of Bidder B. Bidder D proposed a price range of up to $55.11 per share in cash on a fully-diluted basis. Bidder E proposed acquiring Westar for $53.00 per share consisting of 33% cash and 67% common stock of

[28] Proxy Statement at 58.

[29] Proxy Statement at 58-59.

[30] Proxy Statement at 59.

Bidder E, and Bidder F said that it might be willing to acquire Westar for $52.00 per share in cash."[31]

"On April 11, 2016, the Westar Board met to consider the indications of interest. The Westar Board, members of Westar senior management, and representatives from Guggenheim Securities and Baker Botts discussed the key terms of the indications of interest, including price and other relevant terms and conditions. After discussing the indications of interest and the pros and cons of moving forward with discussions concerning a potential transaction, the Westar Board decided to seek definitive proposals from all five companies that had submitted indications of interest, including Great Plains Energy. Each of these companies was given access to an electronic data room containing detailed confidential information about Westar, offered an in-person management presentation regarding Westar's business, operations and prospects, and advised of the process and schedule for submitting definitive proposals. In the course of advising Great Plains Energy that it was being invited to submit a definitive proposal, a representative of Guggenheim Securities provided feedback regarding Great Plains Energy's initial proposal that Westar would prefer a bid with a larger proportion of the consideration consisting of cash."[32]

"On May 19, 2016, Bidder B indicated to Guggenheim Securities that it had determined not to submit a bid to acquire Westar. Bidder B's CEO subsequently confirmed this decision in a telephone call to Mr. Ruelle."[33]

"On May 22, 2016, the Great Plains Energy Board held a special telephonic meeting, which was attended by representatives of Goldman Sachs and Bracewell, to consider the terms of Great Plains Energy's final proposal to Westar. Following discussion of various strategic and financial considerations and analyses, members of Great Plains Energy management recommended that Great Plains Energy's final proposal to Westar should include consideration with a value per share of $58.25 consisting of 85% cash and 15% shares of Great Plains Energy common stock, subject to a collar to provide additional value certainty to Westar, and that the Great Plains Energy Board should authorize Great Plains Energy management to offer merger consideration with a value up to $60.00 per share of Westar common stock, consisting of up to 90% cash and 10% stock, to the extent that in the judgment of Great Plains Energy management, they deemed it advisable in negotiations with Westar following delivery of Great Plains Energy's final proposal. The Great Plains Energy Board concurred with management's recommendation and authorized the submission of a final proposal to Westar on the

[31] Proxy Statement at 59.

[32] Proxy Statement at 59.

[33] Proxy Statement at 61.

recommended terms, and authorized Great Plains Energy to offer additional merger consideration consistent with management's recommendation."[34]

"On May 23, 2016, the deadline set by Westar for submission of definitive written proposals, Great Plains Energy and Bidders D and E submitted written proposals to acquire Westar. Great Plains Energy submitted a proposal to acquire Westar for a price of $58.25 per share, with 85% of the consideration being in cash and 15% in Great Plains Energy common stock. Great Plains Energy's proposal also included a "collar" mechanism on the stock portion of the consideration pursuant to which the exchange ratio of the stock would be adjusted within a range of 7.5% above and below Great Plains Energy's then-current stock price to provide Westar shareholders with a fixed value for the stock portion of the consideration so long as Great Plains Energy's stock price was within the range specified in the collar. Great Plains Energy also submitted a form of merger agreement and commitment letter with respect to the financing for its proposal to acquire Westar. Bidder D proposed to acquire Westar for a price of between $54.00 and $56.00, with 45% of the consideration being in cash and 55% being in common stock of Bidder D. Bidder D did not propose a collar or other form of price protection with respect to the stock portion of the consideration. Bidder D noted that because of exogenous circumstances unrelated to Westar, Bidder D had not had sufficient time to complete a mark-up of the form of merger agreement or obtain a financing commitment letter. Bidder D indicated that it was prepared to move expeditiously to complete the necessary definitive documentation relating to its bid. Bidder E proposed to acquire Westar for a price of $51.00 per share with 80% of the consideration in common stock of Bidder E and 20% in cash. Bidder E did not propose any collar or other form of price protection on the stock portion of the consideration in its proposal. Bidder E submitted a form of merger agreement with its bid and indicated that it would not require outside financing for the cash portion of its bid. Bidder F provided an oral indication of continued interest, stating that it would be interested in acquiring Westar for a purchase price of $52.00 per share in cash, but that it would require additional time to obtain committed financing and negotiate a definitive merger agreement."[35]

"In reviewing the bids that had been received, the Westar Board noted that the price proposed by Great Plains Energy was higher than the upper end of the price range proposed by the next highest bidder, Bidder D, and represented an implied 36% premium to the closing price of Westar common stock on March 9, 2016, the day before an article was published stating that Westar was seeking acquisition proposals. The Westar Board also noted that the consideration proposed by Great Plains Energy was 85% cash and 15% Great Plains Energy common stock, that the Great Plains Energy proposal included some protection for the value of the stock portion of the consideration in the form of a collar on the price of Great Plains Energy common stock, that Great Plains Energy had

[34] Proxy Statement at 61.

[35] Proxy Statement at 61.

obtained committed financing for its proposal and that the proposed form of merger agreement submitted by Great Plains Energy was more favorable to Westar than the form of merger agreement submitted by Bidder E because, among other things, Bidder E's proposal did not contain a reverse break-up fee and provided that Westar would bear more regulatory risk than under the Great Plains Energy proposal. After extensive discussion, the Westar Board instructed Mr. Ruelle, with assistance from Guggenheim Securities and Baker Botts, to negotiate with Great Plains Energy and Bidder D with respect to their proposals to attempt to obtain their best and final bid terms. The Westar Board did not specify the specific terms that it wished to see changed in either of the bids, but it did indicate that the value of the consideration to be received by Westar shareholders, the mix of cash and stock to be received by Westar shareholders and the probability that a closing would occur, including the likelihood that regulators would find the transaction to be in the public interest and thereby gain regulatory approval, were important factors that it would consider. The Westar Board instructed Mr. Ruelle not to terminate discussions with either Bidder E or Bidder F at that time, but not to negotiate with them until the results of further negotiation with Great Plains Energy and Bidder D were known."[36]

"After the meeting, Guggenheim Securities called representatives of Goldman Sachs and Bidder D to inform them that the Westar Board would like them to consider improving the terms of their proposals and that they should submit their best and final proposals as soon as possible. Guggenheim Securities did not specify which terms should be improved, but proposed that the respective financial and legal advisors of Westar and Great Plains Energy convene a conference call the next day to discuss the key changes to the merger agreement proposed by Great Plains Energy to which Westar objected. Guggenheim Securities further indicated that Westar and the Westar Board would review the totality of the bid terms and that the value of the consideration to be received by Westar shareholders, consideration mix and certainty of closing, including the ability to obtain regulatory approvals, were all important terms to the Westar Board."[37]

"On May 26, 2016, in a telephone conversation with Guggenheim Securities, Bidder D indicated that it was prepared to increase the amount of its bid to $56.00 per share and possibly more, with the mix of consideration, comprising $25.00 in cash with the remainder in common stock of Bidder D. Bidder D indicated that it would be able to increase its bid even further if it were able to find additional sources of value following further diligence on Westar. Bidder D subsequently confirmed these changes to its bid in a written letter to Westar delivered on May 27, 2016."[38]

[36] Proxy Statement at 62.

[37] Proxy Statement at 62.

[38] Proxy Statement at 62.

"Also on May 26, 2016, Guggenheim Securities and Baker Botts held a telephone conversation with representatives of Goldman Sachs and Bracewell, Great Plains Energy's financial and legal advisors, respectively. In the call, Guggenheim Securities and Baker Botts reviewed certain adjustments to the terms of the merger agreement proposed by Great Plains Energy that Westar sought, including changes to the termination fees potentially payable by the parties, in particular, (i) increasing the fee payable by Great Plains Energy if the Merger were not completed as a result of failure to obtain required regulatory approvals, (ii) decreasing the fee payable by Westar if it were to terminate the merger agreement under circumstances in which another company had made a superior proposal to acquire Westar, (iii) increasing the fee payable by Great Plains Energy if either Westar terminated the merger agreement following a change by the Great Plains Energy Board of its recommendation to its shareholders relating to the merger, or if Great Plains Energy terminated the merger agreement and subsequently entered into an agreement to be acquired by another company and (iv) adding a fee payable by Great Plains Energy of $80 million in the event that Great Plains Energy shareholders did not vote in favor of the Stock Issuance proposal in circumstances where no other fee was payable by Great Plains Energy; the removal of a condition to the parties' obligations to consummate the merger with respect to the approval of the Charter Amendment proposal, and the removal of the right of Great Plains Energy to terminate the merger agreement prior to the Great Plains Energy shareholder meeting in order to pursue an alternative transaction."[39]

"Following several conferences among members of Great Plains Energy management and Great Plains Energy's legal and financial advisors later that day, a representative of Goldman Sachs, at the direction of Great Plains Energy management, confirmed to a representative of Guggenheim Securities that Great Plains Energy was willing to accept all of the changes to the merger agreement proposed by Baker Botts. In the course of the conversation, the representative of Guggenheim Securities advised the representative of Goldman Sachs that the purchase prices proposed by each of the two final participants in the process were close, and that Great Plains Energy should consider that in conveying its best and final proposal to Guggenheim Securities. Subsequent to receiving that feedback, representatives of Goldman Sachs discussed with members of Great Plains Energy management the competitive nature of the sales process, the potential value of the transaction to Great Plains Energy and the information provided by Guggenheim Securities regarding Great Plains Energy's proposed purchase price. Following these discussions, Great Plains Energy sent Westar a revised bid letter increasing its price to $60.00 per share. The consideration mix remained 85% cash and 15% Great Plains Energy stock with a 7.5% collar on the price of Great Plains Energy's common stock."[40]

[39] Proxy Statement at 62-63.

[40] Proxy Statement at 63.

"Later in the day on May 27, 2016, Mr. Bassham and Mr. Ruelle spoke by telephone to confirm their respective understanding of where principal transaction terms stood. They also agreed that the terms should include Great Plains Energy offering one of the Westar Board members a seat on the Great Plains Energy Board. Upon confirming these things, Mr. Ruelle informed Mr. Bassham that he was prepared to recommend the Great Plains Energy proposal to the Westar Board of Directors for approval, and that Westar would work exclusively with Great Plains Energy over the weekend to attempt to finalize a definitive agreement.[41]

Mr. Ruelle's decision was based on the price and other terms proposed by Great Plains Energy as well as his judgment that it was unlikely that Westar would be able to obtain as high or a higher price from any of the other bidders within the next few days, and that if Westar did not act quickly to execute a merger agreement with Great Plains Energy, the opportunity to enter into a transaction with Great Plains Energy on the terms then proposed could be lost."[42]

"Also at the May 29, 2016 board meeting, the Great Plains Energy Board received a presentation from representatives of Goldman Sachs with respect to its financial analyses of the potential transaction. Representatives of Goldman Sachs rendered its oral opinion to the Great Plains Energy Board, subsequently confirmed in writing by delivery of a written opinion dated as of May 29, 2016, that as of the date of the opinion and based upon and subject to the factors and assumptions set forth therein, the merger consideration to be paid by Great Plains Energy for each outstanding share of Westar common stock pursuant to the merger agreement was fair from a financial point of view to Great Plains Energy. The full text of the written opinion of Goldman Sachs, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is attached to this joint proxy statement/prospectus as Annex C."[43]

"After considering the proposed terms of the merger agreement and the various presentations of its financial and legal advisors, and taking into consideration the matters discussed during the meeting and prior meetings of the Great Plains Energy Board, including the factors described under "-Recommendations of the Great Plains Energy Board and its Reasons for the Merger", the Great Plains Energy Board determined that the merger, including the issuance of shares of Great Plains Energy common stock as contemplated by the merger agreement, was advisable and in the best interests of Great Plains Energy and its shareholders."[44]

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[41] Proxy Statement at 63.

[42] Proxy Statement at 63.

[43] Proxy Statement at 64.

[44] Proxy Statement at 64.

"Also on May 29, 2016, the Westar Board met, with representatives of Westar senior management and Guggenheim Securities and Baker Botts present, to consider the updated bids from Great Plains Energy and Bidder D. Baker Botts provided the Westar Board with legal advice relating to the fiduciary duties of directors in merger and acquisition transactions. Management, Guggenheim Securities and Baker Botts updated the Westar Board with respect to the improved terms of the bids, including that Great Plains Energy had agreed to increase its price and had agreed to changes to the merger agreement requested by Westar, and that Bidder D had increased its price to the high end of its previously indicated range and indicated that it might be able to increase its price further based on additional diligence on Westar. The Westar Board noted that the indicative price of $60.00 per share of Westar common stock proposed by Great Plains Energy was $4.00 higher than the price then proposed by Bidder D, that Bidder D had indicated that it might be able to increase its price further but that there was no assurance that Bidder D would increase its price and that any price increase if it did occur could be less than $4.00 per share. The Westar Board also noted that Great Plains Energy had obtained fully committed financing for the cash portion of its proposal. Guggenheim Securities informed the Westar Board that the indicative price of $60.00 proposed by Great Plains Energy represented a 13.4% premium to the closing price of Westar common stock on May 27, 2016, and a 36.1% premium to Westar's undisturbed closing share price of $44.08 as of March 9, 2016, which was the last trading day before an article was published stating that Westar might be in the early stages of exploring strategic options that could lead to a sale, and a multiple of projected earnings consistent with or favorable to recent utility acquisition agreements included in the comparable transactions reviewed by Guggenheim Securities. The Westar Board also noted that Great Plains Energy had agreed to increase the fees payable to Westar in the event the merger agreement were to be terminated under certain circumstances and reduce the fees payable by Westar in the event the agreement were to be terminated by Westar under certain circumstances, all as noted above. The Westar Board also noted that Great Plains Energy had preserved the price protection in the form of a collar on the stock portion of the consideration in its offer and had offered to include one member of the Westar Board on the Great Plains Energy Board of directors following consummation of the merger. Finally, the Westar Board also considered that Westar would have the right to terminate the merger agreement in order to accept an alternative acquisition proposal upon satisfaction of certain conditions, including payment to Great Plains Energy of a fee of $280 million. The Westar Board also considered that Great Plains Energy had agreed to maintain Westar's corporate headquarters in Topeka, Kansas, which might contribute to a finding by regulators that the transaction would be in the public interest."[45]

"Also at the May 29, 2016 Westar Board meeting, Guggenheim Securities reviewed with the Westar Board Guggenheim Securities' financial analysis of the merger consideration and rendered an oral opinion, confirmed by delivery of a written opinion

[45] Proxy Statement at 64-65.

dated May 30, 2016, to the Westar Board to the effect that, as of that date and based on and subject to the matters considered, the procedures followed, the assumptions made and various limitations of and qualifications to the review undertaken, the merger consideration was fair, from a financial point of view, to the holders of Westar common stock (excluding shares owned by Westar as treasury stock, shares owned by a wholly owned subsidiary of Westar or shares owned directly or indirectly by Great Plains Energy or Merger Sub). Following these presentations, and after discussion, deliberation and consideration of all of the factors that it considered relevant, the Westar Board unanimously determined that the merger was in the best interests of Westar and its shareholders, and declared it advisable for Westar to enter into the merger agreement, adopted the merger agreement and approved Westar's execution, delivery and performance of the merger agreement and the consummation of the transactions contemplated by the merger agreement and resolved to recommend that Westar's shareholders approve the merger agreement. Immediately thereafter, Westar and Great Plains Energy executed the merger agreement and, on May 31, they issued a joint press release announcing the execution of the merger agreement."[46]

[46] Proxy Statement at 65.

Exhibit SH-1
Scott Hempling, Attorney at Law

Scott Hempling is an attorney, expert witness and teacher. As an attorney, he has assisted clients from all industry sectors—regulators, utilities, consumer organizations, independent competitors and environmental organizations. As an expert witness, he has testified numerous times before state commissions and before committees of the United States Congress and the legislatures of Arkansas, California, Maryland, Minnesota, Nevada, North Carolina, South Carolina, Vermont, and Virginia. As a teacher and seminar presenter, he has taught public utility law and policy to a generation of regulators and practitioners, appearing throughout the United States and in Canada, Central America, Germany, India, Italy, Jamaica, Mexico, New Zealand, Nigeria and Peru.

The first volume of his legal treatise, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, was published by the American Bar Association in 2013. It has been described as a "comprehensive regulatory treatise [that] warrants comparison with Kahn and Phillips." The second volume will address the law of corporate structure, mergers and acquisitions. His book of essays, *Preside or Lead? The Attributes and Actions of Effective Regulators*, has been described as "matchless" and "timeless"; a Spanish translation will be widely circulated throughout Latin America, through the auspices of the Asociación Iberoamericana de Entidades Reguladoras de la Energía and REGULATEL (an association of telecommunications regulators from Europe and Latin America). The essays continue monthly at www.scotthemplinglaw.com.

His articles have appeared in the *Energy Bar Journal*, the *Electricity Journal*, *Energy Regulation Quarterly*, *Public Utilities Fortnightly*, *ElectricityPolicy.com*, publications of the American Bar Association, and other professional publications. These articles cover such topics as mergers and acquisitions, the introduction of competition into formerly monopolistic markets, corporate restructuring, ratemaking, utility investments in nonutility businesses, transmission planning, renewable energy and state–federal jurisdictional issues. From 2006 to 2011, he was the Executive Director of the National Regulatory Research Institute.

Hempling is an adjunct professor at the Georgetown University Law Center, where he teaches courses on public utility law and regulatory litigation. He received a B.A. *cum laude* in (1) Economics and Political Science and (2) Music from Yale University, where he was awarded a Continental Grain Fellowship and a Patterson research grant. He received a J.D. *magna cum laude* from Georgetown University Law Center, where he was the recipient of an *American Jurisprudence* award for Constitutional Law. Hempling is a member of the U.S. Department of Energy's Future Electric Utility Regulation Advisory Group. More detail is available at www.scotthemplinglaw.com.

Education

B.A. *cum laude*, Yale University (majors: Economics and Political Science, Music), 1978. Recipient of a Continental Grain Fellowship and a Patterson Research grant.

J.D. *magna cum laude*, Georgetown University Law Center, 1984. Recipient of *American Jurisprudence* award for Constitutional Law; editor of *Law and Policy in International Business*; instructor, legal research and writing.

Professional Experience

President, Scott Hempling, Attorney at Law LLC (2011–present)

Adjunct Professor, Georgetown University Law Center (2011–present)

Executive Director, National Regulatory Research Institute (2006–2011)

Founder and President, Law Offices of Scott Hempling, P.C. (1990–2006)

Attorney, Environmental Action Foundation (1987–1990)

Attorney, Spiegel and McDiarmid (1984–1987)

Past Clients

Independent Power Producers and Marketers

California Wind Energy Association, Cannon Power Company, Electric Power Supply Association, EnerTran Technology Company, National Independent Power Producers, SmartEnergy.com, U.S. Wind Force.

Investor-Owned Utilities

Madison Gas & Electric, Oklahoma Gas & Electric.

Legislative Bodies

Vermont Legislature, South Carolina Senate.

Municipalities and Counties

American Public Power Association; Connecticut Municipal Electric Energy Cooperative; Iowa Association of Municipal Utilities; City of Jacksonville, Florida; Montgomery County, Maryland; City of Winter Park, Florida.

Public Interest Organizations

Alliance for Affordable Energy, American Association of Retired Persons, Consumer Federation of America, Energy Foundation, Environmental Action Foundation, GRID2.0 (Washington, D.C.), Illinois Citizens Utility Board, Union of Concerned Scientists.

Regulatory Commissions and Consumer Agencies

Arkansas Public Service Commission, Arizona Corporation Commission, Connecticut Department of Public Utility Control, Connecticut Office of Consumer Counsel, Delaware Public Service Commission, Hawaii Public Utilities Commission, State of Hawaii Office of Planning, Indiana Utility Regulatory Commission, Kansas Corporation Commission, State of Maryland, Maryland Energy Administration, Maryland Attorney General, Maryland Office of People's Counsel, Massachusetts Attorney General, Massachusetts Department of Public Utilities, Mexico's Comisión Reguladora de Energía, Minnesota Public Utilities Commission, Mississippi Public Service Commission, Mississippi Public Utilities Staff, Missouri Public Service Commission, Montana Public Service Commission, National Association of Regulatory Utility Commissioners, Nevada Consumer Advocate, Nevada Public Service Commission, New Hampshire Public Utilities Commission, New Jersey Division of Ratepayer Advocate, North Carolina Utilities Commission, Ohio Public Utilities Commission, Oklahoma Corporation Commission, Pennsylvania Office of Consumer Advocate, Puerto Rico Energy Commission, South Carolina Public Service Commission, Texas Office of Public Utility Counsel, Vermont Department of Public Service, Virginia State Corporation Commission, Wisconsin Attorney General.

Testimony Before Legislative Bodies

United States Senate

Committee on Energy and Natural Resources, May 2008 (addressing the adequacy of state and federal regulation of electric utility holding company structures).

Committee on Energy and Natural Resources, Feb. 2002 (analyzing bill to amend the Public Utility Holding Company Act) (PUHCA).

Committee on Energy and Natural Resources, May 1993 (analyzing bill to transfer PUHCA functions from SEC to FERC).

Committee on Banking and Urban Affairs, Sept. 1991 (analyzing proposed amendment to PUHCA).

Committee on Energy and Natural Resources, March 1991 (analyzing proposed amendment to PUHCA).

Committee on Energy and Natural Resources, Nov. 1989 (analyzing proposed amendment to PUHCA).

United States House of Representatives

Subcommittees on Energy and Power and Telecommunications and Finance, Commerce Committee, Oct. 1995 (regulation of public utility holding companies).

Subcommittee on Energy and Power, Energy and Commerce Committee, July 1994 (analyzing future of the electric industry).

Subcommittee on Energy and Power, Energy and Commerce Committee, May 1991 (analyzing proposed amendment to PUHCA).

Subcommittee on Environment, Energy and Natural Resources, Government Operations Committee, Oct. 1990 (assessing electric utility policies of FERC).

Appropriations Subcommittee on Commerce, Justice, State and the Judiciary, Apr. 1989 (discussing proposals to increase staff administering PUHCA).

Subcommittee on Energy and Power, Sept. 1988 (discussing "independent power producers" and PUHCA).

State Legislatures

Judiciary Committee, South Carolina Senate (2000) (discussing options for introducing retail electricity competition).

Commerce Committee, Arkansas General Assembly (1999) (discussing legislation to introduce retail electricity competition).

Health Access Oversight Committee, Vermont General Assembly (1999) (discussing options for state regulation of prescription drug pricing).

Electricity Restructuring Task Force, Virginia General Assembly (1999) (discussing options for introducing retail electricity competition).

Study Committee, North Carolina Legislature (1999) (discussing legislation to introduce retail electricity competition).

Committees on General Affairs, Finance, Vermont Senate (February-March 1997) (discussing options for structuring the electric industry).

Task Force to Study Retail Electric Competition, Maryland General Assembly (1997) (discussing options for introducing retail electricity competition).

Interim Committee on Electric Restructuring, Nevada Legislature (1995-97) (discussing options for structuring the electric industry).

Committee on Energy and Public Utilities, California Senate (December 1989) (discussing relationships between electric utilities and their non-regulated affiliates).

Testimony before Commissions, Courts and Arbitration Panels

U.S. District Court for Middle District of Florida: Effect of disaffiliation, mandated by Public Utility Holding Company Act, on corporation's liability under the Comprehensive Environmental Response, Compensation, and Liability Act (2016).

New Jersey Board of Public Utilities: Transfer of utility transmission assets to holding company affiliate (2015-2016).

Hawaii Public Utilities Commission: Holding company acquisition of utility holding company (2015-2016).

Louisiana Public Service Commission: Holding company acquisition of utility holding company (2015).

Connecticut Public Utilities Regulatory Authority: Holding company acquisition of utility holding company (2015).

District of Columbia Public Service Commission: Holding company acquisition of utility holding company (2014-15).

Maryland Public Service Commission: Holding company acquisition of utility holding company (2014-15).

Mississippi Public Service Commission: Utility holding company's divestiture of its utility subsidiaries' transmission assets to an independent transmission company (2013).

U.S. District Court for Minnesota: Effects of Minnesota statute limiting reliance on fossil fuels (2013).

Tobacco Arbitration Panel: Principles for regulating cigarette manufacturers (on behalf of State of Maryland) (2012).

Illinois Commerce Commission: Performance-based ratemaking (2012).

Maryland Public Service Commission: Holding company acquisition of utility holding company (2011).

California Public Utilities Commission: Performance-based ratemaking (2011).

Superior Court of Justice, Ontario, Canada: Renewable energy contractual relations under the Public Utility Regulatory Policies Act (2007).

Florida arbitration panel: Financial responsibility for stranded investment arising from municipalization (2003).

Minnesota Public Utilities Commission: Transmission expansion for renewable power producers (2002).

U.S. District Court for Wisconsin: State corporate structure regulation in relation to the Commerce Clause of the U.S. Constitution (2002).

New Jersey Board of Public Utilities: Conditions for provider of last resort service (2001).

Indiana Utility Regulatory Commission: Risks of overcharging ratepayers using "fair value" rate base (2001).

North Carolina Utilities Commission: Effect of merger on state regulatory powers (2000).

Wisconsin Public Service Commission: Effect of merger on state regulatory powers (2000).

New Jersey Board of Public Utilities: Affiliate relations in telecommunications sector (1999).

Illinois Commerce Commission: Affiliate relations and mixing of utility and non-utility businesses (1998).

Texas Public Utilities Commission: "Incentive" ratemaking, introduction of competition (1996).

Vermont Public Service Board: Cost allocation and interaffiliate pricing between service company and utility affiliates (1990).

Publications

Books

Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction (American Bar Association 2013).

Preside or Lead? The Attributes and Actions of Effective Regulators (2d edition 2013).

Articles, Papers and Book Chapters

"Maryland's Supreme Court Loss: A Win for Consumers, Competition and States," *ElectricityPolicy.com* (June 2016).

"Certifying Regulatory Professionals: Why Not?", *ElectricityPolicy.com* (June 2015).

"Litigation Adversaries and Public Interest Partners: Practice Principles for New Regulatory Lawyers," *Energy Law Journal* (Spring 2015), available at http://www.felj.org/sites/default/files/docs/elj361/14-1-Hempling-Final-4.27.pdf.

"Pricing in Organized Wholesale Electricity Markets: Can We Make the Bright Line any Brighter?", *Infrastructure* (American Bar Association, Spring 2015).

"From Streetcars to Solar Panels: Stranded Investment Law and Policy in the United States," *Energy Regulation Quarterly* (Vol. 3, Issue 3 2015).

"Regulatory Capture: Sources and Solutions," *Emory Corporate Governance and Accountability Review* Vol. 1, Issue 1 (August 2014), available at http://law.emory.edu/ecgar/content/volume-1/issue-1/essays/regulatory-capture.html.

"When Technology Gives Customers Choices, What Happens to Traditional Monopolies?" *Trends* (American Bar Association, Section of Environment, Energy and Resources July/August 2014).

"Democratizing Demand and Diversifying Supply: Legal and Economic Principles for the Microgrid Era," *ElectricityPolicy.com* (March 2014).

"Non-Transmission Alternatives: FERC's 'Comparable Consideration' Needs Correction," *ElectricityPolicy.com* (June 2013).

"Broadband's Role in Smart Grid's Success," in Noam, Pupillo, and Kranz, *Broadband Networks, Smart Grids and Climate Change* (Springer 2013).

"How Order 1000's Regional Transmission Planning Can Accommodate State Policies and Planning," *ElectricityPolicy.com* (September 2012).

"Renewable Energy: Can States Influence Federal Power Act Prices Without Being Preempted?" *Energy and Natural Resources Market Regulation Committee Newsletter* (American Bar Association, June 2012).

"Can We Make Order 1000's Transmission Providers' Obligations Effective and Enforceable?" *ElectricityPolicy.com* (May 2012).

"Riders, Trackers, Surcharges, Pre-Approvals, and Decoupling: How Do They Affect the Cost of Equity?" *ElectricityPolicy.com* (March 2012).

"Regulatory Support for Renewable Energy and Carbon Reduction: Can We Resolve the Tensions Among Our Overlapping Policies and Roles?" (National Regulatory Research Institute 2011).

"Infrastructure, Market Structure, and Utility Performance: Is the Law of Regulation Ready?" (National Regulatory Research Institute 2011).

"Cost-Effective Demand Response Requires Coordinated State-Federal Actions" (National Regulatory Research Institute 2011).

"Effective Regulation: Do Today's Regulators Have What It Takes?" in Kaiser and Heggie, *Energy Law and Policy* (Carswell 2011).

Renewable Energy Prices in State-Level Feed-in Tariffs: Federal Law Constraints and Possible Solutions (lead author, with C. Elefant, K. Cory, and K. Porter), Technical Report NREL//TP-6A2-47408 (January 2010).

Pre-Approval Commitments: When And Under What Conditions Should Regulators Commit Ratepayer Dollars to Utility-Proposed Capital Projects? (National Regulatory Research Institute 2008) (with Scott Strauss).

"Joint Demonstration Projects: Options for Regulatory Treatment," *The Electricity Journal* (June 2008).

"Corporate Structure Events Involving Regulated Utilities: The Need for a Multidisciplinary, Multijurisdictional Approach," *The Electricity Journal* (Aug./Sept. 2006).

"Reassessing Retail Competition: A Chance to Modify the Mix" *The Electricity Journal* (Jan./Feb. 2002).

The Renewables Portfolio Standard: A Practical Guide (National Association of Regulatory Utility Commissioners, Feb. 2001 (with N. Rader).

Promoting Competitive Electricity Markets Through Community Purchasing: The Role of Municipal Aggregation (American Public Power Association, Jan. 2000 (with N. Rader).

"Electric Utility Holding Companies: The New Regulatory Challenges," *Land Economics*, Vol. 71, No. 3 (Aug. 1995).

Is Competition Here? An Evaluation of Defects in the Market for Generation (National Independent Energy Producers 1995) (co-author).

The Regulatory Treatment of Embedded Costs Exceeding Market Prices: Transition to a Competitive Electric Generation Market (1994) (with Ken Rose and Robert Burns).

"Depolarizing the Debate: Can Retail Wheeling Coexist with Integrated Resource Planning?" *The Electricity Journal* (Apr. 1994).

Reducing Ratepayer Risk: State Regulation of Electric Utility Expansion. (American Association of Retired Persons 1993).

"'Incentives' for Purchased Power: Compensation for Risk or Reward for Inefficiency?" *The Electricity Journal* (Sept. 1993).

"Making Competition Work," *The Electricity Journal* (June 1993).

"Confusing 'Competitors' With 'Competition.'" *Public Utilities Fortnightly* (March 15, 1991).

"The Retail Ratepayer's Stake in Wholesale Transmission Access," *Public Utilities Fortnightly* (July 19, 1990).

"Preserving Fair Competition: The Case for the Public Utility Holding Company Act," *The Electricity Journal* (Jan./Feb. 1990).

"Opportunity Cost Pricing." *Wheeling and Transmission Monthly* (Oct. 1989).

"Corporate Restructuring and Consumer Risk: Is the SEC Enforcing the Public Utility Holding Company Act?" *The Electricity Journal* (July 1988).

"The Legal Standard of 'Prudent Utility Practices' in the Context of Joint Construction Projects," *NRECA/APPA Newsletter Legal Reporting Service* (Dec. 1984/Jan. 1985) (co-author).

Speaker and Lecturer

United States: American Antitrust Institute; American Association of Retired Persons; American Bar Association; American Power Conference; American Public Power Association; American Wind Energy Association; Chicago Bar Association (Energy Section); Columbia University Institute for Tele-Information; Electric Cooperatives of South Carolina; Electric Power Research Institute; *Electric Utility Week;* Electricity Consumers Resource Council; *Energy Daily;* Executive Enterprises; Exnet; Federal Energy Bar Association; Federal Energy Bar Association; Harvard Electricity Policy Group; Infocast; Louisiana Energy Bar; Management Exchange; Maryland Resiliency Through Microgrids Task Force; MIT Energy Initiative; Mid-America Association of Regulatory Commissioners; MidAtlantic Demand Resources Initiative; Mid-Atlantic Conference of Regulatory Utility Commissioners; National Association of Regulatory Utility Commissioners; National Association of State Utility Consumer Advocates; National Conference of Regulatory Attorneys; National Governors Association; National Independent Energy Producers; New England Conference of Public Utility Commissioners; New England Public Power Association; New York Bar Association (Energy Section); North Carolina Electric Membership Corporation; Pennsylvania Bar Institute; Puerto Rico Energy Policies Forum; Regulatory Studies programs at Michigan State University, New Mexico State University and University of Idaho; Society of American Military Engineers; Society of Utility and Regulatory Financial Analysts; Southeastern Association of Regulatory Utility Commissioners; U.S. Department of Energy Forum on Electricity Issues; U.S. Environmental Protection Agency; World Regulatory Forum; Yale Alumni in Energy.

International: Australian Competition and Consumer Commission; Australian Energy Regulator; Canadian Association of Members of Utility Tribunals; Canadian Energy Law Forum; Central Electric Regulatory Commission (India); Comisión Reguladora de Energía (Mexico); Independent Power Producers Association of India; India Institute of Technology at Kanpur; Ludwig-Maximilians-Universitat (Munich, Germany); Management Development Institute at Gurgaon, India; National Association of Water Utility Regulators (Italy); New

Zealand Electricity Authority; New Zealand Commerce Commission; Nigeria Electric Regulatory Commission; Office of Utility Regulation of Jamaica; OSIPTEL (the Peruvian Telecom Regulator) Training Program on Regulation for University Students; Petroleum and Natural Gas Regulatory Board (India); Regulatel (an international forum of telecommunications regulators); Regulatory Policy Institute (Cambridge, England); The Energy and Resources Institute (India); Utilities Regulatory Authority of Vanuatu.

Community Activities

Member, PEPCO Work Group, appointed by County Executive of Montgomery County, Maryland (2010–2011).

Sunday School Teacher, Temple Emanuel, Kensington, Maryland (2002–2006, 2008).

Board of Trustees, Temple Emanuel (2005–2006).

Musical performer (cello), Riderwood Village Retirement Community (2003–present).