Approved: Carl Dean Holmes
Date 3-9-99

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Rep. Carl Holmes at 9:11 a.m. on February 10, 1999 in Room 522-S of the Capitol.

All members were present except: Rep. Cliff Franklin
Rep. Annie Kuether

Committee staff present: Lynne Holt, Legislative Research Department
Mary Torrence, Revisor of Statutes
Jo Cook-Whitmore, Committee Secretary

Conferees appearing before the committee: Walker Hendrix, CURB
Mike Taylor, City of Wichita
Jim Martin, Western Resources
Chris Giles, Kansas City Power & Light
David Dittemore, Kansas Corporation Commission

Others attending: See Attached List

Hearing on HB 2247 - Public utility mergers; acquisition premium cannot be included in rates.

Chairman Holmes welcomed Walker Hendrix, Consumer Counsel on behalf of the Citizens' Utility Ratepayer Board, who testified in favor of **HB 2247** (Attachment 1).

Mike Taylor, City of Wichita, next presented testimony in favor of the bill (Attachment 2).

The Chair then opened the floor for questions from the committee for the proponents.

Chairman Holmes then acknowledged Jim Martin, Vice President of Investor Relations and Strategies Planning for Western Resources, who testified as an opponent of **HB 2247** (Attachment 3).

Chris Giles, Director Regulatory Services of Kansas City Power & Light, then testified in opposition to the bill (Attachment 4).

David Dittemore, Director of Utilities for the Kansas Corporation Commission, presented testimony on behalf of the KCC Staff as an opponent of the bill (Attachment 5).

Also distributed to the committee was a letter from Michael R. Murray, Director-Government & Public Affairs for Sprint (Attachment 6).

Following testimony, conferees responded to questions from the committee.

Meeting adjourned at 10:36 a.m.

Next meeting is Thursday, February 11.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: February 10, 1999

NAME	REPRESENTING
Dave Hoeffner	Western Resources
WALKER HENDRIX	CURB
Mike Taylor	City of Wichita
Bill Jarvis	BOEING
Jim Ludwig	Western Resources
Tim Martin	" "
Chris Giles	KCPL
Patrick Hurley	KCC
Bill Burke	Western Resources
Dave Dittemore	KCC
Tim Thurston	Williams
Sandy Braden	McGill, Gaches & Assoc.
Mike Hein	Hein and Weir, Chtd.
Jack Glaves	City - Duke + KN Energy
Ron Gaches	McGill, Gaches & Asso.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: _____

NAME	REPRESENTING
Doug Lawrence	KEC
Mike Murray	Sprint
Rosemary Foreman	KCC
Wayne Kitchen	Western Resources
Charisse Powell	Kansas Bar Association
KEN PETERSON	KAKE TV WICHITA
Kelli Lampe	Western Resources
DICK CARTER	ENRON
JOHN PINEGAR	SITA
Von K Miles	KEC
BRUCE GRAHAM	KEPCo

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: _____

NAME	REPRESENTING
Ted Powers	Rep
Chris Wilson	KS Gov'tal Consulting

HOUSE UTILITIES COMMITTEE
H.B. 2247
Testimony of Walker Hendrix, Consumer Counsel
On behalf of the Citizens' Utility Ratepayer Board

H.B. 2247 is a consumer friendly proposal. No doubt, the utilities will file-in in lock-step to oppose this bill, claiming not unlike Chicken Little said to Henny Penny: "The sky is falling! The sky is falling!" But please, evaluate the benefits from the merger and ask the utility representatives what new rate reductions can be expected from the Western/KCPL merger and what jobs can Kansas be expected to preserve. If no new rate reductions are forthcoming and Kansas loses employment, how is this merger transaction good for the State. If Western continues to maintain no additional concessions can be obtained, are you going to say that you protected your constituents' interests?

The merger will result in the recording of an acquisition premium of approximately $900 million on the books and records of Westar Energy as "goodwill." The acquisition premium represents the amount over and above book value that Western is willing to pay for the KCPL utility assets.

Should ratepayers reimburse the recovery of the acquisition premium? Absolutely not. The acquisition premium is negotiated between the companies. Ratepayers had no part in the determination of this premium and they should have no responsibility for its recovery.

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The shareholders of KCPL are being handsomely rewarded through this merger, with a purchase price that is more than double the book value of their equity in the company. Moreover, the purchase price represents a significant premium of approximately 27% from the KCPL stock prior to the announcement of the merger. The decision to award this significant premium was not made by the ratepayers. It should not have a regulatory impact. Western is providing no additional capital. The transaction is entirely a paper transaction.

Despite the large premiums being paid, Western persists in saying that no benefits should flow to ratepayers as part of this transaction. Even though Western makes no claim for the acquisition premium in the rate case, it wants to book amounts for the premium in order to use it in future rate cases or to include as part of a stranded investment calculation. Currently, there is already an annual $40 million obligation for ratepayers from the premium in the KGE merger.

An acquisition premium runs contrary to ratemaking principles which rely on historical costs. Utilities are permitted a flow of funds from depreciating utility plant. They can use these funds as they please, and we have seen Western use these funds to develop its home security business and to be involved in international energy ventures, rather than reinvesting these monies in utility plant capacity. If a utility is permitted to earn on amounts greater than the historical cost of the plant, they essentially are able to collect twice from ratepayers for their plant investment. This is not fair to ratepayers and your constituents. Accordingly, a premium should not be recognized.

The issue of fairness needs to be examined in the context of the KCPL

merger. Western proposes to move the utility headquarters to Kansas City, Missouri. Because most of the merger savings are tied to labor reductions and the corporate utility offices are going to be moved, it would appear that Kansas would lose jobs as a result of the merger. Western further maintains that ratepayers should not get the benefits of any savings from the merger in the form of rate reductions. They make this claim after writing off substantial severance payments to retiring corporate executives in the 4th Quarter of 1998 and while providing for additional corporate severance as part of the merger. Now, I can understand why the corporate officers would want this compensation, but it is not necessary for ratepayers to fund these golden parachutes.

Ratepayers are entitled to the benefits of the merger. Kansans will lose the corporate headquarters for utility operations. These transactions parallel what has occurred in the banking industry. Remember when we approved interstate banking for Bank IV and allowed Bank IV to acquire financial institutions in Kansas. Bank IV grew and created a critical mass. Then Bank IV was bought by Boatmen's and Boatmen's was bought by Nations. The same thing is going on in the utility industry. If we take into account the $40 million premium we already pay, then add another from the KCPL merger and possibly future premiums from subsequent mergers, when will it stop and how much will ratepayers be asked to pay.

Now consider that Missouri and the FERC do not allow regulatory treatment for acquisition premiums. If Kansas allows the premium, are Kansans the only ratepayers that get to bear it. When it is considered that the utility headquarters are moving to Missouri, I ask you, is this fair to Kansas ratepayers?

What are the benefits of the merger transaction for Kansans? Is the only thing left for Kansans, the Western Resources Holding Company?

I encourage you to favorably pass H.B. 2247. These issues need to be debated more widely so the general public understands the implications of the merger. I would, however, encourage you to adopt one exception for the acquisition premium bill. If there is a liquidation of a utility or utility is in a distressed financial situation, an acquisition premium may be necessary to encourage a company to buy a financially troubled utility. In this event, the inducement of a premium may be the only answer for rehabilitating a failed utility operation as part of a regulatory plan.

In closing, I would encourage you to unite as representatives of the consumers of this state. Don't let the utility companies defeat this measure by dividing the state into geographical areas. Don't let them play South Central Kansas against Northeast Kansas. Or, Eastern Kansas against Western Kansas. Be united in the protection of all Kansas consumers.

CITY OF
WICHITA

TESTIMONY

to
House Utilities Committee
February 10, 1999

House Bill 2247
Public Utility Merger Acquisition Premiums

It's been said that involving the Legislature in the effort to end the Western Resources rate disparity is politics. The suggestion being that the issue doesn't belong with the Legislature, but rather should be left entirely to the Kansas Corporation Commission to decide.

The proposal by Western Resources to use the savings from its merger with Kansas City Power and Light to pay for the acquisition premium is more than politics. It requires the Legislature to make an important policy decision about the meaning of public utility. The policy issue House Bill 2247 asks you to decide is this: Will monopoly utilities be required to serve in the best interest of the public, or will it be allowed to only serve the interests of its stockholders at the expense of hundreds of thousands of its customers?

Right now, Western Resources is trying to cash in on the best of both worlds. It wants, and is allowed, by the Legislature to have a captive customer base, yet when it benefits the shareholders, it wants to act like a company operating in the free market.

In a free market system, Western Resources should be allowed to buy, sell, takeover, merge, acquire utility companies, security alarm companies, even baseball

teams, if the stockholders approve. In a free market system, Western Resources should be allowed to make savvy business deals and bad business deals. But in a monopoly system, Western Resources should not be allowed to do those things on the backs of its captive customers who have no choice but to pay the price the company charges. Under a monopoly system, any merger or business deal a utility undertakes must benefit the customers. That is the policy issue this bill asks the Legislature to consider.

Western Resources executives are skilled in the ways of Wall Street, but they have lost touch with Main Street where their customers live. They have figured out how to pocket the profits for stockholders while letting the customers cover all the risk and foot the bill. It's not hard to pay $1-Billion more for a company than its book value if there is no risk for the stockholders.

The City of Wichita wants Western Resources to be successful and profitable, but not at the expense of hundreds of thousands of citizens who are being forced to pay unfair, inequitable rates. The City of Wichita favors the success of the merged companies if the merger allows the rate disparity issue to be dealt with in a fair and equitable way. Allowing the merger savings to cover the cost of the acquisition premium without the rate disparity being addressed is not fair and is not in the best public interest.

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Throw Western to the wolves

Do you still doubt the arrogance of our electric company, Western Resources, and the regulatory culture that sustains it?

Re-read the Tuesday story, by The Eagle's Scott Rothschild, headlined "Merger may not produce savings." It concerns the appearance of a Kansas Corporation Commission staffer before the House Utilities Committee this week.

DENNEY CLEMENTS

The regulator, whose bosses for years have allowed Western to charge us far higher electric rates than it charges its customers in northeast Kansas, told committee members that the KCC staff thinks we deserve rate relief.

Any cost savings from Western's proposed multibillion-dollar merger with Kansas City Power & Light, he said, should be devoted to electric-rate cuts in south-central Kansas.

But in virtually the same breath, he added, in effect: "Of course, there might not *be* any savings . . ."

Turns out that Western, in mounting a hostile takeover of KCPL in 1996 and 1997, promised stockholders to pay $2 billion for the company, about $1.1 billion over book value.

Western's merger with KCPL will generate a savings, over the next 10 years, of about $900 million. But Western doesn't want to use that money to buy down electric rates in south-central Kansas — which are an average of 40 percent higher than utility rates on the rest of the Western grid. The company wants KCC permission to use the merger savings to offset the $1.1 billion "acquisition premium" that it paid for KCPL's stock.

The attorney for the Citizens Utility Ratepayer Board, which analyzes utility issues, says that paying off the "acquisition premium" in the manner that Western proposes would "consume the (merger) savings, plus some."

Utility law doesn't require that we ratepayers get stuck with the tab for Western's poor business judgment. It requires only that the three corporation commissioners allow electricity providers a reasonable rate of return on their investments in generating capacity, transmission lines, utility poles and the like.

But we've all been electro-cynics in this part of Kansas since our former utility built the incredibly expensive Wolf Creek nuclear plan and foisted off its construction costs on us. Any resident of the region who believes that the corporation commissioners will force Western stockholders to pay the KCPL "acquisition premium" so that we can have lower electric rates has been living on another planet.

Some members of the south-central Kansas delegation want the Legislature to order the KCC to eliminate rate disparities along the Western grid.

Great idea. Never happen: As the 8-5 utilities committee vote against a resolution to that effect on Wednesday suggests, the majority of legislators represent Kansans who enjoy lower rates than we do. Our region simply doesn't have the clout to lower electric rates through legislative action.

There's only one way that south-central Kansas will be freed from electric slavery during my lifetime. That's for the Legislature to mandate electric-utility competition — an idea that could reduce electric rates for a vast majority of Kansans.

Right now, that's a long shot. Western and other investor-owned utilities have stalled so-called retail-wheeling legislation until early in the next century. The IOUs want to make sure that outside utilities can come into Kansas only at an economic disadvantage.

But if such a competitive environment could be brought into being, Western would never again dream of paying an "acquisition premium" — is that a great euphemism for "bad business decision" or what? — for another company.

In a competitive environment, Western would no longer have a captive regulatory agency to allow it to pass the cost of such stupidity on to customers. A company that paid more than 100 percent over book value for another company would get eaten alive on price competition — maybe even go out of business.

The root problem here, in other words, isn't Western's greed. If I were a Western exec who could use the KCC to force customers to pay for my bad business judgment, I'd do exactly the same thing, public opinion be damned.

The root problem is the culture of regulation. In Kansas and many other states, it consistently puts the health of inefficient utilities ahead of the economic health of the people. The utilities inevitably master the "people's" regulators because they have better lobbyists and lawyers than the people.

Oppressed people are great at hope because they lack the power to eliminate the source of their oppression. So here's hoping that legislators, sometime not too far into the new century, will throw Western to the wolves of competition.

If it doesn't get eaten alive, it will be leaner and much more customer friendly. Either way, we'll be free from electro-bondage at last.

Readers can reach Denney Clements by e-mail at dclements@wichitaeagle.com of (316) 268-6261.

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Testimony
before the
HOUSE UTILITIES COMMITTEE
by
Jim Martin, Vice President, Investor Relations and Strategic Planning
Western Resources
February 10, 1999

Chairman Holmes and members of the Committee:

Western Resources is opposed to HB 2247. This bill would prohibit the Corporation Commission from approving any merger of public utilities if any part of an acquisition premium paid in the merger were included in the ratebases, expenses, or rates of return of the merging utilities. "Acquisition premium" is defined as the amount paid to acquire a public utility in excess of its book value.

If enacted, HB 2247 would kill the merger of Western Resources and KCPL. Had this bill been in effect at the time of the merger of KPL and KGE, it would have killed that transaction, because it also involved a price paid above the remaining book value of KGE.

Let me put it in perspective. At the time KPL and KGE agreed to merge, KGE was planning, on a stand-alone basis, to file for a $50 million rate increase. As a result of the merger with KGE, the rate increase was avoided, KGE customers have benefitted from $88 million in rate reductions and rebates, and KPL customers have benefitted from $29 million in rates and rebates. These benefits would not have been possible if HB 2247 had been in effect.

The proposed merger of Western Resources and KCPL is similar. There is an acquisition premium, estimated at $886 million for the regulated utility, which must be recorded on the merged companies' books. The premium will be amortized over 40 years. We estimate merger savings totaling about $950 million over the first ten years after the merger is completed. Without some means of recovering the acquisition premium, shareholders will not invest the capital to achieve the savings. Without the savings, there is no benefit to anybody -- customers or shareholders. If HB 2247 were law, doing this merger or any other transaction which pays more than book value wouldn't make any sense.

I also think it is important to clear up confusion regarding comparisons of the acquisition premium to merger savings. Some have indicated that customers will not reap any benefits because merger savings will be used up entirely to pay the premium. That is not true. While we have asked for the opportunity to recover the premium, that amount would be amortized over the next 40 years. Our savings estimate is based on a ten-year projection. Savings don't just stop after ten years. Comparing ten years of savings ($950 million) to a premium being retired over 40 years ($886 million) is to compare apples to oranges. If the merged company meets its financial targets, there will be benefits for our customers and our shareholders.

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In the Western Resources/KCPL merger, we are not asking the Commission for explicit recovery of the premium in rates. We have proposed a regulatory plan which would give us an incentive to achieve merger savings and reach graduated earnings thresholds. At each predetermined threshold, earnings would be shared between customers and shareholders. If the Commission gives us this opportunity to implement our incentive regulatory plan, we are confident we can achieve benefits for our customers and shareholders, just as we've proven we can do in the KPL/KGE merger.

It is clear from the public hearings on our merger and from press stories, that there is confusion about acquisition premiums. The acquisition premium is part of the investment Western Resources is making when it acquires KCPL. By making this investment, we can reduce costs and create an opportunity to provide a benefit to customers and shareholders. Such an investment is no different from one the company might make in technology. If, for example, we had the opportunity to invest money in Jeffrey Energy Center for technology which would allow us to save fuel costs, which would benefit customers and shareholders, I doubt this legislature would consider legislation to bar the investment. We would make the technological investment, put it in rate base and start to generate savings. Making an investment in an acquisition premium is no different. I believe it is unfair and unwise for this body to pass legislation which prohibits investments of one type which could provide benefits while on the other hand it encourages other investments which may provide benefits.

You may fairly ask why didn't we just pay KCPL shareholders book value and avoid the acquisition premium. To acquire an enterprise, the market requires a buyer to pay fair market value, not book value. Book value for a utility would be original cost minus depreciation. KCPL is obviously worth more than that. A quick review of its stock price, dividends and earnings over the past few years shows its market value is higher than its book value.

The "price" of KCPL was determined after vigorous, arms-length negotiations. Both Western Resources and KCPL had their own, independent financial consultants who analyzed the fairness of the deal. Both companies have financial experts internally who analyzed the transaction. The value offered to KCPL shareholders is consistent with the findings of both sides' analyses. The interests of both companies' shareholders imposed discipline and reasonableness on the offer. The terms of the transaction are comparable to 41 similar utility transactions that have occurred in the past few years.

I want to close on a note of caution. Legislation like HB 2247 sends a very bad message to businesses in and out of state that may be considering doing business or expanding in Kansas. In my role at Western Resources, I have daily contact with financial analysts for the electric utility industry. They make investment recommendations to large and small investors. This kind of legislation, even if it's not enacted, makes it difficult for them to recommend that investors invest in Kansas utilities.

Testimony
before the
HOUSE UTILITIES COMMITTEE
By
Chris Giles, Director Regulatory Services
Kansas City Power & Light Company

Chairman Holmes and members of the Committee:

Kansas City Power & Light Company is opposed to HB 2247. I have reviewed the testimony of Mr. Jim Martin, Vice President, Investor Relations and Strategic Planning, Western Resources regarding HB 2247. Mr. Martin accurately describes the nature of and implications of acquisition premiums. I won't reiterate Mr. Martin's testimony, although I agree with it. I would like to make one additional point.

By statute the Kansas Corporation Commission is given broad discretion to balance the interests of customers and shareholders in establishing just and reasonable rates for regulated utilities. The Commission conducts hearings and receives testimony of all interested parties on a variety of cases that deal with complex technical issues. Resolution of these cases ultimately impact rates to customers and returns to shareholders.

Key factors in any merger proceeding include acquisition premiums and savings related to the merger. The Kansas Corporation Commission is in the best position to evaluate the overall benefits, costs and investments related to mergers. It is bad precedent to remove the discretion of the Commission to evaluate the overall benefit of a merger by unilaterally excluding recovery of acquisition premiums. Benefits may in fact be lost and rates for customers increased should the legislature begin chipping away piecemeal with the Commission's authority.

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Testimony Before the House Utilities Committee on HB 2247
by David N. Dittemore, Director of Utilities
On Behalf of the Kansas Corporation Commission
February 10, 1999

Thank you, Mr. Chairman, for the opportunity to address the committee on HB 2247. I approach this bill with mixed emotions. I have testified as a Staff witness before the KCC on this issue and, based upon the unique circumstances in those particular cases, I have argued that acquisition premium costs should be excluded from rates. I therefore share the concerns expressed in this bill about assigning the costs of acquisition premiums to consumers. I am especially concerned about acquisition costs in those situations where the costs seem disproportionately high compared with the benefits associated with a particular transaction. Notwithstanding these comments, I have several concerns over the lack of flexibility in this proposal that requires all acquisition premium costs to be excluded from rates, regardless of the level of benefits that a particular transaction may hold for consumers.

On occasion, there are qualitative reasons to assign the costs of an acquisition premium to ratepayers. For example, the Commission approved the recovery of acquisition costs for United Cities after it acquired Union Gas. Prior to the acquisition, Staff was concerned about the reliability and safety of the service provided by Union Gas. United Cities agreed as part of the transaction to make system upgrades and to enhance the quality of service provided to the former Union customers. Based upon these unique circumstances, the Commission found that recovery of the premium from customers was warranted given the qualitative benefits derived by customers from the transaction.

In addition, there are instances where savings can be expected from a transaction which otherwise would not occur, absent ratepayer recovery of a portion or all of an acquisition premium. I believe it is important to critically evaluate savings opportunities in determining the extent to which recovery from ratepayers of acquisition premium costs is appropriate.

It should be remembered that the Commission has the authority to disallow any portion of acquisition premium costs from rates consistent with evidence presented in hearings. There are certainly unique circumstances in each merger which have to be evaluated in making these rate making determinations. From a public policy perspective, I believe the discretion to determine whether acquisition premium costs should be incorporated in rates should remain with the Commission.

Passage of this act, while making absolutely certain that consumers would not incur acquisition premium costs, would discourage, and likely prevent, some transactions which otherwise would benefit consumers, either through improved service or lower rates. I suggest the Committee not restrict the Commission from using its discretion in evaluating the acquisition premium costs for rate making purposes. Alternative language could be incorporated stating that an overall public benefit must be demonstrated before any acquisition premium costs are incorporated into rates. Thank you.

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ATTACHMENT 5

Sprint

Michael R. Murray
Director - Governmental
and Public Affairs

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Topeka, KS 66612-1242
Voice 785 232 3826
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February 10, 1999

The Honorable Carl Holmes
Chairman, House Utilities Committee
State Capitol
Topeka, Kansas 66612

RE: HB 2247

Dear Mr. Chairman:

While HB 2247 is still being considered and analyzed by Sprint, initial concerns have been raised by our internal Sprint clients having responsibility for such matters as mergers and acquisitions.

First, book value should not be the basis on which an "acquisition premium" is determined. The most appropriate basis for determining a premium is the difference between the stock price at the time of the acquisition announcement and the price offered for the stock.

Second, the KCC has the authority to disallow certain items for ratemaking purposes, and it is inappropriate to require the KCC to deny a merger based solely on the prospect that an acquisition premium may be included in some future ratemaking procedure. Professionals may differ on the appropriate spread of acquisition costs in rate procedures, and it is for the KCC to analyze and act on the evidence before it. Without extending the discussion at this time, it appears, subject to further review, that the bill could create a conflict with standard finance and accounting rules to which Sprint, and undoubtedly others, adhere.

Thank you for your consideration.

Respectfully,

Michael R. Murray

Cc: Members of House Utilities Committee

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