Kansas Corporation Commission
1500 SW Arrowhead Road
Topeka, Kansas 66604

Communications Workers of America
501 3rd Street NW
Washington, DC 20001

December 18, 2020

In the Matter of the Investigation into the Sustainability Transformation Plan of Evergy (21-EKME-088-GIE)

Dear Commissioners:

The Communications Workers of America ("CWA") writes to provide information that is relevant to Kansas Corporation Commission's investigation of Evergy's Sustainability Transformation Plan ("STP"). We support the Commission's work to engage the public through workshops about the potential outcomes of the STP for stakeholders, including the Evergy customers who are among the nearly 9,000 CWA members in Kansas and Missouri.

CWA believes that the Sustainability Transformation Plan is a modified restatement of the Standalone Path proposed by Elliott Management in January 2020. Although the STP points Evergy's trajectory toward increased reliance on renewable fuels, it retains the Standalone Path's shareholder focus and excludes interests of other stakeholders. While we support the transition to a generation mix that includes more renewable fuel resources, we believe that transition should not come at the expense of workers and customers. We recognize that Evergy has resisted the sorely needed transition to a higher renewable generation mix, but Elliott's intervention has not led to the plan we need.

We enclose with this letter a new research report on the outcomes of Elliott Management's recent interventions in the energy sector. This information is relevant to the STP investigation because it gives the Commission the full context for Elliott's tack with Evergy's management and provides an empirical assessment of Elliott's impact on target firms similar to Evergy. As summarized below, the research finds that, compared to a control group, Elliott's target firms see declines in stock returns, profitability, investment, employment and other measures of financial and operational health in the third year after Elliott's intervention, which reflects Elliott's strategy of engineering stock price increases over a two-year horizon and then exiting its position.

Although the Commission decided that Elliott was not an affiliated party, the fact remains that but for Elliott's intervention, Evergy might not be on this particular path toward engineering financial returns for shareholders. We include at the end of this letter specific questions the Commission could ask Evergy management about its plan to protect ratepayers from costs related to rate hikes and expenses for system remediation due to planned operating and maintenance budget cuts.

The Sustainability Transformation Plan Implements Elliott's Standalone Path

Elliott Management makes money for its investors by forcing target companies to make operational and governance changes that increase share prices in the short-term. This is the strategy it pursued when it announced its investment in Evergy in January 2020 and publicly gave it two options: the "standalone path" of pursuing 10% rate-base growth as an independent company or the "combination path," in which Evergy would seek to be acquired.

When Evergy committed to the standalone path in August, the Strategic Review and Operations Committee ("SROC"), formed under the Elliott-Evergy agreement, presented the "Sustainability Transformation Plan." Elliott Management publicly supported the STP and senior portfolio manager Jeff Rosenbaum said, "The new Sustainability Transformation Plan is well positioned to deliver enhanced, best-in-class rate base and earnings growth, optimize capital allocation and significantly increase operational efficiencies in Evergy's transmission and distribution networks."[1] A comparison of the two plans shows that the STP appears to be derivative of the standalone plan proposed by Elliott.

Comparison Of Standalone Path To Sustainability Transformation Plan		
Criteria	**Elliott's Standalone Plan**	**Evergy's Sustainability Transformation Plan**
Time Horizon	2023	2024
Capital Investment	$4.5 billion in potential increased system capital investment.	$8.9 Billion projected Capex, including additional $1.4 billion under STP.
Operating and Maintenance Cost Reductions	Non-generation O&M reductions: more than $250 million Generation fuel and non-fuel O&M: $200 million.	Non-fuel O&M: $330 million, representing 25 percent reduction by 2024 from 2018 levels.
Base Rate Growth	8%-9% CAGR (2019-2023)	5% to 6% CAGR (2019-2024)
Total Shareholder Return	-	9-11% through 2024.
EPS Target Range	8%-10%	6% to 8% through 2024.
Source	Elliott Letter to Board of Directors of Evergy, Inc.	Sustainability Transformation Plan

[1] Evergy, Inc., "Evergy Announces 'Sustainability Transformation Plan," Evergy News Releases, August 5, 2020.

Elliott abruptly reversed its support of the STP in November 2020 when it demanded that Evergy re-engage in merger talks after reports that Evergy turned down NextEra's $15 billion bid for Evergy.[2] This change in position suggests Elliott has opportunistically sought the highest returns on its investment rather than committing to a plan for long-term sustainable investment that adheres to the existing merger agreement and benefits ratepayers.

Outcomes of Elliott's Past Campaigns Show Troubled Path for Evergy

Elliott's clear influence in shaping the STP warrants the Commission's examination of outcomes of Elliott's previous activist campaigns. The results of these campaigns show that Elliott's demands on Evergy put the company at risk of becoming less competitive and less financially resilient. Kansas City Business Journal editor Brian Kaberline noted in an early January 2020 briefing that "Elliott wants what every activist, every investor, wants — to buy low and sell high. If it gets Evergy to pump more money into its operations, it could increase valuation from analysts and investors."[3] This is Evergy's tack under the STP. An analysis of Elliott's recent activist campaigns in the energy sector, described in detail in the attached report, show that they result in low-quality financial results and compromise the competitiveness of targeted companies.

- **Market Returns Decline.** Companies targeted by Elliott have lower stock returns, on average, in the following one- to-three years, compared to non-targeted control companies. Firm value (as evidenced by stock returns and Tobin's Q) tends to rise about two-years after an activism campaign, but then turns negative three-years out. This reversal aligns with Elliott's average investment holding period of 1.8 years, exiting shortly before the average declines in performance.

- **Lower Profitability by Year Three.** On average, companies targeted by Elliott experience lower profitability in the one- and three-years following an activism campaign. By some metrics, profitability rises in the two-years afterwards, which coincides with Elliott's average exit occurring 1.8 years after the initial targeting date. In year three, profitability clearly deteriorates, likely driven by reductions in operating costs and investment.

- **Reduced Investment Weakens Future Competitiveness**. Compared to non-targeted control companies, companies targeted by Elliott cut back significantly in their spending on new investment, including capital expenditures and acquisitions, in the one- to three-years following activism campaigns. Targeted firms also introduce fewer new products in this period compared to non-targeted firms, harming competitiveness.

- **Apparent Increased Efficiencies Are Result of Corporate Downsizing**. Companies targeted by Elliott also shrink in size following these campaigns, shown in lower total assets and employees. These reductions result in higher efficiency by some ratios but harm the long-term competitiveness of the firms.

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[2] "Elliott Management Statement Regarding Evergy, Inc.," Elliott Management (PR Newswire), November 10, 2020.
[3] Brian Kaberline, "Editor's Briefing: A raider targets a KC company, but the community sleeps," Kansas City Business Journal, January 26, 2020.

- **Higher Capital Costs with Excess Cash for Share Repurchases.** Despite shrinking and cutting back expenditures in almost all areas of investment, companies targeted by Elliott still spend more on share repurchases in all years following a campaign when compared to non-targeted control companies. Overall, targeted companies have higher costs of capital than non-targeted peers in years 2 and 3.

Elliott's formula is not designed to consider the long-term interests of the target firms or their stakeholders. In the case of Evergy, we believe that Elliott's involvement in developing the STP and its shareholder-centric objectives chart Evergy down a course that will ultimately cost customers, workers, and the communities in Kansas served by Evergy. In a rapidly transforming energy sector, investor owned utilities should be required to align their plans with science and the public interest, which is also the surest way to achieve sustainable long-term returns for investors.

Questions For The Commission To Ask Evergy During The December 21, 2020 Workshop

- What employee reductions are anticipated under the STP's provision to reduce operating and maintenance expenses by 25 percent from 2018 levels? What impact might these reductions have on system quality and Evergy's ability to perform system maintenance in a timely manner?

- What is Evergy's plan for sourcing new capital at competitive rates given the intense focus of the STP on increasing capex while reducing O&M?

- What assurances does Evergy give its customers that it will not pursue rate increases and will Evergy commit to subsidizing rates for low-income customers?

- How confident is Evergy that the STP will deliver 9-10% total shareholder return when so many of Elliott Management's previous interventions resulted in stock price declines post-exit? What is the basis for these projections?

Thank you for your attention and diligence in this investigation of Evergy's Sustainability Transformation Plan.

Thank you,

Nell Geiser, CFA
Director of Research
Communications Workers of America

Enclosure: Elliott Management Campaigns (2010-2020)

<u>ELLIOTT MANAGEMENT CAMPAIGNS (2010-2020)</u>

This report provides thorough analyses of all activism campaigns initiated by Elliott Management against companies in the Energy and Utilities sectors between 2010–2020. The report details the range of effects that Elliott has on its targets including: Market Returns and Profitability, and Investments and Operations

Methodology

Data

All campaigns against Energy and Utilities companies led by Elliott between 2010–2020 were identified using data from regulatory filings, professional reports, third-party data providers (e.g., Activist Insight and Audit Analytics), and other sources. Financial, accounting, operational, social and other data come from a variety of other sources.

Matching

Analyses are based on matched samples using Coarsened Exact Matching (CEM), a rigorous matching methodology used to ensure reliable comparison groups. CEM helps improve the estimation of causal effects of hedge fund activism by matching all targeted companies to lookalike "control" companies that were not targeted by Elliott, but are otherwise similar to the companies that were targeted by Elliott. CEM retains *all* control companies that are considered close matches (i.e., fall into the same strata) to the targeted companies.

The term "targeted companies" refers to all companies in the analyses that were targeted by Elliott; the term "non-targeted companies" refers to all lookalike control companies that were matched to the targeted companies on the following characteristics: (1) Firm size (book value of total assets); (2) Workforce size (number of employees); (3) Profitability (return-on-assets); and Market value (Tobin's Q).

Matching is conducted within the same industry and in *t*, the year when an activism campaign takes place. For example, if a company in the Energy sector was targeted in 2013 then the matched companies would be found based on their characteristics in 2013.

In total, we identified and were able to collect data for six companies targeted by Elliott: Hess Corporation, Marathon Petroleum, NRG Energy, Ocean Rig, QEP Resources, and Sempera Energy Three companies targeted by Elliott did not match because of missing financial and accounting data (Energen, Peabody, and Roan Resources); two did not match because they were not listed on either the NYSE or NASDAQ (Energias de Portugal and Dragon Oil); and two were not retained because they were targeted in 2020 (Evergy and Noble Energy). The remaining six targeted companies were matched to 42 non-targeted companies (listed in **Appendix A**), leaving an average number of eight non-targeted companies for each targeted company.

Analyses

All analyses compare the average of each indicator variable between the targeted companies and non-targeted companies to their pre-targeting level in the year immediately preceding an activism campaign ($t - 1$).

PART I: MARKET RETURNS AND PROFITABILITY

The following graphs illustrate the effects that Elliott campaigns have on the market returns and profitability of targeted companies, including market returns, profitability, total sales and income, and operating cash flows. Market return graphs document the monthly returns following Elliott campaigns. "Change" graphs report the changes in the relevant variable from the year before an activism event ($t - 1$) to the one-, two-, and three-years after the event for non-targeted companies and companies targeted by Elliott. The remaining graphs indicate the levels of the relevant variable in the one- to three-years after activism.

Lower Market Returns Overall

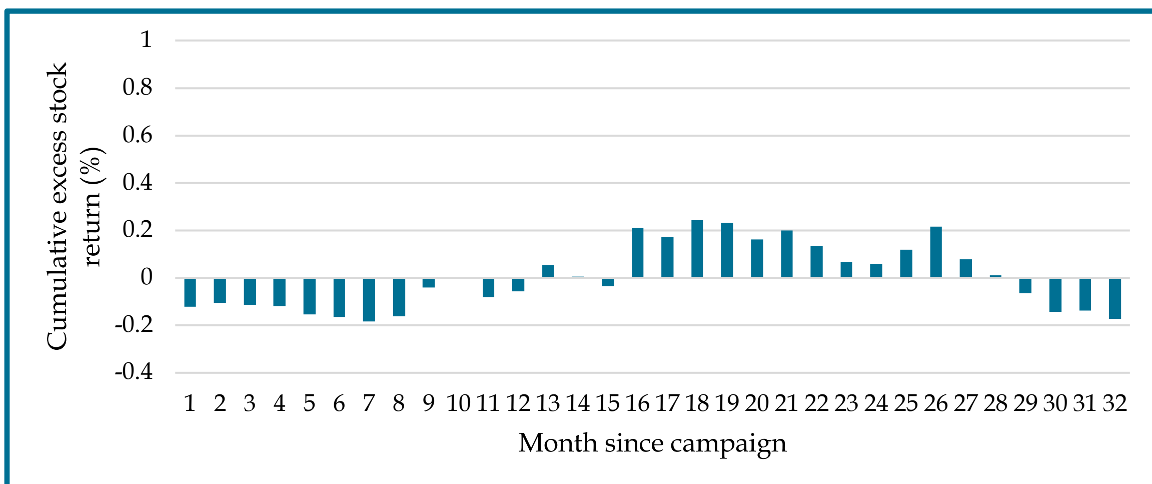
Summary of Findings

Companies targeted by Elliott have lower stock returns in the following one- to-three years, compared to non-targeted control companies. Firm value (as evidenced by stock returns and Tobin's Q) tends to rise about two-years after an activism campaign, but then trails off again, turning negative, three-years out. This reversal at two-years compares with Elliott's average investment holding period of 1.8 years, exiting shortly before the average declines in performance.

Cumulative Excess Monthly Returns

Intuition: This figure plots the cumulative excess monthly returns for firms targeted by Elliott. Returns are calculated by aggregating all prior monthly excess returns since the initial campaign date for which there are two of more firms in the sample. "Excess" is important as it refers to the returns the targeted companies earned over above the expected market returns.

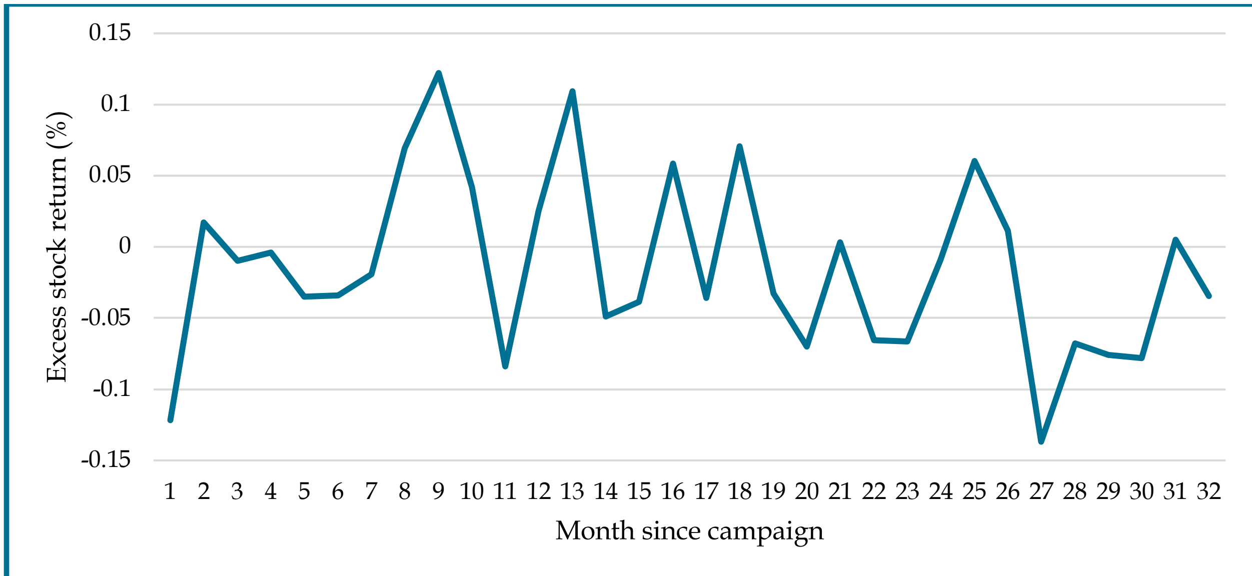
Note: The Fama-French Three Factor Model is an asset pricing model that adjusts for the outperforming tendency of small-cap stocks by including size risk and value risk factors. The number of firms included in the sample drops over the sample window.

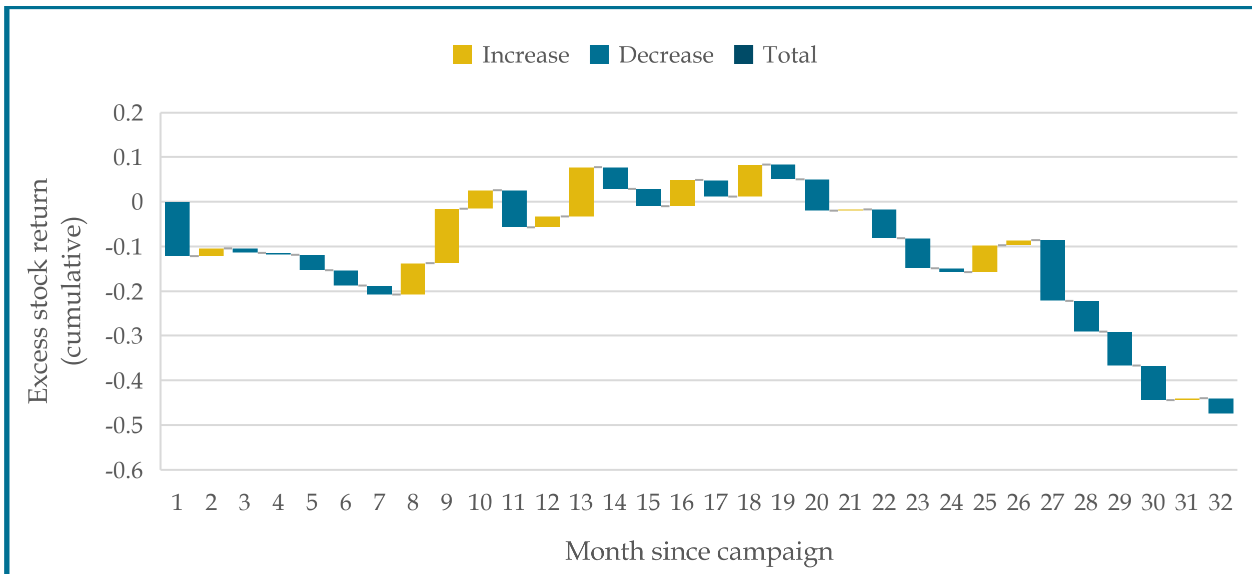


Monthly Returns

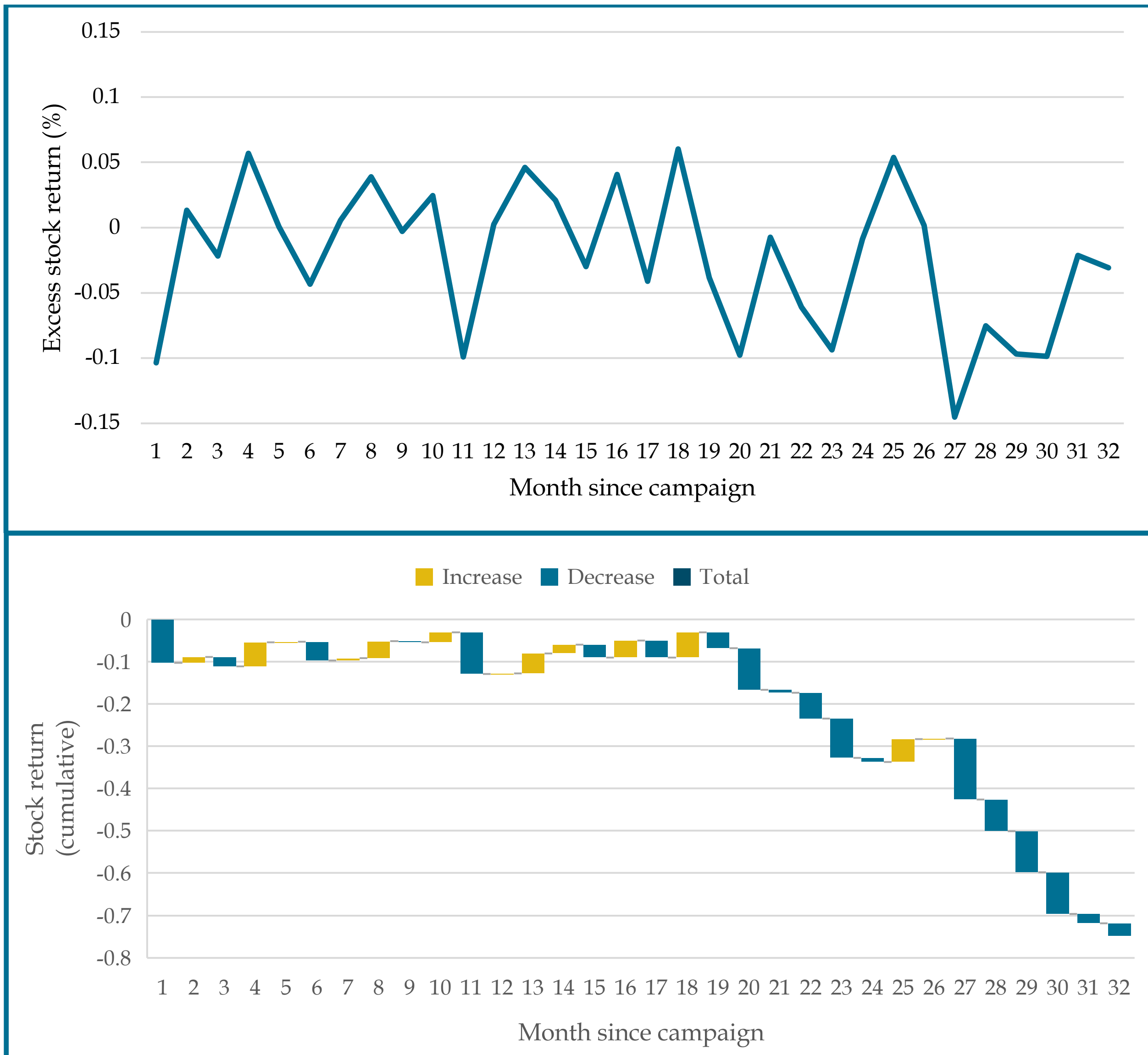
Intuition: The following figures plot the stock returns of companies targeted by Elliott on a monthly basis. The line graphs show each month's return as the difference between the stock price at the end of the month and the beginning of the month, divided by the stock price at the beginning of the month. The waterfall graphs show the cumulative returns an investor would earn over the same period by using the month-over-month percentage change in stock prices.

Fama-French Three Factor Models



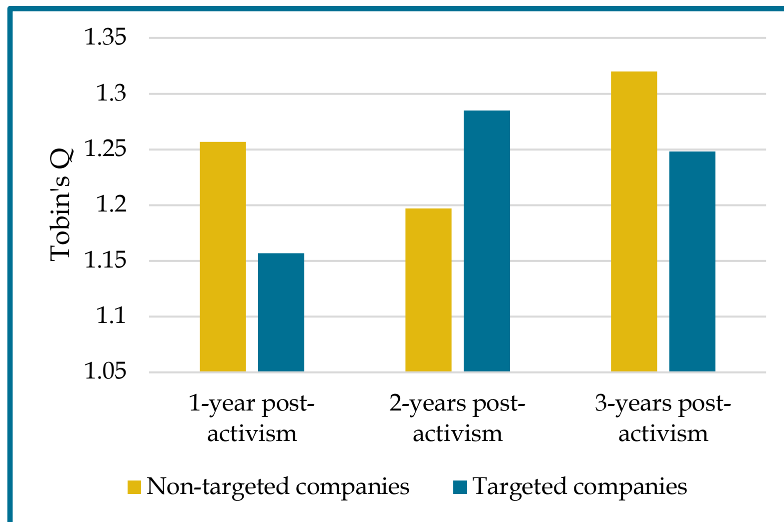


Unadjusted Market Models



Tobin's Q (Market Value)

Measure: *Tobin's Q* provide an alternative measure of firm value, calculated as the market value of assets divided by the replacement cost of assets.



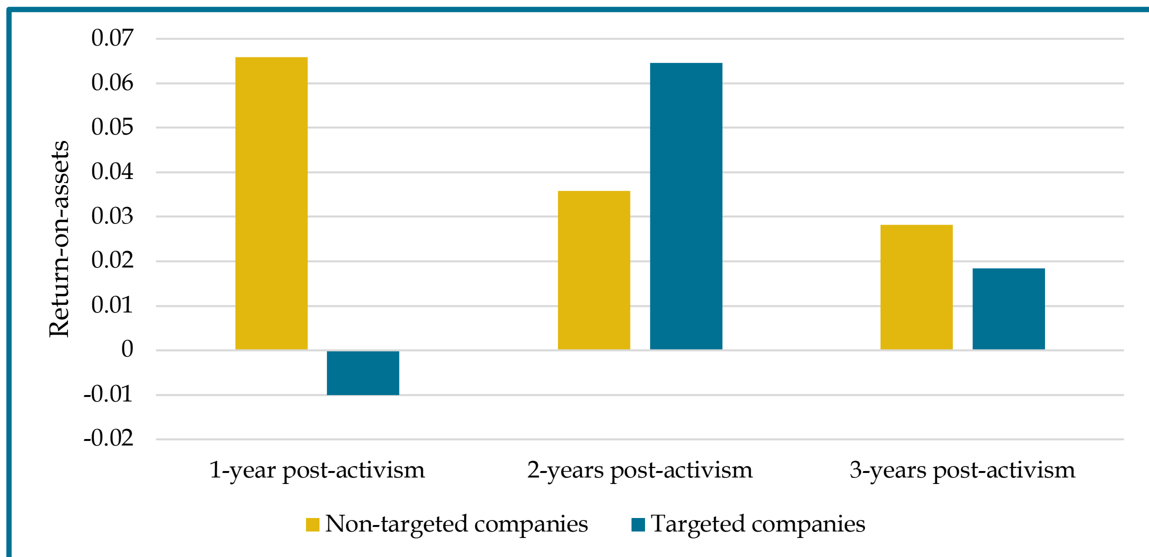
Lower Profitability by Year Three

Summary of Findings

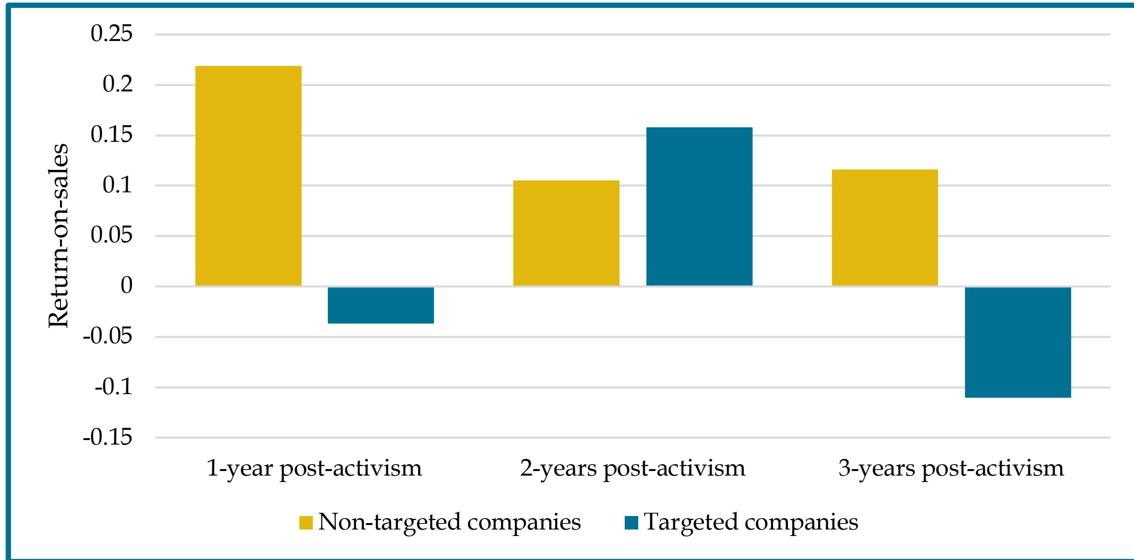
On average, companies targeted by Elliott experience lower profitability in the one- and three-years following an activism campaign. By some metrics, profitability rises in the two-years afterwards, which coincides with Elliott's average exit occurring 1.8 years after the initial targeting date. In year three, profitability clearly deteriorates, likely driven by reductions in operations and investment.

Return-on-Assets and Return-on-Sales

Return-on-assets is calculated as operating income after depreciation divided by total assets.



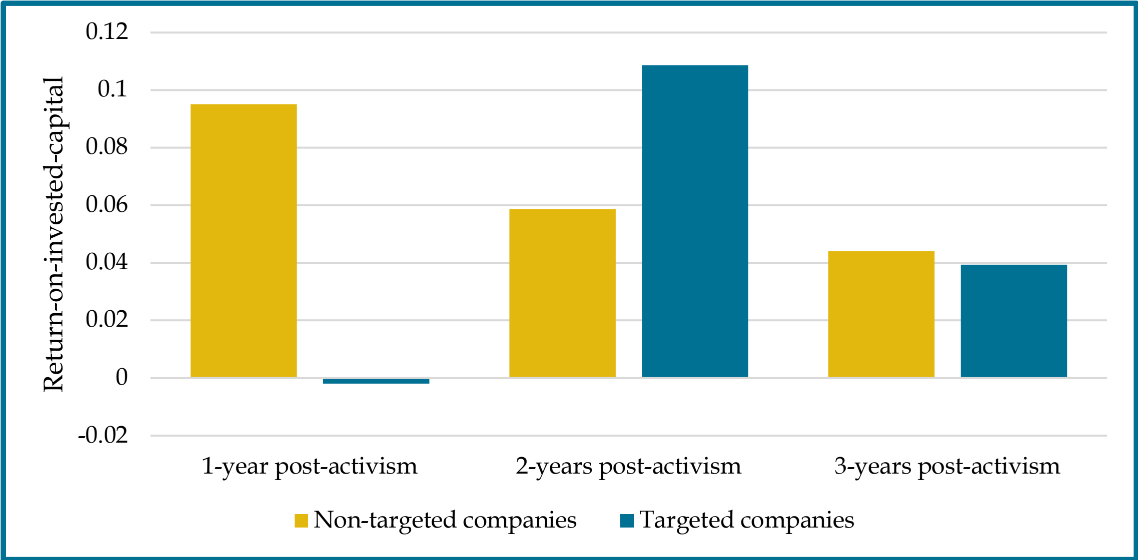
Return-on-sales is calculated as operating income after depreciation divided by total sales.



Return-on-Equity and Return-on-Invested-Capital

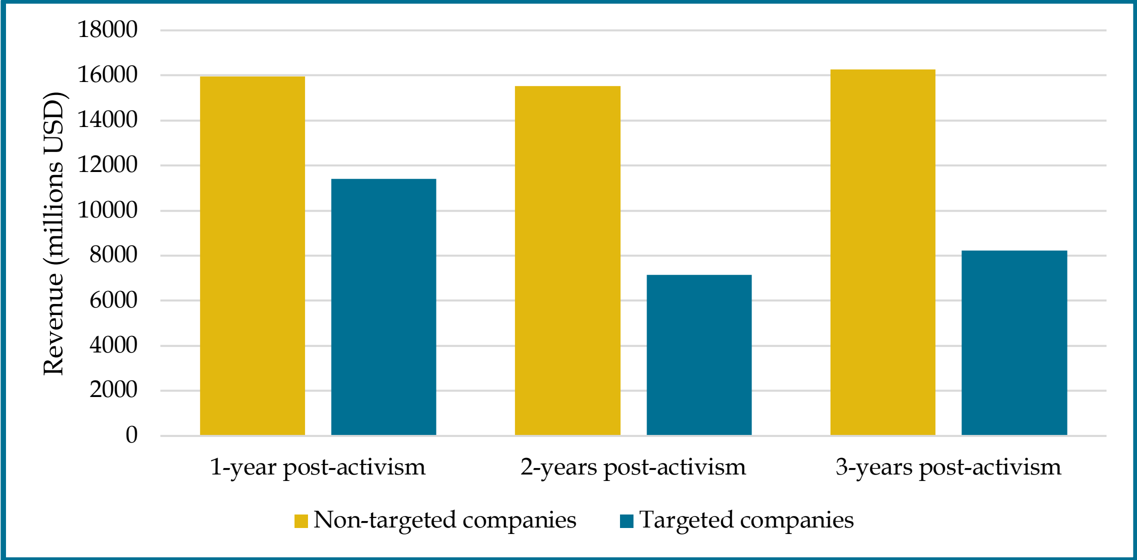
Return-on-equity equals income after depreciation divided by total shareholders' equity.

Return-on-invested-capital is calculated as net income divided by total invested capital.

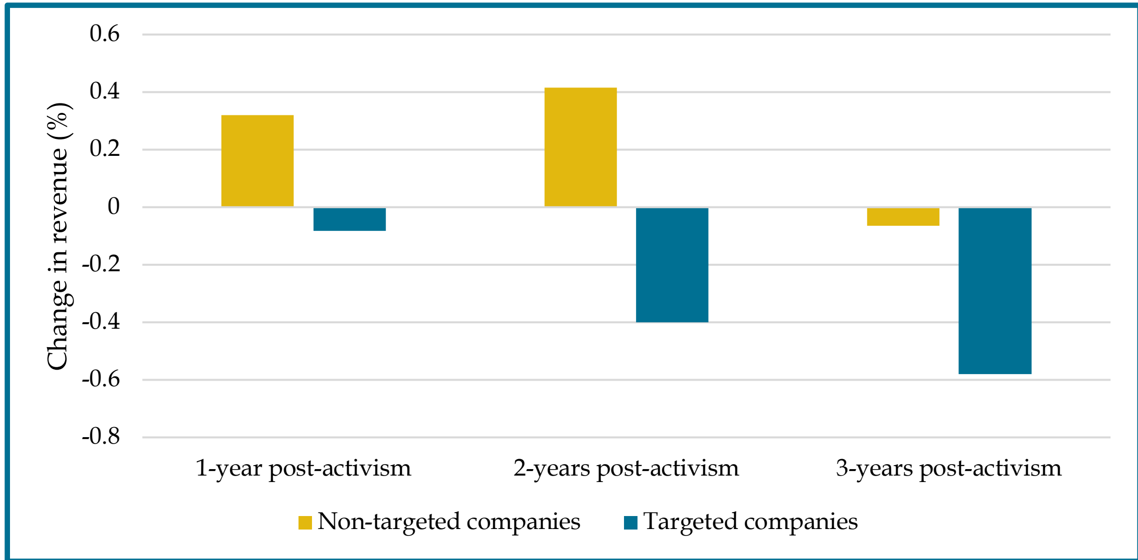


Total Revenue

Revenue is calculated as the total revenues earned in millions of USD.



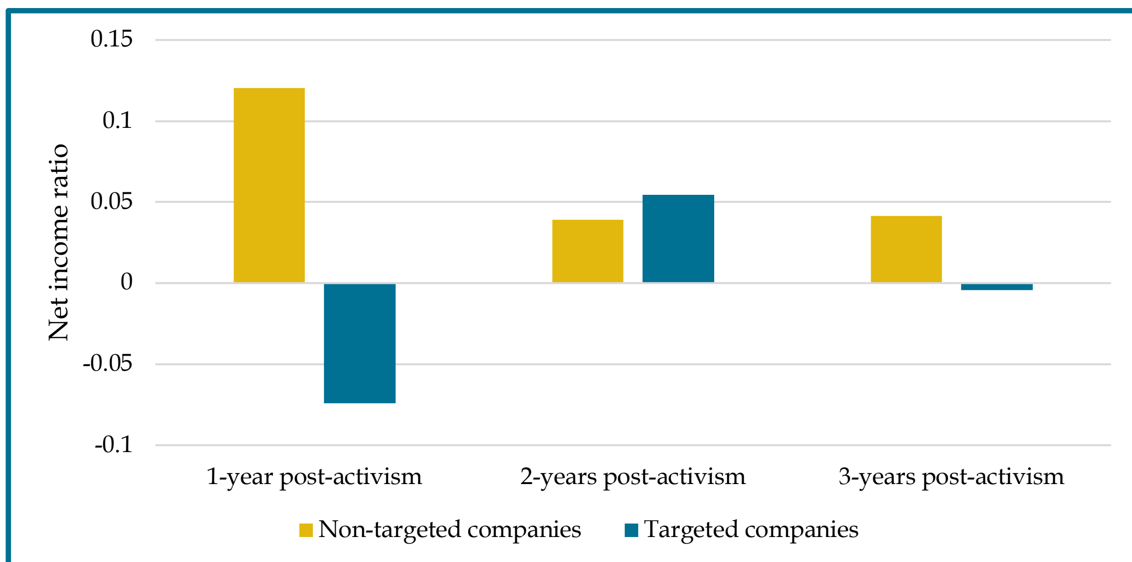
Change in revenue is calculated as the percentage change in *revenue* from $t - 1$ to $t + \text{n}$.



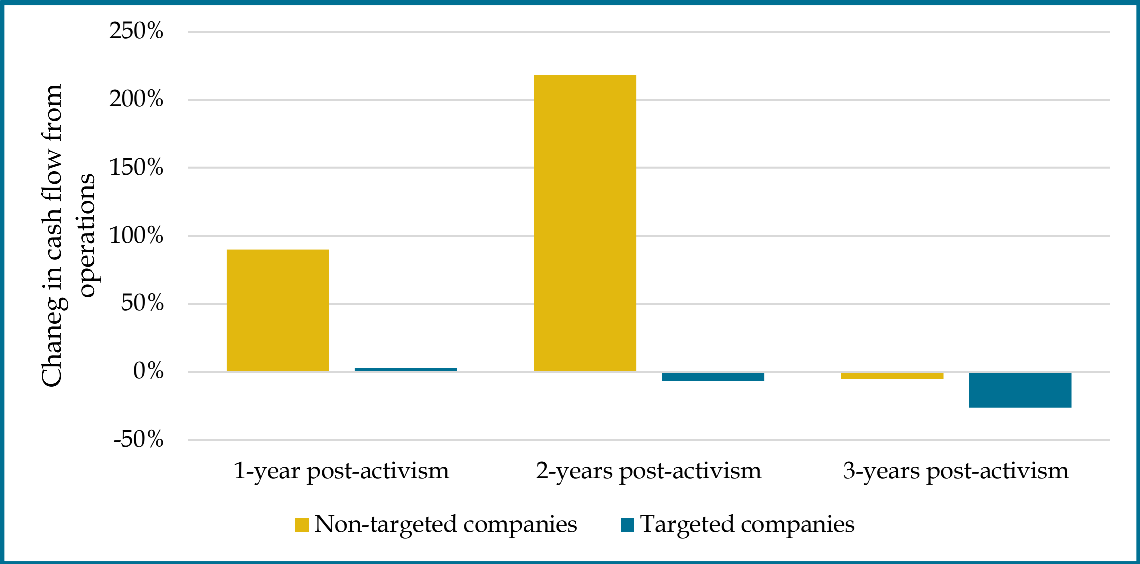
Net Income Ratio and Cash Flow from Operations

<u>Measures</u>:

Net income ratio is calculated as the ratio of net income to total revenues.



Change in cash flow from operations equals the percentage change in the money earned from ongoing, regular business activities (e.g., manufacturing and selling goods) from $t-1$ to $t+n$.



Part II: Investments and Operations

The preceding section shows that companies targeted by Elliott, compared to lookalike control companies, experience lower stock returns and profitability in the years following intervention, especially by year three. This section provides explanation for these lower performance levels by illustrating the effects that Elliott campaigns have on the investments and operations of targeted companies, including company scale, employees, capital and acquisition spending, cash flow from investing, share repurchases, and cost of capital.

Reduced Investment Weakens Future Competitiveness

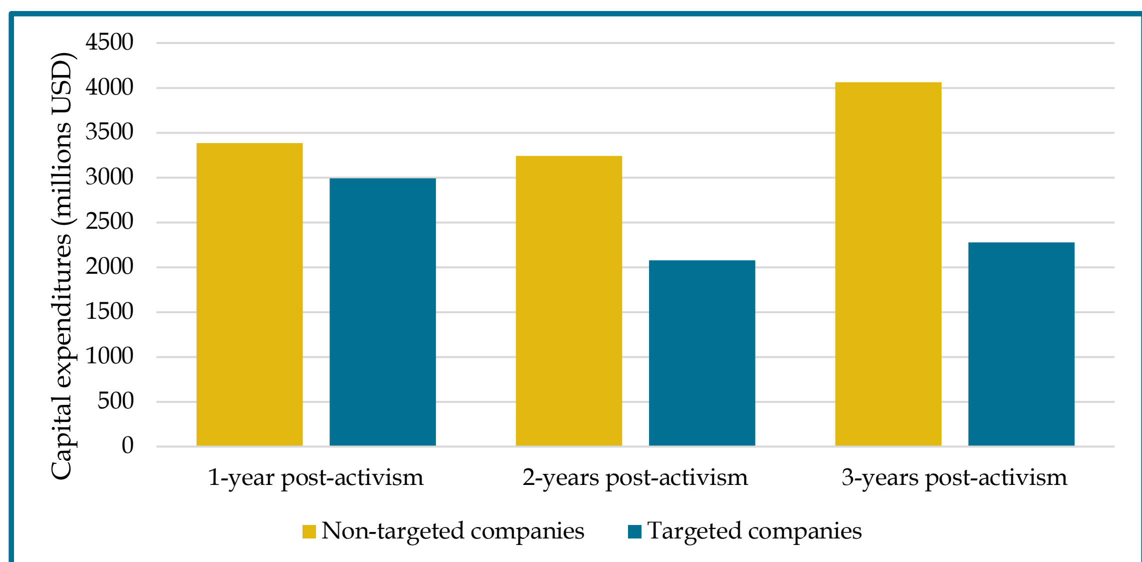
Summary of Findings

Compared to non-targeted control companies, companies targeted by Elliott cutback significantly in their spending on new investment, including capital expenditures and acquisitions, in the one- to three-years following activism campaigns. These cutbacks result in fewer new products being introduced, harming competitiveness, and higher cash flows from investing.

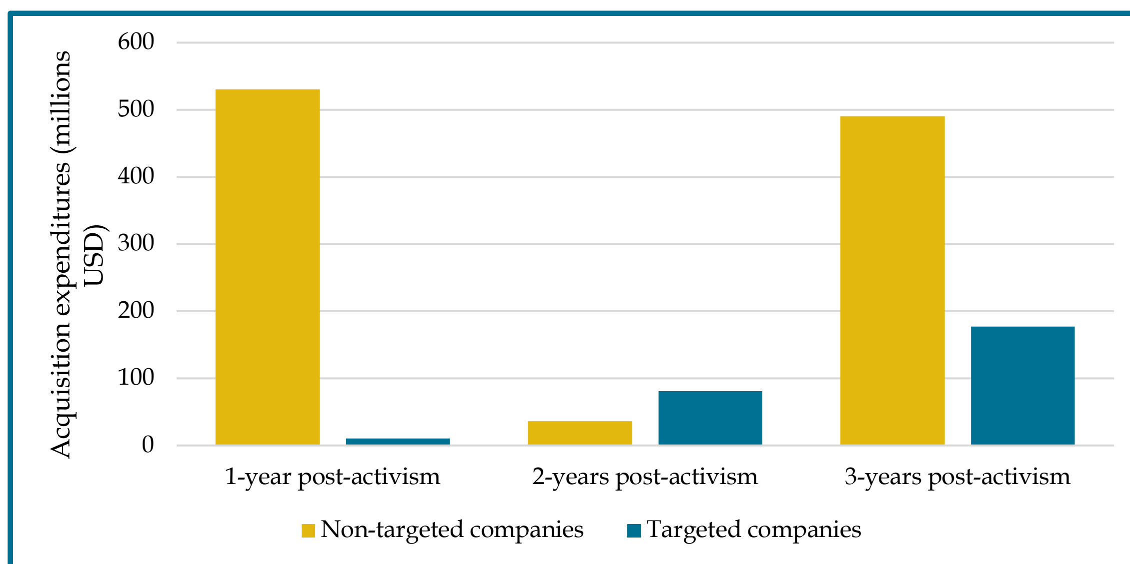
Capital Expenditures and Acquisition Expenditures

Measures:

Capital expenditures is calculated as the funds used for additions to property, plant, and equipment, excluding amounts arising from acquisitions (for example, fixed assets of purchased companies), in millions of USD.



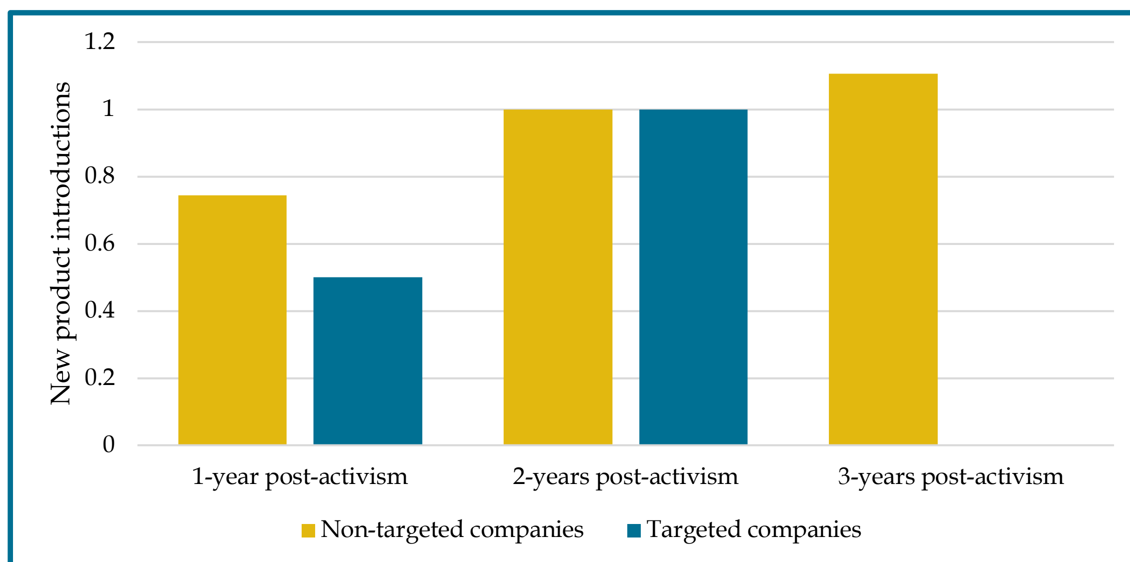
Acquisition expenditures is calculated as the cash outflow of funds used for costs relating to the acquisition of a company in the current year or effects of an acquisition in a prior year carried over to the current year.



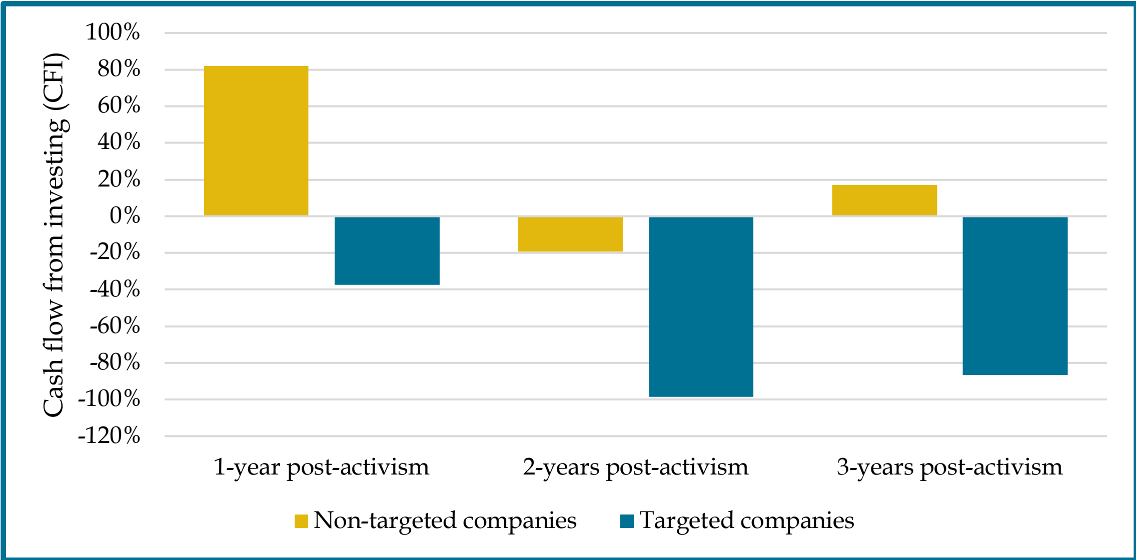
New Product Pipeline and Cash Flow from Investing

<u>Measures</u>:

New product introductions is calculated as the total number of new products and services announced by a firm in a year.



Change in cash flow from investing equals the percentage change in cash generated or spent from various investment-related activities (e.g., purchases of physical assets, investments in securities, or the sale of securities or assets) from $t - 1$ to $t + n$. Negative values indicate lower outflows of cash used for investment purposes.



Higher Capital Costs with Excess Cash for Share Repurchases

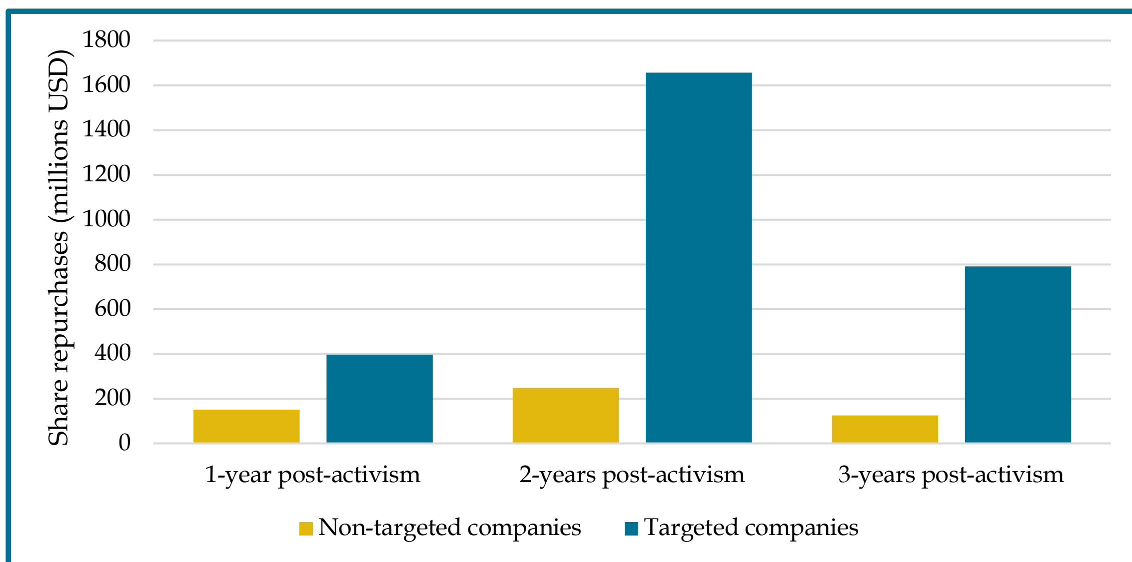
Summary of Findings

Despite shrinking, and cutting back expenditures in almost all areas of investment, companies targeted by Elliott still spend more on share repurchases in all years following a campaign when compared to non-targeted control companies. Financing changes drive up capital costs.

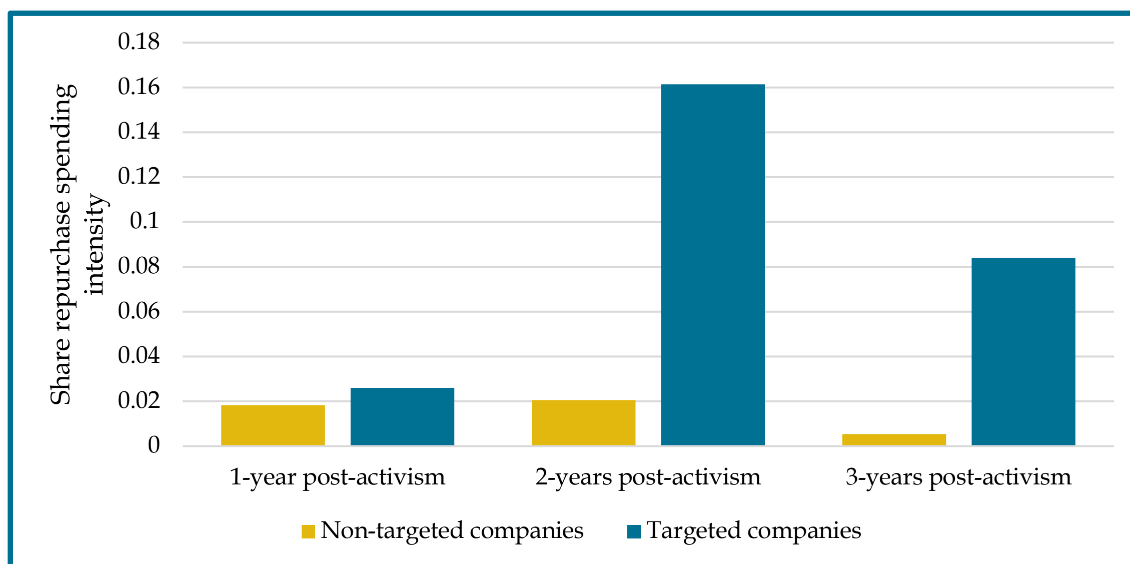
Share Repurchases

Measures:

Share repurchases represents any use of funds which decreases common and/or preferred stock in millions of USD.



Share repurchases spending intensity is calculated as *share repurchases* divided by *revenue*.



Cost of Capital

<u>Measure</u>: *Cost of capital* equals the total interest and related expense (expense to the company of securing short- and long-term debt) divided by the debt in current liabilities (amount of short-term notes and the current portion of long-term debt due in one year).

Smaller Companies Result in Some Increased Efficiencies

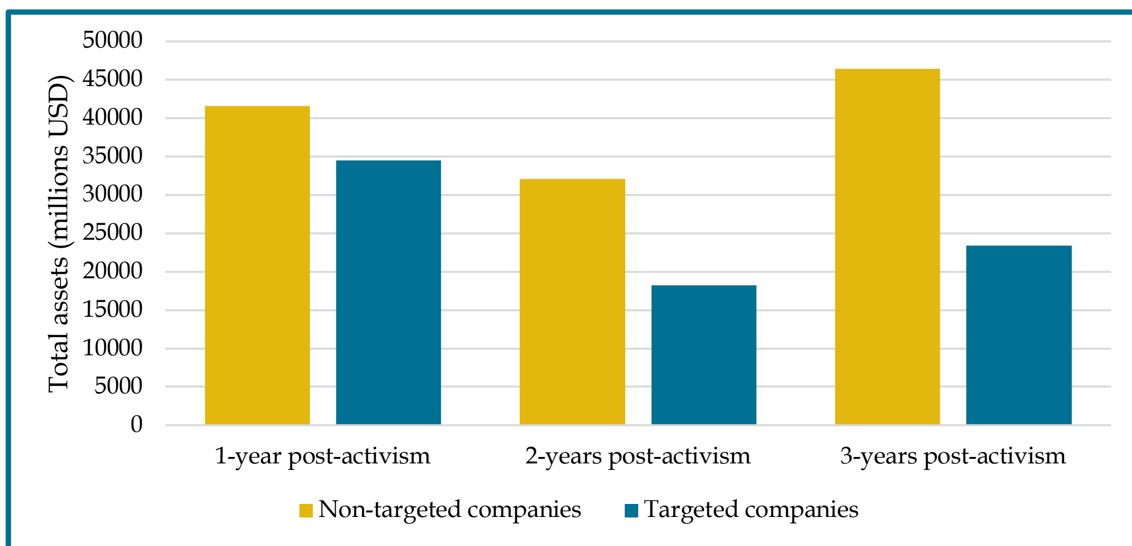
Summary of Findings

Companies targeted by Elliott also shrink in size following these campaigns, shown in lower total assets and employees. These reductions result in higher efficiency by some ratios.

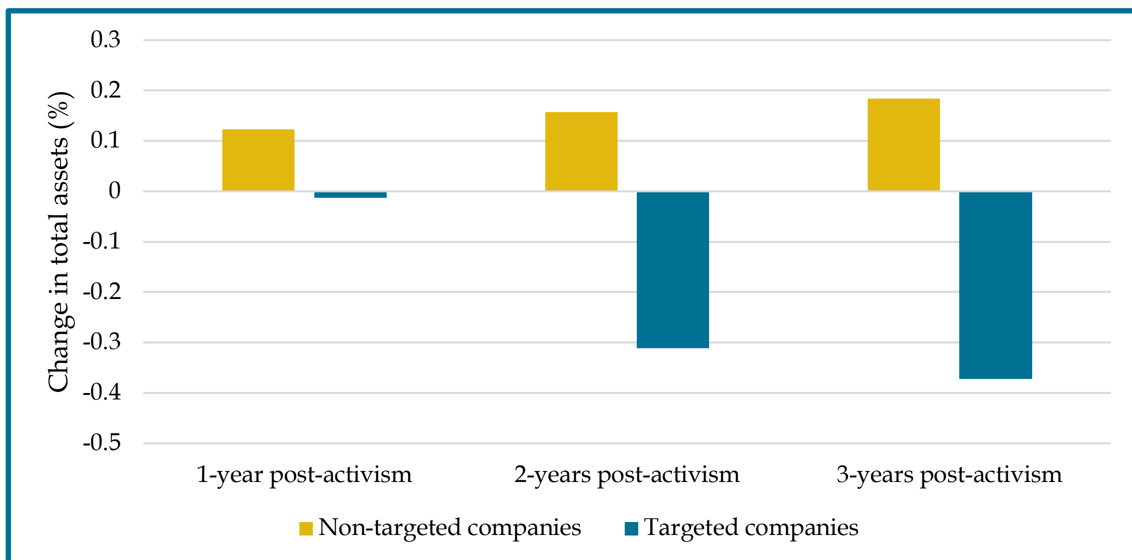
Company Size: Total Assets

Measures:

Total assets equals the total value of all assets in millions of USD.



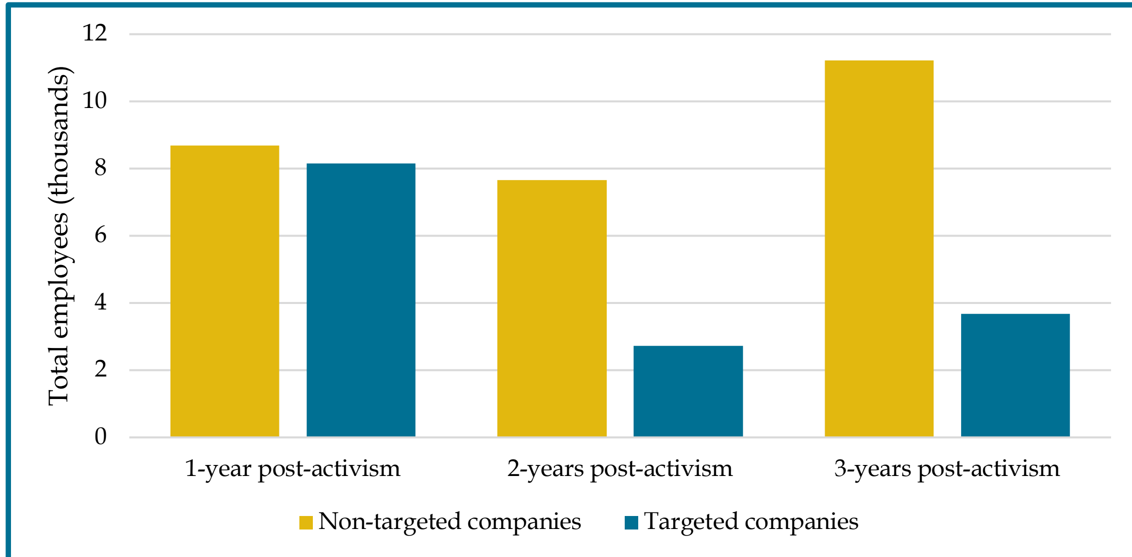
Change in total assets is calculated as the percentage change in *total assets* from $t - 1$ to $t + \text{n}$.



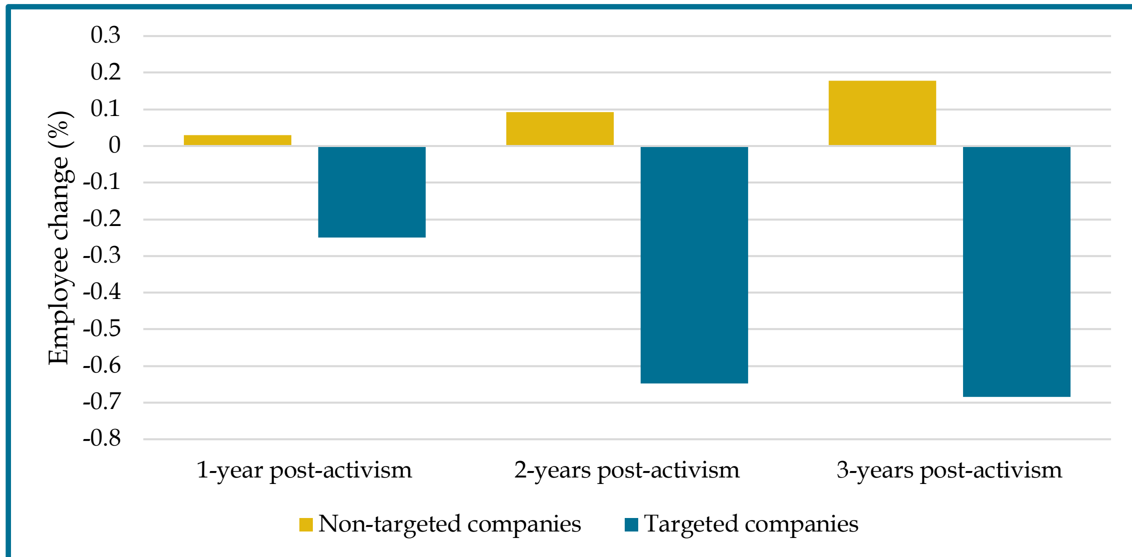
Company Size: Total Employees

<u>Measures</u>:

Total employees is calculated as the total number of people employed by the company and its consolidated subsidiaries in thousands.



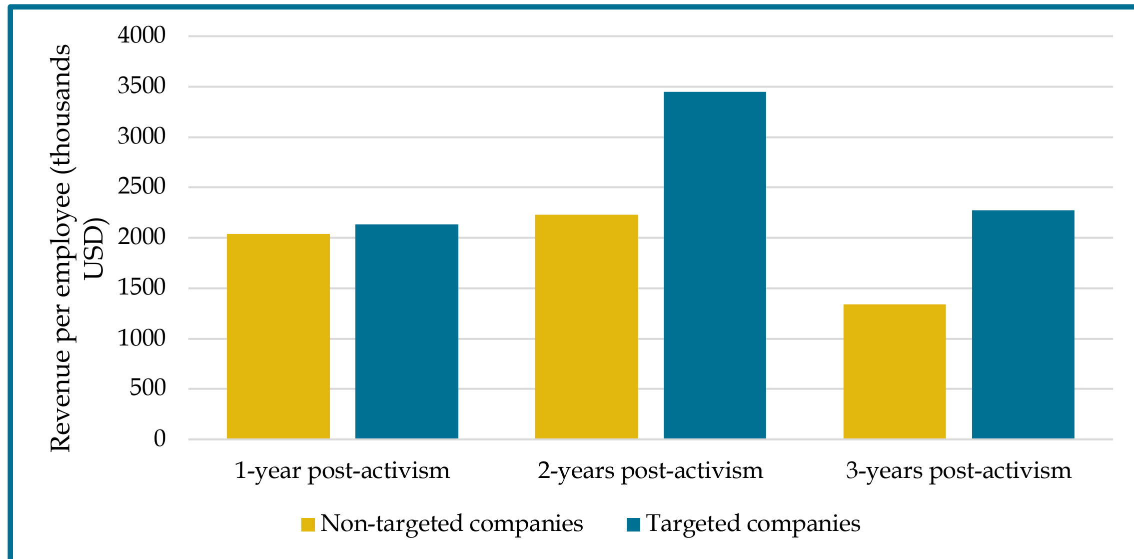
Change in total employees is calculated as the percentage change in *total assets* from $t - 1$ to $t +$ n.



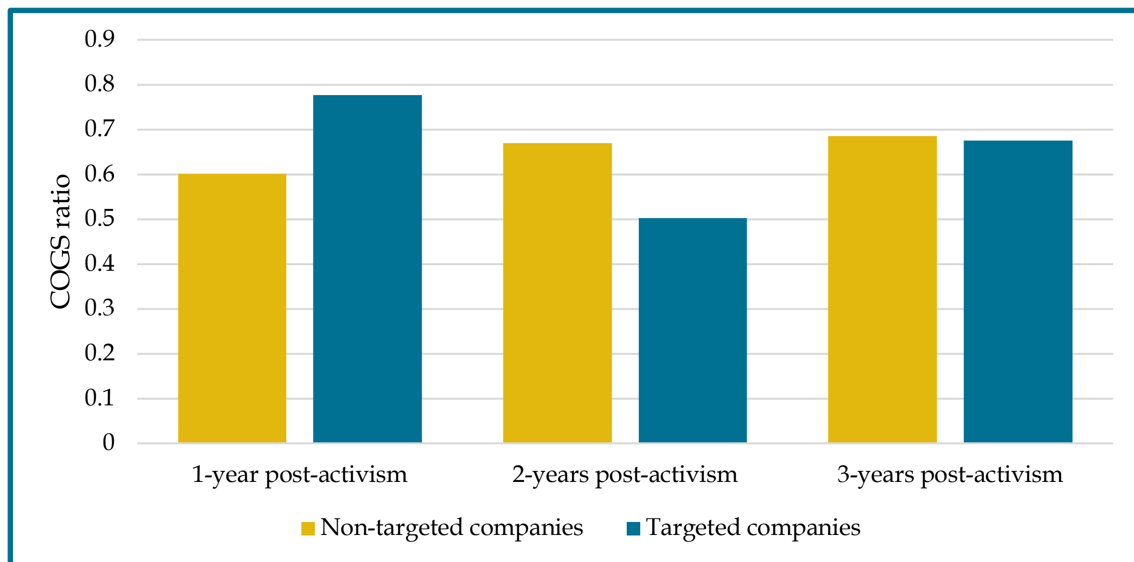
Efficiencies in Employees and COGS

<u>Measures</u>:

Revenue per employee is calculated as *revenue* divided by *total employees* and is denoted in thousands of USD.



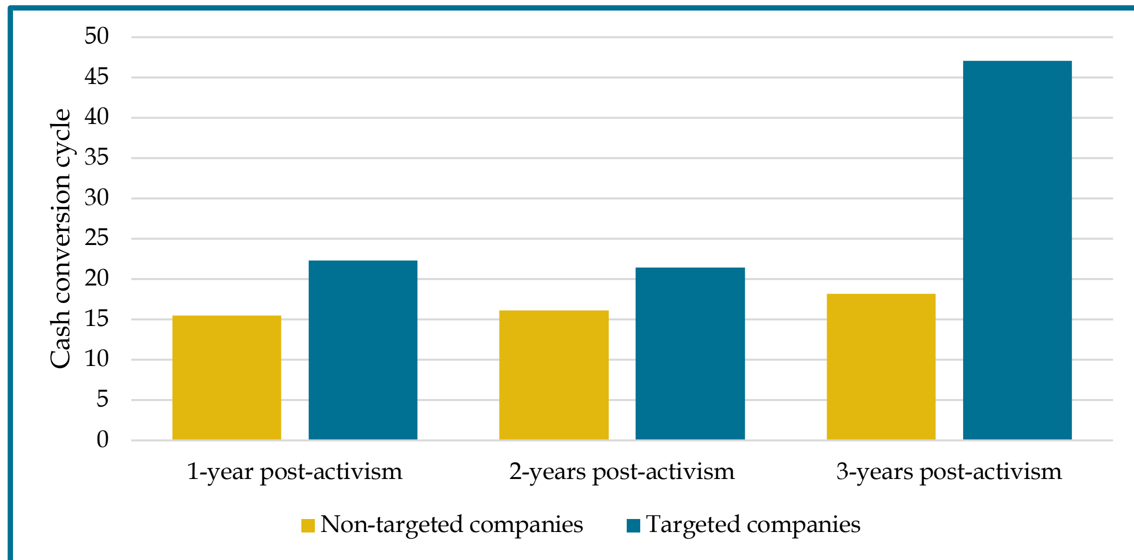
COGS ratio is calculated as the ratio of cost of goods sold to *revenue*.



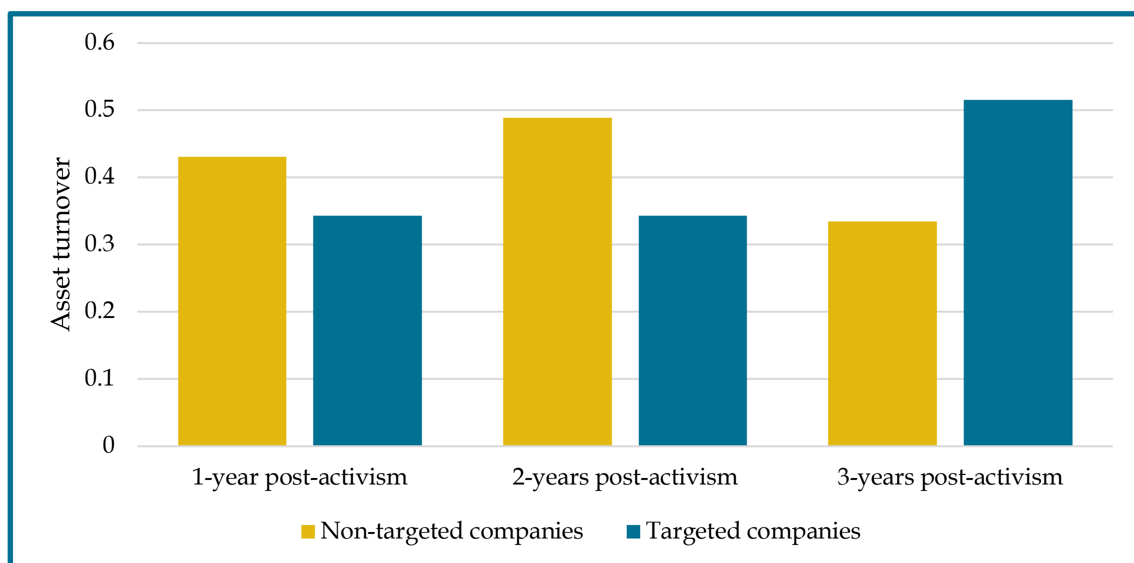
Efficiencies in Operations

Measures:

Cash conversion cycle expresses the time (measured in days) it takes for a company to convert its investments in inventory and other resources into cash flows from sales. The formula is days of inventory outstanding plus days sales outstanding less days payables outstanding. Higher values indicate greater efficiency due to faster conversions of inventory into cash.



Asset turnover equals *revenue* divided by average assets, calculated as the average of the beginning and ending assets in a year.



Appendix A: List of Non-Targeted Control Companies

Following is a complete list of all companies included in the non-targeted control group using CEM.

AMEREN CORP
AMERICAN WATER WORKS CO INC
AVANGRID INC
BAKER HUGHES CO
CABOT OIL & GAS CORP
CALUMET SPECIALTY PRODS -LP
CENTERPOINT ENERGY INC
CIMAREX ENERGY CO
CMS ENERGY CORP
CNOOC LTD
CNX RESOURCES CORPORATION
CONOCOPHILLIPS
CONSOLIDATED EDISON INC
CVR ENERGY INC
DTE ENERGY CO
ECOPETROL SA
EDISON INTERNATIONAL
ELETROBRAS-CENTR ELETR BRAS
ENEL AMERICAS SA
ENERGY TRANSFER LP
ENTERGY CORP
EVERSOURCE ENERGY
FIRSTENERGY CORP
FORTIS INC
HELIX ENERGY SOLUTIONS GROUP
KINDER MORGAN INC
NEXTERA ENERGY INC
NISOURCE INC
OASIS PETROLEUM INC
OCCIDENTAL PETROLEUM CORP
PARSLEY ENERGY INC
PHILLIPS 66
PPL CORP
PUBLIC SERVICE ENTRP GRP INC
RANGE RESOURCES CORP
SCHLUMBERGER LTD
SUNCOR ENERGY INC
TC ENERGY CORP
UNIT CORP
WEC ENERGY GROUP INC
WPX ENERGY INC