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DRAFT

Mr. Carl Koupal
Executive Vice President
Western Resources, Inc.
818 S. Kansas Avenue
PO Box 889
Topeka, Kansas 66601

Dear Mr. Koupal:

Deloitte & Touche LLP ("Deloitte & Touche") was retained by Western Resources, Inc. ("Western Resources" or the "Company") to review the cash bonuses to be awarded per the Company's Short-Term Incentive Plan for the 1997 fiscal year. This letter, together with the exhibits contained herein, details our review of the competitiveness of the plan and the reasonableness of the payouts associated with the plan, as well as recommendations in regards to alternative vehicles for the bonus award payouts.

BACKGROUND

Western Resources is a full-service, diversified security and energy company with total assets of almost $7 billion, including security company holdings of $1 billion and more than 35,000 security customers in 48 states. Its ~~utilities,~~ KPL, ~~and~~ KGE, operating in Kansas and Oklahoma, provide natural gas service to approximately 650,000 customers and electric service to approximately 600,000 customers. Through its subsidiaries, Westar Energy, Westar Capital, and The Wing Group, a full range of energy and energy-related products and services are developed and marketed in the continental U.S., and offshore.

During fiscal 1997, the Company expanded into non-regulated businesses primarily the monitored security business, began ~~utilizing electric~~ power marketing to prepare for the deregulation of the electric utility industry, and sold all of its Tyco common shares for which the Company recorded a ~~record~~ material gain on the sale. Each of the above led to record results including dramatic increases over prior years in financial categories such as net income, book value per share, and operating revenues.

In January 1997, the Western Resource, Inc. Short-Term Incentive Plan ("the Plan") was implemented to link and reward employees based on the short-term objectives of the Company. ~~Thirty~~ to ~~fifty~~ percent, depending upon the organizational level of the employee, of the participant's annual incentive targeted percentage is linked to Company financial performance, or more specifically, earnings per share and stock price appreciation. Without knowledge of the

tremendous growth ahead for the Company, targets were determined for these two financial categories. These targets were significantly over-achieved which has lead to bonus awards of, for some participants, over 400% of the targeted payout percentage. Although the awards were performance-oriented and in accordance with best practices around the United States, due to the large payouts, management has concerns over shareholder perception of the payouts and over the large outlay of cash associated with the awards.

APPROACH

Our approach in completing this review was to:

- Speak with Carl Koupal to gain an understanding of the incentive plan and the payouts to be made in February 1998.
- Gather relevant Company background information.
- Review the competitiveness of the incentive plan's provisions.
- Review data on other significant one-time performance bonus awards in comparable circumstances.
- Research alternative payout vehicles.
- Discuss the tax implications associated with the alternative payout vehicles with key Deloitte & Touche personnel.
- Prepare a letter report documenting our findings and recommendations.

ANALYSIS AND CONCLUSIONS

Incentive Plan Review

Deloitte & Touche reviewed the Plan to determine the competitiveness of the Plan's provisions including eligibility, the means for determining payouts, and the level of payout. Our review is based on both findings from The American Compensation Association's (ACA) Compensation in Higher Performing Companies and our experience in the design of short-term incentive plans. The ACA study details the differences in compensation practices of higher-, middle-, and lower-performing companies representing a broad range of industries, categorized by total shareholder return. Exhibit A displays the total shareholder return ranges for each of the categories.

REDACTED

Western Resources' Plan allows for executives, officers, select exempt employees in pay grades 30 and above, and others who the Board of Directors or the Plan's administering committee deem eligible, to participate. According to the ACA study, nearly all corporate executives are participants in an annual incentive plan, but differences exist in the use of incentives for nonexecutives. Higher-performing companies tend to extend their incentive plans further down into the organization, whereby approximately 81% of companies have programs in which non-executives participate. On average, 30% more of higher-performing companies extend eligibility past the executive group than do middle- to lower-performing companies.

The Plan utilizes three sets of criteria to determine an individual's incentive: company performance on financial criteria, achievement level on individual objectives, and discretionary judgment on managerial effectiveness. Our research indicates that using financial results to determine annual incentives is the most prevalent performance measure. The three most widely used performance measures include net income, earnings per share, and return on equity, which are used independently or in conjunction with each other. Western Resources utilizes both earnings per share and stock price appreciation to make up the company financial performance portion of the award. The use of earnings per share is utilized by almost half of the companies reviewed by the ACA study and ranks as the second most commonly utilized measure.

Targeted payout percentages as a percent of base salary are determined in the Plan based on salary grade. Utilizing published survey data on targeted annual incentive award opportunities from The ECS Industry Report on Top and Middle Management, we established a competitive annual incentive target for each salary grade. The competitive percentages were determined utilizing the average salary level for each of the five tiers in Western Resources' Plan. The following table represents Western Resources' incentive targets and the market competitive target levels. One must bear in mind that "target" payouts correspond with the achievement of target performance. Performance in excess of target, yields corresponding rewards. Once again, this is in alignment with ACA's findings thus:

Grade	Western Resource Target	Market Competitive Target
1,2	60%	68.6%
3-7	55%	48.2%
8	40%	36.4%
9-11	30%	30.1%
30-33	15%	22.9%

Because the earnings per share goal was enormously exceeded by the Company, large bonus payouts will be made under the incentive plan. Payouts as a percent of base will range between 430% of base salary for the top tier down through 70% of base salary for the bottom tier. Since some shareholders may view these payments skeptically due to the absolute amounts involved, analysis was performed on the occurrence of large bonus payments in relation to company

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performance by other organizations. The table in Exhibit B represents one-time bonus awards as a multiple of base salary for executives in similar significant situations. This data aids in substantiating the reasonableness of the Western Resources' payouts. There is ample precedent to paying significant one-time performance based bonuses to executives for helping their companies achieve financial success, and would not be uncompetitive for Western Resources to do the same. This analysis, coupled with ACA's study and our own experience in the execution of such plans all point to a reasonably designed program.

Incentive Plan Conclusion

Based on our analysis, the Western Resources, Inc. Short-Term Incentive Plan is competitive with the market. The eligibility under the Plan is consistent with those practices of higher-performing companies, and we would recommend that Western Resources continue to incent employees through the exempt levels to meet annual corporate objectives. In addition, the formula driven incentive payout calculations which are derived from corporate, individual, and discretionary performance is also competitive with the practices of higher-performing companies. The financial performance criteria including earnings per share and stock price appreciation are consistently used in the marketplace and provide good and easy to track measures of corporate performance. These measures also ensure that the shareholder is being compensated prior to awards being paid out to employees. Finally, the targeted payout awards are consistent with the targeted levels of award in peer companies. For all but one grouping, the targets are slightly below market. We recommend that Western Resources continue to utilize the established targets.

Because the Company outperformed the financial goals determined as performance measures under the Plan, large payouts will be made. Although these payouts are larger than typical annual incentive awards, they are not uncommon when companies significantly exceed targeted goals. In addition, many companies make much larger awards than those proposed by Western Resources. As a multiple of base salary, the significant one-time bonus awards range from .40 to 78.01, and Western Resources' payouts range from approximately .71 to 4.33. Based on these findings, we determined the payouts proposed under the Plan are reasonable.

Payout Vehicle

Currently, the Western Resources' Plan calls for payment of the incentive awards to be made annually in cash. Because the payouts are much larger than anticipated, we recommend that the Company consider alternative payout vehicles. Utilizing alternatives to cash could make the Board less concerned of the large payouts and would also prevent the Company from making a large outlay of cash.

We determined three alternatives the Company should consider on how to pay the employees the incentive award. There are pros and cons to each of the alternatives. Below is a discussion regarding each of the alternatives and the advantages and disadvantages of each.

1. The first alternative Western Resources has is to make the payment in cash. Listed below are the advantages and disadvantages associated with an all cash payout:

Advantages	Disadvantages
- aligned with the plan document	- perception by the marketplace could be unfavorable
	- employee will incur a large tax liability

2. A second alternative Western Resources should consider is paying out the award partially in cash and partially in restricted stock. We would recommend that the award be divided one-third in cash and two-thirds in restricted stock. The following details the advantages and disadvantages to this approach:

Advantages	Disadvantages
- Company does not have to make as large of a cash outlay	- not consistent with the terms of the incentive plan
- employee's tax liability is decreased because he/she is taxed on the cash at the time of the award and taxed on the restricted stock as the award vests	- award of stock will dilute the shareholders
- restricted stock links employees to the interests of shareholders	- the value of the bonus award is not guaranteed because if the stock price depreciates, the employee may receive less value than their bonus award
- acts as a retention device through the use of the vesting schedule	
- promotes stock ownership among the employees	
- if the stock price appreciates, the Company's tax deduction will exceed the associated charge to earnings	

If restricted stock is utilized to compensate for a portion of the bonus payout, we recommend placing a premium on the amount of the award deferred into the restricted stock since a dollar of cash is more liquid and therefore more valuable than a dollar of restricted stock. A premium of 10% is recommended to compensate for the lost time value of money and the risk/reward relationship between cash and stock. In addition, we would recommend vesting the restricted stock either one-half or one-third on each of the first two/three anniversaries of the award. This would provide significant retention capabilities to the Company and would defer the tax whereas the executive would be taxed on the portion of the award that vests each year. The employee's

tax on the restricted stock is equal to the fair market value on the date of grant times the number of shares that vest in that particular year. (See Exhibit C - Restricted Stock Summary)

3. A third alternative for the Company to consider is a partial cash payout and the remaining portion of the award being deferred into a traditional non-qualified deferred compensation plan or Deloitte & Touche's proprietary KEYSOP™ program. The advantages and disadvantages of this alternative are contained below:

Advantages	Disadvantages
- Company does not have to make as large of a cash outlay	- not consistent with the terms of the incentive plan
- the employee's tax liability is decreased because he/she is taxed on the cash at the time of the award and taxed on the deferred monies when the taxable amount becomes income to the employee	- the vehicle must contain a risk of forfeiture in order to defer the tax to the employee
- the monies deferred can be invested in a diversified portfolio of mutual funds and grow on a pre-tax basis	- the Company loses its tax deduction until the employee recognizes income

In considering alternatives two and three, two important tax principles must be considered to avoid the executive being taxed on the monies deferred into restricted stock or a nonqualified deferred compensation vehicle. The first principle is constructive receipt. "Under the doctrine of constructive receipt, a taxpayer may not deliberately turn his back upon income and thereby select the year for which he will report it." (IRS Revenue Ruling 60-31) The doctrine of constructive receipt states:

"Income, although not actually reduced to a taxpayer's possession, is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions."

In other words, if the executive could reach out and take the money, regardless of whether he or she did, it will be considered taxable income. The chances of such an interpretation being made is minimized if the individual makes a determination before the amount is earned. In addition, if the employee indicates a preference but the final decision is in the hands of a compensation committee, the likelihood of a problem with constructive receipt is also minimized. Thus, in adopting either alternative two or three, the issues of "who makes the determination" and "at what point in time" are critical considerations. In order to alleviate constructive receipt issues, we recommend that neither of the two alternatives be voluntary deferrals, but rather mandatory as decided by the Board of Directors or compensation committee.

What about premium for loss of liquidity, is in increased Risk? #2 this would encourage employees to agree to change in C in of payout.

Another tax principle closely allied with the doctrine of constructive receipt is the theory of economic benefit. This principle will need to be considered if alternative three is chosen. The deferral mechanism must have a substantial risk of forfeiture. If the plan does not have a substantial risk of forfeiture, it will be considered funded and an economic value can be calculated on a yearly basis from which the employee will be taxed.

CONCLUSION

Based on our review of the Western Resources' Plan and the competitive analysis performed, Deloitte & Touche believes the Plan is well designed. You and your Board should be commended for being in alignment with top-performing companies and their focus on performance based incentives. The Plan was designed to reward excellent performance and that is what is occurring for fiscal 1997. In addition, we believe the payouts for 1997 are reasonable in light of the performance levels achieved over the past year. The employees of Western Resources created significant value for the shareholders and are sharing in the gains made from the Company's success.

1) have they considered pooling?
2) have they considered need for shareholder approval?

As to the payout vehicle, we prefer alternative two, but alternative three is very sound. However, alternative two's methodology is effective at further linking the employees to Company performance while at the same time saving the Company from making significant outlays of cash and the employee from a large tax liability.

* * *

We appreciate the opportunity to be of assistance to Western Resources. If you have any questions regarding the analysis and recommendations above, you can reach me at (713) 756-2110 or Cara Lyons at (713) 756-2134.

Very truly yours,

Brent Longnecker, National Practice Director
Performance Management and Compensation Consulting

cc: Cara Lyons, Deloitte & Touche LLP

REDACTED

Significant One-Time Bonus Awards

Exhibit B

Company	Description	Year
AK Steel Holding Corp.	COB/CEO T. Graham paid $2 million for 2 consecutive quarters of operating profit & 6% net income @ IPO closing date	1993
Alexander & Alexander Svcs	SVP Ronald A. Iles received $292,012 for profit improvement of certain reinsurance operations	1993
ACS Technologies, Inc.	J. Coors, Office of the President, received $100,000 for financial results of Coors Ceramics	1994
Allied Signal Inc.	CEO L. Bossidy received annual incentive of $1.5 million	1993
American Medical Holdings	COB/CEO received $250k for achieving special performance goals	1995
Apria Healthcare Group Inc.	COB/CEO T. Aitken's paid $3.02 million bonus for the successful merger of Abbey HC with Homedco	1995
AT&T	Pursuant to company's restructuring, special awards of stock options & restricted units equal to 1.5-4.5X total compensation were given to key ee's	1995
Bank United	Special one-time cash and restricted stock awards were granted to the executives after the successful completion of the IPO: CEO Burkholder $2.5M bonus and $1.6M RSA; EVP/CFO Nocella $874k bonus and $500k RSA; EVP/COO/GC Heffron $804k bonus and $500k RSA; EVP Coben and SVP Green $160k bonus and $80k RSA	1996
Burlington Northern Santa Fe	COB R. Bressler got $2 million in recognition of extensive contributions	1991
Carson Pirie Scott & Co.	VCOB/CEO paid $1.1 million for contributions during restructuring	1988
Chemical Banking Corp.	COB/CEO McGillicuddy received $2.5 million cash special performance bonus	1993
Chemical Banking Corp.	Pursuant to achievement of merger objectives, COB/CEO J. McGillicuddy was paid a $1.4 million bonus and President Shipley was paid a $1.25 million bonus	1992
CBS, Inc.	President of CBS received $850,000 for achieving first standing in prime-time	1994

	ratings	
Coca-Cola Co.	COB/CEO R. Goizueta received $1.5 million for "extraordinary contributions"	1989
Cyprus Amax Minerals	COB/CEO M. Ward got $1.5 million for successful acquisitions/divestitures, mainly merger with AMAX	1993
DSC Communications	COB/CEO Donald was paid a special one time bonus of $1 million in recognition of performance in 1993	1993
Eastman Kodak Co.	EVP W. Prezzano was paid $1,351,200 for divestiture of non-imaging health business	1995
Equitable Companies Inc.	CEO/COB R. Jenrette paid $5 million bonus in part for successful IPO of Donaldson Lufkin & Jenrette	1995
Farah Manufacturing Co, Inc.	Special award of 75,000 restricted shares (valued at $1.4 million) to CEO Allender for his role company's turnaround & prior salary concessions	1994
First Interstate Bancorp	COB/CEO E. Carson paid $1.5M bonus in recognition of his significant contributions	1994
Foundation Health Systems	CoCOB/Pres/CoCEO Dr. Hasan received a special $1M bonus paid in 1994 for performance in obtaining government contracts	1994
Greenpoint Financial	COB/CEO T. Johnson paid $1 million related to conversion of bank into stock corporation & consummation of IPO	1994
Hasbro Industries, Inc.	Special $1 million performance bonus to B. Stein, Division Head	1994
Intel	Most employees got a special 1-time flat bonus related to company's excellent 1996 financial results; the CEO A. Grove got $2,578,300	1996
Lear Corporation	Top two executives Way and Rossiter got $830,000 each, and executives Hollars, Vandenberghe, and Melson got $277,000 each, all for past services	1993
Litton Industries, Inc.	One-time awards to then COB Hock ($768,000), then CEO Brann ($408,000), and then VCOB Casey ($264,000) related to Western Atlas spin-off	1993
Marsh & McLennan Co's, Inc.	L. Lasser was paid a $10.5 million one time award reflecting exceptional financial results; prior year, Lasser received a $3 million award reflecting his contributions to Putnam's performance over several years	1994 1993

McCaw Cellular Communications	CEO McCaw got $7.5 million for AT&T merger	1993
Medco Containment Services	COB Wygod got $62.4 million and SEVP/Sec/CFO Manning got $15.1 million from sale of Medco to Merck	1993
Nortek, Inc.	CEO got $2.45 million for "leadership" during 1991-1993 when company had no net earnings	1993
OfficeMax	COB/CEO Feuer's $1 million bonus was based on his work in completing spin-off from K-Mart & sale of subsidiary	1995
Premark International	COB/CEO got $500,000 bonus for Premark's "progress under his leadership"	1993
RJR Nabisco Holdings	H.J. Greenious got special bonuses of $300,000 for his role in preparing & implementing the IPO of Nabisco stock	1995
Scott Paper Co.	VCOB Leaman, head of S.D. Warren subsidiary got $500,000 bonus for successful sale of Warren	1994
TJX Companies, Inc.	Special cash awards were granted to Pres/CEO Cammarata, BVP Campbell, EVP/COO Lesser in amounts of $500k, $175k, $225k respectively in	1996
	recognition of their efforts in restructuring of company through sale of division and acquisition of company	
Sterling Software, Inc.	Pres/CEO S. Williams granted options for 750,000 shares @ FMV ($41.75) for his role in the spin-off of Sterling Commerce; options were automatically accelerated and exercised upon IPO of spin-off	1996
Uniroyal Chemical	One time performance bonus paid to top 5 in addition to regular bonus: CEO/COB Mazaika- $340,000; VP Ingulli- $180,000; VP Krakower- $125,000; VP Stephenson- $41,000; VP Johnson- $160,000	1994

Restricted Stock

Key Features

- Outright grant of shares to executives with restrictions as to sale, transfer and pledging
- Restrictions lapse over a period of time (e.g., three to five years)
- As restrictions lapse, executive has unrestricted shares which he or she may sell, transfer or pledge
- If executive terminates employment, all unvested shares are forfeited
- During restriction period, executive receives dividends and can vote the shares

Earnings

- Fair market value at grant charged to earnings over restriction period
- Subsequent appreciation not charged to earnings
- Immediate dilution of EPS for total shares granted

Tax Impact

- At grant – no tax
- As restrictions lapse—the current market value of vested shares taxed as ordinary income
- Dividends received during restriction period taxed as ordinary income

Tax Impact

- At grant -- no tax deduction
- As restrictions lapse – company receives tax deduction equal to executive's ordinary income
- At sale -- no tax deduction
- Dividends paid during restriction period are deductible by company when paid

(1) Assumes 83(b) election is not made. If an 83(b) is made, executive recognizes income on the date the restricted stock was issued, and the company receives an immediate tax deduction for the initial value of the shares (but not for subsequent appreciation during the restriction period); dividends paid during the restriction period are not deductible.

Advantages

- No executive investment required
- Promotes immediate stock ownership
- Charge to earnings is fixed at time of grant
- If stock appreciates, company's tax deduction exceeds fixed charge to earnings
- Aligns executive's interests with shareholders
- Recognizable to most executives
- Offers executive potentially long-term appreciation as company grows

Disadvantages

- Charge to earnings
- Immediate dilution of EPS
- Executive may incur tax liability before shares are sold
- If stock depreciates, company's fixed-earnings charge exceeds tax deduction

Restricted Stock (RS) works as follows...

Restricted Stock	Grant		Restrictions Lapse
Fair Market Value:	$5	→	$10
Dividends:	$0	→	$1.00
Executive Investment:	$0	→	$0
Executive Gain:	$0	→	$11.00 (Ordinary Income)
Executive Tax[1]:	$0	→ ($11.00 X .396)	$4.36 Tax Due
Executive Net Gain: (After Tax)	$0	→	$6.64 Net Gain

(1) Assumes the executive is subject to an ordinary income tax rate of 39.6%. If an 83(b) election was made within 30 days of the award, the executive would be taxed on the fair value of the stock at grant as ordinary income, with subsequent appreciation treated as a capital gain. 83(b) elections are not typically made because the executive cannot recover taxes paid at grant if he or she forfeits the shares or if the shares decrease in value.

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