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BEFORE THE

KANSAS CORPORATION COMMISSION

DIRECT TESTIMONY OF EARNEST A. LEHMAN

ON BEHALF OF

MIDWEST ENERGY, INC.

DIRECT TESTIMONY OF EARNEST A. LEHMAN

Q: Please state your name, position and business qualifications.

A: My name is Earnest A. Lehman, President and General Manager of Midwest Energy, Inc. (Midwest Energy). I have been employed by Midwest Energy since 2003, first as Chief Operating Officer, and since the beginning of 2004 as President and General Manager. I have been a regulator or employee of natural gas and electric utilities since 1976. I worked for more than 18 years in regulatory, corporate development and marketing management positions with the company now known as Westar and one of its predecessors, followed by several years running an energy services division/subsidiary of El Paso Electric Company in Texas. My earliest regulatory experience was gained as an Economist at the Civil Aeronautics Board and then the Federal Power Commission/Federal Energy Regulatory Commission in Washington, DC. I have a B.A. in Economics with Distinction from the University of Wisconsin-Madison and an MBA in Finance and Analysis from The George Washington University. I testified before the Commission many times during my years with Westar and Kansas Gas and Electric Company. This is my third appearance on behalf of Midwest Energy.

Q: What is the purpose of your testimony?

A: I will provide an overview of Midwest Energy's application, the reasons for the increase, and the impact of this filing on our customer-owners. I conclude my testimony by explaining how the ownership of Midwest Energy by its customers has driven and is reflected in this filing to increase their electric rates.

Q: What is the magnitude of the revenue increase proposed by Midwest Energy?

A: Based on a proforma test year ending August 31, 2010, Midwest Energy proposes to raise base rate revenues by $3,280,490 (2.5%) net of incremental transmission revenue that would otherwise be recovered through the Transmission Formula Rider. The revenue requirement is detailed and supported by the testimony of Tom Meis, Midwest Energy's Chief Financial Officer, with support for the cost of member-provided equity given by the testimony of William K. Edwards of the National Rural Utilities Cooperative Finance Corporation (CFC).

Q: What is the impact of the proposed increase on a typical residential customer utility bill?

A: It is important to note that the effect on customers is derived partly from the cost increases reflected in this filing and partly from the reallocation of purchased capacity costs currently being collected through our Energy Cost Adjustment Clause (ECA) as more fully explained by Mr. Volker. Using the proforma test year, the average bill for an M System Residential class customer will increase by $1.04 per month based on usage of 871 kWh. The rate design and spread of the increase is detailed and supported by the testimony of Michael Volker. The average residential bill for a W System Residential class customer will increase by $6.75 per month based on usage of 912 kWh.

Q: Why does Midwest Energy seek to raise electric rates?

A: When we last filed for an electric rate increase in 2007 we indicated Midwest Energy was in the early stages of a large scale replacement of its electric infrastructure. We've since made substantial progress in that effort, much of which is not yet included in our cost of service. For example, a series of weather-related disasters we endured from 2004 through 2008 triggered a total of $144 million in repair and reconstruction costs to our transmission and distribution system. We are truly fortunate that federal and state government is expected to reimburse us for all but $21.6 million of this cost. But that is still a sizeable addition to rate base for a company our size. Fortunately we are within weeks of finally concluding this rebuilding effort. While those expenditures were unplanned, we've made many planned investments where our system has either grown or aged. Capital expenditures for transmission and distribution are running between $20 and $30 million per year and should remain at this level over our five year planning horizon. We're completing a $6 million project to implement a new, integrated finance, accounting, payroll and customer information system. Our largest new investment, the Goodman Energy Center, is already reflected in rates, but it is possible we will need to construct additional peaking generation in the years ahead, depending on the availability, accessibility and cost of alternate resources. Though generation costs are not a significant component of this rate case, we need to maintain the financial strength necessary to undertake such construction later at a competitive borrowing cost. Finally, we have experienced cost increases for all sorts of things from fuel to medical insurance that exceed what can be recovered through current rates.

Q: How does Midwest Energy help customers faced with paying these higher costs?

A: It should go without saying that Midwest Energy takes no pleasure in proposing this rate increase. In the face of rising energy costs, including the unavoidable but substantial cost increases in wholesale energy we buy from Westar, our best response is to help customers use less energy. We've been successful in these efforts for many years, most noticeably through the How$mart® program. We also strive to provide service more efficiently without sacrificing reliability or customer convenience. This is why, for example, we tied together our 20 customer service representatives located in 8 different offices into a virtual call center several years ago. We improved our phone responsiveness while maintaining a local presence for walk-in customers. Simply by choosing to be the only integrated gas and electric utility left in Kansas we demonstrate our commitment to minimizing costs for our customer-owners. We constantly strive to achieve economies of scale and scope.

Q: Why is the ownership of Midwest Energy by its customers an important factor in this proceeding?

A: Mr. Edwards addresses the meaning and impact of customer-ownership generically in his testimony. I can speak specifically to its impact as the General Manager selected by and accountable to a customer-elected Board of Directors. I am not charged with meeting quarterly earnings expectations from Wall Street or "maximizing shareholder value", however one chooses to interpret that. Beyond making sure we earn enough to reinvest in our business and pay our debts I am not rewarded for increasing margins. Keeping our service affordable isn't a matter of competitive positioning, it's a matter of very real concern for the individuals who pay our bills. All the costs we incur can only be paid with customers' money. It becomes a matter of allocation between different rate classes, between yesterday's customers (retained member equity), today's customers (rates/test year margins) and tomorrow's customers (deferred costs). While the Commission is the ultimate authority over this rate increase, the customers who comprise our Board had to authorize it first. The Board Resolution is included in Section 1 of the Application.

Q: How does this Board Resolution differ from those in previous rate applications?

A: At least during my tenure the Board has consistently targeted achieving a 40% common equity ratio within 8 years. Note that in this application the Board has determined a 35% ratio was appropriate and allowed us 12 years to reach that level.

Q: Why the change?

A: Our Board is concerned about recent increases in wholesale power costs compounded by the impact of our relatively large construction program and other cost increases. They challenged us to determine how we might soften or defer further cost increases. This is a matter of both controlling our budget and determining how we could accept some degree of additional financial risk. Mr. Edwards notes our relatively weak financial position compared to other electric cooperatives. We as management together with our Board took note of the fact that unlike other retail electric cooperatives, Midwest Energy owns significant generation and transmission facilities. Other retail cooperatives usually receive such services from a wholesale generation and transmission cooperative. Such entities tend to have more debt relative to equity than retail cooperatives. And so our Board felt comfortable accepting some additional degree of financial risk by changing its resolution. Note, however, the Board chose not to change the current 20-year target rotation for patronage capital.

Q: Why does Midwest Energy use the term "patronage capital" for equity?

A: Because, as with other cooperatives, Midwest Energy's customers build their equity ownership through their use of our services.

Q: Why does Midwest Energy target a 20 year rotation of patronage capital?

A: Unlike investors in publicly traded utilities, cooperative customers do not receive dividends. They also do not hold fungible shares of stock that can be traded in a liquid market. Midwest Energy's Board, like that of other Kansas cooperatives and cooperatives across the country, believes customers should at some point get their money back, and have it be replaced by margins earned more recently. This ensures that customers currently receiving service are providing the capital for that service. That's why we call it capital rotation. Our 20 year capital rotation cycle, with full payment of capital credits to estates, reflects Midwest Energy's need to balance the risks and lower costs of debt against the financial flexibility and higher cost of equity financing for system replacements, improvements and additions.

Q: Does this conclude your testimony?

A: Yes.