

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

DIRECT TESTIMONY
OF
L. EARL WATKINS, JR.

DOCKET NO. 09-MKEE-____-RTS

1 **Q. Please state your name.**

2 A. My name is L. Earl Watkins, Jr.

3

4 **Q. Are you an officer of Mid-Kansas Electric Company, LLC (“Mid-Kansas”)?**

5 A. Yes, I am the President and Chief Executive Officer of Mid-Kansas and have
6 been since its inception in July 2005.

7

8 **Q. By who are you employed and what is your business address?**

9 A. I am employed by Sunflower Electric Power Corporation (“Sunflower”). My
10 business address is 301 W. 13th Street, Hays, Kansas.

11

12 **Q. What is your present position at Sunflower, how long have you held the
13 position and other positions at Sunflower?**

14 A. I am the President and Chief Executive Officer. I assumed this position on June
15 1, 2004. I was Sunflower’s Executive Vice President and General Counsel from
16 November 2001 until June 2004. Before November 2001, I was in private law
17 practice and was Sunflower’s general counsel for over 20 years.

1

2 **Q. What is Sunflower's relationship with Mid-Kansas?**

3 A. Sunflower provides contract services to Mid-Kansas for all of the generation and
4 transmission activities of Mid-Kansas.

5

6 **Q. What is the purpose of your testimony?**

7 A. The purpose of my testimony is to provide: (1) background information on Mid-
8 Kansas; (2) background and summary information of the Application including
9 the general rate impacts on the Mid-Kansas customers; and (3) a summary of the
10 financial covenants of Mid-Kansas and the reasons for the times interest earned
11 ratio ("TIER") included in the wholesale portion of the Application.

12

13 BACKGROUND INFORMATION ON MID-KANSAS

14 **Q. Please provide an overview of the business of Mid-Kansas.**

15 A. Mid-Kansas is a Kansas limited liability company with its principal place of
16 business located in Hays, Kansas. Mid-Kansas is owned by five Kansas
17 consumer-owned cooperatives and one subsidiary of a consumer-owned
18 cooperative who organized Mid-Kansas for the purpose of acquiring and
19 operating the former Aquila-WPK electric utility business and operations. The
20 five Kansas cooperatives and subsidiary company, collectively referred to as Mid-
21 Kansas Members, and their headquarters are as follows: Lane-Scott Electric
22 Cooperative, Inc., Dighton; Prairie Land Electric Cooperative Association, Inc.,
23 Norton; Victory Electric Cooperative Association, Inc., Dodge City; Western

1 Cooperative Electric Association, Inc., WaKeeney; Wheatland Electric
2 Cooperative, Inc., Scott City and Southern Pioneer Electric Company, a
3 subsidiary of Pioneer Electric Cooperative, Inc., Ulysses. Mid-Kansas was
4 organized in 2005. The five cooperative Members of Mid-Kansas plus Pioneer
5 Electric also own Sunflower Electric Power Corporation.

6
7 **Q. When did Mid-Kansas acquire the Aquila-WPK electric assets?**

8 A. Mid-Kansas was notified that it was the successful bidder for the Aquila-WPK
9 electric assets in September, 2005. On November, 15, 2005, Aquila and Mid-
10 Kansas made a joint filing before the Commission to transfer the Kansas electric
11 assets to Mid-Kansas. On February 23, 2007, the Commission issued an order
12 approving the sale and transfer of the Aquila-WPK electric assets to Mid-Kansas.
13 Mid-Kansas subsequently began operation of those assets on April 1, 2007.

14
15 **Q. Mr. Watkins, please describe the generation and transmission assets**
16 **acquired by Mid-Kansas that are used to provide wholesale electric service to**
17 **the Mid-Kansas Members.**

18 A. Mid-Kansas owns approximately 1,083 miles of transmission line facilities and
19 associated substation facilities which consists of 932 miles of 115 kV, 76 miles of
20 138 kV and 171 miles of 230 kV transmission line and 40 substations. Mid-
21 Kansas owns 389 MW of gas-fired generation which consists of 145 MW at Fort
22 Dodge Station, 99 MW at Great Bend Station, 68 MW at Clifton Station; and 77
23 MW at Cimarron River Station. Additionally, Mid-Kansas has a purchase power

1 agreement for 175 MW of coal-fired capacity from Jeffrey Energy Center and 75
2 MW of wind generation which consists of 50 MW from the Gray County Wind
3 facility and 25 MW from the Smoky Hills Wind Farm facility.

4
5 **Q. You previously said that five of the six Members of Mid-Kansas are**
6 **consumer-owned cooperatives. What does that mean?**

7 A. Five of the Members of Mid-Kansas are non-profit cooperative corporations
8 owned by their customers. All of the electric customers of these Members
9 become owners of the cooperative when they purchase utility service from the
10 cooperative. That is, all year-end revenues in excess of the cooperatives' actual
11 cost of service are allocated to capital accounts for the benefit of the customers,
12 and may be periodically refunded to the customer. In addition, members
13 participate in management oversight of the cooperative by electing its directors.
14 In a cooperative utility, the ratepayers and the owners of the utility are one and the
15 same. There are no competing interests between stockholders who want higher
16 returns and customers who want lower rates and better service.

17
18 **Q. Does this mean that rates are not an issue?**

19 A. No, rates are an issue because cooperative members want low rates like anyone
20 else. However, in a cooperative business model, there are not competing
21 interests between the ratepayer and the owner of the utility as there are in an
22 investor owned utility. In a cooperative, only the customer is benefited if rates

1 exceed the cost of service, so there is no incentive for the cooperative to charge
2 rates in excess of the true cost of service.

3

4 **Q. Are the Members of Mid-Kansas regulated by the Kansas Corporation**
5 **Commission (“Commission”)?**

6 A. Wheatland Electric and Pioneer Electric, the parent company of Southern Pioneer
7 Electric Company, are currently regulated by the Commission. The members of
8 the other cooperatives in Mid-Kansas voted to remove Commission regulation
9 over their rates pursuant to the provisions found in K.S.A. 66-104d. Mid-Kansas
10 is currently fully regulated by the Commission.

11

12 **Q. Are you familiar with the provisions of Senate Substitute for House Bill No.**
13 **2369 passed during the 2009 legislative session and recently signed by the**
14 **Governor?**

15 A. Yes.

16

17 **Q. Does the bill address deregulating entities such as Mid-Kansas and the Mid-**
18 **Kansas Members?**

19 A. Yes, it does. The bill removes the 15,000 customer limitation and amends the
20 definition of “cooperative” as used in K.S.A. 66-104d by including any limited
21 liability company or corporation providing electric service at wholesale in the
22 state of Kansas that is owned by four or more electric cooperatives that provide

1 retail service in the state of Kansas and any member-owned corporation formed
2 prior to 2004.

3

4 **Q. What are the implications of this legislative change to Mid-Kansas and the**
5 **Mid-Kansas Members?**

6 A. First, removal of the 15,000 customer limitation means that all of the Mid-Kansas
7 Members who are cooperatives would be eligible to deregulate. Second, Mid-
8 Kansas, as a limited liability company, owned by four or more cooperatives
9 would be eligible to deregulate. Only Southern Pioneer would not be eligible for
10 deregulation.

11

12 **Q. Does Mid-Kansas and/or the eligible Mid-Kansas Members intend to**
13 **deregulate?**

14 A. The Mid-Kansas board does not at this time intend to submit the issue of
15 deregulation to its Members. At some time in the future, Mid-Kansas anticipates
16 requesting the Commission to allow it to transfer the certified service territory and
17 associated customers to the Mid-Kansas Members at which time Mid-Kansas and
18 the eligible Mid-Kansas Members may consider pursuing a deregulation vote. It
19 is important to note that when the Mid-Kansas retail customers are transferred to
20 Mid-Kansas Members, those Mid-Kansas Members, who currently are
21 deregulated, would require a vote of the transferred Mid-Kansas Member
22 customers on any deregulation initiative as required pursuant to the terms of the
23 Stipulation and Agreement filed in Docket No. 06-MKKEE-524-ACQ.

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OVERVIEW OF THE APPLICATION

Q. Please provide a brief summary of the Application?

A. Basically, Mid-Kansas is requesting implementation of an initial wholesale rate to the Mid-Kansas Members and implementation of divisional retail rates.

Q. What do you mean by divisional rates?

A. Currently, the Mid-Kansas retail customers are served by a single set of retail rates by the six Mid-Kansas Members serving the Mid-Kansas retail customers through the Electric Customer Service Agreement approved by the Commission. In this application, Mid-Kansas is requesting that the Commission approve “divisional rates” for each Mid-Kansas Member based upon the specific cost of service of the retail customers served by the individual Mid-Kansas Members. The divisional rates for each Mid-Kansas Member as applied for herein will result in a change to the current retail rates.

Q. Will rates change for all Mid-Kansas retail customers served through the Mid-Kansas Members?

A. No. The application does not seek the implementation of any changes in the retail rates for the Mid-Kansas customers served by Wheatland Electric. Mid-Kansas intends to adopt the current rates for use with the retail customers served by Wheatland Electric.

1 **Q. Why is there a need for divisional rates?**

2 A. Technically, the retail customers served by the Mid-Kansas Members are Mid-
3 Kansas retail customers, although their primary contact and relationship is with
4 the servicing Mid-Kansas Member. The revenue structure of the current service
5 contracts result in the cost of service for retail customers differing for each Mid-
6 Kansas Member, thereby resulting in the need for a rate specifically applicable to
7 the customers of each individual Mid-Kansas Member. Therefore, until the
8 certified service territory and associated customers are transferred to Mid-Kansas
9 Members, divisional rates are necessitated to insure rates to the retail customers
10 are just and reasonable.

11

12 **Q. When does Mid-Kansas anticipate making application to transfer the**
13 **certified service territory and associated customers to the Mid-Kansas**
14 **Members?**

15 A. Mid-Kansas would like to make this application as soon as possible. However,
16 before it can make this application, Mid-Kansas must have a wholesale rate and
17 power supply agreements in place with each of the Mid-Kansas Members or else
18 Mid-Kansas would be in breach of its loan covenants with its lender. A
19 complicating factor in getting power supply agreements in place is that Mid-
20 Kansas must not only obtain approval of the Mid-Kansas lender, but because of
21 the Mid-Kansas Members relationship with the Rural Utilities Service (RUS), it
22 must also obtain approval of RUS, which may take up to two years though we
23 hope approval will be much quicker than that.

1

2 **Q. What wholesale rate related relief is Mid-Kansas requesting?**

3 A. Mid-Kansas is requesting the Commission approve a wholesale rate to the Mid-
4 Kansas Members; approve modified ECA rates; approve changes in the Mid-
5 Kansas OATT and rates contained therein; and approve modifications to rates for
6 transmission service to KEPCo.

7

8 **Q. Does Mid-Kansas currently have a wholesale rate it charges the Mid-Kansas**
9 **Members?**

10 A. No. Because Mid-Kansas is technically a vertically integrated company and the
11 rates charged to the retail customers are those previously approved by the
12 Commission in January 2005 for a test year ending in 2003 Mid-Kansas currently
13 charges power costs to its Members by calculating the revenue needed to meet
14 expenses and minimum financial ratios and then allocates these costs to the Mid-
15 Kansas Members.

16

17 **Q. Why does Mid-Kansas wish to change this methodology?**

18 A. Primarily, we view the development of a wholesale rate to the Mid-Kansas
19 Members as a pre-cursor to transferring the certified service territory. Once the
20 wholesale and divisional rates are approved and the wholesale power supply
21 agreements in place, the process of transferring the certified service territory to
22 the Mid-Kansas Members will be a fairly simple and straightforward process.
23 Also, the implementation of a wholesale rate will reflect a more traditional rate

1 structure between a retail distribution electric supplier and a generation and
2 transmission company (G&T) wholesale electric supply, which is the structure
3 under which the Mid-Kansas Members and Mid-Kansas wish to eventually
4 operate.

5

6 **Q. What is the rate impact to the Mid-Kansas retail customers being served by**
7 **the Mid-Kansas Members?**

8 A. The proposed retail rates will generate approximately \$16.4 million in additional
9 revenue which includes the wholesale power increase to the five affected
10 divisional Mid-Kansas Members. This translates to an approximate 11.7%
11 increase in retail rates affecting 5 of the 6 Mid-Kansas Member divisions.

12

13 **Q. Please elaborate on the wholesale power increase your previously mentioned.**

14 A. As previously stated, a portion of the retail rate increase is related to the
15 wholesale power cost increase incorporated in this application. Mid-Kansas is
16 requesting approximately \$10.0 million of wholesale Member revenue over the
17 pro form test year amount in the Application, of which \$6.9 million would be
18 recovered through wholesale sales to the Mid-Kansas Members, including the
19 Wheatland Electric division, with the balance being recovered from third-party
20 transmission customers.

21

22 OVERVIEW OF MID-KANSAS FINANCIAL COVENANTS

23 **Q. Mr. Watkins, where can the financial covenants of Mid-Kansas be found?**

1 A. The Mid-Kansas financial covenants are found in the Loan Agreement with the
2 National Cooperative Services Corporation (“NCSC”).

3

4 **Q. Who is NCSC?**

5 A. NCSC is a subsidiary of National Rural Utilities Cooperative Finance Corporation
6 (“CFC”), formed by CFC to service loans to non-coop entities that are owned by
7 cooperatives.

8

9 **Q. What are the specific financial covenants with respect to TIER, DSC and**
10 **Equity Ratio?**

11 A. With respect to TIER and DSC, Mid-Kansas is required to maintain a minimum
12 TIER and DSC of 1.10 calculated on a rolling four quarter basis. Mid-Kansas also
13 has minimum equity ratio requirements which are 2.5% for calendar years 2012
14 through 2016; 5.0% for calendar years 2017 through 2021; and 10.0% for
15 calendar year 2022 and thereafter.

16

17 **Q. What if Mid-Kansas fails to meet the aforementioned financial ratios?**

18 A. Mid-Kansas must notify NCSC of its failure to meet any of the minimum required
19 financial ratios and, in consultation with NCSC, develop a plan within 30 days
20 that sets forth the actions needed to achieve the minimum financial ratios. Should
21 Mid-Kansas be unable to meet the minimum financial ratios, the lender may
22 declare the loan in default.

23

1 MID-KANSAS WHOLESale TIER

2 **Q. Mr. Watkins, do you know what financial ratios are used to develop the**
3 **proposed rates for Mid-Kansas in this application?**

4 A. Mid-Kansas used an operating TIER of 1.5 in developing its revenue requirement
5 for the proposed wholesale rates. The Mid-Kansas Member divisional rates were
6 developed utilizing a 2.2 operating TIER which will be addressed by Rich Macke
7 who is sponsoring the Mid-Kansas Member divisional rates.

8

9 **Q. Why does Mid-Kansas require a TIER greater than the minimum TIER**
10 **required in its financial covenants?**

11 A. There are several reasons why Mid-Kansas needs to utilize a TIER greater than
12 the minimum TIER. First, a higher TIER would support Mid-Kansas' current and
13 future credit needs by providing creditors assurance that interest and principal and
14 credit on debt can be paid. Second, a higher TIER provides Mid-Kansas the
15 opportunity to build equity and meet the equity requirements contained in the
16 financial covenants.

17

18 Third, the higher TIER requested provides a "cushion" for Mid-Kansas to meet its
19 minimum required financial ratios due to events such as unanticipated cost
20 increases, economic downturns, unfavorable weather, and unbudgeted costs.

21

22 Finally, a higher TIER provides short-term support for new financing needs for
23 capital additions and new regulatory initiatives such as a hedge program.

1

2 **Q. Do you believe that Mid-Kansas' request for a 1.5 TIER is reasonable?**

3 A. Yes.

4

5 **Q. What is your basis for this opinion?**

6 A. A comparison of G&T cooperatives provides a substantial amount of support for a
7 1.5 TIER.

8

9 **Q. Is a comparison of G&T cooperatives to Mid-Kansas appropriate?**

10 A. Yes. Even though Mid-Kansas is technically not a G&T cooperative, the service
11 to the retail customers under contract with the Mid-Kansas Members and
12 formation of a wholesale rate will essentially mirror the typical G&T structure
13 under which Mid-Kansas and the Mid-Kansas Members seek to operate.
14 Therefore, the requested 1.5 TIER for Mid-Kansas is applicable and appropriate

15 **Q. Please summarize the results of the comparison with other G&T
16 cooperatives.**

17 A. Based on 2007 operating results as published in the June 2008 G&T Accounting
18 and Finance Association Annual Directory, the average TIER for the 51 reporting
19 G&T was 1.98; the median TIER was 1.48; for comparable employee sized G&T
20 cooperatives (200 to 400 employees) the average TIER was 1.47; for G&T
21 cooperatives whose member sales ranged from 1.6 to 2.7 million megawatt hours
22 the average TIER was 1.52; and for G&T cooperatives having less than 10%

1 equity the TIER was 1.43. Mid-Kansas had Member sales of 2.04 million
2 megawatt hours in 2008.

3

4 **Q. Do you have any other observations supporting the Mid-Kansas request for a**
5 **1.5 TIER?**

6 A. Yes, there are a couple of other observations I would like to make. First, a 1.5
7 TIER for the Mid-Kansas G&T business is appropriate because the operating
8 history for Mid-Kansas is limited, thus making it more difficult to anticipate the
9 “normal” level of variation in operating results. A 1.5 TIER would give some
10 level of protection to Mid-Kansas for achieving its required financial ratio.

11

12 Second, I would like to point out that the financial covenants of Mid-Kansas are
13 more restrictive than other G&T type organizations. For example, Sunflower’s
14 financing documents requires that it achieve a minimum TIER of the best two out
15 of three years while as previously noted the Mid-Kansas TIER requirement is
16 based on a rolling four quarter calculation.

17

18 **Q. In summary what are the actions Mid-Kansas is requesting of the**
19 **Commission?**

20 A. As stated in the Application, Mid-Kansas is requesting approval of the following
21 documents.

- 22 • Wholesale rate for sales from Mid-Kansas to the Mid-Kansas Members.
- 23 • Modification of the OATT rates.

- 1 • An ECA for use with wholesale sales to the Mid-Kansas Members.
- 2 • An ECA for Wheatland Electric for use with sales made to Mid-Kansas
- 3 retail customers served by Wheatland Electric.
- 4 • Modified transmission service schedule 88-TSV-1 associated with the
- 5 contract between KEPCo and Mid-Kansas.
- 6 • Divisional retail rates for Mid-Kansas retail customers served by the Mid-
- 7 Kansas Members (with the exception of Wheatland Electric) that reflect
- 8 the appropriate allocation of the cost of service of providing retail electric
- 9 service to the Mid-Kansas customer served by the respective Mid-Kansas
- 10 Member. Local access charge for each of the Mid-Kansas Members (with
- 11 the exception of Wheatland) for third-party use of the respective Mid-
- 12 Kansas Member's 34.5 kV system

13 Additionally, Mid-Kansas is requesting the Commission confirm that all of

14 the transmission facilities of Mid-Kansas meet the criteria of SPP-OATT

15 Attachment AI as discussed in the direct testimony of Noman Williams.

16

17 **Q. Mr. Watkins, you previously indicated that Mid-Kansas was not seeking a**

18 **change in retail rates for the Wheatland Electric Division and that Mid-**

19 **Kansas is seeking to adopt the current Mid-Kansas rates for the Wheatland**

20 **Electric division at the present time. Why isn't Mid-Kansas seeking to**

21 **modify the Wheatland Electric division's rate structure?**

22 A. Each of Mid-Kansas divisions essentially operates autonomously from Mid-

23 Kansas and the other Mid-Kansas Members through the service agreement

1 between Mid-Kansas and the Mid-Kansas Members previously approved by the
2 Commission. Through this service agreement each Mid-Kansas Member is
3 responsible for providing service to the Mid-Kansas' customers in their respective
4 areas. Additionally, the source of revenue used to service each Mid-Kansas
5 Members debt and operating cost is derived from the Mid-Kansas retail rates. I
6 can't comment on Wheatland Electric's financial position as it pertains to Mid-
7 Kansas. However, Wheatland Electric has asked Mid-Kansas not to adjust the
8 retail rate structure for the Mid-Kansas area served by Wheatland but rather that
9 Mid-Kansas continue to utilize the current rate structure for the Wheatland
10 Electric division.

11 **Q. Does this conclude your testimony?**

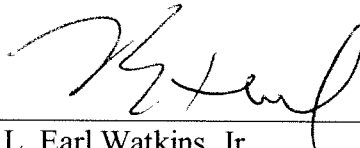
12 A. Yes.

13

VERIFICATION OF L. EARL WATKINS, JR.

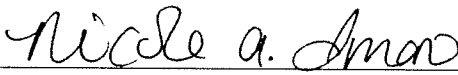
STATE OF KANSAS)
) ss:
COUNTY OF ELLIS)

L. Earl Watkins, Jr., being first duly sworn, deposes and says that he is L. Earl Watkins, Jr. referred to in the foregoing document entitled "Direct Testimony of L. Earl Watkins, Jr." before the State Corporation Commission of the State of Kansas and that the statements therein were prepared by him or under his direction and are true and correct to the best of his information, knowledge and belief.



L. Earl Watkins, Jr.

SUBSCRIBED AND SWORN to before me this 12th day of June, 2009.



Notary Public

My Appointment Expires: 11/05/12

