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Kansas Corporation Commission
/S/ Susan K. Duffy

STATE CORPORATION COMMISSION

DEC 21 2007

BEFORE THE

 Docket
Room

KANSAS CORPORATION COMMISSION

PREPARED DIRECT TESTIMONY OF

EARMEST A. LEHMAN

ON BEHALF OF

MIDWEST ENERGY, INC.

DIRECT TESTIMONY OF EARNEST A. LEHMAN

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

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

16 **Q: What is the purpose of your testimony?**

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

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

1 A: Based on a pro forma test year ending June 30, 2007 and including the complete
2 integration of all nine units of the Goodman Energy Center (GMEC), Midwest Energy
3 proposes to increase base rate revenues collected from M and W System customers by
4 \$10.0 million, an approximate 10.5% increase. Midwest Energy proposes the rate
5 increase take effect when all nine units of GMEC have entered commercial service in
6 September 2008. The revenue requirement is detailed and supported by the testimony
7 of Tom Meis, Midwest Energy's Chief Financial Officer, with support for the cost of
8 member-provided equity given by the testimony of William K. Edwards of the
9 National Rural Utilities Cooperative Finance Corporation (CFC).

10 **Q: What is the total revenue requirement supported by Mr. Meis?**

11 A: \$107,857,327.

12 **Q: Including the full proposed increase, how much revenue will Midwest Energy**
13 **collect?**

14 A: \$107,856,558.

15 **Q: What does the difference of \$769 represent?**

16 A: Minor rounding differences in rate design.

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

19 A: Using the pro forma test year, the average bill for an M System Residential class
20 customer will increase by \$12.99 per month based on usage of 851 kWh. The average
21 bill for a W System Residential class customer will increase by \$13.09 per month

1 based on usage of 855 kWh. The rate design and spread of the increase is detailed
2 and supported by the testimony of Michael Volker.

3 **Q: Who else is pre-filing direct testimony with respect to this application?**

4 A: Gary Vicinus, Vice President of Pace Global Energy Services, LLC will describe our
5 Risk Integrated Resource Plan (RIRP) and the supporting role of wind energy. Gary
6 Groninger, Senior Project Manager with Burns & McDonnell, details the RFP process
7 that followed development of our RIRP. Mr. Groninger explains how Midwest
8 Energy came to build GMEC and how it fits into Midwest Energy's power supply
9 portfolio. Ted Kelly, a Principal with Burns & McDonnell, will describe the
10 condition of Midwest Energy's other generating units and their suitability for
11 continued use. William Dowling, Vice President of Energy Management and Supply,
12 will testify to the classification of transmission assets. Finally, H. Edwin Overcast,
13 Director with Black & Veatch Corporation, provides information and support for
14 Midwest Energy's proposed Transmission Service Charge Adjustment.

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

16 A: Midwest Energy is in the early stages of a large scale replacement of its electric
17 infrastructure. Most obviously, our power supply contracts are expiring. By June 1,
18 2008 only one of Midwest Energy's current long-term Purchase Power Agreements
19 will remain in effect. That agreement, for 125 MW of coal-fired capacity from
20 Westar Energy, will expire June 1, 2010. After a generation of increasing reliance on
21 other utilities, Midwest Energy now sees tangible and intangible benefits from
22 providing at least some of its own peaking energy needs. We are also making major

1 investments in our transmission system with years more work ahead. And although
2 we are proud of our reliability record, it is also increasingly evident that our
3 distribution system is aging to the point where significant maintenance and
4 replacement is required. Three recent winter storms (November 2005, New Years
5 weekend at the end of 2006 and December 2007) plus the May 2007 Greensburg
6 tornado (which entered Midwest Energy service territory shortly after leveling the
7 town) wreaked havoc with large portions of our system. We are still assessing the
8 damage from the December 2007 storm and its costs are not reflected in this filing.
9 Even with the significant financial and technical assistance available through FEMA
10 and the Kansas Division of Emergency Management, these storms trigger significant
11 unplanned investments. Fortunately, Midwest Energy's electric customers have
12 benefited for many years from our ability to capture efficiencies and achieve
13 economies of scale. Since 1989 Midwest Energy's base electric rates have declined
14 once (\$420,000 in 2000) and increased once (\$600,000 in 2003) for a net impact of
15 \$180,000 per year. This is less than 0.2% of test year revenues under current rates.
16 Unfortunately, recent and near-term projected cost increases mean we can no longer
17 hold the line on electric rates. Even with continuing modest sales growth, expenses
18 are increasing faster.

19 **Q: How have Midwest Energy's construction projects contributed to this rate**
20 **request?**

21 **A:** Construction projects are the main driver for this rate request. GMEC is the single
22 largest component. While GMEC is a cost-effective addition to Midwest Energy's

1 generating resources, it is still costly when compared to our heavily depreciated, older
2 power plants. We recently upgraded the operating voltage on the transmission line
3 connecting Hays and Great Bend (the Knoll-Heizer line) from 115 kV to 230 kV at a
4 cost of \$6.6 million. This project will improve reliability across much of our service
5 territory. Additionally, Midwest Energy has made large investments in improving
6 service to customers formerly served by Westar (the W System). Since acquiring
7 these properties in August 2003, Midwest Energy conservatively estimates it has
8 invested \$6.7 million in new facilities. This investment will grow exponentially after
9 the December 2007 ice storm. For examples of our work so far, we have replaced and
10 upgraded a critical transmission transformer, replaced a 60 year-old relay system,
11 grounded 22 miles of 34.5 kV transmission lines and provided overhead shielding on
12 these lines. We constructed a new warehouse/garage and a new relay building. All of
13 these examples pertain only to Rice County.

14 **Q: How have material, equipment and labor costs contributed to this rate request?**

15 A. In general, costs of material and equipment have soared in the last several years,
16 particularly in the aftermath of Hurricanes Katrina and Rita in 2005. Single phase,
17 pole-mounted transformers have gone up 44% in cost since 2004. Distribution poles
18 cost 29% more than they did three years ago. Finally, wage and related benefit costs
19 have increased thanks to a growing shortage of employees in many of our skilled
20 professions and continued escalation in the cost of health care.

21 **Q: Other than building generation, is Midwest Energy embarking in any new**
22 **directions?**

1 A: Yes, it is. Midwest Energy recently completed an Energy Efficiency Potential Study.
2 New programs are being designed consistent with the greatest areas of potential. Also
3 consider the launch, with our thanks for Commission support, of the How\$martSM
4 program and expanded efficiency efforts, covered in some detail by Mr. Volker's
5 testimony. This important new program and additional programs being developed in
6 concert with our older established energy efficiency and conservation programs,
7 signals Midwest Energy's increasing emphasis on minimizing customer bills, and not
8 necessarily having the lowest rates. More subtly, customers will have more choices in
9 how and when they will choose to consume energy. Midwest Energy will further
10 engage its customers in efforts to limit costs, and to limit the impact of their energy
11 use on the environment. We often forget that the choices we make in the buildings
12 where we live and work can be as significant to the environment as how we control
13 emissions from power plants and what vehicles we drive.

14 **Q: How else will Midwest Energy demonstrate environmental stewardship?**

15 A: Throughout history we have focused on the direct environmental impact of the
16 materials and equipment installed in our system. We stabilized or removed asbestos.
17 We monitored and replaced transformers with PCB's. We worked to reduce oil spills.
18 We did many day-to-day things which we will continue doing. But the world is
19 changing, and we all are becoming more aware of the links between energy, the
20 environment and economics. One cannot make a choice in one of these three areas
21 without a significant effect on the other two. This is one reason why Midwest Energy
22 is increasing its use of wind energy, even when such energy may displace cheaper

1 fossil-fueled resources. This is also one reason why we chose to construct GMEC. It
2 is both an efficient and clean generating resource. And this is a key reason why we
3 support the construction of both the Holcomb 2 power plant (for which no costs are
4 included in this rate case) and efforts to minimize its environmental impact. In
5 addition to these changes in how we run our business, Midwest Energy will play a
6 greater role in providing environmental information to its customers and in helping
7 customers understand the costs of various environmental choices. Make no mistake,
8 our expertise lies in energy. We are not environmental experts. But we do recognize
9 our responsibility to consider the environmental effects of the energy decisions we
10 make.

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

13 A: Given my career working for investor-owned utilities and formerly as one of their
14 regulators, I am in a unique position to appreciate the irony of applying the standard
15 regulatory model to a customer-owned cooperative. Mr. Edwards addresses the
16 meaning and impact of customer-ownership generically in his testimony. Midwest
17 Energy respects the Commission's statutory and regulatory authority and the expertise
18 that Staff and interveners bring to the table. But in the end it is all the customers'
19 money and simply a matter of allocation between different rate classes, between
20 yesterday (retained member equity), today (rates/test year margins) and tomorrow
21 (deferred costs). Midwest Energy's management has no incentive to inflate or drive
22 up the costs of serving customers. They pay us. The Board they elect holds us

1 accountable for providing efficient and reliable service at a competitive cost. While
2 the Commission is the ultimate authority over this rate increase, the Board had to
3 authorize it first. The Board Resolution is included in Section 1 of the Application.

4 **Q: Why does Midwest Energy use the term “patronage capital” for equity?**

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

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

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

18 **Q: Does this conclude your testimony?**

19 A: Yes.