

BEFORE THE CORPORATION COMMISSION
OF THE STATE OF KANSAS

STATE CORPORATION COMMISSION

DEC 11 2006

 Docket
Room

IN THE MATTER OF THE JOINT]
APPLICATION OF AQUILA, INC. d/b/a]
AQUILA NETWORKS – WPK (“WPK”)]
MID-KANSAS ELECTRIC COMPANY, LLC]
 (“MKEC”), JOINT APPLICANTS, FOR]
AN ORDER APPROVING THE TRANSFER]
TO MKEC OF WPK’S CERTIFICATES]
OF CONVENIENCE AND FRANCHISES]
WITH RESPECT TO ALL OF WPK’S]
KANSAS ELECTRIC BUSINESS,]
INCLUDING ITS GENERATION,]
TRANSMISSION AND LOCAL]
DISTRIBUTION FACILITIES LOCATED]
IN THE STATE OF KANSAS, AND FOR]
OTHER RELATED RELIEF]

KCC Docket No. 06-MKEE-524-ACQ

CROSS-ANSWERING TESTIMONY OF

ANDREA C. CRANE

ON BEHALF OF

THE CITIZENS’ UTILITY RATEPAYER BOARD

December 11, 2006

1 **Q. Please state your name and business address.**

2 A. My name is Andrea C. Crane and my business address is One North Main Street,
3 P.O. Box 810, Georgetown, Connecticut 06829.

4
5 **Q. Did you previously file testimony in this proceeding?**

6 A. Yes, on November 22, 2006, I filed Direct Testimony on behalf of the Citizens'
7 Utility Ratepayer Board ("CURB") relating to the proposed acquisition of Aquila
8 Networks-WPK ("WPK") by Mid-Kansas Electric Company, LLC ("MKEC").
9 In my Direct Testimony, I outlined several concerns that CURB has with regard
10 to the proposed transaction and discussed a series of safeguards that the Kansas
11 Corporation Commission ("KCC") should adopt if it decides to approve the
12 proposed sale.

13

14 **Q. What is the purpose of your Cross-Answering Testimony?**

15 A. The purpose of my Cross-Answering Testimony is to respond to three
16 recommendations by KCC Staff in its Direct Testimony. Specifically, I will
17 address the following Staff's recommendations:

18 ➤ Mr. Holloway's recommendation that all of the acquisition
19 premium be spun-down to the distribution companies;

20 ➤ Mr. Dittmore's recommendation that MKEC's request for a five-
21 year rate freeze be denied;

22 ➤ Mr. Dittmore's recommendation that the MKEC members be
23 permitted to request recovery of the acquisition premium for a

1 period of 30 years, provided they can demonstrate offsetting
2 savings.

3 ➤ Mr. Dittmore’s proposal that actual lease costs associated with the
4 Jeffrey Energy Center be included in cost of service.

5 Each of these proposals would be harmful to ratepayers. Moreover, Mr.
6 Dittmore’s proposal for a thirty-year recovery period for the acquisition premium
7 adds tremendous complexity to an already complex transaction and, from a
8 practical perspective, would be virtually impossible to implement.

9

10 **Q. Please describe Mr. Holloway’s recommendation that the entire acquisition**
11 **premium be spun-down to the distribution companies.**

12 A. Mr. Holloway’s recommendation would assign 100% of the acquisition premium
13 to the distribution assets that are being acquired, and none of the acquisition
14 premium to the transmission or generation assets. Mr. Holloway’s proposal has
15 the potential to increase rates to customers and is not supported by the record in
16 this case. If the KCC decides that the acquisition premium should be spun-down
17 from MKEC, then the distribution companies should receive the acquisition
18 premium associated with distribution assets and Sunflower Electric Power
19 Corporation (“Sunflower”) should receive the acquisition premium associated
20 with transmission and generation assets.

21

22

23

1 **Q. What is Mr. Holloway’s rationale for assigning the entire acquisition**
2 **premium to the distribution assets?**

3 A. As noted on page 9 of his Direct Testimony, Mr. Holloway explains that FERC
4 does not allow recovery of acquisition premiums in FERC-approved transmission
5 rates. As noted by Mr. Holloway, “Staff has advocated in previous Sunflower
6 cases, and the Commission has agreed, to similar treatment of transmission
7 access, rates, and rate design to that implemented by FERC, and traditionally
8 FERC does not allow recovery of AP [acquisition premium] in FERC-approved
9 transmission rates.” Thus, Staff’s first concern appears to be that assigning some
10 of the acquisition premium to the transmission and generation assets will result in
11 MKEC members being unable to recover these amounts. Rather than ensuring
12 full recovery of the acquisition premium by the MKEC members, I believe that a
13 more critical issue is why Staff believes that any acquisition premium should be
14 recoverable from ratepayers, when FERC clearly does not allow this practice.

15 Mr. Holloway then states on page 9 of his Direct Testimony that “MKEC
16 has indicated to Staff that there is little, if any, excess of net book value for
17 MKEC’s aging generation fleet” and that Staff agrees. However, he offers no
18 supporting study or quantitative analysis or any other substantive evidence for his
19 conclusion. In fact, the evidence in the record is contrary to Staff’s position. The
20 financing for this transaction is fairly evenly split between the distribution assets
21 and the generation and transmission assets. Mr. Holloway’s testimony suggests
22 that MKEC, and the other bidders, would have included the same acquisition
23 premium in their bids, even if there were no transmission or generation assets

1 included in the sale. I think this assumption is highly unlikely. In any event,
2 there is nothing in the record in this case to demonstrate that the transmission and
3 generation assets were not considered valuable enough by the bidders to have
4 some influence on the level of the acquisition premium.
5

6 **Q. How will Mr. Holloway's proposal harm ratepayers?**

7 A. Mr. Holloway's proposal will harm ratepayers because it makes them potentially
8 responsible for a larger share of the acquisition premium than they would be if the
9 acquisition premium were allocated between distribution and transmission and
10 generation functions. As noted, is not likely that Sunflower would be permitted to
11 recover any of the acquisition premium, since FERC policy prohibits such
12 recovery. Therefore, any acquisition premium allocated to the transmission and
13 generation function would be ineligible for recovery. By allocating the entire
14 acquisition premium to the distribution companies, Mr. Holloway's proposal
15 makes more of the acquisition premium potentially recoverable from ratepayers.
16

17 **Q. Turning to the issue of the rate freeze and recovery of the acquisition
18 premium, what did MKEC propose with regard to these issues?**

19 A. MKEC proposed a five-year rate freeze for base rates. Fuel and purchased power
20 costs would continue to be recovered during this period through the Energy Cost
21 Adjustment ("ECA") mechanism. During this five-year period, MKEC estimates
22 that savings resulting from the transaction will be greater than the total acquisition
23 premium. MKEC left open the possibility of filing for recovery of a portion of

1 the acquisition premium after the five-year rate freeze expires, provided that it
2 could demonstrate that it had achieved savings in excess of the acquisition
3 premium. However, by MKEC's own estimate, the MKEC members should
4 recover the full acquisition premium during the rate freeze period.

5

6 **Q. What did CURB recommend in its Direct Testimony?**

7 A. CURB supports the Company's proposed five-year rate freeze. In addition, since
8 the Company has estimated that cost savings during this five-year period will be
9 greater than the acquisition premium, CURB recommends that the proposed
10 transaction be approved subject to the condition that MKEC will not seek
11 recovery of any additional acquisition premium in rates once the rate freeze
12 expires.

13

14 **Q. Why does Mr. Dittmore recommend that the KCC address the issue of the**
15 **acquisition premium in this case?**

16 A. On page 3 of his Direct Testimony, Mr. Dittmore states that the "...Commission
17 is not required to make determinations concerning the recoverability of the AP
18 costs...in this application..." However, Mr. Dittmore goes on recommend that
19 the Commission address this issue at this time. According to Mr. Dittmore,
20 "Staff believes that a hindsight review of transaction savings, conducted to
21 determine the appropriate treatment of AP costs, is difficult and may not result in
22 a meaningful analysis."

23

1 **Q What is Mr. Dittimore's recommendations with regard to these issues?**

2 A. Mr. Dittimore recommends that the KCC reject MKEC's proposed five-year rate
3 freeze. In addition, Mr. Dittimore recommends that the acquisition premium be
4 amortized over a period of thirty-years, and that MKEC be permitted to recover
5 the acquisition premium in rates, to the extent that it can demonstrate cost savings
6 relating to the acquisition. Mr. Dittimore's recommendation would require the
7 same type of "hindsight review of transaction savings" that he states in his
8 testimony "may not result in a meaningful analysis."
9

10 **Q. Why are you opposed to Mr. Dittimore's recommendations?**

11 A. I am opposed for many reasons. Mr. Dittimore's recommendations greatly
12 complicate the transaction in a number of ways. First, by opposing the rate
13 freeze, Mr. Dittimore leaves open the possibility of a base rate change
14 immediately. There are three possible outcomes of such a rate change. One, the
15 MKEC members could request an increase in base rates for the WPK customers.
16 Under that scenario, ratepayers would be worse off than under MKEC's proposal.
17 Two, the MKEC companies could decide not to file for a rate change, even
18 though they have the right to do so. In that case, ratepayers are basically just
19 where they would be if MKEC's five-year rate freeze proposal was approved.
20 Three, MKEC could seek to reduce rates, or the KCC could seek to reduce the
21 rates of one or more of the MKEC members. Realistically, the KCC has to ask
22 itself, is it more likely that MKEC would ask for an increase during this five-year
23 period, or that MKEC (or Staff) would seek a rate decrease? Based on over

1 twenty years of experience in utility regulation, I contend that the former is more
2 likely than the latter. In the absence of a base rate freeze, ratepayers have a much
3 better chance of ending up with a rate increase rather than a rate decrease at some
4 point during the first five years.

5 Moreover, since, as noted by Mr. Dittmore, the customers of the MKEC
6 members are ultimately the shareholders as well, since the customers are the
7 owners of the cooperatives. Therefore, this same pool of customers will
8 ultimately be paying the acquisition premium in any case. Mr. Dittmore
9 proposes a complex analysis that will be required for the next 30 years in order to
10 determine what portion, if any, of the acquisition premium should be recovered in
11 utility rates. I propose a less complex methodology, to have the
12 owner/shareholders absorb the acquisition premium without it being reflected in
13 utility rates. The result should be the same for the cooperatives members, but my
14 recommendation eliminates thirty years of regulatory haggling over the issue of
15 cost savings.

16 In addition, theoretically, it is the owner/shareholders that have decided to
17 incur this acquisition premium, based on their estimate of transaction savings.
18 According to MKEC, those savings are sufficient to cover the acquisition
19 premium during the first five years following the acquisition. The KCC should
20 hold MKEC accountable for its saving estimates. The savings estimated by
21 MKEC during the first five years of the transaction are more than 2 ½ times the
22 proposed acquisition premium. MKEC's projected savings in just Administrative

1 and General costs and taxes are sufficient to cover the acquisition premium.¹

2 Once the assets are spun-down, at least four of the six distribution companies will
3 be regulated.² Instead of adopting a convoluted methodology that will require the
4 calculation of cost savings in every rate case filed by at least these four regulated
5 entities over the next thirty years, I believe that it makes much more sense to hold
6 MKEC accountable for its saving estimates by freezing base rates for five years,
7 allowing MKEC to recover the acquisition premium during this period, and
8 prohibiting further recovery of the acquisition premium through rates once the
9 rate freeze is over.

10
11 **Q. Why is it especially difficult to measure cost savings in this case?**

12 A. The measurement of cost savings is always difficult. Moreover, it is always more
13 difficult, and less reliable, the further removed the analysis is from the acquisition
14 date. Under Mr. Dittmore's proposal, the parties would need to determine what

1 WPK's rates include a significant income tax expense, even though Aquila, Inc. has realized large income tax benefits (negative expense) in recent years. Thus, one of the "benefits" of the proposed transaction is that ratepayers will no longer be paying for income taxes that they should not have been paying, and Aquila has not paid, in the first place.

Since the KCC has not yet adopted consolidated income tax adjustments, it has permitted Aquila to collect in rates millions of dollars of income tax expense that Aquila has never paid, and that will never be paid, to the Internal Revenue Service ("IRS"). Given tax losses by Aquila, it is even questionable whether the IRS will recapture the accumulated deferred income taxes ("ADIT") discussed on pages 23-25 of Mr. Dittmore's testimony. To the extent that the IRS does not recapture these taxes, then the ADIT balance of \$44.1 million, which was paid for by WPK customers, will be transferred to shareholders.

Regarding the anticipated reduction in administrative and general costs, in testimony filed in Docket No. 99-WPEE-818-RTS, CURB expressed its concerns about the high level of administrative costs allocated to WPK once it was acquired by Utilicorp United, Inc., now Aquila. CURB likened these costs to a "negative saving" from that merger. In the current transaction, the reduction in administrative and general costs (the negative merger savings from the prior transaction) is now being claimed as a benefit of this transaction and used as justification for recovery of the acquisition premium.

2 Potentially the WPK customers allocated to all six distribution companies will be regulated, if the KCC adopts Staff's recommendation to require the Lane Scott and Western customers to vote affirmatively for deregulation and such an affirmative vote does not occur.

1 the transaction savings are five, ten, twenty, even thirty years after the acquisition
2 has occurred. No one can definitively determine that long after the fact what the
3 revenue requirement for WPK ratepayers would have been had the acquisition not
4 occurred. There are simply too many changes that will occur in the industry, in
5 the market, in the economy in general, in technology, in fuel markets, in every
6 aspect for any party to be able to make such a calculation with accuracy. We are
7 deluding ourselves if we believe that a meaningful calculation can be made that
8 long after the acquisition has occurred.

9 However, in this case, this difficult exercise becomes still further
10 complicated by the fact that the WPK assets will be distributed into six different
11 distribution companies, with different work rules, different organizational
12 structures, different practices, different tax structures, different cost centers, and
13 different rates. In addition, each of those six entities may have two different sets
14 of rates, one for existing customers and one for the acquired WPK customers. It
15 is sheer folly for Mr. Dittmore to suggest that he, or anyone, can accurately
16 measure acquisition savings at each of the six distribution companies many years
17 after the acquisition has occurred. While it is always difficult to measure merger
18 savings, in this case it will be virtually impossible. The WPK distribution assets
19 will be spread among six different entities. Five of the entities are tax-free and
20 one is taxable. Moreover, the cooperatives may maintain two rate schedules, at
21 least for some point in time.

22

23

1 **Q. Are you proposing that the five-year rate freeze be extended to the existing**
2 **customers of the MKEC members?**

3 A. Not necessarily. However, the KCC should ensure that the existing customers of
4 MKEC members are not harmed by the proposed transaction. It would be
5 unconscionable for the MKEC members to agree to a rate freeze for the WPK
6 customers, and then turn around and request significant increases from their
7 existing customer base in the event that estimated savings do not materialize. In
8 my Direct Testimony, I stated that the existing customers of MKEC members
9 should not be harmed due to the high leverage that will result from this
10 transaction. Similarly, the existing customers should not be harmed due to higher
11 than anticipated operating costs once the transaction is complete. Any rate
12 changes proposed for existing customers of the MKEC members should be fully
13 supported based on financial conditions absent the proposed transaction.

14
15 **Q. Please comment on Mr. Dittmore’s testimony on page 12 where he states**
16 **“[i]t is not unusual for regulators to assign the costs associated with an AP to**
17 **be shared between ratepayers and shareholders.”**

18 A. Mr. Dittmore’s statement ignores that fact that, in many acquisition cases,
19 shareholders are responsible for all of the costs of the acquisition premium.
20 While I recognize that in Kansas this Commission has permitted recovery of
21 acquisition premiums in certain cases, this is certainly not the norm. As
22 acknowledged by Mr. Dittmore, FERC routinely disallows acquisition premiums

1 and I have been involved in many merger proceedings where the parties did not
2 seek, or agreed to forego, recovery of any acquisition premium.

3

4 **Q. Please comment on Mr. Dittmore’s statement on page 28 of his testimony**
5 **that excluding certain acquisition premium costs from rates “will likely have**
6 **negative financial implications for MKEC and its member owners...”.**

7 A. No one forced MKEC to bid for the WPK assets. The decision to pursue
8 acquisition of these assets, and at what price, was made by the MKEC members
9 based on their estimate of available cost savings. Moreover, their own estimate is
10 that cost savings during the first five years of operations will be more than
11 sufficient to cover the cost of any acquisition premium. If the MKEC members
12 believed that the purchase price would have negative financial implications for
13 their operations, then the companies should not have bid as high as they did for
14 WPK. The MKEC members engaged a well-known and experienced consulting
15 firm to assist them in evaluating the financial impacts of this transaction. They
16 made an informed bid for the assets, based on that expertise and advice. The
17 KCC should rely upon the same cost savings estimates that the MKEC members
18 relied upon when MKEC bid for the assets, and conclude that cost savings during
19 the first five years will provide for recovery of the acquisition premium.

20

21

22

1 **Q. Please comment on Mr. Dittimore's recommendation that the entire lease**
2 **cost included in the Westar Purchased Power Agreement ("PPA") should be**
3 **recovered in rates.**

4 A. Mr. Dittimore's recommendation results in another penalty for ratepayers,
5 particularly for WPK customers. The WPK customers were the ones that
6 originally paid for the JEC assets. When these assets were subsequently
7 transferred to Wilmington Trust through a financing agreement, the KCC
8 reviewed the transaction and determined that ratepayers should be held harmless
9 as a result of the financing. The KCC therefore concluded that the lease expense
10 included in WPK's revenue requirement should be no greater than the amount that
11 ratepayers would have paid had the utility continued to own the assets. In
12 addition, the KCC allowed Aquila to charge ratepayers for a portion of the
13 acquisition premium in the lease payments included in WPK's regulated revenue
14 requirement, on the basis that the acquisition resulted in commensurate cost
15 savings.

16 Now that Aquila will no longer own the WPK assets, any acquisition
17 premium previously included in the lease payment for ratemaking purposes
18 should be disallowed. In addition, the lease payment should continue to reflect
19 the amount that ratepayers would have paid, had the original utility continued to
20 own the assets.

21 Staff's recommendation to increase the amount of the lease payment
22 included in regulate rates effectively unravels the ratemaking treatment already
23 decided upon by the KCC for this lease. Mr. Dittimore's recommendation will

1 cost ratepayers \$37.5 million over the next five years. These are the same
2 ratepayers that originally owned the JEC assets. Moreover, under the original
3 lease, it is my understanding that Aquila had the right to purchase the JEC assets
4 that are the subject of the lease once the lease expired. This option will no longer
5 be available to the WPK customers if the proposed transaction is approved. Thus,
6 not only will WPK customers pay more for the JEC lease under Staff's
7 recommendation, but they will also lose the right to purchase a valuable supply
8 asset at a relatively low price.

9
10 **Q. What do you recommend?**

11 A. If the proposed transaction is approved, the KCC should continue the ratemaking
12 treatment previously adopted for the JEC lease, and reject Staff's
13 recommendation to increase lease costs by \$37.5 million over the next five years.
14 In addition, the lease payments should be adjusted to remove any acquisition
15 premium associated with the original Aquila acquisition. Finally, ratepayers
16 should receive some compensation for the loss of the right to purchase the JEC
17 assets that are the subject of the lease.

18
19 **Q. Please summarize your Cross-Answering Testimony.**

20 A. If the KCC approves the proposed transaction, then the Commission should reject
21 Staff's recommendation that the entire acquisition premium be spun-down to the
22 distribution companies, and instead require that a reasonable portion of the
23 premium be assigned to the transmission and generation assets. In addition, the

1 KCC should require a five-year base rate freeze, during which the MKEC
2 members will have the ability to recover the acquisition premium. At the end of
3 the five-year freeze, the MKEC members should be prohibited from recovering
4 any additional portion of the acquisition premium from ratepayers. Finally, the
5 KCC should continue its ratemaking treatment for the JEC lease. Without these
6 safeguards, the proposed transaction should not be approved.

7

8 **Q Does this complete your Cross-Answering Testimony?**

9 A. Yes, it does.

VERIFICATION

STATE OF CONNECTICUT)
COUNTY OF FAIRFIELD) ss:

Andrea C. Crane, being duly sworn upon her oath, deposes and states that she is a consultant for the Citizens' Utility Ratepayer Board, that she has read and is familiar with the foregoing testimony, and that the statements made herein are true to the best of her knowledge, information and belief.

Andrea C. Crane
Andrea C. Crane

Subscribed and sworn before me this 4th day of December, 2006,

Notary Public Majorie M. Dexin

My Commission Expires: December 31, 2008

CERTIFICATE OF SERVICE

06-MKEE-524-ACQ

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was placed in the United States mail, postage prepaid, or hand-delivered this 12th day of December, 2006, to the following:

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