

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Mid-Kansas)	
Electric Company, LLC for an Order Approving)	Docket No. 18-MKEE- <u>014-MIS</u>
the Conversion of Mid-Kansas Electric Company, LLC to)	
Mid-Kansas Electric Company, Inc.)	

DIRECT TESTIMONY OF

H. DAVIS ROONEY

ON BEHALF OF

MID-KANSAS ELECTRIC COMPANY, LLC

JULY 12, 2017

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

2 A. My name is H. Davis Rooney.

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

4 A. Yes. I am Vice President and Chief Financial Officer of Mid-Kansas and have
5 been since November 21, 2008.

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

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

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

11 A. I am Vice President and Chief Financial Officer. I assumed this position on
12 October 22, 2008.

13 **Q. What prior positions have you held?**

14 A. Prior to joining Sunflower, I held positions at Kansas City Power & Light
15 Company (“KCP&L”); Aquila, Inc. (“Aquila”); and Arthur Andersen.

16 **Q. Please describe your education, experience and employment history.**

17 A. I graduated from the University of Kansas. I received a B.A., with distinction, in
18 Mathematics (1982), and a B.S., with distinction, in Business (1983), with majors
19 in Accounting and Business Administration and a concentration in Computer
20 Science. I obtained my Certified Public Accountant certificate in 1983 and
21 practiced in public accounting from 1983 to 1992. In 1992, I joined Aquila, Inc. as
22 Controller of its WestPlains Energy division and held several positions focused
23 on financial management and analysis including Director of Accounting and

1 Finance for the Missouri Electric divisions of Aquila Networks. My last position at
2 Aquila was as Director of Resource Planning and Commodity Analysis. At
3 KCP&L I held the position of Manager, CEP Business Operations. My
4 responsibilities included business planning and analysis concerning infrastructure
5 investment projects for KCP&L and Aquila (d/b/a KCP&L Greater Missouri
6 Operations Company).

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

8 A. Sunflower provides contract services to Mid-Kansas for all the generation and
9 transmission activities of Mid-Kansas. Mid-Kansas has no employees, so
10 Sunflower operates Mid-Kansas under a contract approved by the Commission.

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

12 A. The purpose of my testimony is to address the financial and accounting
13 implications of the conversion of Mid-Kansas from a limited liability company to a
14 corporation. I will address the following areas:

- 15 ○ Brief discussion on the reason for the conversion.
- 16 ○ Treatment of member equity.
- 17 ○ Methodology for allocation of net margins.
- 18 ○ Implication of taxation.
- 19 ○ Accounting treatment for income and expenses.
- 20 ○ Rate implications
- 21 ○ Discuss cooperative principles.
- 22 ○ Accounting treatment for assets and liabilities.

1 **Q. What prompted Mid-Kansas to elect to convert from a limited liability**
2 **company to a corporation?**

3 A. As more specifically discussed in Stuart Lowry's testimony, FEMA has taken the
4 position that Mid-Kansas, as a limited liability company, is not eligible for public
5 assistance in the event of damage to its facilities due to a declared natural
6 disaster.

7 **Q. How does converting to a corporation address the denial of eligibility?**

8 A. As Mr. Lowry has testified, we do not have the benefit of a perfect understanding
9 of all the specific reasoning from FEMA, but it is our understanding that a utility
10 formed as a not-for-profit, limited liability company is not viewed by FEMA as an
11 eligible entity under the Stafford Act. However, Sunflower, the sister organization
12 of Mid-Kansas, has never been denied eligibility for public assistance. Sunflower
13 is formed as a taxable, nonprofit, non-stock membership corporation, operated
14 on cooperative principles. Therefore, the member owners elected to restructure
15 Mid-Kansas to mirror the corporate structure of Sunflower.

16 **Q. What actions have the member owners taken to mitigate the risk of being**
17 **ineligible for public assistance?**

18 A. Knowing Commission approval could take up to 300 days, the member owners
19 did all they could do immediately to position Mid-Kansas to prevail with FEMA if a
20 natural disaster happened before the completion of the conversion. The member
21 owners amended the Mid-Kansas Operating Agreement to provide for and to
22 operate in accordance with cooperative principles. Primarily, cooperative
23 principles require one-member one-vote and provide for allocation of patronage

1 to the member owners. Mid-Kansas was already formed as a not-for-profit
2 company. By amending the Operating Agreement and making a tax election,
3 Mid-Kansas took on a business structure similar to that of Sunflower. Sunflower
4 is a taxable, nonprofit, non-stock membership company, operated on cooperative
5 principles. With these modifications, Mid-Kansas is better positioned to assert its
6 eligibility for public assistance until the actual conversion to a taxable, nonprofit,
7 non-stock membership corporation is approved by the Commission. The
8 Application will complete the process by obtaining approval of the Commission to
9 actually convert to a corporation in accordance with the Kansas Business Entity
10 Transaction Act. Upon approval, Mid-Kansas will have statutorily converted to a
11 corporation which we fully expect to be FEMA eligible.

12 **Q. With the conversion, will members retain the equity built in Mid-Kansas?**

13 A. Each member's share of equity will remain the same as prior to conversion.
14 Generally accepted accounting principles ("GAAP") may require the member's
15 capital account to be recharacterized as additional paid in capital, but each
16 member's share of total equity will remain the same.

17 **Q. With the conversion, will the members earn patronage?**

18 A. Member earnings will be allocated on a patronage basis, like Sunflower. The
19 method of allocation is as set forth in the proposed bylaws attached to the
20 Conversion Agreement as part of the Application.

21 **Q. With conversion, what will be the tax implications for Mid-Kansas?**

22 A. Like Sunflower, Mid-Kansas will be a taxable, nonprofit, non-stock membership
23 corporation, operated cooperatively. This means that Mid-Kansas will allocate

1 earnings to its members based on patronage, as it does now, and will receive a
2 patronage tax deduction to substantially reduce or eliminate income taxes on
3 member related income, as it does now. Non-member income, like Sunflower,
4 will be taxable to the extent non-member income exceeds allocated tax
5 deductions.

6 **Q. With the conversion, will the accounting for income and expenses be**
7 **impacted by conversion to a corporation?**

8 A. Mid-Kansas will be treated like Sunflower. Nothing has come to my attention to
9 cause me to believe there will be any change in accounting or amounts of our
10 income or expenses as a result of the conversion. There may be one-time
11 expenses incurred for various items such as consulting fees, document name
12 changes, filing fees, and various related expenses. As discussed in the
13 Application and Mr. Lowry's testimony, we do expect to become FEMA eligible as
14 a result of the conversion. This will reduce certain costs of replacements and
15 repairs that may occur as a result of future natural disasters.

16 **Q. Will conversion impact any of Mid-Kansas' loans or borrowing obligations?**

17 A We have contacted our lenders and they have expressed no concerns regarding
18 these changes. We remain obligated for the same amounts and subject to the
19 same financial and non-financial covenants and the trust indenture secures the
20 obligations, as before.

21 **Q. Will the conversion impact rates?**

22 A. The current rates, charges, classifications or schedule of charges, and any rule
23 or regulation or practice pertaining to the service or rates of Mid-Kansas Electric

1 Company, LLC will be the same in Mid-Kansas Electric Company, Inc. However,
2 we expect the conversion will have a favorable impact on rates. FEMA eligibility
3 will reduce facility maintenance and replacement costs in the event of a declared
4 natural disaster.

5 **Q. What does it mean to adopt cooperative principles?**

6 A. There can be different interpretations of this, but the key elements for Mid-
7 Kansas are the adoption of democratic voting and adoption of patronage
8 allocations.

9 **Q. What is meant by democratic voting?**

10 A. Prior to adopting cooperative principles, each member of Mid-Kansas had a fixed
11 ownership percentage. While decisions made by the Board of Directors were
12 based on the six equal votes of the board members, decisions subject to a vote
13 of the members were based on the ownership percentages. Now both member
14 and board votes are based on one-member one-vote, like Sunflower. This will
15 continue after conversion to a corporation, as provided for in the proposed
16 bylaws.

17 **Q. What is meant by patronage allocations?**

18 A. Cooperatives are owned by their members who are also customers (patrons) of
19 the cooperative. When the cooperative has member related earnings, those
20 earnings are allocated to the members, as described in the bylaws, in proportion
21 to their level of business (patronage) with the cooperative. In effect, the IRS
22 considers the allocation of patronage to be a refund of revenue to the members,
23 whether redeemed immediately in cash or not, and thus treats it as a reduction to

1 taxable income (patronage tax deduction). If the allocated patronage is not
2 immediately redeemed in cash, it is retained as a member equity investment in
3 the cooperative. In effect, the IRS treats this equity investment by the member in
4 the cooperative as a separate transaction.

5 **Q. Were there balance sheet impacts from the election of corporate taxation**
6 **and adoption of cooperative principles?**

7 A. Yes. Prior to electing to be taxed as a corporation, Mid-Kansas had no income
8 tax expense or liabilities. After electing to be taxed as a corporation, income tax
9 liabilities are reflected at Mid-Kansas, instead of at the members. In accordance
10 with GAAP, Mid-Kansas is required to establish accumulated deferred income
11 tax ("ADIT") liabilities and assets. However, consistent with our tax and rate
12 treatment, any net tax liability is expected to be offset by a regulatory asset. The
13 regulatory asset reflects the expectation that when ADIT liabilities reverse, they
14 will either not result in tax expense payable (because of offsetting patronage
15 deductions and tax assets), or will be collected in rates to maintain an acceptable
16 TIER, MFI, and/or DSC. This is like Sunflower. Sunflower has historically not had
17 net accumulated income tax liabilities on its balance sheet, as its net operating
18 loss ("NOL") tax assets have exceeded its ADIT liabilities.

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

20 A. Yes.

VERIFICATION

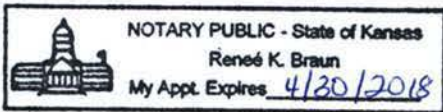
STATE OF KANSAS)
) ss:
COUNTY OF ELLIS)

H. DAVIS ROONEY, being first duly sworn, deposes and says that he is the H. DAVIS ROONEY referred to in the foregoing document entitled "DIRECT TESTIMONY OF H. DAVIS ROONEY" 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.



H. Davis Rooney

SUBSCRIBED AND SWORN to before me this 12th day of July, 2017.





Notary Public

My Appointment Expires: