

BEFORE THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS

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DIRECT TESTIMONY  
OF  
L. EARL WATKINS, JR.

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DOCKET NO. 06-MKEE-524-ACQ

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

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

3

4 **Q. By who are you employed.**

5 A. I am employed by Sunflower Electric Power Corporation ("Sunflower"). My  
6 business address is 301 W. 13<sup>th</sup> Street, Hays, Kansas.

7

8 **Q. What is your present position at Sunflower and how long have you held  
9 the position?**

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

15

16 **Q. Are you also an officer of Mid-Kansas Electric Company, LLC  
17 ("MKEC")?**

1 A. Yes, I am also the President and Chief Executive Officer of MKEC since its  
2 inception in July 2005.

3

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

5 A. The purpose of my testimony is to provide: (1) background information on  
6 MKEC, (2) an overview of the transaction and how the electric business of  
7 Aquila, Inc., d/b/a Aquila Networks - WPK ("WPK") electric business fits in the  
8 members of MKEC's service territories; (3) an explanation of how this  
9 transaction meets the public interest standard, and (4) other matters with  
10 respect to rates and integrating the WPK properties into MKEC.

11

12 BACKGROUND INFORMATION ON MKEC

13 **Q. Please provide an overview of the business of MKEC.**

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

1 City and Southern Pioneer Electric Company, a subsidiary of Pioneer Electric  
2 Cooperative, Inc., Ulysses. MKEC was organized in 2005. The five  
3 cooperative members of MKEC plus Pioneer Electric also own Sunflower.  
4

5 **Q. You said that the five of six members of MKEC are "... consumer-owned**  
6 **cooperatives." What does that mean?**

7 A. These members of MKEC are non-profit corporations owned by their  
8 customers. All of the electric customers of these members become owners  
9 of the cooperative when they purchase utility service. That is, all year-end  
10 revenues in excess of the cooperatives' actual cost of service are allocated to  
11 capital accounts for the benefit of the customers, and these amounts are  
12 periodically refunded. In addition, members participate in management  
13 oversight of the cooperative by electing its directors. In a cooperative utility,  
14 the ratepayers and the owners of the utility are one and the same. There is  
15 no competing interest between stockholders who want higher returns and  
16 customers who want lower rates and better service.  
17

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

19 A. No, cooperative members want low rates like anyone else. However, if  
20 higher rates are necessary to provide better service, the customers, not  
21 unassociated stockholders, receive all the benefits of the increased rates.  
22

1 **Q. Are the members of MKEC regulated by the Kansas Corporation**  
2 **Commission (“Commission”).**

3 A. Wheatland Electric and Pioneer Electric, the parent company of Southern  
4 Pioneer Electric Company, are currently regulated by the Commission. The  
5 members of the other cooperatives in MKEC voted to remove Commission  
6 regulation over their rates pursuant to the provisions found in K.S.A. 66-104d.  
7 MKEC will be fully regulated by the Commission. At some time in the future,  
8 MKEC may spin-off the distribution properties to the MKEC members. In  
9 fact, that is the ultimate goal of the members of MKEC. Once that occurs,  
10 Victory Electric and Prairie Land Electric would likely become subject to KCC  
11 jurisdiction and only Western Electric and Lane-Scott Electric would meet the  
12 conditions of K.S.A 66-104d to remain exempt from rate regulation by the  
13 Commission.

14 OVERVIEW OF THE TRANSACTION AND STRATEGIC FIT WITH MKEC

15 **Q. Please describe the transaction.**

16 A. MKEC has agreed to acquire all of WPK’s electric utility assets all described  
17 and identified in Exhibit “D” and Exhibit “E” to the Joint Application. The  
18 properties serve approximately 68,000 metered retail Kansas electric  
19 customers. The purchase price will be \$255.2 million, plus working capital  
20 and subject to certain adjustments, as specified in the Asset Purchase  
21 Agreement (“Agreement”).

22

23 **Q. How did the parties arrive at that price?**

1 A. MKEC participated in a bidding process established by Aquila after Aquila  
2 announced that it was selling several utility properties, including the WPK  
3 electric utility properties. MKEC engaged the firm of UBS Investment Bank to  
4 assist with the valuation. Their work is more fully described in the testimony  
5 of Walter S. Hulse III.

6

7 **Q. Geographically, how do the subject properties align with the members  
8 of MKEC's and Sunflower's existing electric properties?**

9 A. There is a very good fit. The six members of MKEC's and Sunflower's  
10 existing systems generally abut or are near to WPK's electric utility properties  
11 as shown on the map labeled Exhibit E attached to the Joint Application.

12

13 **Q. Will the transfer of these properties to MKEC result in any customers  
14 being far from qualified employees?**

15 A. No. Employment will be offered to all of WPK's employees who serve the  
16 affected customers. There are currently no plans to relocate any of the  
17 employees who are directly involved in providing service. The final location  
18 of employees is dependent upon acceptance of employment offers.  
19 Additionally, the members of MKEC, which will be operating the distribution  
20 assets of WPK, have electric operations employees stationed throughout  
21 western Kansas. Therefore, the customers will be close to a much larger  
22 work force.

23

1 **Q. Why did MKEC decide to acquire these assets?**

2 A. MKEC's members, Sunflower and WPK have adjacent facilities and have  
3 conducted business together for many years. The entities are very familiar  
4 with each other and the employees in the field. MKEC's analysis shows that  
5 the acquisition will result in additional stability and margins for the member  
6 cooperatives and their customers.

7

8 **Q. How will the acquired assets be operated?**

9 A. The MKEC members will operate and maintain the WPK distribution assets  
10 and Sunflower will operate and maintain the WPK transmission and  
11 generation assets as provided in the service and operation agreements with  
12 MKEC attached as Exhibits K and L to the Application. Employees of WPK  
13 will be assigned and employed by the MKEC members and Sunflower.  
14 Service to the public will be seamless.

15

16 **Q. How will combined operations affect service quality?**

17 A. Combining the work forces offers advantages in the provision of service.  
18 Given the close proximity of the subject properties to the MKEC members'  
19 systems, there will be many instances of improved response times. WPK's  
20 former customers will be close to existing MKEC members' personnel.  
21 Without an increase in the total number of field personnel, a larger combined  
22 work force will provide quicker response times. MKEC members also have

1 significant knowledge of the service needs of the customers in this area in  
2 that they are very similar to MKEC members' existing customers.

3

4 THE TRANSACTION AND PUBLIC INTEREST STANDARD

5 **Q. What is your understanding of the standard of the Kansas Corporation  
6 Commission ("Commission") will apply in determining whether to  
7 approve this acquisition?**

8 A. The Commission established that a merger or acquisition must be "in the  
9 public interest" in the KPL/KGE merger case, Docket Nos. 172,745-U and  
10 174,155-U. The Commission set out several factors to weigh when  
11 considering the merits of proposed transactions.

12

13 **Q. What factors did the Commission adopt in the KPL/KGE merger case?**

14 A. The Commission said it would weigh and consider:

15 a. The effect of the transaction on consumers, including (i) the effect of  
16 the proposed transaction on the financial condition of the newly  
17 created entity as compared to the financial condition of the stand-  
18 alone entity; (ii) reasonableness of the purchase price, including  
19 whether the purchase price was reasonable in light of the savings that  
20 can be demonstrated from the merger and whether the purchase price  
21 is within a reasonable range; (iii) whether ratepayer benefits resulting  
22 from the transaction can be quantified; (iv) whether there are  
23 operational synergies that justify payment of a premium in excess of

- 1 book value; and (v) the effect of the proposed transaction on the  
2 existing competition.
- 3 b. The effect of the transaction on the environment.
- 4 c. Whether the proposed transaction will be beneficial on an overall  
5 basis to state and local economies and to communities in the area  
6 served by the resulting public utility operations in the state.
- 7 d. Whether the proposed transaction will preserve the jurisdiction of the  
8 Commission to effectively regulate and audit public utility operations in  
9 the state.
- 10 e. Whether the transaction maximizes the use of Kansas energy  
11 resources.
- 12 f. Whether the transaction will reduce the possibility of economic waste.
- 13 g. What impact, if any, the transaction has on the public safety.

14

15 **Q. Did the Commission's decision result in rigid application of the**  
16 **standards?**

17 A. No. The Commission was seeking to uniformly review mergers and  
18 acquisitions, but stated that the factors would maintain flexibility to deal with  
19 circumstances of each transaction.

20

21 **Q. Does MKEC's proposed acquisition of WPK's electric utility properties**  
22 **present circumstances not considered in the KPL/KGE merger when**  
23 **the review factors were established?**



1 A. Yes, there are three characteristics about this case that were neither present  
2 in the KPL/KGE merger, nor most other mergers and acquisitions. First, five  
3 of the six members of MKEC are cooperatives, owned entirely by their  
4 customers and the sixth member, Southern Pioneer Electric Company, is a  
5 wholly owned subsidiary of a cooperative - Pioneer Electric Cooperative, Inc.  
6 The distinction between shareholders and customers as separate groups with  
7 competing interests is not present in this transaction. The second difference  
8 is that MKEC's members maintain a local presence in their service areas and  
9 are very familiar with the needs of electric customers in western Kansas.  
10 Finally, most of the WPK service territory is adjacent to the MKEC members  
11 service territories, a factor which is not present in most other cases.

12

13 **Q. How should the Commission deal with the items you just discussed**  
14 **that were not present when the review factors were established in the**  
15 **KPL/KGE merger?**

16 A. The Commission mentioned the need for flexibility regarding the  
17 circumstances of each transaction. Customer ownership, maintenance of a  
18 local presence, and taking advantage of adjacent service areas and  
19 operations all add value for customers. As the Commission reviews this  
20 application, those factors should also be considered.

21

22 **Q. Please review this transaction in light of the factors established in the**  
23 **KPL/KGE merger case?**

1 A. The first factor deals with the effect of the transaction on customers. The  
2 transaction will have a positive effect on current WPK customers because the  
3 MKEC members can operate and maintain the WPK distribution system more  
4 efficiently and Sunflower can operate the transmission and generation assets  
5 in a more efficient manner resulting in significant operational savings as  
6 explained in the testimony of Dennis Eicher. Furthermore, MKEC plans to  
7 adopt WPK's current rate structure and does not anticipate any future  
8 increase in rates for a period of time. The reasonableness of the purchase  
9 price in light of other mergers in the industry will be addressed by Walter S.  
10 Hulse III.

11  
12 **Q. Do you expect to achieve savings from the transaction?**

13 A. Yes, savings will be generated as corporate administrative and overhead  
14 costs are reduced, crew assignments are optimized, duplication of facilities is  
15 avoided, etc. In addition to these savings, this transaction should allow for  
16 efficiencies in the development of new generation for western Kansas.

17  
18 **Q. Have your quantified expected savings?**

19 A. Dennis Eicher along with a witness panel will address the savings associated  
20 with the transaction. MKEC understands that before it can seek to recover  
21 any acquisition premium in rates, it will have to obtain Commission approval  
22 and will have to show that savings have occurred equal to the premium  
23 sought to be recovered that have resulted from this transaction.

1

2 **Q. Are there other ratepayer benefits?**

3 A. There are both quantifiable and qualitative benefits. I have already  
4 mentioned qualitative benefits including elimination of competing interests  
5 between shareholders and customers and maintenance of a local presence  
6 in communities served.

7

8 **Q. Can you quantify any other benefits?**

9 A. Yes, there are other benefits associated with the transaction. The  
10 transaction will allow current coal-fired generation owned and operated by  
11 Sunflower to be incorporated into the generation mix that will serve the  
12 MKEC load; the transaction will take advantage of approximately 20 MW of  
13 peak load diversity between the Sunflower and WPK systems; and the  
14 transaction will allow Sunflower to aggressively develop a new western  
15 Kansas coal-fired resource.

16

17 **Q. How will current coal-fired generation be incorporated in the generation  
18 mix used to serve the current WPK customers?**

19 A. Sunflower currently sells hourly into the market when coal-fired energy is not  
20 required for member services. We also have contractual commitments to  
21 other utility customers that utilize Sunflower's current coal-fired resource,  
22 Holcomb Unit 1. As these contractual commitments expire, Sunflower will  
23 most likely develop contractual commitments with MKEC since our members

1 will own both entities that will allow the more efficient utilization of Holcomb  
2 power and energy in the generation mix to serve the current WPK load. This  
3 power and energy will displace power and energy currently being generated  
4 for WPK customers by more expensive gas-fired generating units and will  
5 provide Sunflower with a more steady source of revenue. Steady revenue  
6 allows for better planning and better planning results in even more efficient  
7 operations.

8

9 **Q. How will the load diversity between Sunflower and WPK benefit the**  
10 **proposed transaction?**

11 A. The proposed transaction will allow the Sunflower and WPK loads to be  
12 dispatched as a single system. There is approximately 20 MW of load  
13 diversity savings if the systems are dispatched as a single system versus  
14 dispatched individually. This means that the customers will be paying for 20  
15 MW less generation to serve the load as a combined entity because the  
16 diversity reduces operating and planning reserve requirements.

17

18 **Q. How will the transaction allow Sunflower to aggressively develop a new**  
19 **western Kansas coal-fired generation resource?**

20 A. The current WPK system is highly dependent upon natural gas generation to  
21 meet a large portion of its load requirements. MKEC intends to participate in  
22 the development of a new coal-fired generation resources at Sunflower's

1 Holcomb generating site to displace some of the reliance of natural gas  
2 generation to serve current and future WPK loads.

3

4 **Q. Does MKEC intend to purchase the entire output of this new coal-fired**  
5 **generating resource?**

6 A. No. Only a portion of the new coal-fired resource would be allocated to  
7 MKEC. Other regional utilities would purchase the balance.

8

9 **Q. Will this transaction have any effect on existing competition?**

10 A. Retail electric service areas in Kansas are regulated by the Commission as  
11 single-certificated service areas. Presently, WPK holds the certificate to  
12 serve the area; post-transaction, MKEC will hold the certificate. Thus, there  
13 will be no reduction in the number of retail energy suppliers for customers  
14 included in the acquisition.

15

16 **Q. Will the transaction have any adverse impact on the environment?**

17 A. The impact will be positive. As mentioned above, jointly dispatching the  
18 Sunflower and MKEC systems will reduce the generation capacity necessary  
19 to serve the load. That is a positive to the environment. Additionally, the  
20 MKEC members and Sunflower conduct their operations to meet or exceed  
21 state and federal environmental regulations.

22

1 **Q. How will the proposed transaction affect state and local economies and**  
2 **the communities in the service area?**

3 A. The proposed transaction will have a positive effect on state and local  
4 economies primarily because the MKEC members have a vested interest in  
5 the customers they serve. With respect to communities, the MKEC members  
6 and their employees have a history of community service, civil organization  
7 participation and economic development assistance.

8

9 **Q. Will the jurisdiction of the Commission be preserved?**

10 A. Yes. The proposed transaction will preserve the jurisdiction of the  
11 Commission and the capacity of the Commission to effectively regulate and  
12 audit public utility operations relating to the current WPK electric utility  
13 properties. Under the ownership of MKEC, the WPK electric utility properties  
14 will remain under the auspices of and jurisdiction of the Commission.

15

16 **Q. Will the transaction have any negative impact on the use of Kansas**  
17 **energy sources?**

18 A. No. In fact, the transaction will have a positive impact on the use of Kansas  
19 energy sources because generation resources will be able to be used more  
20 efficiently and it will facilitate the development of new coal generation in  
21 Kansas.

22

23 **Q. Will this acquisition reduce the possibility of economic waste?**

1 A. Yes, I believe it will. The operation of the distribution assets by the MKEC  
2 members and operation of the generation and transmission assets by  
3 Sunflower will allow the WPK electric utility properties to be operated and  
4 maintained in a manner conducive to reducing economic waste. For instance,  
5 the acquisition will allow Sunflower to operate the WPK generation assets in  
6 such a manner that will reduce the current dependence on natural gas  
7 generating resources.

8

9 **Q. Will there be an impact on public safety?**

10 A. I expect that WPK's good safety record will be maintained or improved. The  
11 MKEC members have an excellent safety record.

12

13 OTHER MATTERS

14 **Q. The application states that MKEC intends to adopt WPK's retail tariffs  
15 and to charge WPK's existing rates. Can you discuss this proposal?**

16 A. MKEC proposed to adopt WPK's current retail tariffs and utilize the rates to  
17 charge MKEC customers for a specified period of time. This will allow a  
18 smooth transition and allow the recovery of a portion of the acquisition  
19 premium. At the end of the specified period, I would expect MKEC to file a  
20 rate case with the Commission based on MKEC's cost of service along with a  
21 request to recover any remaining acquisition premium based on a showing of  
22 off-setting savings.

23

1 I think it worthy to note that unlike the current owner, MKEC does not intend  
2 to seek an additional rate increase in the near future. It is MKEC's intention  
3 to stabilize rates paid by current WPK customers and that this stabilization  
4 will lead to planning and planning will lead to economic development and  
5 economic development will lead to the growth of the system.  
6

7 **Q. Is MKEC requesting that rates charged to MKEC customers be frozen**  
8 **for a specific period of time?**

9 A. Yes, MKEC is requesting the Commission to allow MKEC to adopt the  
10 current WPK rate structure for a period of five years with an exception for  
11 expenses associated with construction of transmission facilities ordered by a  
12 governmental agency, Regional Transmission Organization ("RTO"), or  
13 required to comply with North American Electric Reliability Council ("NERC")  
14 criteria.  
15

16 **Q. What about current contract customer rates?**

17 A. Sunflower will honor the current contractual commitments of WPK. At the  
18 end of those commitments, the customer would either be subject to retail  
19 MKEC rates or another contract may be negotiated with MKEC.  
20

21 **Q. Has Sunflower and MKEC developed a plan for integrating the WPK**  
22 **electric utility properties into MKEC and Sunflower?**



1 A. The MKEC members and Sunflower have developed an “integration plan” for  
2 this project that is attached as Exhibit LEW-1. The integration plan is a road  
3 map for assimilating the WPK electric utility properties and customers into  
4 MKEC. The plan is broken into sections that addresses the issues faced by  
5 Sunflower and the MKEC members with respect to the transaction and  
6 attempts to resolve these issues. The plan may leave some issues  
7 unresolved, but it is important that these issues are identified nonetheless.

8

9 **Q. Does MKEC have any long range plans with respect to assimilating**  
10 **former WPK customers into the membership of MKEC’s member**  
11 **cooperatives?**

12 A. The structure of MKEC was designed to withstand the test of time. However,  
13 it may be the desire of the MKEC membership to at some point in time “spin-  
14 off” the distribution assets to the respective MKEC members and generation  
15 and transmission assets to Sunflower. At that time, Sunflower and the MKEC  
16 members would seek Commission approval to complete this step. Upon  
17 Commission approval of the “spin-off”, MKEC would cease to exist.

18

19 **Q. In summary what actions are the parties to the Application requesting**  
20 **of the Commission?**

21 A. The parties to the application are asking to the Commission to: 1) approve  
22 the transfer to MKEC of WPK’s Certificates of Convenience and WPK’s  
23 franchises with respect the WPK electric utility properties; 2) grant MKEC

1 authority to serve the electric customers within the area at the same rates  
2 currently in effect for WPK's customers for 5 years with the exception of  
3 certain transmission related expense that may be recovered through rates  
4 and granting WPK authority to cease providing electric service to customers  
5 within the area; 3) authorize MKEC to amortize and recover through rates the  
6 acquisition premium subject to a showing by MKEC to the Commission that  
7 the amount of savings resulting from the transaction is at least equal to the  
8 acquisition premium; 4) approve the operating agreements between the  
9 members of MKEC and MKEC; and approve the operating agreement  
10 between Sunflower and MKEC.

11


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

13 **A. Yes.**

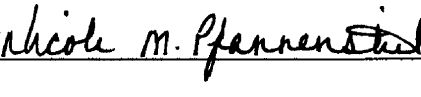
**VERIFICATION OF L. EARL WATKINS, JR.**

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 9th day of November, 2005.

  
\_\_\_\_\_  
Notary Public

My Appointment Expires:

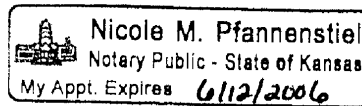


Exhibit LEW-1  
Confidential

**MID-KANSAS ELECTRIC COMPANY, LLC**  
**AQUILA KANSAS ELECTRIC NETWORK INTEGRATION PLAN**