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THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Mid-Kansas Electric Company, LLC for Approval to Make Certain Changes in its Charges for Electric Services in the Geographic Service Territory Served by Lane Scott Electric Cooperative, Inc.	)))))	Docket No. 12-MKEE-410-RTS

POST HEARING BRIEF OF THE CITIZENS' UTILITY RATEPAYER BOARD

C. Steven Rarrick #13127
Citizens' Utility Ratepayer Board
1500 SW Arrowhead Road
Topeka, KS 66604
(785) 271-3200
(785) 271-3116 Fax

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COMES NOW, the Citizens' Utility Ratepayer Board ("CURB"), and files this post-hearing brief pursuant to the Commission's January 17, 2013, Order on CURB's January 15, 2013 Motions and Mid-Kansas' and Staff's Oral and Written Responses and Order Requesting Briefs ("January 17th Order"). In support of its brief, CURB states as follows:

I. BACKGROUND AND PRELIMINARY MATTERS

1. This rate case was filed by Mid-Kansas Electric Company ("MKEC" or "Company") for changes in its rates provided to MKEC retail customers within MKEC's designated geographic service territory served by Lane Scott Electric Cooperative, Inc. ("Lane Scott") [1] MKEC is an electric public utility regulated by the Commission. [2]

2. The Service Agreement between MKEC and Lane Scott requires Lane Scott to provide to MKEC certain electric service to facilitate MKEC's ability to service MKEC customers

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[1] Application, p. 1, ¶12.
[2] Application, ¶2.

within MKEC's certificated service territory. [3] The Lane Scott MKEC division customers are, according to MKEC's application, customers of MKEC, not Lane Scott. [4]

3. The Stipulation & Agreement ("524 S&A") and Order Adopting Stipulation and Agreement ("524 Order") in KCC Docket No. 06-MKEE-524-RTS required MKEC member distribution cooperatives to "maintain separate books and records for their newly acquired WPK division until such time as acquired WPK retail customers and the acquiring Distribution Cooperatives' retail customers are served under the same general terms and conditions and rates." [5]

4. The 524 S&A and Order also required MKEC member distribution cooperatives to develop "cost allocation procedures":

> The Distribution Cooperatives *shall develop cost allocation procedures* to make an appropriate assignment of costs between divisions. [6]
>
> Because of the nature of this transaction, the Commission finds it appropriate to expressly approve the following items listed in the Agreement: ... (4) *development of cost allocation procedures* to assure that costs are appropriately assigned between divisions, Agreement, ¶¶ 19-20; Watkins, 5-6; [7]

5. The 524 S&A and Order also required that the "acquired WPK customers will become *full members of cooperatives* <u>and</u> receive the benefits of accruing patronage capital and of being a cooperative member owner." [8]

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[3] Application, ¶ 7.
[4] Application, ¶¶ 5, 7, 8 ("Mid-Kansas customers"; "Mid-Kansas's ability to service its customers..."; "The distribution assets transferred to the respective members were to be utilized, in part, for the service of <u>Mid-Kansas's customers</u> as required under the service agreements.") (emphasis added).
[5] Order Adopting Stipulation &Agreement ("524 Order"), January 7, 2007, ¶ 15, KCC Docket No. 06-MKEE-524-ACQ; Joint Motion for Approval of Stipulation and Agreement with attached Stipulation and Agreement ("524 S&A"), ¶ 14, February 23, 2007, KCC Docket No. 06-MKEE-524-ACQ.
[6] 524 S&A, ¶ 19 (emphasis added).
[7] 524 Order, ¶ 15 (emphasis added).
[8] 524 Order, ¶ 10; 524 S&A, ¶ 13, 25.

6. Lane Scott signed the Acknowledgement of the Terms and Conditions of Stipulation and Agreement, March 19, 2007, KCC Docket No. 06-MKEE-524-ACQ, wherein Lane Scott agreed to be bound by the terms of the 524 S&A and Order. [9]

7. A regulatory commission may consider a non-unanimous proposed settlement on the merits and adopt it only if it makes an independent finding on the merits that the proposed agreement is fair, just and reasonable and supported by substantial evidence on the record as a whole, and that the proposal will establish just and reasonable rates. [10]

> In spite of contradictory testimony that may be present in the record, this court must consider whether KCC's action is supported by substantial competent evidence. K.S.A. 77-621(c)(7). This means evidence must possess "something of substance and relevant consequence, and [must furnish] a substantial basis of fact from which the issues tendered can reasonably be resolved." *Southwestern Bell Tel. Co. v. Kansas Corporation Commission,* 4 Kan.App.2d 44, 46, 602 P.2d 131 (1979), *rev. denied* 227 Kan. 927 (1980). Furthermore, if KCC's action is taken with regard to the benefit of all interested parties and has foundation and is supported by fact in the record, it is not unreasonable, arbitrary, or capricious. K.S.A. 77-621(c)(8); *Pork Motel, Corp. v. Kansas Dept. of Health & Environment,* 234 Kan. 374, 381, 673 P.2d 1126 (1983).[11]

8. Decisions of the United States Supreme Court in the *Hope*[12] *and Permian Basin Area Rate Cases,* [13]

> "did not establish, as a constitutional requirement, that the end result of a rate-making body's adjudication must be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility. Rather, *Hope* requires *only* that the regulatory authority *balance competing consumer and investor interests to determine just and reasonable rates providing a return on used and useful property*."[14]

[9] Acknowledgement of the Terms and Conditions of Stipulation and Agreement, March 19, 2007, KCC Docket No. 06-MKEE-524-ACQ; Morris, Tr. p. 130-31.
[10] *Farmland Industries, Inc. v. State Corp. Comm'n of Kansas*, 24 Kan.App.2d 172, 186, 199, 943 P.2d 470 (1997) (citing *Mobil Oil Corp. v. FPC,* 417 U.S. 283, 314, 94 S.Ct. 2328, 2348-49, 41 L.Ed.2d 72 (1974)).
[11] *Id.*, at 193.
[12] *Power Comm'n v. Hope Gas Co.,* 320 U.S. 591, 88 L. Ed. 333, 64 S. Ct. 281 (1944).
[13] *Permian Basin Area Rate Cases,* 390 U.S. 747, 770, 20 L. Ed. 2d 312, 88 S. Ct. 1344, *reh. denied,* 392 U.S. 917 (1968).
[14] *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n,* 238 Kan. 483, 489-90, 720 P.2d 1063 (1986) (emphasis

9. Under this principle, a court has concluded that the Pennsylvania commission was not precluded from eliminating from a utility's rate base all costs associated with a unit of a nuclear power plant involved in a near meltdown or in determining that another unit which had been previously shut down by order of the NRC was likewise no longer used and useful in public service because its return to service was not imminent or certain. [15]

10. Rates cannot be determined just and reasonable unless consumer interests are protected, and utility rates may not be set so high as to constitute an unreasonable burden on ratepayers. [16]

11. Rates are an issue to customers of MKEC because cooperative members want low rates like anyone else. [17]

12. If established rates prove insufficient to allow a utility to recover its reasonable costs, the utility cannot request compensation to remedy the revenue shortfall caused by those inadequate rates. Similarly, if established rates allow for recovery beyond the target rate of return, the Commission cannot require a utility to refund that additional revenue. [18] In other words, a Commission has the power to fix rates prospectively only. This is illustrated by the following:

> Here, the Commission established rates for Ponderosa based, in part, on its estimate of Ponderosa's costs. These costs included interest on the RTB loans. The RTB patronage shares represented a reduction in this interest expense. Thus, when the RTB redeemed the patronage shares, *those proceeds related to a past cost that was factored into the rate established at that time*. Accordingly, when the Commission credited the redemption proceeds to the ratepayers, it was, in effect, adjusting previously established rates to account for the cost savings the telephone companies

added).

[15] *Id.*, at 489.

[16] *Id.*, at 490.

[17] Lowry, Tr. p. 72; Lowry Direct, p. 4.

[18] *Ponderosa Telephone Co. v. Public Utilities Comm'n*, 197 Cal.App.4th 48, 61, 127 Cal.Rptr.3d 844 (2011) (citing, *Southern Cal. Edison Co. v. Public Utilities Com.* (1978) 20 Cal.3d 813, 816, 144 Cal.Rptr. 905, 576 P.2d 945).

realized on their past loan payments. Because the Commission's decision on the patronage shares is *based on costs that were incurred in the past* and used to establish prior general rates, the Decision violates the rule against *retroactive ratemaking*. The Commission relies on a cost forecast to set general rates and cannot reset those rates when the actual costs differ from the forecast. By doing so here, the Commission acted in excess of its authority. Therefore, the Decision is invalid. [19]

13. CURB is the statutory "*official intervenor*" in proceedings before the Commission under Kansas statutes, [20] has been given the specific statutory right to "represent residential and small commercial ratepayers before the state corporation commission" and to "function as an *official intervenor* in cases filed with the state corporation commission, including rate increase requests," [21] and has been given the specific statutory right to seek judicial review of Commission orders and decisions. [22]

14. CURB's statutory authority to represent residential and small commercial ratepayers of MKEC is superior to any other party to this proceeding and was briefed in the CURB's Prehearing Brief. CURB incorporates its Prehearing Brief herein by reference. However, this issue appears to be moot since the Commission went forward with the evidentiary hearing and received the evidence offered by CURB in opposition to the proposed settlement.

II. THE PROPOSED $370,000 RATE INCREASE SETTLEMENT SHOULD BE REJECTED BY THE COMMISSION.

15. The $370,000 rate increase settlement proposed by the Company and Staff should be denied on the grounds it is excessive and not supported by substantial competent evidence. Because

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[19] *Id.* (emphasis added).

[20] K.S.A. 66-1223(b). *See, Citizens' Utility Ratepayer Board v. Kansas Corporation Comm'n,* 24 Kan. App.2d 63, 68, rev. den. 262 Kan. 959 (1997) ("*CURB v. KCC*"). *See also, Farmland Industries, Inc. v. Kansas Corp. Comm'n,* 29 Kan.App.2d 1031, 1047-48, 37 P.3d 640 (2001) ("The bulk of current customers otherwise entitled to receive refunds are *statutorily represented* by CURB. See K.S.A. 66-1223(a)")

[21] K.S.A. 66-1223(a) and (b) (emphasis added).

[22] K.S.A. 66-1223(f).

the settlement is excessive and is not supported by substantial competent evidence, it does not fall within the zone of reasonableness and does not result in just and reasonable rates.

16. Two methods were used by the parties to analyze the revenue requirement of the Lane Scott MKEC Division - the traditional rate base, rate of return methodology, and a TIER methodology. [23]

17. The following three rate base, rate of return recommendations were made by MKEC, Staff, and CURB:

- MKEC recommended a $510,915 rate increase, using a hypothetical capital structure of 100% Equity (despite a negative equity claim), an ROE of <u>8.718%,</u> no acquisition adjustment, and a resulting operating margin of $434,667. [24]
- CURB recommended a $48,888 rate increase, using a hypothetical capital structure of 50% equity, 50% debt (based on state and national median ratios), [25] the ROE of <u>8.718%</u> proposed by MKEC, an $2.9 million acquisition adjustment to rate base ($2.6 million net adjustment), and a resulting operating margin of $122,723. [26]
- Staff recommended a $31,334 rate increase, using a consolidated capital structure of 19.15% equity, 80.85% debt, an ROE of <u>14.25%</u>, a similar acquisition adjustment to rate base as was made by CURB, and a resulting operating margin of $80,105. [27]

18. One TIER recommendation was made by Staff: [28]

- Staff recommended a $312,310 rate increase, [29] based on nonexistent "*de facto*" debt with no loan covenants, [30] a TIER of 2.0, [31] and a resulting operating margin of $260,951. [32]

[23] Crane Testimony in Opposition to S&A ("Crane Opposition"), pp. 4-5.
[24] Crane Opposition, pp. 4-5.
[25] Cotton Direct, pp. 2-9; Harden Direct, p. 5; Bell, Tr. p. 283; Morris, Tr. pp. 144-46; CURB Exh. 7.
[26] Crane Opposition, p. 4.
[27] Crane Opposition, pp. 4-5.
[28] This is Staff's primary recommendation.
[29] Crane Opposition, p. 4.
[30] Shepherd Direct. pp. 7-8; Crane Opposition, pp. 11-14; Shepherd, Tr. pp. 210, 246; Morris, Tr. pp. 109, 144; CURB Exh. 6; CURB Exh. 14.
[31] Crane Opposition, pp. 4, 12-14, 20-21.
[32] Crane Opposition, p. 5.

19. CURB will demonstrate below that the proposed $370,000 rate increase settlement is excessive and is not supported by substantial competent evidence. The $370,000 rate increase proposed in the settlement is more than double the amount that can be reasonably determined from the evidence in the record. As a result, the proposed $370,000 rate increase does not fall within the zone of reasonableness and does not result in just and reasonable rates.

A. The proposed $370,000 rate increase settlement is excessive and not supported by the rate base, rate of return evidence.

20. The proposed $370,000 rate increase is excessive and not supported by the rate base, rate of return evidence in the record. As described by CURB witness Andrea Crane, in her Testimony in Opposition to the Stipulation and Agreement, [33] even if the Commission accepted MKEC's capital structure of 100% equity and its ROE of 8.171% [34] and adopts only three adjustments that are either unopposed by MKEC or proposed by both Staff and CURB, the $370,000 proposed rate increase is clearly excessive and not within the zone of reasonableness. These three adjustments to MKEC's rate base, rate of return recommendation are summarized below.

21. First, MKEC's filed revenue deficiency decreases from $510,915 to <u>$281,000</u> with the $2.9 million adjustment ($2.6 million net adjustment) to Plant in Service for the Aquila acquisition adjustment recommended by both CURB and Staff. [35] The acquisition adjustment made by CURB and Staff is reasonable, consistent with how negative acquisition adjustments have been treated in past cases, [36] consistent with the principle that ratepayers shouldn't have to pay for assets

[33] Crane Opposition. This testimony was unopposed at the evidentiary hearing.
[34] MKEC's 100% capital structure is unreasonable and inefficient. *See,* Cotton Direct Testimony, pp. 6-7; Shepherd, Tr., p. 211; Shepherd Rebuttal, p.7.
[35] Crane Opposition, pp. 7-9, ACC-SA-1; Bell, Tr. pp. 285-86, 299; Bell Direct, p. 13-14.
[36] Bell, Tr. pp. 285-86; Bell Direct, pp. 13-14.

that weren't actually paid for by the utility, [37] and consistent with the 524 S&A and Order. [38]

22. Second, MKEC's filed revenue deficiency decreases further to either $181,130 with the $78,439 adjustments made by CURB to depreciation expense on the acquisition adjustment[39] or to $202,449 with the $99,758 adjustment made by Staff to the amortization of the acquisition adjustment. [40] This adjustment will be discussed more fully in Argument D below.

23. Finally, the Company's filed revenue deficiency decreases further by another $34,915 with the uncontested $400,596 rate base adjustment for materials and supplies, [41] assuming the Company's requested return of 8.718% - resulting in a reasonable revenue deficiency between $146,000 and $167,500, well below the $370,000 rate increase reached in the proposed settlement between MKEC and Staff. [42] This is why CURB could not agree to the settlement, and why the $370,000 rate increase proposed in settlement is excessive and unreasonable.

24. The Commission should keep in mind the $146,000 to $167,500 revenue deficiency range still includes the Company's unreasonable and inefficient 100% capital structure. [43] A reasonable revenue deficiency range is even less if the Commission adopts CURB's hypothetical capital structure based on national and state median ratios. [44]

[37] Bell, Tr. p. 286; Bell Direct, p. 12-13; Crane Direct, pp. 7-13.
[38] Bell Direct, p. 23.
[39] Crane Direct, pp. 16-18, Schedule ACC-2; Crane Opposition, p. 9, ACC-SA-2; Harden Direct, pp. 5.
[40] Crane Opposition, pp. 8-10, ACC-SA-3; Staff Rate Base/Rate of Return Schedules, Schedule B-2, Adjustment No. 2; Bell Direct Testimony, pp. 21-22.
[41] Crane Opposition, p. 10; Harden Direct, pp. 5, 7, Schedule SMH-3; CURB Exh. 1.
[42] Crane Opposition, p. 10; Harden Direct, p. 7, Schedule SMH-3; CURB Exh. 1.
[43] Shepherd, Tr., p. 211; Shepherd Rebuttal, p.7; Cotton Direct, pp. 6-7.
[44] Cotton Direct, pp. 2-9; Harden Direct, p. 5; Bell, Tr. pp. 283-84; Morris, Tr. pp. 144-46; CURB Exh. 7.

25. Staff's criticism of the following "shortcomings" [45] of the Company's use of a rate base, rate of analysis or methodology in this case was not supported by the testimony of Staff's own witnesses:

- The use of a capital structure with zero long-term debt could be handled by using a reasonable hypothetical capital structure which has been used by Staff and approved by the Commission in prior cases, such as the 50% equity, 50% debt capital structure tied to national and median ratios used by CURB.[46]
- The use of a capital structure with 100% negative equity could be handled by using a hypothetical capital structure. [47]
- The assumption that Lane Scott will have zero debt in the future could be handled by using a hypothetical capital structure. [48]
- The need to make a determination on how to treat the acquisition premium on Lane-Scott's books with regard to its treatment in rate base could be handled by adopting the adjustment proposed by both CURB and Staff, which is consistent with the principle that ratepayers shouldn't have to pay for assets that weren't actually paid for by the utility and consistent with prior rate cases. [49]
- The fact that prior filings by other MKEC cooperatives were not based on a rate base, rate of return methodology is irrelevant as the KCC has utilized a rate base, rate of return methodology for other cooperatives, such as Midwest Energy. [50]

26. Staff witness John Bell testified that with any ratemaking model, "if you put bad data into it, you are going to get a bad answer out of it." [51] Mr. Bell opined that there were anomalies in the Company's test year that "go so far that every party had to massage the data generally. CURB has their way of doing it. Staff has our way of doing it. The Company has their way of doing it." [52]

27. Contrary to Mr. Bell's statement, CURB did not "massage" the data, but performed a traditional rate base, rate of return analysis utilizing a hypothetical capital structure consistent with

[45] Bell Direct, pp. 10-11.
[46] Bell, Tr. pp. 283-84. *See also,* Cotton Direct, pp. 2-9; Harden Direct, p. 5; Morris, Tr. pp. 144-46; CURB Exh. 7.
[47] Bell, Tr. p. 284.
[48] Bell, Tr. pp. 284-85.
[49] Bell, Tr. pp. 285-86.
[50] Gatewood, Tr., p. 254; Bell, Tr. pp. 285-86.
[51] Bell, Tr., p. 300.
[52] *Id.*

prior Staff and Commission practice (which Mr. Bell agreed was fair and tied to national and state ratios).[53]

28. In 2008, the Lane Scott MKEC division had a net operating loss of $310,000. In 2009, the net operating loss was $235,000. At year end 2010, the end of the test year, the Company's net operating loss had been reduced to $2,126. [54] The nearly break-even result in the test year, following the significantly greater losses in 2009 and 2008, resulted from the increased revenues from the rate case filed in 2009, KCC Docket No. 09-MKEE-969-RTS. [55] This demonstrates the Company does not need the $510,000 or the $370,000 rate increase proposed in the settlement.

29. MKEC chose to file its case based upon a rate base, rate of return approach.[56] Staff, by its own admission, performed a thorough rate base, rate of return analysis. [57] Staff did not omit or fail to include any operating expenses in its rate base, rate of return recommendation, and Staff's $31,333 rate base, rate of return rate increase recommendation will cover the Lane Scott MKEC division's cost of service, including depreciation expense and an operating margin. [58]

30. Because the proposed $370,000 rate increase is excessive (over two times the amount supported by the record) and is not supported by credible rate base, rate of return evidence in the record as a whole, the proposed settlement does not fall within the zone of reasonableness and does not result in just and reasonable rates.

[53] Bell, Tr., p. 283.
[54] Shepherd, Tr., pp. 215-16.
[55] Shepherd, Tr., pp. 239.
[56] Crane Opposition, p. 7; Shepherd Rebuttal, pp. 5-6.
[57] Bell, Tr. p. 297.
[58] Bell, Tr. pp. 296-97.

B. The proposed $370,000 rate increase settlement is excessive and cannot be supported by Staff's TIER approach.

1. Staff's TIER approach is flawed and not supported by substantial competent evidence.

31. The $370,000 rate increase proposal is not supported by Staff's TIER methodology, which is fatally flawed and not based on substantial competent evidence. Staff's TIER methodology is based on a premise that does not exist in this case, i.e., that a utility must achieve a certain margin in order to meet a covenant required by its lender. [59] When Staff does a TIER analysis to check its rate base, rate of return analysis, it has always used actual loans with terms, interest rates, and documentation. [60]

32. The 524 S&A and Order required MKEC member distribution cooperatives to maintain separate books and records, [61] yet the Company uses one checking account because it was "not economically practical," [62] to maintain separate accounts. This comingling of funds makes it virtually impossible to document what was purchased or paid for with the $2.9 million intercompany payable, and the Company has failed to provide any such documentation. There is no documentation of any purported loan or debt, and the Company denies it is a liability or payable. The 524 S&A and Order also required MKEC member distribution cooperatives to *develop* "cost allocation *procedures*," [63] yet the Company relies upon the *ad hoc* decision of an office person who simply uses her "common sense." As a result, we are left with no record of what the $2.9 million was used for or

[59] Crane Opposition, pp. 11-12.
[60] Bell, Tr. pp. 323-24.
[61] 524 Order, ¶ 15; 524 S&A, ¶ 14.
[62] Morris Direct, p. 2; Morris, Tr. p. 137.
[63] 524 S&A, ¶ 19; 524 Order, ¶ 15.

what allocation methodology was used in allocating costs to the Lane Scott MKEC division that resulted in this $2.9 million balance.

33. While the evidence irrefutably establishes that the Lane Scott MKEC division has no debt[64], no interest expense [65] and no loan covenants or terms and conditions to satisfy,[66] the Company and Staff now seek to base the revenue requirement on $2.9 million in nonexistent, undocumented intercompany payables or "*de facto*" debt, despite the Company's failure to both keep separate books and records and develop cost allocation procedures.

34. MKEC chose to file its case based upon a rate base, rate of return approach,[67] yet Staff chose to override the Company's management's prerogative in choosing a rate base, rate of return methodology and instead substituted its own TIER methodology. [68] The testimony of Company witness Douglas Shepherd is clear and unambiguous; it is mathematically impossible to calculate either a TIER or DCS ratio because the Lane Scott MKEC division currently has no debt and no interest expense. [69] This leads one to question why Staff felt compelled to resort to a TIER analysis based on $2.9 million in intercompany payables that Staff determined were "fraught with assumptions" and involved "significant co-mingling of financing,"[70] when the Company admitted on numerous occasions that it had no debt, no interest expense, and did not consider the intercompany payable a liability.

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[64] Shepherd Direct. pp. 7-8; Shepherd, Tr. pp. 210, 246; Morris, Tr. pp. 109, 144; Crane Opposition, pp. 11-14; CURB Exh. 6; CURB Exh. 14.
[65] Morris, Tr. p. 109, 144; Crane Opposition, pp. 11-12; Shepherd, Tr. pp. 210, 246; CURB Exh. 14.
[66] Morris, Tr. pp. 109, 144; Crane Opposition, pp. 11-14; Shepherd, Tr. pp. 210, 246; CURB Exh. 14.
[67] Crane Opposition, p. 7; Shepherd Rebuttal, pp. 5-6.
[68] Crane Opposition, pp. 7-8.
[69] Shepherd, Tr. pp. 210, 245-46. *See also*, Crane Opposition, pp. 11-12; Shepherd Direct. pp. 7-8; Morris, Tr. p. 109; CURB Exh. 14.
[70] Bell Direct, p. 16.

35. It should be noted that the TIER analysis performed in the Company's last rate case was possible because the Lane Scott MKEC division debt related to the acquisition of the Aquila assets was allocated to the Lane Scott MKEC division and accounted for by the division.[71] However, the debt that was used in the TIER calculations in the 969 Docket has since been retired.[72]

36. In order to accept the reasonableness of the $370,000 proposed rate increase settlement, the Commission must accept the "reasonableness of the '*de facto*' loan."[73] The overwhelming evidence in the record regarding the $2.9 million intercompany payable does not support a conclusion by the Commission that it constitutes a loan with specified covenants upon which a revenue requirement may reasonably be based. To the contrary, the evidence establishes that Staff's use of the TIER analysis in this case is misguided and erroneously based on assumptions (not substantial competent evidence) and "bad data."[74] Specifically:

- Staff witness John Bell "assume[d]" that the $2.9 million is made up of approximately the $2.4 million and another $500,000 for incidental items that "we just don't know how they got there."[75]
- Mr. Bell's "assumption" is inconsistent with his admissions that the Lane Scott MKEC division was actually making payments on that loan prior to the intercompany payments and that he doesn't know what amount was coming from an intercompany payable or from the Lane Scott MKEC division itself because he wasn't provided that information by the Company even though Staff specifically requested the information.[76]
- Mr. Bell's admission that "This case is fraught with assumptions."[77]
- Staff tried but was not able to tie the net operating loss of the MKEC system to the intercompany payable, and Staff has never been given an explanation as to what the components were of the $2.9 million in intercompany payables.[78]

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[71] Morris, Tr. p. 108-09; Bell, Tr., p. 280; Crane Opposition, pp. 5, 11-12.
[72] Morris, Tr. p. 168.
[73] Bell, Tr. pp. 298-99.
[74] Bell, Tr. pp. 299-300 ("…as with any model if you put bad data into it, you are going to get a bad answer out of it...").
[75] Bell, Tr. p. 281.
[76] Bell, Tr. pp. 281-82.
[77] Bell, Tr. p. 282.
[78] Bell, Tr. pp. 293-94; Shepherd, Tr., p. 216-18; CURB Exh. 5.

- Staff had no way of knowing what the allocations were for any expenses that were included in the $2.9 million in intercompany payables, and if any of these unknown allocations were incorrect the Lane Scott MKEC division would be subsidizing the unregulated Lane Scott native division. [79]
- Mr. Bell had no specific example of any of the expenditures included in the $2.9 million in intercompany payables. [80]
- Mr. Bell testified that the $2.9 million in intercompany payables "could" include past losses that were incurred by the Company. [81]
- Mr. Bell testified that "Additionally, there appears to be significant co-mingling of financing between the Lane-Scott native cooperative and the MKEC-division." [82]
- Staff witnesses Adam Gatewood and John Bell could not identify one prior case in which Commission Staff has used nonexistent or hypothetical debt in a TIER analysis. [83]
- In his 28 years of testifying in cases involving cooperatives, Mr. Bell has never used a "*de facto*" loan in order to come up with numbers for a case. [84]
- A TIER analysis requires examination of the loan document and covenants with respect to what the lender requires of that utility. [85]
- There is no loan document containing terms and conditions, interest rates, or covenants to examine for the Lane Scott MKEC division, which has no debt and does not consider the intercompany payable to be a liability. [86]

37. The lack of documentation regarding the $2.9 million in intercompany payables and Staff's uncertainty about and assumptions underlying its conclusion regarding the "*de facto*" loan is demonstrated by the following testimony by Mr. Bell: "We still *think* the loan is real. We *think*–we *think* it is based upon amounts owed by the MKEC division to the native division. And it would be – otherwise, it wouldn't be negative." [87] Yet Mr. Bell also testified that "there appears to be significant co-mingling of financing between the Lane-Scott native cooperative and the MKEC-division." [88] It is clear from Mr. Bell's own testimony that the data massaging and utilization of "bad data" referenced

[79] Bell, Tr. pp. 294-95.
[80] Bell, Tr. p. 295.
[81] Bell, Tr. p. 295.
[82] Bell Direct, p. 16.
[83] Bell, Tr. p. 282; Gatewood, Tr. p. 255.
[84] Bell, Tr. p. 298.
[85] Gatewood, Tr. pp. 255, 257-58.
[86] Morris, Tr. pp. 142-44; Crane Direct, p. 21; CURB Exh. 6.
[87] Bell, Tr., pp. 323-24.
[88] Bell Direct, p. 16.

by Mr. Bell[89] was performed by Staff in performing its TIER analysis using nonexistent debt. Staff's treatment of the unverified \$2.9 million in intercompany payables as a "*de facto*" loan is unreasonably based on unsubstantiated "assumptions" about what the unverified \$2.9 million was used to pay for and unknown intercompany allocations used in each unverified payment.[90]

38. In *Williams Natural Gas Co. v. State Corp. Com'n*, the Kansas Court of Appeals determined that the Kansas Corporation Commission has no power to permit an entity to add to its rate base or otherwise recover costs which were not incurred by that entity.[91] Especially troubling for the *Williams* court was the fact that the Applicants did not directly assume any debt or liability as a result of its purchase of the assets of the entities involved.[92] Here, like the Applicants in *Williams,* Staff's TIER analysis attempts to set the revenue requirement for the Company based on interest expense that was not incurred by the Company. The Company stated on numerous occasions in testimony and discovery responses that it did not have debt, did not incur interest expense, and did not consider the intercompany payable a liability.

39. In Docket No. 09-MKEE-969-RTS ("969 Case"), the Lane Scott Division requested an operating margin of \$110,000, based on a TIER of 2.2.[93] Moreover, when that case was filed, the Lane Scott Division was responsible for debt that had been incurred in order to acquire the Aquila assets. In this case, the Company is requesting an operating margin of \$434,667,[94] or almost four times the margin requested in its last base rate case. CURB's recommended rate increase provides

[89] *Id.*
[90] Bell, Tr., pp. 281-82, 293-95; Shepherd, Tr., p. 216-18; CURB Exh. 5.
[91] *Williams Natural Gas Co. v. State Corp. Comm'n*, 22 Kan.App.2d 326, 335-37, 916 P.2d 52 (1996).
[92] *Id.,* at 337.
[93] Crane Opposition, p. 5.
[94] *Id.*

for an operating margin of $122,723[95] is in line with the Company's request in its last base rate case. CURB provides for this margin of $122,723 with its recommended rate increase of $48,888.

40. Because the proposed $370,000 rate increase is excessive (over two times the amount supported by the record) and Staff's TIER analysis is not supported by credible evidence in the record as a whole, the proposed settlement does not fall within the zone of reasonableness and does not result in just and reasonable rates.

2. *Staff's TIER approach constitutes retroactive ratemaking.*

41. Staff's recommended TIER methodology constitutes retroactive ratemaking. There is no evidence in the record showing what the $2.9 million in intercompany payments were made for, even though Staff specifically requested this information in discovery.[96] Moreover, the $2.9 million in intercompany payables were used in some manner to pay off prior year losses.[97]

42. A Commission's decision *based on costs that were incurred in the past* and used to establish prior general rates violates the rule against *retroactive ratemaking*.[98] The Commission should therefore decline to adopt Staff's TIER analysis on the grounds that the intercompany payable Staff deems to be a *"de facto"* loan includes undetermined costs (losses) incurred in the past violates the principle of retroactive ratemaking. John Bell admitted that Staff's decision to adopt a TIER methodology was intended to compensate the Company for past losses, stating that the rate increase resulting from Staff's rate base, rate of return methodology "is substantially less than the $510,915

[95] Harden Direct, Schedule SMH-1.
[96] Shepherd, Tr. pp. 216-18, 248-49; CURB Exhibit 5.
[97] Shepherd, Tr. p. 247.
[98] *Ponderosa Telephone Co. v. Public Utilities Comm'n*, 197 Cal.App.4th 48, 61, 127 Cal.Rptr.3d 844 (2011) (citing, *Southern Cal. Edison Co. v. Public Utilities Com.* (1978) 20 Cal.3d 813, 816, 144 Cal.Rptr. 905, 576 P.2d 945).

requested by Lane Scott, and in Staff's opinion is not adequate to compensate for the losses that the cooperative has incurred in the recent past, or even recover its current cost of service."[99] But as noted, Mr. Bell and Staff witness Timothy Rehagan testified that Staff's rate base, rate of return recommendation did provide for recovery of all cost of service components.[100] Thus, it is clear that Staff's recommendation is intended to compensate the Company for past losses, in direct violation of the prohibition against retroactive ratemaking.

III. CURB'S RATE BASE, RATE OF RETURN RECOMMENDATION SHOULD BE ADOPTED BY THE COMMISSION

A. Rate base, rate of return ratemaking is the appropriate methodology to utilize in this case.

43. The appropriate ratemaking methodology to utilize in this case is rate base, rate of return ratemaking, which is the method employed by the Company in its application.

44. The deficiencies in using a TIER analysis where the utility admittedly has no debt, no interest expense, no loan covenants to apply, and no liability for the intercompany payable are obvious. Staff witnesses Adam Gatewood and John Bell could not identify one prior case in which Commission Staff has used nonexistent or hypothetical debt in a TIER analysis,[101] and Mr. Bell was candid in admitting that in his 28 years of testifying in cases involving cooperatives, he has never used a "*de facto*" loan in order to come up with numbers for a case.[102]

45. There simply is no evidence in the record to justify the use of the TIER analysis by Staff. CURB respectfully requests that the Commission decline to adopt Staff's TIER analysis as not

[99] Bell Direct, pp. 24-25.
[100] Bell, Tr. pp. 297-98; Rehagen Direct, p. 5.
[101] Bell, Tr. p. 282; Gatewood, Tr. p. 255.
[102] Bell, Tr. p. 298.

supported by substantial competent evidence, but instead adopt the rate base, rate of return methodology utilized by all parties to this docket, including Staff in its alternative presentation.

B. CURB'S proposed capital structure and cost of equity are reasonable and should be adopted.

46. CURB'S recommends a pro forma capital structure of 50% equity and 50% long-term debt for the Company based on national and median ratios.[103] CURB will demonstrate below that CURB's proposal is reasonable and should be adopted by the Commission.

47. The authority of a regulatory commission to adopt a hypothetical equity ratio for rate of return purposes has been almost universally upheld in the courts, including Kansas courts.[104] While a regulatory commission does not have the actual authority to revise a utility's capital structure or to order the utility to change its actual capital structure, regulatory judgment may determine what effect a different or more desirable capital structure would have on the cost of capital:

> "It is solely in the area of assuming what effect a different or more desirable capital structure would have on the cost of capital, if it were adopted, that the regulatory judgment may function. As a practical matter, of course, such a hypothetical assumption of an ideal or optimum capital structure, as distinguished from that which actually exists, may have the same dollars-and-cents results, as far as the return allowance is concerned, as an actual change in the capital structure. In other words, the regulatory authority may say to the utility company, in effect: 'We find that if the debt to equity ratio were different from what it actually is, your capital costs would be lower, so therefore we will consider the cost of capital just as if the capital structure were different, in making the return allowance.'
>
> "This distinction between the function of management and that of the regulatory authority has been succinctly stated by the Maryland court of appeals in a recent decision (*C. & P. Tel. Co. v. Public Service*, 230 Md. 395, 187 A.2d 475 (1963)) wherein it was said that the owners and management of a utility have the right to

[103] Cotton Direct, pp. 2-9, Schedule BDC-2; CURB Exh. 7.
[104] *Sekan Elec. Co-op. Ass'n, Inc. v. State Corp. Commission*, 4 Kan.App.2d 477, 480, 609 P.2d 188 (1980) (citing E. Nichols, Ruling Principles of Utility Regulation, 267-273 (1955).

determine what the debt-equity ratio should be, but they may not always make the ratepayers foot the bill resulting from the choice." [105]

48. A capital structure with 100% equity is not an efficient capital structure for an electric utility. [106] The use of a capital structure consisting of 100% equity is even more unreasonable in this case, since the Company claims it actually has negative equity. Another reason using 200% equity is unreasonable and inefficient is because equity is more costly than debt. [107] Staff agrees that the Company's use of a capital structure with 100% negative equity could be handled by using a hypothetical capital structure. [108] Staff believes that any time a capital structure is out of the 40 to 60 percent range for either debt or equity, use of a hypothetical capital structure is appropriate, [109] which is what CURB did by proposing a hypothetical capital structure of 50% equity, 50% debt tied to national and median ratios.[110] Staff has recommended and the Commission has approved the use of a hypothetical capital structure in prior cases. [111] Even the Company's witness Mr. Shepherd acknowledged that "... 100% is not an efficient capital structure for an electric utility." [112]

49. CURB respectfully requests that the Commission adopt CURB's proposed hypothetical capital structure.

C. CURB's rate base adjustments should be adopted by the Commission:

50. CURB respectfully requests that the Commission adopt the following rate base adjustments proposed by CURB.

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[105] *Id.* (quoting E. Nichols, Ruling Principles of Utility Regulation, 267-273 (1955)) (emphasis added).
[106] Shepherd, Tr., p. 211; Shepherd Rebuttal, p.7; Cotton Direct, pp. 6-7.
[107] *Id.*
[108] Bell, Tr. p. 284; *See,* Cotton Direct, pp. pp. 2-9.
[109] Bell, Tr. pp. 283-84.
[110] Bell, Tr. p. 283; Morris, Tr. pp. 144-46; Cotton Direct, pp. 2-9; Harden Direct, p. 5; Morris, Tr. pp. 144-46; CURB Exh. 7.
[111] Bell, Tr. p. 284.
[112] Shepherd Rebuttal, p.7; Shepherd, Tr., p. 211.

1. Acquisition Adjustment: the Company's rate base should reflect an asset valuation based on the purchase price for the Aquila assets, resulting in a net reduction of $2,638,535.

51. The Company's rate base claim includes $5,413,704 of plant acquired from Aquila even though the Lane Scott Division only paid $2,475,896 for this plant. [113] MKEC did not include an acquisition adjustment, which means the Company is requesting a return on and return of $2.94 million in plant that was never paid for by the Company. [114] Both CURB and Staff have made an acquisition adjustment, with CURB recommending a net reduction to rate base of $2,638,535 [115] and Staff recommending an adjustment of the entire $2.9 million. [116]

52. Staff & CURB's acquisition adjustment is reasonable and consistent with the 524 Docket S&A, which required that any acquisition premium be recorded below the line so ratepayers would not pay the cost of the premium paid by MKEC over and above the value of the assets purchased. [117] Nor should ratepayers have to pay for costs that were not actually incurred by the utility. As acknowledged by Mr. Bell during his cross-examination, Staff and CURB's treatment of the negative acquisition adjustment "is based upon the principle that ratepayers shouldn't have to pay for assets that weren't actually paid for." [118]

53. Furthermore, all prior MKEC rate cases involved an acquisition premium, not a negative acquisition adjustment, [119] and the 524 S&A and Order spoke only of an acquisition

[113] Crane Direct, p. 8; Crane Opposition, p. 8.
[114] Crane Direct, p. 8.
[115] Crane Direct, pp. 15-16, Schedule ACC-1.
[116] Bell Direct, pp. 4, 9, 12-13; Bell, Tr. p. 285-86.
[117] Crane Direct, pp. 14-16; Crane Opposition, pp. 7-8, ACC-SA-1; Bell Direct, pp. 12, 22.
[118] Bell, Tr. pp. 285-86. *See also,* Crane Direct, pp. 7-16.
[119] Morris, Tr. pp. 102-103.

premium. [120] In addition, prior MKEC rate cases involved TIER analysis,[121] (with actual debt), not rate of return analysis, which does not involve consideration of the acquisition adjustment. In KCC Docket No. 08-WSEE-1041-RTS, the Westar 1041 negative acquisition adjustment was treated consistent with Staff and CURB's recommendations. [122]

54. In Kansas, a utility is only allowed a return on *used and useful property*." [123] However, a utility should not receive a return on and a return of property that the utility never funded in the first place. If utilities were to receive a return on amounts that they never invested, the results would be excessive utility rates. A similar result would occur if utilities were given a return of investment dollars that they had never made through depreciation charges on this phantom investment. Therefore, the amount included in rate base, and used to determine depreciation expense, should be no higher than the amount actually paid by the utility. The asymmetric principle described by Mr. Bell[124] is a well-established ratemaking principle, a portion of which was reflected in the 524 S&A. The 524 S&A did not contemplate the situation we are facing here, where the acquisition adjustment is negative. This is because the methodology outlined in the 524 S&A for allocating the acquisition premium would have distributed that premium to all MKEC members. However, the Members did not use the methodology outlined in the 524 S&A. Instead, they used a methodology based on EBITDA, which resulted in the allocation of a negative acquisition adjustment to one member, the Lane Scott Division. As discussed by Mr. Bell during his cross-

[120] Shepherd, Tr., pp. 244.
[121] Morris, Tr., pp. 107-08; Crane Direct, p. 13.
[122] Bell, Tr. p. 285-86; Bell Direct, p. 13.
[123] *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n,* 238 Kan. 483, 489-90, 720 P.2d 1063 (1986) (emphasis added).
[124] Bell, Tr. pp. 285 ("you would either use the lower of the cost that was actually paid or the net book value. If there was a premium, that premium would be – would be subtracted from rate base. If it's a negative one, it would be – it would reduce the book value to the price that was actually paid.") *See also,* Crane Direct, pp. 7-16.

examination, the $2.94 million in plant that was never paid for by the Company - does not constitute used and useful property that was financed by the utility. The plant amount that was never paid for is similar to plant funded by a third party, such as contributions in aid of construction, which are similarly excluded from rate base. As a result, the Company is not entitled to a return on an investment that was never made.

55. CURB therefore respectfully requests that the Commission adopt the acquisition adjustment recommended by both CURB and Staff and limit rate base to the amounts actually paid by the utility.

2. *Working Capital should be reduced $400,596.*

56. CURB's recommendation included a rate base adjustment to reduce the material and supplies balance by $400,596. This adjustment was simply to correct an error in the Company's filing [125] and was not opposed by the Company in its Rebuttal Testimony. Staff proposed a similar adjustment. This error occurred because in its filing, the Company originally allocated 100% of its materials and supplies to the Lane Scott MKEC Division and none to the unregulated Lane Scott native system.

57. This materials and supplies adjustment would reduce the Company's request by another $34,915, assuming the Company's requested return of 8.718%. [126] CURB respectfully requests that the Commission adopt this non-controversial adjustment.

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[125] Harden Direct, p. 7, Schedule SMH-3; Crane Opposition, p. 10; CURB Exh. 1.
[126] $400,496 X $8.718% = $34,915.

3. Cash Working Capital should be reduced $72,959.

58. Both Staff and CURB did make an adjustment to reduce cash working capital by $72,959 to eliminate working capital on energy costs recovered through the Energy Charge Adjustment ("ECA").[127]

59. The ECA mechanism approved in KCC Docket No. 07-MKEE-974-TAR allows the Company to estimate its purchased power costs for the current period and then true-up this estimate annually. In any given month, an under-recovery or over-recovery of purchased power costs will likely occur. Consequently, in any particular month, the revenue collected by Lane Scott may be reimbursing the Company for power purchased in the past, or it may be providing funds for fuel and power that is still to be purchased in the future. As a result, there is no need for cash working capital for purchased power costs handled by the ECA mechanism.[128]

60. CURB therefore respectfully requests that the Commission adopt CURB's cash working capital adjustment.

D. CURB's adjustments to operating income at present rates should be adopted by the Commission:

61. The question was raised at the hearing as to why it is important to scrutinize the costs of a regulated cooperative utility. It is important for the KCC to examine the Lane Scott Division's costs with the same level of scrutiny that they provide to the review of investor-owned utilities, for several reasons. MKEC could have transferred the Lane Scott Division's certificate to Lane Scott and the customers of the cooperative could have voted to exempt themselves from regulation. They

[127] Harden Direct, pp. 5-6, 8, Schedule SMH-4; Crane Opposition, p. 18.
[128] Harden Direct, p. 8, Schedule SMH-4; Crane Opposition, p. 18.

did not do so. Since the certificate has not yet been transferred, it is incumbent upon the KCC to insure that regulated rates are just and reasonable.

62. As stated by Ms. Crane at the hearing, "...the Legislature has given you the responsibility to regulate rates for...the Lane Scott Division. Whether you agree with that or not, you have that responsibility....we need to make sure those rates are just and reasonable and that goes to the overall level of the rates."[129] Ms. Crane testified that in the case of the Lane Scott MKEC division, it was important to review "...the allocation process and whether...regulated ratepayers are subsidizing or being subsidized by...the unregulated customers."[130]

63. Ms. Crane went on to state that management of the utility still rests with the cooperative, noting that if the KCC disallows a particular expense, the cooperative has two options: the cost will have to be picked up in margin or the co-op will have to decide to no longer incur the expense.[131] This is similar to the choice facing investor-owned utilities when the KCC disallows an expenditure: either that cost is no longer incurred by the utility or it is recovered through margins, which for an investor-owned utility is shareholder equity.

64. Finally, Ms. Crane noted that the integrity of the regulatory process is at issue, noting that "...once you begin to make decisions, for example, that you are not going to examine the financials of a co-op, even though you have the regulatory or statutory responsibility to do so,...I think that hurts the process. I think to the extent that you approve recovery... in regulated rates of things like lobbying, advertising, golf tournaments...trips to Orlando, that will have a spill over

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[129] Crane, Tr. p. 343.
[130] Crane, Tr. p. 344.
[131] Crane, Tr. p. 343.

effect onto investor-owned utilities…there is a bigger public interest that we haven't really talked about today. But I think it's an important one." [132]

65. CURB respectfully requests that the Commission adopt the following adjustments to operating income at present rates proposed by CURB.

> ***1. Depreciation/Amortization Associated with Acquisition Adjustment: The Company's depreciation expense should be adjusted to reflect depreciation based on the purchase price of the Aquila assets, resulting in a reduction of $78,439.***

66. CURB and Staff made similar adjustments with respect to the depreciation associated with the negative acquisition adjustment. CURB reduced depreciation expense by $78,439, and Staff made a $99,758 adjustment to the amortization of the acquisition adjustment. [133]

67. Staff and CURB's adjustments are necessary to reflect depreciation based on the actual costs that the Company incurred in the acquisition of the Aquila assets. The Company's claim includes depreciation expense on the full amount of the assets, including on amounts that were never paid by the Company. Since the Company never made the investment in the first place, it is not entitled to any return of this investment. [134]

68. CURB therefore respectfully requests that the Commission adopt CURB's depreciation expense adjustment (or Staff's adjustment to the amortization of the acquisition adjustment).

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[132] Crane, Tr. pp. 344-345.
[133] Crane Direct, pp. 16-18, Schedule ACC-2; Crane Opposition, pp. 8-10; Bell Direct, pp. 21-23.
[134] Crane Direct, pp. 16-17; Crane Opposition, pp. 8-10; Bell Direct, p. 21.

2. *Dues, Donations, Lobbying expenses should be reduced $5,615.*

69. CURB requests that the Commission adopt CURB's dues, donations, and lobbying expense adjustment of $5,615 as described in the direct testimony of CURB witness Stacey Harden.[135]

3. *Advertising expenses should be reduced $11,420.*

70. Charges for advertising expenses listed as "yellow page ad", "race car sponsorship", "after prom donation", "radio-spots", "rodeo sponsorship", and "golf tournament sponsorship," are unrelated to providing safe and reliable utility service and should not be included in rates.[136]

71. CURB requests that the Commission adopt CURB's adjustment to advertising expenses of $11,420

4. *Entertainment should be reduced $5,234.*

72. Golf tournaments, a catered BBQ meal, carnival rides, and numerous door prizes at the Lane Scott annual meeting are not related to the provision of safe and reliable utility service and should not be paid for by ratepayers.[137]

73. CURB requests that the Commission adopt CURB's adjustment to reduce advertising expenses by $11,420.

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[135] Harden Direct, pp. 9-12, Schedule SMH-5, Schedule SMH-6.
[136] Harden Direct, p. 13, Schedule SMH-7.
[137] Harden Direct, pp. 14-16, Schedule SMH-8.

5. Directors fees and expenses should be reduced $48,486.

74. CURB requests that the Commission adopt CURB's director's fees and expenses adjustment of $48,486 as described in the direct testimony of CURB witness Stacey Harden.[138]

6. Miscellaneous expenses (satellite radio, marketing tools) should be reduced $888.

75. CURB requests that the Commission adopt CURB's miscellaneous expenses (satellite radio, marketing tools) adjustment of $888 as described in the direct testimony of CURB witness Stacey Harden.[139]

E. The Lane Scott MKEC division has an overall revenue deficiency of $48,888.

76. CURB's adjustments described above bring the Company's revenue deficiency at present rates to $48,888.[140] CURB therefore respectfully urges the Commission to award a revenue increase of $48,888. This increase will permit the Company to earn an operating margin of $122,723 as shown on page 6 of Ms. Crane's Testimony in Opposition to the S&A. In addition, since the Company has no interest expense liability, all of this margin will be available to increase the Company's equity balance.

[138] Harden Direct, pp. 16-23, Schedule SMH-9.
[139] Harden Direct, p. 23, Schedule SMH-10.
[140] Harden Direct, pp. 5, 23-24, Schedule SMH-1; Crane Opposition, pp. 4, 6-8.

IV. THE COMMISSION SHOULD FIND THE LANE SCOTT MKEC DIVISION IS NOT IN COMPLIANCE WITH THE PROVISIONS OF THE ORDER AND STIPULATION & AGREEMENT IN KCC DOCKET NO. 06-MKEE-524-ACQ.

77. The Company has not complied with the requirements of the 524 S&A and Order for member distribution cooperatives to "maintain separate books and records," [141] develop "cost allocation procedures," and make the acquired WPK customers *full members* of the cooperatives.[142]

78. These basic 524 Docket requirements were not complied with by the Lane Scott MKEC division. Instead, the Company makes undocumented intercompany payments out of one checking account, using allocations that have been modified during the course of this rate case and that have never been formalized through a cost allocation manual.

79. The Company did not keep separate books and records, [143] a requirement the Company appears to have ignored because it was "not economically practical," [144] even though the same witness admitted it isn't that difficult or expensive to maintain separate checking accounts for the regulated (MKEC) and unregulated (native) companies. [145] The intercompany payable is an accounting entry only for which the Company has not established a payable or liability, does not consider it a liability, and has no record of any formal agreement or written documentation.[146] In addition, Staff determined that Mr. Bell also testified that "there appears to be significant co-mingling of financing between the Lane-Scott native cooperative and the MKEC-division."[147]

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[141] 524 Order, ¶ 15; 524 S&A, ¶ 14.
[142] 524 S&A , ¶¶ 13, 19, 25; 524 Order, ¶¶ 10, 15
[143] Crane Direct, pp. 21-23.
[144] Morris Direct, p. 2; Morris, Tr. p. 137.
[145] Morris, Tr. p. 138.
[146] Morris, Tr. pp. 142-44; Crane Direct, p. 21; Crane Opposition, pp. 11-14; Shepherd, Tr. pp. 210, 246; CURB Exh. 6; CURB Exh. 14.
[147] Bell Direct, p. 16.

80. The Company likewise didn't give customers full membership rights. Instead, the representation of Lane Scott MKEC members is one tenth of the representation of the Lane Scott native members prior to the Aquila acquisition. The Lane Scott Electric Cooperative, Inc. Board didn't add any additional Board members but merely added an additional county to the territory that its Board members represented. [148] There are currently the same number of trustees that represent the interests of customers for Lane Scott Electric Cooperative, Inc. as there are now, after the acquisition of the Aquila assets. [149] The only change made to the trustee representation of members was that the bylaws were amended to add Rush County to the two trustees representing Ness County. [150] Prior to the acquisition of the Aquila territory and customers, the Lane Scott trustee representation per member ranged from between 93-176. [151] However, after the acquisition, the newly acquired Aquila customers (Lane Scott MKEC division customers) have a trustee representation per member of approximately 1,000, giving the former Aquila customers significantly less trustee representation than prior to the acquisition. [152]

81. In addition, the nominating committee has remained unchanged from 2005, prior to the acquisition, until at least 2010, the test year in this case. [153] As a result, the Lane Scott MKEC customers have between 10-20% of the trustee representation as the majority of the Lane Scott native customers, and have no members on the nominating committee that virtually controls who is elected to the board of trustees of Lane Scott.

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[148] Lowry, Tr. p. 77.
[149] Morris, Tr. pp. 119-124; CURB Exh. 2.
[150] Morris, Tr. pp. 120-21; CURB Exh. 2.
[151] Morris, Tr. p. 123; CURB Exh. 2.
[152] Morris, Tr. p. 124; CURB Exh. 2.
[153] Morris, Tr. p. 127-29; CURB Exh. 12; CURB Exh. 13.

82. CURB respectfully submits that the Commission should find the Company is not in compliance with the provisions of the 524 S&A and Order.

V. THE COMMISSION SHOULD FIND THE LANE SCOTT MKEC DIVISION HAS NOT BEEN OPERATED OR MANAGED INDEPENDENTLY FROM THE LANE SCOTT NATIVE SYSTEM AS REQUIRED BY THE ORDER AND S&A IN KCC DOCKET NO. 06-MKEE-524-ACQ

83. The evidence clearly indicates that the Lane Scott MKEC division has not been operating or managed independently from the Lane Scott deregulated native system as required by the 524 S&A and Order. Using one checking account for the separate deregulated and regulated utilities, failing to document what intercompany payables were for, failing to develop cost allocation procedures, all indicate a Company that didn't believe the provisions of the Commission's 524 Order needed to be followed.

84. CURB respectfully submits that the Commission should find the Company has not been operated or managed independently from the native division as required by the Commission's 524 Order, and Order the Company to begin compliance forthwith.

VI. THE LANE SCOTT MKEC DIVISION AND LANE SCOTT NATIVE SYSTEM SHOULD BE REQUIRED TO FORMALIZE ANY FUTURE INTERCOMPANY LOANS TO ALLOW PROPER EVALUATION OF THE FINANCIAL CONDITION OF THE REGULATED ENTITY.

85. The anomalies, assumptions, bad data, and failure to document the $2.9 million in intercompany payables have made this rate case extremely difficult, to the extent Staff witness John Bell believed that parties were required to "massage the data." These uncertainties, at least with respect to any *future* intercompany payable issues, would be resolved if the Commission would order

the Company to formalize any future intercompany payables or loans to allow the proper evaluation of the financial condition of the Lane Scott MKEC division.

VII. CONCLUSION

86. WHEREFORE, CURB respectfully requests that the Commission deny the proposed settlement, grant the revenue requirement recommended by CURB, make the above requested findings and orders, and for such further relief as may be just and equitable.

Respectfully submitted,

C. Steven Rarrick #13127
Citizens' Utility Ratepayer Board
1500 SW Arrowhead Road
Topeka, KS 66604
(785) 271-3200
(785) 271-3116 Fax

VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

I, C. Steven Rarrick, of lawful age, being first duly sworn upon his oath states:

That he is an attorney for the above named petitioner; that he has read the above and foregoing document, and, upon information and belief, states that the matters therein appearing are true and correct.

C. Steven Rarrick

SUBSCRIBED AND SWORN to before me this 22nd day of February, 2013.

DELLA J. SMITH
Notary Public - State of Kansas
My Appt. Expires January 26, 2017

Notary Public

My Commission expires: 01-26-2017.

CERTIFICATE OF SERVICE

12-MKEE-410-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service this 22nd day of February, 2013, to the following parties who have waived receipt of follow-up hard copies:

RAY BERGMEIER, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027
r.bergmeier@kcc.ks.gov

SAMUEL FEATHER, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027
s.feather@kcc.ks.gov

HOLLY FISHER, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027
h.fisher@kcc.ks.gov

RENEE K. BRAUN, CORPORATE PARALEGAL, SUPERVISOR
MID-KANSAS ELECTRIC COMPANY, LLC
301 WEST 13TH STREET
PO BOX 980
HAYS, KS 67601
rbraun@sunflower.net

DON GULLEY, VP, SENIOR MANAGER
REGULATORY RELATIONS AND BILLING
MID-KANSAS ELECTRIC COMPANY, LLC
301 WEST 13TH STREET
PO BOX 980
HAYS, KS 67601
dgulley@sunflower.net

L. DOW MORRIS, INTERIM GENERAL MANAGER
LANE-SCOTT ELECTRIC COOPERATIVE, INC.
PO BOX 758
DIGHTON, KS 67839-0758
dow.morris@lanescott.coop

MARK D. CALCARA, ATTORNEY
WATKINS CALCARA CHTD.
1321 MAIN STREET SUITE 300
PO DRAWER 1110
GREAT BEND, KS 67530
mcalcara@wcrf.com

LINDSAY SHEPARD, EXECUTIVE MANAGER CORPORATE COMPLIANCE &
ASSOCIATE GENERAL COUNSEL
SUNFLOWER ELECTRIC POWER CORPORATION
301 W. 13TH
PO BOX 1020 (67601-1020)
HAYS, KS 67601
lshepard@sunflower.net

GLENDA. CAFER, ATTORNEY
CAFER LAW OFFICE, L.L.C.
3321 SW 6TH STREET
TOPEKA, KS 66606
glenda@caferlaw.com

TERRI PEMBERTON, ATTORNEY
CAFER LAW OFFICE, L.L.C.
3321 SW 6TH STREET
TOPEKA, KS 66606
terri@caferlaw.com

Della Smith
Della Smith
Administrative Specialist