

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

MAR 05 2013

by
State Corporation Commission
of Kansas

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

**POST-HEARING REPLY BRIEF OF THE
CITIZENS' UTILITY RATEPAYER BOARD**

COMES NOW, the Citizens' Utility Ratepayer Board ("CURB"), and files this post-hearing reply 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 reply brief, CURB states as follows:

I. REPLY TO STAFF BRIEF

1. Staff argues that the proposed non-unanimous settlement agreement "eliminated all unsupported or thinly supported positions and forged middle ground between Staff's and Mid-Kansas' firmly held positions."¹ This statement is contrary to the substantial adjustments made by Staff. Specifically, Staff's \$2.9 million Plant in Service adjustment² and Staff's \$99,758 adjustment to the amortization of the acquisition adjustment³ were not "unsupported or thinly supported" in either prefiled testimony or testimony at the evidentiary hearing. Further, the Company conceded the "uncontested \$400,596 rate base adjustment for materials and supplies that the Company admits was

¹ Staff's Post Hearing Brief in Support of the Settlement Agreement ("Staff's Brief"), ¶ 2.

² Bell, Tr. pp. 285-86, 299; Bell Direct, p. 13-14; Crane Opposition, pp. 7-9, ACC-SA-1.

³ Staff Rate Base/Rate of Return Schedules, Schedule B-2, Adjustment No. 2; Bell Direct Testimony, pp. 21-22; Crane Opposition, pp. 8-10, ACC-SA-3.

an error in its application.⁴ These three adjustments, applied to the Company's inefficient capital structure⁵ and the Company's ROE of 8.171%, reduce the Company's filed revenue deficiency claim from \$510,915 to 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.⁶ While these adjustments may have been ignored by the proposed settlement between Staff and the Company, they were certainly not eliminated and are fully discussed in the Post-Hearing Brief of the Citizens' Utility Ratepayer Board ("CURB's Brief").⁷

2. Staff's argument that the \$370,000 proposed rate increase settlement falls within the "zone of reasonableness" relies entirely upon its flawed TIER approach. Staff correctly states that decisions by the Commission must be based on "substantial competent evidence which possesses *something of substance and relevant consequence*, and which *furnishes a substantial basis of fact from which the issues tendered can reasonably be resolved.*"⁸ Staff attempts to support this standard by stating, "Staff witness Bell describes a *plausible* scenario that *could* produce a \$370,000 revenue increase."⁹ The scenario presented by Mr. Bell is hardly plausible, unless one accepts the following definition of plausible: "*superficially* fair, reasonable, or valuable but often *specious.*"¹⁰ The scenario described by Mr. Bell relies entirely on Staff's flawed TIER analysis and made-up debt,

⁴ Crane Opposition, p. 10; Harden Direct, pp. 5, 7, Schedule SMH-3; CURB Exh. 1.

⁵ CURB does not agree with the Company's unreasonable and inefficient 100% equity capital structure, but applies these three adjustments to the Company's capital structure to illustrate the unreasonableness of the \$370,000 revenue deficiency in the proposed settlement. *See*, Post-Hearing Brief of the Citizens' Utility Ratepayer Board ("CURB's Brief"), ¶¶ 15-30, 46-49; Cotton Direct Testimony, pp. 6-7; Shepherd, Tr., p. 211; Shepherd Rebuttal, p.7.

⁶ Crane Opposition, p. 10; Harden Direct, p. 7, Schedule SMH-3; CURB Exh. 1.

⁷ CURB's Brief, ¶¶ 20-24.

⁸ Staff's Brief, ¶ 9 (citing, *Jones v. Kansas Gas and Electric Co.*, 222 Kan. 290, Syl. ¶ 3 (1977)).

⁹ Staff's Brief, ¶ 10.

¹⁰ 2013 Merriam-Webster's Online Dictionary, <http://www.merriam-webster.com/dictionary/plausible>

which CURB has demonstrated is flawed, not supported by substantial competent evidence, and constitutes retroactive ratemaking.¹¹

3. Staff's made-up debt and interest expense, expressly contrary to the Company's sworn testimony and discovery responses, do not possess *something of substance and relevant consequence*, and which *furnishes a substantial basis of fact from which the issues tendered can reasonably be resolved.*"¹² Staff admits that its TIER analysis requires the Commission to accept the "reasonableness of the 'de facto' loan,"¹³ which is not possible based on the overwhelming evidence in the record:

- Mr. Bell's admission that "This case is fraught with assumptions."¹⁴
- 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.¹⁵
- 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.¹⁶
- Staff had no specific example of any of the expenditures included in the \$2.9 million in intercompany payables.¹⁷
- The \$2.9 million in intercompany payables "could" include past losses that were incurred by the Company.¹⁸
- "[T]here appears to be significant co-mingling of financing between the Lane-Scott native cooperative and the MKEC-division."¹⁹
- 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.²⁰

¹¹ CURB's Brief, ¶¶ 31-42.

¹² *Jones v. Kansas Gas and Electric Co.*, 222 Kan. 290, Syl. ¶ 3 (1977).

¹³ Bell, Tr. pp. 298-99.

¹⁴ Bell, Tr. p. 282.

¹⁵ Bell, Tr. pp. 293-94; Shepherd, Tr., p. 216-18; CURB Exh. 5.

¹⁶ Bell, Tr. pp. 294-95.

¹⁷ Bell, Tr. p. 295.

¹⁸ Bell, Tr. p. 295.

¹⁹ Bell Direct, p. 16.

²⁰ Morris, Tr. pp. 142-44; Crane Direct, p. 21; CURB Exh. 6.

- Staff “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.”²¹
- Staff’s “assumption” is inconsistent with Mr. Bell’s 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.²²

4. A TIER analysis requires examination of the loan document and covenants with respect to what the lender requires of that utility,²³ yet the Company’s sworn testimony establishes there was no debt, no loan, no loan covenants, no interest expense, and the company did not consider the \$2.9 million in intercompany payables to be a liability.²⁴ 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, yet Staff chose to do so in this docket.²⁵

5. Staff attempts to rebut CURB’s argument that there is “no theoretical support for using a TIER methodology, since the TIER methodology is based on a premise that does not exist in this case;’ namely, that there is no debt.”²⁶ Staff argues that Staff “*believes*” this subsidy is a loan,²⁷ and concludes that this loan is “*reflective*” of Lane Scott’s accumulated losses and capital investments which have been subsidized by the Lane-Scott native load side of the business that has incurred long-term debt, or used up equity to subsidize those losses.”²⁸

²¹ Bell, Tr. p. 281.

²² Bell, Tr. pp. 281-82.

²³ Gatewood, Tr. pp. 255, 257-58.

²⁴ Shepherd, Tr. pp. 210, 245-46; Shepherd Direct. pp. 7-8; Morris, Tr. pp. 109, 142-44; Crane Direct, p. 21; Crane Opposition, pp. 11-12; CURB Exh. 6; CURB Exh. 14.

²⁵ Bell, Tr. p. 282; Gatewood, Tr. p. 255. In 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. Bell, Tr. p. 298.

²⁶ Staff Brief, ¶ 15.

²⁷ Staff Brief, ¶ 16.

²⁸ *Id.*, ¶ 15.

6. Staff's *belief* that the intercompany payables is a loan based on its conclusion that intercompany payables is *reflective* of the Company's accumulative losses and capital investments is hardly substantial competent evidence. Staff's conclusion that the intercompany payable constitutes a loan, *de facto* or otherwise, is admittedly based on *assumptions*²⁹ its *belief*,³⁰ that the intercompany payables is *reflective*³¹ of accumulated losses and capital investments that Staff was *unable to tie* to the payables and is *unaware of the components for which the losses were incurred*.³² Staff's assumptions and belief is simply not credible or reasonable in light of the Company's sworn testimony that there was no debt, no loan, no loan covenants, no interest expense, and no liability for the intercompany payables.³³ Using and relying upon a TIER analysis is simply not plausible, not reasonable, and not based on substantial competent evidence in the record as a whole.

7. Staff claims that Lane-Scott is a financial troubled utility that is not currently recovering its cost of service,³⁴ yet the record reflects that at year-end 2010, the end of the test year, the Company's net operating loss had been reduced to \$2,126 because of increase revenues resulting from the last rate case.³⁵ Further, because Staff performed a thorough rate base/rate of return analysis³⁶ and did not omit or fail to include any operating expenses in its rate base/rate of return recommendation, Staff's \$31,333 rate base/rate of return revenue deficiency recommendation *will cover the Lane Scott MKEC division's cost of service*, including depreciation expense and an

²⁹ Bell, Tr. pp. 281-82.

³⁰ Staff Brief, ¶ 16.

³¹ Staff Brief, ¶ 16.

³² Bell, Tr. pp. 293-94; Shepherd, Tr., p. 216-18; CURB Exh. 5.

³³ Shepherd, Tr. pp. 210, 245-46; Shepherd Direct. pp. 7-8; Morris, Tr. pp. 109, 142-44; Crane Direct, p. 21; Crane Opposition, pp. 11-12; CURB Exh. 6; CURB Exh. 14.

³⁴ Staff Brief, ¶ 17.

³⁵ Shepherd, Tr., pp. 215-16.

³⁶ Bell, Tr. p. 297.

operating margin.³⁷ The reason Staff rejected its rate base/rate of return recommendation was that it failed to compensate the Company for *past losses*.³⁸ Staff's attempt to compensate the Company for *past losses* clearly constitutes retroactive ratemaking, in violation of sound regulatory principles.

8. Staff *contends* that in order to accept the reasonableness of the \$370,000 proposed rate increase, the only decision the Commission has to make is whether the loan is real or not and whether it deserves repayment.”³⁹ First, as noted previously, the Company's own sworn testimony establishes that there was no debt, no loan, no loan covenants, no interest expense, and no liability for the intercompany payables.⁴⁰ Second, Staff appears unable or unwilling to comprehend the concept of debt being a legal liability or obligation. The Company has stated throughout the record that it does not consider the intercompany payables a liability. Whether the intercompany payable in Staff's opinion “deserves repayment” is irrelevant; there is no loan, the Company does not consider intercompany payable to be a liability, and the Company has failed to identify the components of the intercompany payable to allow Staff or CURB to tie the \$2.9 million to *any* of the undisclosed components. Based on the overwhelming evidence in the record as a whole, including the Company's own sworn testimony and discovery responses, the Commission should find that there is no loan and therefore no repayment obligation.

9. Contrary to Staff's argument otherwise,⁴¹ CURB vigorously asserts that the revenue deficiency of \$370,000 in the proposed settlement is not within the zone of reasonableness.⁴² Staff appears to mistakenly believe testimony is required with respect to the legal conclusion of whether a

³⁷ Bell, Tr. pp. 296-97 (emphasis added); Crane Opposition, p. 16.

³⁸ Bell Direct, pp. 24-25; Bell, Tr. pp. 295-96.

³⁹ Staff Brief, ¶ 18.

⁴⁰ Shepherd, Tr. pp. 210, 245-46; Shepherd Direct. pp. 7-8; Morris, Tr. pp. 109, 142-44; Crane Direct, p. 21; Crane Opposition, pp. 11-12; CURB Exh. 6; CURB Exh. 14.

⁴¹ Staff Brief, ¶ 27.

⁴² CURB Brief, ¶¶ 15, 19-20, 30, 40.

proposed settlement is or is not within the zone of reasonableness, yet Staff fails to provide any citation to authority supporting this erroneous conclusion.

II. REPLY TO COMPANY BRIEF

10. The Company criticizes CURB's decision to oppose the settlement despite what the Company characterizes as "lack of concern" by the Lane Scott members, something that often exists in investor owned utility rate cases because the average ratepayer has no way to respond with evidence to a proposed rate increase. However, the Company fails to acknowledge or even mention that the two nearly identical adjustments made by Staff and CURB regarding the negative acquisition adjustment⁴³ and associated depreciation or amortization⁴⁴ plus the additional uncontested adjustment related to the \$400,596 rate base error in the application for materials and supplies,⁴⁵ would reduce the Company's requested revenue deficiency from \$510,915 to between \$146,000 and \$167,500.⁴⁶

11. It defies logic to conclude that the Company's customers do not care whether the rate increase is the \$370,000 proposed in the settlement, or less than half of that - \$146,000 to \$167,500. The Company's own witness admitted that "rates are an issue to customers of MKEC because cooperative members want low rates like anyone else."⁴⁷ The Company's disregard to these three

⁴³ See, CURB Brief, ¶ 21, 51-55; Crane Direct, pp. 7-13; Crane Opposition, pp. 7-9, ACC-SA-1; Bell, Tr. pp. 285-86, 299; Bell Direct, pp. 12-14, 23.

⁴⁴ See, CURB Brief, ¶ 22, 66-68; Crane Direct, pp. 16-18, Schedule ACC-2; Crane Opposition, pp. 7-10, ACC-SA-1, ACC-SA-2, ACC-SA-3; Harden Direct, pp. 5; Bell, Tr. pp. 285-86, 299; Staff Rate Base/Rate of Return Schedules, Schedule B-2, Adjustment No. 2; Bell Direct, pp. 13-14, 21-22.

⁴⁵ See, CURB Brief, ¶¶ 23, 56-57; Crane Opposition, p. 10; Harden Direct, pp. 5, 7, Schedule SMH-3; CURB Exh. 1.

⁴⁶ See, CURB Brief, ¶¶ 21-23; Crane Opposition, pp. 9-11; Harden Direct, pp. 5, 7, Schedule SMH-3; CURB Exh. 1.

⁴⁷ Lowry, Tr. p. 72; Lowry Direct, p. 4.

significant adjustments, two proposed by Staff and CURB and one unopposed by the Company, “calls into question the validity of”⁴⁸ the Company’s entire brief.

12. CURB finds it peculiar that the Company conveniently adopts Staff’s “*de facto*” loan theory and TIER analysis,⁴⁹ despite the sworn testimony of Company witness Douglas Shepherd that clearly expressed his opinion that the intercompany payables did not constitute a payable or debt: “[t]he Applicant had no debt at the end of the test year;”⁵⁰ “because the Lane-Scott Division currently has no interest expense, it was mathematically impossible to calculate either a Times Interest Earned Ratio (“TIER”) or a Debt Service Coverage (“DSC”) ratio;”⁵¹ and “the company does not consider the negative cash balance a liability...”⁵²

13. The Company argues that because it always intended to merge the operations of the unregulated native division with the regulated MKEC division, it opted not to obtain a loan from a third party.⁵³ However, no one is suggesting that the Company take out a loan from a third party; CURB simply objects to creating a loan out of thin air. *If* the intercompany payable was an intercompany liability and loan (contrary to the Company’s sworn testimony otherwise), then all the Company had to do is *document the loan and was it incurred for in the separate records and books* it was required to keep pursuant to the 524 S&A and Order.⁵⁴ However, the Company has stated under oath on multiple occasions that it had no debt at the end of the test year and did not consider the

⁴⁸ Company Brief, ¶ 9.

⁴⁹ Company Brief, ¶¶ 13-14, 27.

⁵⁰ Shepherd Rebuttal, pp. 5-6; Shepherd, Tr. p. 210; Shepherd Direct, pp. 7-8; Morris, Tr. p. 109; Crane Opposition, pp. 11-12; Crane Direct, p. 21; CURB Exh. 6; CURB Exh. 14.

⁵¹ Shepherd Rebuttal, pp. 5-6; Shepherd, Tr. pp. 245-46; Crane Direct, p. 21.

⁵² Morris, Tr. pp. 142-44; Crane Opposition, pp. 11-12; CURB Exh. 6; Shepherd Direct, Exhibit DSS-1, Section P, December 31, 2010 and 2009, Notes to Consolidated Financial Statements, p. 23 (“As of December 31, 2010, the amount of the potential liability [for MKEC debt obligations], as calculated under FIN 45, is insignificant to the consolidated financial statements taken as a whole. Therefore, no liability is recorded in the consolidated financial statements.”).

⁵³ Company Brief, ¶ 15.

⁵⁴ 524 Order, ¶ 15; 524 S&A, ¶ 14.

intercompany payables a liability. The Company's sworn testimony that it does not consider the intercompany payables a liability is consistent with its failure to document the intercompany payables as a liability and loan in the separate records and books required by the 524 S&A and Order.

14. Formalizing an intercompany loan *would not*, as asserted by the Company, increase expenses to the MKEC division members or the cooperative as a whole.⁵⁵ It would have merely complied with the *separate records and books* requirement of the 524 S&A and Order and documented the payables as a liability and loan, something the Company's sworn testimony denies. The Company now wants to reinvent history and have what it has never considered a liability to be treated as a liability, in order to justify Staff's TIER analysis and recommendation.

15. The Company argues that Staff uses the TIER analysis to compare rate base/rate of return results with reality.⁵⁶ However, the Company fails to acknowledge that the TIER analysis performed by Staff is not based on reality, as confirmed by Company witness Shepherd, who testified that it was "mathematically impossible" to calculate a TIER analysis because the Company currently has no interest expense.⁵⁷ In this case, the reality check referenced by Staff should be the rate base/rate of return analysis performed by CURB and Staff, as Staff's TIER analysis is flawed as it is unreasonably based on a made-up, *de facto* loan where there is no liability or loan established or documented for the intercompany payables.

⁵⁵ Company Brief, ¶ 16.

⁵⁶ Company Brief, ¶ 17.

⁵⁷ Shepherd Rebuttal, pp. 5-6; Shepherd, Tr. pp. 210, 245-46; Shepherd Direct. pp. 7-8. *See also*, Crane Opposition, pp. 11-12; Morris, Tr. p. 109; CURB Exh. 14.

16. The Company argues that CURB erroneously “assumes that CURB’s position on Acquisition Adjustment and intercompany debt would be accepted by the Commission.”⁵⁸ First, the Company has apparently overlooked the fact that both CURB *and Staff* recommended nearly identical adjustments for the acquisition adjustment, with Staff removing the full \$2.9 million and CURB removing the net amount of \$2,638,535.⁵⁹

17. Second, contrary to the Company’s argument,⁶⁰ the position taken by Staff and CURB regarding the Acquisition Adjustment is fundamentally fair and consistent with the 524 S&A and Order. 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.”⁶¹ Furthermore, prior MKEC rate cases involved an acquisition *premium*, not a *negative* acquisition adjustment,⁶² and the 524 S&A and Order spoke only of an acquisition premium.⁶³ In addition, prior MKEC rate cases involved TIER analysis,⁶⁴ (with actual debt), not rate base/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.⁶⁵

18. A utility is only allowed a return on *used and useful property*.⁶⁶ The Lane Scott MKEC division should not receive a return on and a return of property that the utility never funded

⁵⁸ Company Brief, ¶ 25.

⁵⁹ CURB Brief, ¶ 21, 51-55; Crane Direct, pp. 7-16, Schedule ACC-1; Crane Opposition, pp. 7-9, ACC-SA-1; Bell, Tr. pp. 285-86, 299; Bell Direct, pp. 4, 9, 12-14, 23.

⁶⁰ Company Brief, ¶ 26.

⁶¹ Bell, Tr. pp. 285-86. *See also*, Crane Direct, pp. 7-16.

⁶² Morris, Tr. pp. 102-103.

⁶³ Shepherd, Tr., pp. 244.

⁶⁴ Morris, Tr., pp. 107-08; Crane Direct, p. 13.

⁶⁵ Bell, Tr. p. 285-86; Bell Direct, p. 13.

⁶⁶ *Kansas Gas & Electric Co. v. Kansas Corporation Comm’n*, 238 Kan. 483, 489-90, 720 P.2d 1063 (1986) (emphasis

in the first place.⁶⁷ The asymmetric principle described by Mr. Bell⁶⁸ is a well-established ratemaking principle, a portion of which was reflected in the 524 S&A and Order. As a result, the Company is not entitled to a return on an investment that was never made.

III. CONCLUSION

19. In summary, the \$370,000 rate increase proposed by Staff and the Company is not based on substantial competent evidence in the record as a whole, does not fall within the zone of reasonableness, will not result in just and reasonable rates, and erroneously relies on Staff's flawed TIER analysis. As such, CURB recommends that the Commission find the proposed settlement is not in the public interest.

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

Respectfully submitted,



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added).

⁶⁷ See, CURB Brief, ¶¶ 51-55.

⁶⁸ 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.

VERIFICATION

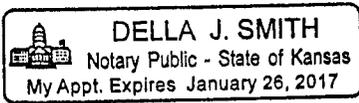
STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

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 5th day of March, 2013.




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 5th day of March, 2013, to the following parties who have waived receipt of follow-up hard copies:

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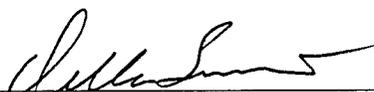
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