

BEFORE THE  
KANSAS CORPORATION COMMISSION

STATE CORPORATION COMMISSION

MAR 19 2007

 Docket  
Room

IN THE MATTER OF THE APPLICATION ]  
OF AQUILA, INC. d/b/a AQUILA ] KCC Docket No. 07-AQLG-431-RTS  
NETWORKS-KGO, FOR APPROVAL ]  
OF THE COMMISSION TO MAKE ]  
CERTAIN CHANGES IN ITS RATES FOR ]  
NATURAL GAS SERVICE ]

DIRECT TESTIMONY OF

BRIAN KALCIC

ON BEHALF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

March 19, 2007

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

2 A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.

3

4 **Q. What is your occupation?**

5 A. I am an economist and consultant in the field of public utility regulation, and principal of  
6 Excel Consulting. My qualifications are described in the Appendix to this testimony.

7

8 **Q. On whose behalf are you testifying in this case?**

9 A. I am testifying on behalf of the Citizens' Utility Ratepayer Board ("CURB").

10

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

12 A. I will address Aquila, Inc.'s ("Aquila" or "Company") proposed changes to its existing  
13 Residential Service class ("RS") and Small Commercial Service class ("SC") rate  
14 structures. In particular, I will critique the Company's preferred Maximum Daily Quantity  
15 ("MDQ") or demand-based rate design proposal, and sponsor an alternative set of RS and  
16 SC rate design guidelines for the Commission's consideration in this proceeding.

17

18 **Q. Do you have any preliminary comments?**

19 A. Yes. I wish to note that my testimony in this proceeding makes certain references to  
20 Aquila's proposed RS and SC class revenue requirement levels. Such references are  
21 intended to facilitate a comparison of alternative RS and SC rate designs, and should not be  
22 construed as support for Aquila's overall requested revenue requirement or proposed class  
23 revenue distribution.

1

2 **Q. Please summarize your findings and recommendations.**

3 A. Based upon my analysis of Aquila's filing, I find that:

4 • the MDQ rate proposal is misleading, in that it would not charge RS and SC  
5 customers according to the maximum demands they place on the Company's  
6 system;7 • the Company's MDQ proposal is unfair to ratepayers in that it would reduce  
8 Aquila's risk related to revenue recovery without a compensating reduction  
9 in the Company's return on equity;10 • the Company's MDQ rate design would be difficult for RS and SC  
11 customers to comprehend, and impractical to implement;12 • the MDQ rate proposal would be unduly discriminatory and discourage  
13 conservation;14 • the Company's flat charge rate proposal suffers from many of the same  
15 deficiencies as Aquila's MDQ rate design; and16 • the Company's traditional rate design alternative would produce  
17 unacceptable customer bill impacts within the RS and SC classes.

18 Moreover, based upon the above findings, I recommend that the Commission:

19 • reject the Company's MDQ, flat rate and traditional rate design alternatives  
20 for the RS and SC rate classes; and

21 • adopt CURB's recommended RS and SC rate design guidelines.

1 The specific details associated with CURB's findings and recommendations are discussed  
2 below.

3

4 **RS and SC Rate Design**

5 **Q. Mr. Kalcic, have you reviewed the Company's rate design proposals for the RS and**  
6 **SC rate classes in this proceeding?**

7 A. Yes, I have.

8

9 **Q. Please provide a brief description of those rate design proposals.**

10 A. Aquila has actually prepared three separate rate design proposals for the RS and SC classes:  
11 1) a "traditional" rate design comprised of a two-part rate;<sup>1</sup> 2) an alternative MDQ rate  
12 design proposal which would add a third rate component, i.e., a demand charge, to the  
13 Company's existing two-part rate; and 3) a flat charge rate design which would use a  
14 single, flat charge per bill per month in place of the Company's existing two-part rate  
15 design. The Company clearly states its desire for the KCC to approve its MDQ-based  
16 proposal, having prepared its traditional and flat charge alternatives for consideration only  
17 in the event that the KCC rejects its preferred MDQ rate proposal.

18 Table 1 below summarizes the Company's RS and SC rate design proposals in this  
19 proceeding.

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<sup>1</sup> The Company's existing two-part rate design consists of: i) a customer (i.e., fixed) charge; and ii) a single-block usage charge.

1

2

3

4

**Table 1**  
Company Proposed RS and SC Base Rate Charges

	<i>Traditional</i>	<i>MDQ</i>	<i>Flat Charge</i>
RS	\$16.88 per month; \$0.15108 per therm -	\$13.00 per month \$0.01919 per therm \$1.4346 per MDQ	\$27.62 per month - -
SC	\$25.00 per month; \$0.15108 per therm -	\$20.00 per month \$0.01919 per therm \$1.4346 per MDQ	\$27.62 per month - -

5

6

7

8

9

10 **Q. Please describe the Company's MDQ rate design proposal in greater detail.**

11 A. As previously stated, the Company's proposed MDQ rate design would add a third  
12 component to the Company's traditional two-part rate design for all of its firm service  
13 classes. This third component would take the form of a demand charge (in \$/MDQ/month)  
14 that would be applied to a customer's assigned MDQ. Under Aquila's proposal, a  
15 customer's MDQ would remain unchanged for twelve (12) months, and would be  
16 recalibrated just once annually in the month of August.

17

18

**Q. How specifically would the MDQ be calculated?**

19

20

A. The MDQ would be based upon a customer's highest recorded monthly usage (in therms)  
within the most recent thirty-six month period. In particular, the Company would divide a

1 customer's maximum monthly usage by 20, and round the result to the nearest whole  
2 number, to arrive at the customer's presumed MDQ for billing purposes.<sup>2</sup>

3  
4 **Q. Why must Aquila estimate a customer's MDQ in the above manner?**

5 A. Mr. Sullivan explains that the majority of Aquila's customer meters are not capable of  
6 providing peak-day demand information. Generally, only usage information between  
7 successive meter reads is available. Therefore, as an alternative to actual monthly demand  
8 data, the Company proposes to divide total monthly usage by 20, with the result deemed to  
9 be the customer's maximum daily demand or MDQ.

10  
11 **Q. Does Aquila propose to use the same divisor (i.e., 20) for computing the MDQs of all  
12 RS and SC customers?**

13 A. Yes. Mr. Sullivan explains that using a divisor of 20 would equate to an implied monthly  
14 load factor of approximately 66%, which he considers a reasonable proxy for determining  
15 monthly demand (from monthly usage information).

16  
17 **Q. Mr. Kalcic, what rationale does Aquila give for introducing its MDQ rate design  
18 proposal in this proceeding?**

19 A. On pages 18-19 of his direct testimony, Mr. Sullivan argues that most of the Company's  
20 investment and cost is associated with facilities that are designed to meet customers' peak-  
21 day requirements. As such, Mr. Sullivan claims that Aquila's MDQ rate design "is a more  
22 equitable and direct way to match rates and revenue recovery with the fixed nature of

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<sup>2</sup> As discussed below, Aquila is also proposing to establish minimum customer MDQs, by rate class. For RS customers, the minimum MDQ would be 5. For SC customers, the minimum would be 15.

1       Aquila’s network costs and how customers impose capacity costs on the gas network.” Mr.  
2       Sullivan also notes that the MDQ rate design proposal satisfies several important rate  
3       design principles, producing rates that would: 1) be based on the cost to serve customers;  
4       2) recover Aquila’s claimed revenue requirement; 3) provide revenue and rate stability; 4)  
5       be practical to implement; and 5) not be unduly discriminatory.

6               I will comment on each of these points below.

7  
8       **Q. With respect to the Company’s first argument concerning customer cost of service, do**  
9       **you agree that Aquila’s MDQ rate design would produce an equitable match between**  
10       **the rates charged to individual customers and the demand-based cost incurred by**  
11       **Aquila to serve them?**

12       A. No. The premise underlying the Company’s argument is that since most of its costs are  
13       demand-related, it is only appropriate to charge customers according to the level of the  
14       demand that they place on Aquila’s system. However, as previously discussed, Aquila does  
15       not possess actual customer demand data. Instead, Aquila proposes to estimate peak  
16       monthly demand, based on a customer’s peak monthly *usage*.

17               In reality, by applying the same divisor (i.e., 20) to the peak monthly usage of RS  
18       and SC customers, the Company is deeming *all* customers to have the exact same monthly  
19       load factor. As a result, the Company’s MDQ rate design does not recognize differences in  
20       actual customer load factors, i.e., demand, as intended. Stated differently, the proposed  
21       MDQ is mathematically equivalent to peak monthly *usage*, not maximum daily demand.  
22       Therefore, the MDQ proposal is incapable of producing an “equitable match” between the  
23       Company’s tariff charges and its demand-driven costs, as Aquila claims.

1 **Q. Do you agree that Aquila's proposed MDQ rate design would recover the Company's**  
2 **requested revenue requirement?**

3 A. Yes. However, such an outcome merely speaks to the accuracy of the accompanying proof  
4 of revenue. It reveals nothing about the alleged merits inherent in the proposed rate  
5 structure.

6  
7 **Q. Do you agree that Aquila's proposed MDQ rate design would provide revenue and**  
8 **rate stability?**

9 A. I agree that the MDQ proposal would provide Aquila with greater revenue stability. I  
10 disagree with Aquila's rate stability claim. Rate stability implies a degree of rate  
11 continuity, wherein customers remain familiar with the rates or charges that make up their  
12 monthly bills. Rate continuity is the exact opposite of what would transpire if the  
13 Company's existing rate structure were to be replaced by Aquila's proposed MDQ rate  
14 design.

15  
16 **Q. What percentage of the Company's current RS and SC base revenues is recovered via**  
17 **fixed charges?**

18 A. On a combined basis, approximately \$15.2 million, or 55.2%, of Aquila's total current RS  
19 and SC base revenues of \$27.6 million is collected via the customer charge.<sup>3</sup>

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<sup>3</sup>See Exhibit\_\_(KHW-8).



1 **Q. How much of the Company's proposed RS and SC base revenues would be recovered**  
2 **via fixed charges under its MDQ rate design proposal?**

3 A. On a combined basis, the total would be \$32.3 million, or 95.4%, of Aquila's total  
4 proposed base revenues of \$33.9 million.<sup>4</sup>

5

6 **Q. Why does the Company believe it is appropriate to recover 95.4% of its proposed RS**  
7 **and SC base revenues via fixed charges under its MDQ rate design proposal?**

8 A. In the Company's view, fixed costs should not be recovered in usage charges, and fully  
9 95.4% of Aquila's proposed RS and SC base rate revenue requirement is deemed to be  
10 fixed in nature.

11

12 **Q. Do you agree with the Company regarding fixed cost recovery?**

13 A. No, I disagree. I am unaware of any natural gas distribution company tariff that provides  
14 for a one-to-one correspondence between the level of fixed charges and the level of the  
15 utility's fixed cost incurrence. However, if the KCC were to approve Aquila's MDQ rate  
16 design, it would virtually guarantee that the Company would collect its entire approved  
17 base rate revenue requirement from ratepayers. That is not the case today under Aquila's  
18 current rate structure. As a result, the Company's MDQ rate proposal would lower the  
19 Company's risk of not collecting the level of revenues it needs in order to earn its  
20 authorized return. To the extent that the MDQ rate design would reduce the Company's

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<sup>4</sup>*Id.*

1 risk, the Commission should recognize that benefit and implement an appropriate  
2 adjustment to Aquila's allowed return on equity if the MDQ rate design is approved.<sup>5</sup>

3  
4 **Q. Mr. Kalcic, do you agree with the Company that its MDQ rate design proposal would  
5 be practical to implement?**

6 A. No, I do not. I have no doubt that Aquila is prepared to implement its proposal if it  
7 receives Commission approval. However, a rate design should also be sensible or practical  
8 from a customer's perspective. I find it difficult to believe that the Company will find it  
9 straightforward to explain to RS and SC customers that the size of their monthly bills now  
10 depends upon the amount of gas they consumed in a *single* month, as far back as three years  
11 ago.<sup>6</sup> Moreover, if RS and SC customers do not understand the rate design change, I would  
12 not expect them to be accepting or tolerant of it. As a result, I would expect customer  
13 complaints to increase.

14  
15 **Q. Mr. Kalcic, are you aware of any natural gas utility that has implemented a demand  
16 charge applicable to residential and/or small commercial customers?**

17 A. No, I am not.

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<sup>5</sup> CURB witness Andrea Crane discusses the specifics of such an adjustment in her direct testimony.

<sup>6</sup> For example, how do you explain to a residential customer with a brand new, energy efficient heating system that his/her monthly gas bill savings will now be lower than expected, due to the rate design change?

1 **Q. Finally, Aquila claims that its MDQ rate design would not be unduly discriminatory.**

2 **Do you agree?**

3 A. No. Since the Company would not have a billing history for new customers, such  
4 customers would automatically be assigned a minimum MDQ for up to (their first) twelve  
5 months of service. During that time, it is quite possible that “like” customers could be  
6 charged “unequal rates for equal service,” which would be discriminatory. Moreover, the  
7 same situation could also apply to *existing* customers that move to a new residence/location  
8 within Aquila’s service territory.

9  
10 **Q. On page 32 of his direct testimony, Mr. Raab states that rate structures like Aquila’s**  
11 **MDQ proposal “provide a stronger incentive for utilities to promote conservation**  
12 **because they ‘decouple’ the utility’s volumetric sales from its profitability. Thus, the**  
13 **utility is not penalized in the form of decreased earnings for encouraging the efficient**  
14 **use of natural gas.” Do you have any comment?**

15 A. Yes. I find it ironic that the Company should seek to append the conservation label to its  
16 MDQ proposal in an attempt to win Commission approval. While the proposed MDQ rate  
17 design would, in fact, decouple Aquila’s sales from its profitability, and thereby reduce the  
18 Company’s risk, it would also *reduce* the current usage charge applicable to RS and SC  
19 customers by 87.3%.<sup>7</sup> All else equal, such a reduction would *discourage* conservation by  
20 RS and SC customers.

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<sup>7</sup> Compare lines 6 and 19 of Exhibit\_\_\_(KHW-8).

1 **Q. Mr. Kalcic, should the KCC approve the Company's MDQ rate design proposal?**

2 A. No, for all of the following reasons. First, the MDQ proposal is misleading in that it would  
3 not charge RS and SC customers according to the maximum demands they place on the  
4 Company's system. Second, the proposal is unfair to ratepayers in that it would reduce  
5 Aquila's risk related to revenue variability without a compensating reduction in the  
6 Company's return on equity. Third, the Company's MDQ rate design would be difficult for  
7 RS and SC customers to comprehend, and impractical to implement. And, finally, the  
8 proposal would be unduly discriminatory and discourage conservation.

9

10 **Q. Mr. Kalcic, please turn now to Aquila's flat charge rate design alternative. How did**  
11 **Mr. Sullivan determine the flat charge to be paid by RS and SC customers?**

12 A. Mr. Sullivan summed the Company's proposed RS and SC base rate revenue requirements,  
13 and divided the total by the number of RS and SC bills to arrive at a flat rate of \$27.62 per  
14 customer per month.

15

16 **Q. How much of the Company's proposed RS and SC base revenue requirement would it**  
17 **recover via fixed charges under its flat rate proposal?**

18 A. By definition, Aquila would recover 100% of such revenues through the fixed charge.

19

20 **Q. Is a flat charge rate design appropriate for Aquila's RS and SC customers?**

21 A. No. A flat charge rate design fails to recognize any differences in the cost to serve  
22 customers, and is therefore unduly discriminatory. Also, like the Company's MDQ  
23 proposal, it would discourage conservation. Moreover, as filed, the proposal would be

1 unfair to ratepayers since it would reduce Aquila's risk without providing a commensurate  
2 reduction in the Company's return on equity. Accordingly, I recommend that the KCC  
3 reject the Company's flat rate proposal.

4  
5 **Q. Mr. Kalcic, please refer now to Aquila's "traditional" rate design alternative. How  
6 did the Company arrive at the specific charges shown in Table 1 above?**

7 A. The Company derived its proposed two-part rate design by leaving the current RS/SC usage  
8 charge unchanged, and recovering 100% of its proposed RS and SC class increases via the  
9 classes' customer charges.

10  
11 **Q. How much of the Company's proposed RS and SC base revenues would be recovered  
12 via customer charges under its traditional rate design proposal?**

13 A. On a combined basis, the total would be \$21.5 million, or 63.5%, of Aquila's total  
14 proposed base revenues of \$33.9 million.<sup>8</sup>

15  
16 **Q. Does the fact that Aquila is proposing to collect "only" 63.5% of its total proposed RS  
17 and SC revenue requirement via fixed charges under this proposal make it an  
18 acceptable alternative to the Company's MDQ and flat rate proposals?**

19 A. No. Certainly, the Company's traditional rate design proposal is less extreme than its two  
20 alternatives. However, the Company's two-part rate design proposal entails an RS  
21 customer charge increase of 40.7% and an SC customer charge increase of 47.1%.<sup>9</sup> These

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<sup>8</sup>See Exhibit \_\_ (KHW-9), Table 3.

<sup>9</sup>*Id.*

1 increases must be compared to the Company's proposed 0.0% increase to the current RS  
2 and SC usage charge. In CURB's view, such disparate increases would result in  
3 unacceptable customer bill impacts within the RS and SC classes. As such, CURB also  
4 opposes Aquila's traditional rate design alternative for the RS and SC classes.

5  
6 **Q. Mr. Kalcic, is CURB opposed to the Company collecting a greater percentage of its**  
7 **total RS and SC revenue requirement via fixed charges at the conclusion of this**  
8 **proceeding?**

9 A. Conceptually, no. However, CURB is opposed to increasing the percentage of RS and SC  
10 revenues collected via the customer charge from 55.2% to 63.5% in a single rate  
11 proceeding, as under the Company's traditional rate design alternative.

12  
13 **Q. Is it necessary to implement any of the Company's alternative rate design proposals in**  
14 **order to effectuate a reasonable increase in the percentage of costs recovered via RS**  
15 **and SC fixed charges?**

16 A. Certainly not. Such an outcome could be achieved by simply applying a greater than  
17 average percentage increase to the current RS and SC customer charges, as illustrated in  
18 Schedule BK-1.

19  
20 **Q. How did you arrive at the RS and SC rate designs shown in Schedule BK-1?**

21 A. I derived my illustrative RS and SC rate design via two (2) steps. First, I assigned the RS  
22 and SC usage charge an increase of 0.5 times the combined (i.e., overall) RS and SC base  
23 rate increase proposed by Aquila, or 11.4%. Second, I assigned the RS and SC customer

1 charges the residual increases necessary to achieve the Company's proposed RS and SC  
2 base revenue levels. As a result, my illustrative RS and SC rate designs encompass  
3 customer charge increase of 31.8% and 33.9%, respectively.

4 On a combined basis, CURB's illustrative rate design would collect \$20.1 million,  
5 or 59.3%, of Aquila's total proposed RS and SC base revenues via customer charges (up  
6 from 55.2%), while mitigating the customer bill impacts inherent in the Company's two-  
7 part rate design proposal.

8  
9 **Q. Mr. Kalcic, do you have a recommendation regarding an alternative to Aquila's**  
10 **MDQ, flat rate and traditional rate design proposals in this proceeding?**

11 A. Yes, I do. In the event that the Commission decides to approve an increase in the relative  
12 amount of total revenues collected via the fixed monthly charges paid by RS and SC  
13 customers, I recommend that the Commission: a) adopt the customer charge and usage  
14 charge levels shown on lines 2 and 5, respectively, of Schedule BK-1; and b) order the  
15 Company to scale back the RS and SC charges shown on lines 2 and 5, proportionally, in  
16 order to achieve the overall base rate revenue requirement level approved by the  
17 Commission for these two classes.

18  
19 **Q. Does this conclude your direct testimony?**

20 A. Yes.

## APPENDIX

### Qualifications of Brian Kalcic

Mr. Kalcic graduated from Benedictine University with a Bachelor of Arts degree in Economics in December 1974. In May 1977, he received a Master of Arts degree in Economics from Washington University, St. Louis. In addition, he has completed all course requirements at Washington University for a Ph.D. in Economics.

From 1977 to 1982, Mr. Kalcic taught courses in economics at both Washington University and Webster University, including such subjects as Microeconomic and Macroeconomic Theory, Labor Economics and Public Finance.

During 1980 and 1981, Mr. Kalcic was a consultant to the Equal Employment Opportunity Commission, St. Louis District Office. His responsibilities included data collection and organization, statistical analysis and trial testimony.

From 1982 to 1996, Mr. Kalcic joined the firm of Cook, Eisdorfer & Associates, Inc. During that time, he participated in the analysis of electric, gas and water utility rate case filings. His primary responsibilities included cost-of-service and economic analysis, model building, and statistical analysis.

In 1996, Mr. Kalcic founded Excel Consulting, a consulting practice which offers business and regulatory services.

Mr. Kalcic has previously testified before the state regulatory commissions of Delaware, Kansas, Kentucky, Maine, Massachusetts, Minnesota, Missouri, New Jersey, New York, Ohio, Oregon, Pennsylvania, and Texas, as well as the Bonneville Power Administration.



**AQUILA, INC.**  
 Summary of RS and SC Base Rates and Revenues  
 Using CURB's Illustrative Rate Design

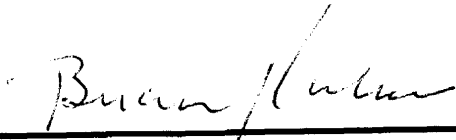
<i>CURB</i>	<u>Residential</u>	<u>Small</u>
<i>Illustrative Rates</i>	RS	Commercial - SC
	(1)	(2)
1 No. of Bills	1,128,120	98,700
2 Customer Charge	<u>\$15.82</u>	<u>\$22.76</u>
3 Customer Revenue	\$ 17,852,048	\$ 2,246,609
4 Volume - Therms	69,063,161	12,812,972
5 Usage Charge	<u>\$0.16832</u>	<u>\$0.16832</u>
6 Usage Revenue	\$ 11,624,711	\$ 2,156,679
7 Total Base Revenue	\$ 29,476,759	\$ 4,403,288
 <i>Present Rates</i>		
8 No. of Bills	1,128,120	98,700
9 Customer Charge	<u>\$12.00</u>	<u>\$17.00</u>
10 Customer Revenue	\$ 13,537,440	\$ 1,677,900
11 Volume - Therms	69,063,161	12,812,972
12 Usage Charge	<u>\$0.15108</u>	<u>\$0.15108</u>
13 Usage Revenue	\$ 10,434,062	\$ 1,935,784
14 Total Base Revenue	\$ 23,971,502	\$ 3,613,684
15 Co. Prop. Increase	\$ 5,505,257	\$ 789,604
16 %	22.97%	21.85%

Source: Billing Determinants and Class Revenue Targets  
 per Exh.\_\_(KHW-9), Table 3.

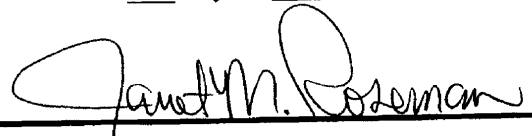
**VERIFICATION**

STATE OF MISSOURI                    )  
  )        ss:  
COUNTY OF                            )

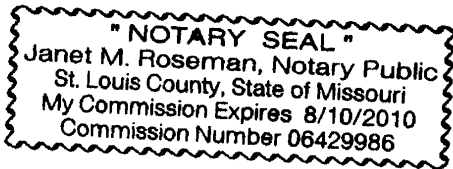
Brian Kalcic, being fully sworn upon his oath, deposes and states that he is a consultant for the Citizens' Utility Ratepayer Board, that he has read and is familiar with the foregoing testimony, and that the statements made herein are true and correct to the best of his knowledge, information and belief.

  
\_\_\_\_\_  
Brian Kalcic

SUBSCRIBED AND SWORN to before me this 15<sup>th</sup> day of March, 2007.

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

My Commission expires:



**CERTIFICATE OF SERVICE**

07-AQLG-431-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was placed in the United States mail, postage prepaid, or hand-delivered this 19th day of March, 2007, to the following:

JAMES G. FLAHERTY, ATTORNEY  
ANDERSON & BYRD, L.L.P.  
216 SOUTH HICKORY  
PO BOX 17  
OTTAWA, KS 66067  
Fax: 785-242-1279  
jflaherty@abrffh.com

\* JON R. EMPSON, SR VP REGULATORY  
LEGISLATIVE & GAS SUPPLY  
AQUILA, INC.  
D/B/A AQUILA NETWORKS - WPK / AQUILA NETWORK.  
- KGO  
1815 CAPITOL AVENUE  
OMAHA, NE 68102  
jon.empson@aquila.com

\* LARRY HEADLEY  
AQUILA, INC.  
D/B/A AQUILA NETWORKS - WPK / AQUILA NETWORKS  
- KGO  
1815 CAPITOL AVENUE  
OMAHA, NE 68102  
larry.headley@aquila.com

\* JAY C. HINKEL, ASSISTANT CITY ATTORNEY  
CITY OF WICHITA  
CITY HALL 13TH FLOOR  
455 N MAIN STREET  
WICHITA, KS 67202  
Fax: 316-268-4335  
jhinkel@wichita.gov

\* JOE ALLEN LANG, FIRST ASST. CITY ATTORNEY  
CITY OF WICHITA  
CITY HALL 13TH FLOOR  
455 N MAIN STREET  
WICHITA, KS 67202  
Fax: 316-268-4335  
jlang@wichita.gov

GARY E. REBENSTORF, CITY ATTORNEY  
CITY OF WICHITA  
CITY HALL 13TH FLOOR  
455 N MAIN STREET  
WICHITA, KS 67202  
Fax: 316-268-4335  
grebenstorf@wichita.gov

RICHARD HAUBENSAK  
CORNERSTONE ENERGY, INC  
11011 Q STREET, SUITE 106A  
OMAHA, NE 68137  
dhaubensak@cornerenergy.com

\* BRIAN KALCIC, PRINCIPAL  
EXCEL CONSULTING  
225 S MERAMEC AVE. STE. 7207  
ST. LOUIS, MO 63105

\* JASON GRAY, ASSISTANT GENERAL COUNSEL  
KANSAS CORPORATION COMMISSION  
1500 SW ARROWHEAD ROAD  
TOPEKA, KS 66604-4027  
Fax: 785-271-3354  
j.gray@kcc.state.ks.us  
\*\*\*\* Hand Deliver \*\*\*\*

\* MATTHEW R. TOMC, ASSISTANT GENERAL COUNSEL  
KANSAS CORPORATION COMMISSION  
1500 SW ARROWHEAD ROAD  
TOPEKA, KS 66604-4027  
Fax: 785-271-3354  
m.tomc@kcc.state.ks.us  
\*\*\*\* Hand Deliver \*\*\*\*

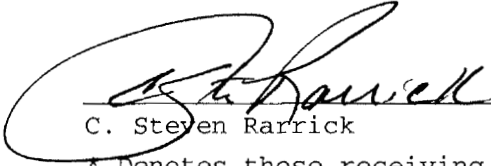
MICHAEL LENNEN, ATTORNEY  
MORRIS LAING EVANS BROCK & KENNEDY CHTD  
OLD TOWN SQUARE SUITE 200  
300 N MEAD STREET  
WICHITA, KS 67202-2722  
Fax: 316-262-5991  
mlennen@morrislaing.com

\* DAVID BANKS, ENERGY MANAGER  
UNIFIED SCHOOL DISTRICT 259  
SCHOOL SERVICE CENTER COMPLEX  
3850 N HYDRAULIC  
WICHITA, KS 67219-3399  
Fax: 316-973-2150  
dbanks@usd259.net

**CERTIFICATE OF SERVICE**

07-AQLG-431-RTS

\* SARAH J LOQUIST, ASSISTANT GENERAL COUNSEL  
UNIFIED SCHOOL DISTRICT 259  
ROOM 405  
201 N WATER  
WICHITA, KS 67202  
Fax: 316-973-4497  
sloquist@usd259.net

  
C. Steven Rarrick

\* Denotes those receiving the Confidential  
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