Exhibit No:	
Issues:	Updated exhibits, Maintenance expenses, Cash working capital, Property tax expense, Rate case expenses, Payroll expenses, Payroll tax expenses, Employee severance costs.
Witness:	Richard G. Petersen
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	Aquila Networks – MPS Aquila Networks – L&P
Case No:	GR-2004-0072
Date Testimony Prepared:	February 13, 2004

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2004-0072

FILED[3]
JUN 2 1 2004
Missouri Public Service Commission

REBUTTAL TESTIMONY

OF

RICHARD G. PETERSEN

ON BEHALF OF

AQUILA, INC.
d/b/a
AQUILA NETWORKS – MPS
and
AQUILA NETWORKS – L&P

Omaha, Nebraska
February, 2004

Exhibit No. 18
Date 3/31/04 Case No. GR-2004-0072
Reporter KF

State of Nebraska)

) ss

County of Douglas)

AFFIDAVIT OF Richard G. Petersen

Richard G. Petersen, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony and schedules entitled "Rebuttal Testimony of Richard G. Petersen"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Richard G. Petersen

Subscribed and sworn to before me this 12th day of February, 2004.

GENERAL NOTARY - State of Nebraska
TERESA A. KEEFE
My Comm. Exp. Oct. 31, 2005

Teresa A Keefe

Notary Public

My Commission expires: October 31, 2005

Table of Contents

REBUTTAL TESTIMONY OF RICHARD G. PETERSEN

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard G. Petersen and my business address is 1815 Capitol Ave., Omaha, Nebraska.

Q. ARE YOU THE SAME RICHARD G. PETERSEN WHO SPONSORED TESTIMONY IN THIS PROCEEDING BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION") ON BEHALF OF AQUILA, INC. ("AQUILA" OR "COMPANY").

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to introduce into the record the September 30, 2003 update to the 2002 filed financial data for Aquila Networks-MPS ("MPS") Gas operations ("MPS Total"), MPS Gas operations without the Eastern System ("MPS Total without Eastern") and Aquila Networks-L&P Gas operations ("L&P"). I will also discuss the following areas which were part of the direct testimony of several witnesses for the Commission Staff ("Staff") and the Office of the Public Counsel ("OPC"):

-Normalized maintenance expense

-Cash Working Capital components

-Property tax expense

-Rate case expense amortization

-Payroll expense

-Payroll tax expense

-Employee severance payments

INTRODUCTION OF UPDATED EXHIBITS

Q. DO YOU HAVE UPDATED INFORMATION TO ENTER INTO THE RECORD FOR THIS RATE CASE FILING?

A. Yes. I wish to introduce exhibits that update the test period of the rate filing to September 30,2003.

Q. WHAT ARE THE SPECIFIC EXHIBITS?

A. The exhibits to be introduced are as follows:

-Aquila Networks MPS

Exhibit RGP-1 Revenue Requirement

Exhibit RGP-2 Rate Base

Exhibit RGP-3 Income Statement

Exhibit RGP-4 Adjustments

-Aquila Networks L&P

Exhibit RGP-1 Revenue Requirement

Exhibit RGP-2 Rate Base

Exhibit RGP-3 Income Statement

Exhibit RGP-4 Adjustments

-Aquila MPS without Eastern System

Exhibit RGP-1 Revenue Requirement

Exhibit RGP-2 Rate Base

Exhibit RGP-3 Income Statement

Exhibit RGP-4 Adjustments

Q. WHAT IS THE REVENUE DEFICIENCY NOTED ON EACH OF THE THREE GROUPS OF SCHEDULES?

A. The revenue deficiencies calculated on Schedule RGP-1 for each group is as follows:

Total MPS- $6, 686,939

Total L&P- $977,790

MPS without the Eastern System- $6,403,984

Q. ARE THERE ANY FURTHER EXHIBITS YOU WISH TO ENTER INTO THE RECORD?

A. No.

<u>NORMALIZED MAINTENANCE EXPENSES</u>

Q. PLEASE EXPLAIN THE MAINTENANCE EXPENSE NORMALIZATION ADJUSTMENT PREPARED BY STAFF WITNESS LESLEY PRESTON.

A. Staff witness Preston proposes to normalize MPS' non-payroll maintenance expense for transmission and distribution operations with a 69-month average of expenses covering the period January 1, 1998 through September 30, 2003.

Q. WHAT FERC ACCOUNTS ARE COVERED BY THIS ADJUSTMENT?

A. The accounts include Transmission accounts 861 through 867, and distribution accounts 885 through 894.

Q. WHAT IS WITNESS PRESTON'S RATIONALE FOR MAKING THIS ADJUSTMENT TO EXPENSES?

A. On page 22 of his testimony, line 23, she states that "Normalization adjustments reflect the removal of events or items within the test year that are non-recurring, or exhibit a fluctuation from the level which would be normally expected to occur. Normalization adjustments need to be made to the test year to achieve the appropriate forward-looking focus of investment/revenue/expense relationship.

Q. WAS ANY OTHER INFORMATION PROVIDED IN SUPPORT OF THIS NORMALIZATION ADJUSTMENT TO NON-PAYROLL TRANSMISSION AND DISTRIBUTION EXPENSE?

A. No.

Q. DO YOU AGREE WITH THE NORMALIZATION ADJUSTMENT PROPOSED BY WITNESS PRESTON?

A. No. Normalization adjustments are made to reflect the anticipated level of expenses to be incurred when the rates set in the rate case become effective. The historical expenses experienced in the rate case test year, adjusted for any abnormal expenses, are the best representation of expenses to be incurred in the future, and therefore match the future retail rates that will be in effect at the conclusion of the rate case. This procedure for expenses to be incurred in the future is the traditional method of estimating future expenses, and has been used by Aquila in filings in other states, and by the Staff, for other test year expenses in this proceeding.

Q. WHY HAS WITNESS PRESTON DEVIATED FROM THE TRADITIONAL APPROACH OF DETERMINING NON-PAYROLL EXPENSES FOR TRANSMISSION AND DISTRIBUTION OPERATIONS?

A. I do not have a reason for the deviation from traditional procedure. No further support was offered in Witness Preston's testimony. However, several issues should be noted as areas of concern.

Q. WHAT ARE THESE ISSUES?

A. First, by using historical data to determine some type of average expense, whether it be for distribution expenses, or any other expenses, brings into question the time period used to determine the average. What is more appropriate? Three years, forty months, five years, ten years? Which number of months or years would be the "most representative"? Why is the use of a five-year average the "most representative"? Witness Preston does not elaborate on the basis for using a 69-month average of expenses. Additionally, it does not appear that the Staff reviewed the 69 months of expenses in detail to determine if any abnormalities in expenses needed to be eliminated before the average expenses were determined for the 69 months.

Q. WHAT IS THE SECOND AREA OF CONCERN?

A. The next question would be why only normalize Transmission and Distribution non-payroll expenses? Witness Preston does recognize that payroll costs are annualized separately, but why single out Transmission and Distribution expenses for normalization? If the justification for using a 69-month average is overwhelming, why not make similar proposals for other non-payroll FERC accounts?

Q. ARE THERE OTHER CONCERNS?

A. Yes. Two areas of concern involve inflation and growth in investment. First, costs experienced in a recent test year can be expected to rise by some level of inflation each year. In this rate case filing the test year is 2002. 2002 expenses should be more representative of the actual inflated costs to be experienced over the next several years. By "normalizing" non-payroll transmission and distribution expenses based on a 69-month historical average, as witness Preston has done, retail rates would be set on a lower level of expenses than can be expected to actually occur in future years.

Secondly, it is nearly certain that dollars invested in utility property will grow each year as Aquila expands its number of customers served. The increased number of customers and accompanying increased level of plant investment, will lead to increased non-payroll maintenance costs. By using a 69-month historical average to determine test year expense, as Witness Preston has done, the Company will experience higher future expenses than those being recovered through the retail rates ultimately approved in this rate filing. Using the recent 2002 test year expenses for transmission and distribution non-payroll costs, as the Company has done in its filing, will support retail rates that properly recover expenses that will be higher due to inflation and increased plant investment, as discussed above.

Q. WHAT WOULD BE THE APPROPRIATE METHOD TO DETERMINE EXPENSES FOR THE ADJUSTED TEST YEAR?

A. The *traditional method of using* test year expenses, adjusted for any abnormalities, represents the most recent actual expenditures experienced and would therefore be closer to the level of inflation that could be experienced in future years. This would also reflect the most recent expenses based on actual levels of investment and the expenses required to maintain this investment. A rate of inflation could be applied to the test year expenses, via use of the Consumer Price Index for example, in order to more closely match test year expenses to the level of expenses expected in the future. However, the Company has not proposed such an inflation adjustment in this filing.

Q. HAS THE COMMISSION PREVIOUSLY RULED ON NORMALIZATION OF NON-PAYROLL EXPENSES VIA HISTORICAL AVERAGING?

A. Yes. Case No. ER-97-394 the Commission ruled against the staff regarding a similar adjustment.

CASH WORKING CAPITAL

Q. ARE THERE DISAGREEMENTS WITH STAFF PROPOSALS IN THE AREA OF CASH WORKING CAPITAL?

A. Yes. In my testimony I will address the position taken by the Staff to include the effects of an Accounts Receivable sales program, even though Aquila no longer has such a program in place.

Q. CAN YOU SUMMARIZE THE STAFF POSITION ON THIS ISSUE?

A. Yes. Staff Witness Preston, in the calculation of the revenue collection lag, has computed a shorter than typical time period for revenue collection because of her decision to include the impact of an accounts receivable sales program. The problem with this decision is that Aquila does not have an accounts receivable sales program in place.

Q. PLEASE EXPLAIN FURTHER.

A. Staff Witness Preston has included in her calculation the assumption that the accounts receivable sales program is functioning at Aquila. The reality is that the program to sell accounts receivable to Ciesco was terminated on November 1, 2002. Witness Preston acknowledges that Aquila no longer participates in an accounts receivable program, but has included the impact of such a program in her lead/lag calculations. She speculates that the elimination of the program resulted from financial issues in Aquila's non-regulated operations, and that since the non-regulated activities caused the demise of the accounts receivable sales program, that the regulated operations should still enjoy the benefits of a shorter collection lag and resulting supposed reduction in the Company's need for cash working capital. Annualized fees of the program were estimated and included.

Q. DO YOU AGREE WITH WITNESS PRESTON'S ASSUMPTIONS?

A. No. It is true that the program was eliminated because Ciesco was no longer able after November 1, 2002 to fund this short-term loan program to Aquila once Aquila's credit rating fell below investment grade. But few other utility companies ever had such a program. To impute, and thereby retain, this benefit Aquila, and its customers, once employed while Aquila's non-regulated operations were strong, but at the same time to make "the best effort to eliminate all costs associated with the corporate financial restructuring that Aquila is facing due to its poor financial condition, as these costs are not directly related to regulated activities" (page 18, line lines 5 through 9) is contradictory. It is appropriate for the Staff to make best efforts to properly eliminate non-regulated <u>costs</u>, but to then say that the <u>benefits</u> of non-regulated, non-traditional and non-existent activities should be imputed and retained, is improper.

Q. IS IT POSSIBLE THAT AQUILA WILL RE-ESTABLISH THE ACCOUNTS RECEIVABLE SALES PROGRAM IN THE NEAR FUTURE.

A. It is unlikely.

<u>PROPERTY TAX EXPENSE</u>

Q. PLEASE EXPLAIN STAFF WITNESS MILLER'S ANNUALIZATION ADJUSTMENT FOR PROPERTY TAXES.

A. After a review of 2000, 2001 and 2002 property tax payments, Witness Miller calculated a ratio of property tax payments to the dollar value of property. This percentage was then applied to net plant in service, fuel stock and materials and supplies as of December 31, 2002, which was the end of the test period. This resulted in the annualized amount of property tax used in the staff cost of service.

Q. WHAT WAS AQUILA'S APPROACH TO THE ANNUALIZATION FOR PROPERTY TAXES?

A. Aquila developed a percentage of actual property tax payments in 2002 compared to plant in service at December 31, 2001. This ratio was then applied to plant, fuel stock and materials and supplies as of September 30, 2003, which was the update period in this rate case. September 30, 2003 would represent the balance of property on which property taxes will be assessed and paid in the future.

Q. WHY DOES AQUILA BELIEVE PLANT IN SERVICE AT SEPTEMBER 30, 2003 SHOULD BE USED TO ANNUALIZE PROPERTY TAXES?

A. Although Staff and Aquila have used the same basic approach of comparing property tax payments to plant, using Witness Miller's calculation using three years of historical payments, results in the loss of recovery of property tax expenses, which are based on the latest known and measurable time period, which is the update period of September 30, 2003.

Rate Case Expense Amortization

Q. DO YOU HAVE A CONCERN WITH THE RATE CASE EXPENSE AMORTIZATION METHOD USED BY THE STAFF WITNESS MILLER?

A. I agree with the procedure used to accumulate rate case expenses and to amortize these costs over a three-year period. The total of actual rate case expenses incurred by MPS and L&P through August 31, 2003 is being allowed by Witness Miller. She indicates that additional costs will be considered for inclusion later in the case. This is an important issue since most of the Company's rate case expenses will be incurred as the Company progresses through discovery, pre-hearing and hearings. The rate case costs estimated in the Company's rate filing by Adjustment CS-50 is more representative of the total costs likely to be experienced by the Company in this rate filing.

PAYROLL EXPENSE

Q. DO YOU HAVE ANY COMMENT REGARDING THE PROCEDURES USED BY STAFF WITNESS DANA EAVES?

A. Witness Eaves utilized procedures for annualization of payroll expenses that were similar to those used by the Company in its rate case filing. The number of employees and normal payroll costs at the end of September, 2003 were used to annualize payroll expenses. Other payroll costs, such as overtime, were then added to these annualized payroll costs. The costs were then assigned or allocated to MPS and L&P gas operations based on August 2003 allocation methods.

Q. WERE THERE ANY DIFFERENCES NOTED?

A. Yes. First, a 3% union employee contract payroll increase that will become effective April 1, 2004, was not included. Secondly, corporate restructuring adjustments proposed by Staff Witness Hyneman were incorporated into Witness Eaves' payroll annualization. (See page 28 of Witness Hyneman's testimony, beginning with line 10). This adjustment by Witness Hyneman reflects an apparent arbitrary elimination of payroll costs from certain corporate departments that, in Witness Hyneman's opinion, performed work related to corporate restructuring efforts at Aquila.

Q. WHAT ELIMINATIONS DID STAFF WITNESS HYNEMAN PROPOSE?

A. Witness Hyneman proposed to eliminate the following departments and related percentages of payroll costs:

-Dept 4035 CFO	75% elimination
-Dept 4040 Chairman and CEO	75% elimination
-Dept 4030 COO	50% elimination
-Dept 4031 General Counsel	50% elimination
-Dept 4043 BOD Management	50% elimination
-Dept 4183 Corporate Financial Reporting	25% elimination
-Dept 4194 Income Tax team	25% elimination
-Dept 6131 Global Networks Financial Management	25% elimination

Q. DID OPC WITNESS JAMES DITTMER INCLUDE A SIMILAR ADJUSTMENT TO ELIMINATE CERTAIN PAYROLL AND NONPAYROLL COSTS THAT HE FELT WERE ASSOCIATED WITH CORPORATE RESTRUCTURING ACTIVITIES?

A. Yes. However, Witness Dittmer reflected an arbitrary adjustment to eliminate 50% of per book amounts for the identified departments, whereas Staff Witness Hyneman eliminated certain department costs based on the annualized levels of payroll, payroll taxes and benefits. (See page 14 of Witness Dittmer's testimony). It should also be noted that Staff Witness Hyneman and OPC Witness Dittmer agreed on only four of the eight departments they each proposed for partial elimination.

Q. WILL YOU ADDRESS THE COMPANY'S OPPOSITION TO THE PARTIAL ELIMINATION OF THESE DEPARTMENTAL COSTS BY STAFF WITNESS HYNEMAN AND OPC WITNESS DITTMER?

A. No. Company Witness Jon Empson will discuss the Company's concerns regarding these eliminations. I will discuss the 3% union contract increase for MPS employees that was not included in Witness Eaves' payroll annualization.

Q. DID WITNESS EAVES STATE WHY THE UNION PAYROLL INCREASE WAS NOT INCLUDED IN HIS ADJUSTMENT CALCULATION?

A. No.

Q. WHY SHOULD THE 3% UNION MERIT INCREASE FOR MPS EMPLOYEES EFFECTIVE APRIL 1, 2004, AS PER THE UNION CONTRACT, BE INCLUDED IN THE PAYROLL ANNUALIZATION

A. Simply stated, the merit increase for union employees is a known and measurable change that will occur within several months after the end of the September 30, 2003 updated test period, and will occur before a decision is reached by the Commission on the merits of this rate filing, and the resulting implementation of final retail rates. If this increase is not reflected in Witness Eaves payroll annualization calculation, future approved retail rates will not cover a very known and very measurable cost.

Q. HAS THE STAFF EVER ALLOWED A PAY INCREASE THAT OCCURRED OUTSIDE OF THE UPDATED TEST PERIOD?

A. Yes. In the last MPS electric rate case, Case No. ER-2001-672, Staff used a test year ending December 31,2000 with known and measurable changes through

June 30,2001. In direct testimony in that case, Staff Witness Graham Vesely describes, on page 3 of his testimony, a union pay increase of two percent effective October 1, 2001, and an estimated pay increase of 3.98% for ESF departments effective January 1, 2002. These increases were included in the payroll annualization amounts. Both of these recommended wage increase were outside of the test period.

Q. WHAT IS THE DOLLAR IMPACT TO THE COMPANY OF NOT INCLUDING THE 3% UNION MERIT INCREASE?

A. The amount of the payroll costs not recovered would be $54,589.

PAYROLL TAX EXPENSE

Q. PLEASE EXPLAIN THE METHOD USED BY STAFF WITNESS EAVES TO CALCULATE AN ANNUALIZED LEVEL OF PAYROLL TAX EXPENSE.

A. Witness Eaves calculated totals of annualized payroll expense that would be subject to the limits of social security tax ("FICA"), federal unemployment tax ("FUTA"), state unemployment tax ("SUTA") and Medicare tax. Tax rates for these taxes were multiplied by the appropriate annualized payroll limits in order to calculate the expense for each tax category.

Q. DO YOU HAVE ANY ISSUES WITH THE METHODS USED BY WITNESS EAVES TO DETERMINE THE PAYROLL TAX EXPENSES?

A. No. However, I do have a concern with calculating payroll taxes on a reduced level of annualized payroll expense as indicated in the prior section of my rebuttal testimony.

Q. WHAT WOULD REMEDY THIS SITUATION IN YOUR OPINION?

A. If the annualized payroll amounts as calculated by the Company in the rate case filing were used to determine the proper level of payroll tax expense, then the resulting level of payroll tax expense would properly match the final retail rates that will be approved in this case.

EMPLOYEE SEVERANCE PAYMENTS

Q. WILL YOU DESCRIBE THE EMPLOYEE SEVERANCE PAYMENT ADJUSTMENT INCLUDED IN AQUILA'S RATE CASE FILING?

A. In 2002, which was the test year for this rate case, the network operations of Aquila changed to a state-based organization, which provides utility services in seven states. As a result of this significant change in Aquila Networks, a number of employee jobs were eliminated. In order to fairly treat employees whose positions were eliminated, Aquila, per its established policy on eliminated positions, agreed to make severance payments to the affected employees. These payments were based on Aquila's stated policy criteria related to age, length of service with the Company, and salary at the time of severance. These severance payments, which have a maximum payout of one year's salary for the affected employees, are intended to help the employee in the transition from employment at Aquila to employment at another company. Accordingly, Aquila included in its rate case filing a three-year amortization of these severance costs (Company Adjustment CS-10).

Q. DID THE STAFF AND OPC ACCEPT THE INCLUSION OF THE AMORTIZATION OF THE SEVERANCE COSTS OVER A THREE-YEAR PERIOD?

A. No. Staff Witness Hyneman, and OPC Witness Dittmer recommended in their direct testimony that the severance amortization adjustment should be eliminated from the filing. (See line 13, page 22 of Staff Witness Hyneman Direct Testimony, and line 14, page 6 of OPC Witness Dittmer's Direct Testimony).

Q. WERE REASONS GIVEN, BY THESE TWO WITNESSES FOR ELIMINATING THE SEVERANCE AMORTIZATION ADJUSTMENT CALCULATED BY THE COMPANY?

A. The witnesses made the same assertion regarding the elimination of severance cost amortization that they made in Aquila's current electric rate case filing (Case Nos. ER-2004-0034 and HR-2004-0024-Consolidated).

Staff Witness Hyneman gave the following reasons for not including severance costs in the gas and electric rate case filings:

-Staff has historically not included severance costs in rate case filings.

-Costs are not extraordinary in nature since they were not part of an Accounting Authoring Order filing by Aquila.

OPC Witness Dittmer provided these reasons for not including severance costs in the case:

-Restructuring costs are non-recurring.

-Regulatory lag has benefited the Company since the time of each severed employee's termination date to the present.

-It is impossible for Aquila to quantify the costs incurred during the decentralization and restructuring process.

Q. DO THESE REASONS SEEM APPROPRIATE TO YOU?

A. No.

Q. PLEASE EXPLAIN.

A. The severance payments to employees resulted from the Company's efforts to restructure network operations and become more focused on state-based utility operations. Employee terminations and accompanying severance payments, paid according to the provisions of Aquila's existing Workforce Transition Plan, were a natural, but difficult, extension of the restructuring and reorganization plans. It is correct that these severance costs are non-recurring costs, but they still are costs that resulted from efforts to streamline the utility operations of the Company.

Q. WERE THESE EMPLOYEE SEVERANCE COSTS EXTRAORDINARY?

A. In my opinion, they certainly were extraordinary since a restructuring of this type along with the accompanying employee severances is an effort that will not occur each year. However, the restructuring evolved, as opposed to being a dramatic one-time event that took place over a short period of time. An event such as an ice storm and its devastation on electrical properties, or a flood and the impact on buried gas pipe, are easy candidates for Accounting Authority Orders to be requested of the Commission. But an event such as a major restructuring of operations, is one in which events unfold over a number of months. The Company has therefore accumulated these severance costs and is proposing in its rate filing, a recovery over a three-year amortization period. Whether or not Aquila should have technically asked the Commission for an Accounting Authority Order to allow recovery of these severance costs does not change the fact that such costs were expended by the Company during a restructuring process to improve the operating efficiency of the Networks Group of Aquila. Proper recovery can be accomplished via the severance amortization adjustment made by the Company in its rate filing.

Q. HOW WAS THE THREE-YEAR AMORTIZATION PERIOD DETERMINED BY AQUILA?

A. A three year period is an approximation of the time in which the retail rates ultimately approved in this rate filing will be in effect before the next proposed rate action. During this period, retail rates will then allow for proper recovery of the severance costs being amortized. During this time, customers will also benefit from the overall reduced level of staffing that resulted form the Company's restructuring efforts.

Q. IN THE DIRECT TESTIMONY OF OPC WITNESS DITTMER, HE STATES THAT THE SEVERANCE COSTS RELATED TO THE RESTRUCTURING, OR DECENTRALIZATION EFFORT AS WITNESS DITTMER REFERS TO IT, WERE IMPOSSIBLE TO QUANTIFY. DO YOU AGREE WITH HIS ASSESSMENT?

A. No. The Company accumulated lists of employees that were severed, by department, and their related payroll costs. Severance costs that were directly related to state regulated network restructuring, or decentralization plans, were separately identified and assigned to the appropriate state. It is true that some corporate positions were eliminated that may have performed work in the past for both regulated and nonregulated operations. Therefore, an employee severance could have resulted from not only a reduced level of support necessary for the restructured network operations, but may also reflect a reduction in the level of non-regulated businesses supported by this common corporate employee. However, the regulated operations will share the benefit of the reduced level of ongoing corporate costs that occurred for whatever reason (either regulated restructuring/decentralization, or, elimination of nonregulated business operations), just as they will receive their allocated share of amortized severance costs that provided the overall benefit of a reduction in employee payroll and related payroll costs.

Q. OPC WITNESS DITTMER ALSO STATES IN HIS DIRECT TESTIMONY THAT THE COMPANY HAS ALREADY BENEFITED FROM THE VALUE OF THESE REDUCED EMPLOYEE PAYROLL COSTS BECAUSE OF THE "REGULATORY LAG" INHERENT IN THE REGULATORY PROCESS. CAN YOU COMMENT ON THAT ASSERTION?

A. It is correct that there is a regulatory lag impact associated with this severance issue. However, as with many arguments, there are opposing viewpoints. While the Company would have received a "benefit" from the eliminated cost of employees severed with no corresponding reduction in its retail rates, there are numerous other incidences of <u>increased</u> costs for which the Company did not receive the "benefit" of an immediate increase in its retail rates that would allow for current recovery of the costs. A simple example would be merit increases that are paid to deserving employees during the year. The Company realizes an immediate increase in its payroll costs; however, these increased costs are not recovered in retail rates until the time of the next approved rate filing.

Q. IS THERE FURTHER SUPPORT FOR YOUR VIEW?

A. Yes. Ironically, early in this rebuttal testimony it was noted that Staff Witness Eaves had excluded from the Staff payroll annualization adjustment a union contract increase of 3%. The end of the update period was September 30, 2003, and the union contract increase is to become effective April 1, 2004, which is before the expected decision date in this proceeding. If this exclusion is analyzed it can easily be seen that, using Staff Witness Eaves' proposed annualization, the Company will incur a "negative" regulatory lag impact. This would negatively affect the Company until the time of its next rate filing that would utilize a test year that would precisely include the April 1, 2004 union contract increase within the limits of the test period. To force the Company to absorb this "negative" regulatory lag impact, while at the same time asserting that recovery of employee severance costs should be denied because the Company has already received "enough" of a benefit of the eliminated employees' payroll costs via "positive" regulatory lag, is inconsistent.

Q. DO YOU HAVE A FINAL COMMENT ON THE SEVERANCE COST ISSUE?

A. Yes. The Company simply requests that it be allowed to recover the properly accumulated employee severance costs over a three-year amortization period that would also reflect lower payroll costs resulting from the severance of a number of employees that occurred due to the restructuring and decentralization of Company network activities.

Q. WHAT IS THE VALUE OF THE SEVERANCE COST ADJUSTMENT PROPOSED BY THE COMPANY IN ITS GAS RATE FILING?

A. The value is $176,041 for MPS and $12,469 for L&P.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY.

A. Yes.

Aquila Networks - MPS
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Revenue Requirement

Line	(a)		Mid 9.739% Return (b)
1	Net Orig Cost of Rate Base (Sch 2)	$	60,049,139
2	Rate of Return		9.739%
3	Net Operating Income Requirement	$	5,847,885
4	Net Income Available (Sch 7)	$	1,727,978
5	Additional NOIBT Needed		4,119,907
6	Additional Current Tax Required	$	2,567,032
7	Required Deferred ITC		
8	Test Year Deferred ITC		
9	Additional Deferred ITC Required	$	-
10	Total Additional Tax Required		2,567,032
11	Gross Revenue Requirement		6,686,939

Schedule RGP-1

Aquila Networks - MPS
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Rate Base

Line No.	Line Description		Amount
	(a)		(b)
	Total Plant :		
1	Total Plant in Service-MPS Only (Sch 3)	$	88,404,555
1a	Total Plant in Service-MPS' Share of UCU (Sch 3a)		6,390,590
	Total Plant		94,795,145
	Subtract from Total Plant:		
2	Depr Reserve-MPS & UCU Share (Sch 5)		39,323,205
	Total Depreciation Reserve		39,323,205
3	**Net Plant in Service**	$	55,471,940
	Add to Net Plant in Service		
4	Cash Working Capital		(547,351)
5	Materials and Supplies		1,669,464
6	Gas Storage		3,460,490
7	Prepayments		2,957,237
8	AAO Gas Pipe replacement		1,195,422
9	Regulatory Asset - FAS 109		3,688,910
	Subtract from Net Plant:		
10	Customer Advances for Construction	$	43,496
11	Customer Deposits		174,192
12	Deferred Income Taxes - Depreciation		3,405,591
13	Deferred Income Taxes - AAO		458,923
14	Unamortized Investment Tax Credit		3,748
15	Deferred Income Taxes - Synergies to MPS		72,114
16	FAS 109 - Deferred Tax Liability		3,688,910
17	Total Rate Base	$	60,049,139

Aquila Networks - MPS
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Income Statement

Line No.	Description	Total Gas	Adjustment	Gas As Adjusted
	(A)	(B)	(E)	(F)
1	Operating Revenue	46,093,613	4,898,784	50,992,397
2	Operating Expenses:			
3	Production	29,520,514	3,068,640	32,589,154
4	Transmission	179,617	3,437	183,054
5	Distribution	3,657,153	(26,473)	3,630,680
6	Customer Accounting	2,220,139	(327,277)	1,892,862
7	Customer Services	116,038	(9,412)	106,626
8	Sales	62,612	(25,092)	37,520
9	A & G Expenses	5,568,067	666,300	6,234,367
10	Total O & M Expenses	41,324,140	3,350,123	44,674,263
11	Depreciation Expense	3,167,311	338,152	3,505,463
12	Amortization Expense	50,341	869	51,210
13	Taxes other than Income Tax	846,819	319,662	1,166,481
14	Net Operating Income before Tax	705,002	889,978	1,594,980
15	Income Taxes	(1,172,698)	876,180	(296,518)
16	Income Taxes Deferred	200,581	5,431	206,012
17	Investment Tax Credit	(42,492)	-	(42,492)
18	Total Taxes	(1,014,609)	881,611	(132,998)
19	Total Net Operating Income	1,719,611	8,367	1,727,978

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
R-10	**Customer & Weather Adj** This adjusts test period revenues to reflect normal heating degree days and annualizes revenues for 2002 customer level Operating Revenues	Sullivan	$	2,172,385
R-15	**Eliminate Provision for Rate Refund** This adjustment reverses an entry originally booked during 2001 to defer incremental expense incurred and incremental revenues lost pending a decision in case No. GO-2202-175 for recognition of uncollectibles expense under the terms of 4 CSR 240-13.055(10)1. Operating Revenues	R. Petersen	$	500,000
R-20	**Eliminate Unbilled Revenues** This adjusts revenues to a billed basis. Operating Revenues	R. Petersen	$	2,169,946
R-25	**Fee Revenue** This adjustment reflects the addition or increase in service fees for connections, reconnections, special meter reads, collection fees, and charges for bad checks Operating Revenues	B. Amdor	$	56,453
CS-1	**Customer & Weather Adj** This adjusts test period purchases to reflect normal heating degree days and annualizes revenues for 2002 customer level Gas Purchases	T. Sullivan	$	1,560,296
CS-2	**Eliminate Unbilled Purchases** This adjusts test period purchases to match billed revenues. Gas Purchases	R. Petersen	$	1,495,408
CS-4	**Miscellaneous Purchases** This adjusts test period purchases for gas cost omitted from test period expenses related to Interdepartmental Sales, L&U on Small Volume Transportation, and other miscellaneous purchase adjustment. Gas Purchases	R. Petersen	$	12,907
CS-5	**Payroll** This adjustment annualizes payroll expense for the test year. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	A. Stichler	$	105,973

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
CS-6	**Incentive**	R. Petersen	$	56,968
	This adjustment annualizes incentive expenses to be paid at target levels.			
	Production			
	Transmission			
	Distribution			
	Customer Accounting			
	Customer Service			
	Sales			
	Administrative & General			
	Total			
CS-10	**Restructuring**	J. Thomas	$	(218,592)
	This adjustment amortizes restructuring related expenses during the test year over three years.			
	Production			
	Transmission			
	Distribution			
	Administrative & General			
	Taxes Other Than Income Taxes			
	Total			
CS-11	**Employee Benefits**	H. Mikkelsen	$	49,624
	This adjustment annualizes the MPS portion of employee benefits made on behalf of its employees.			
	Administrative and General			
CS-16	**ESF/IBU Adjustments**	B. Agut	$	(304,644)
	This adjustment updates the ESF and IBU corporate allocation factors to January 2003 drivers.			
	Administrative and General			
CS-17	**O&M L&P Merger Synergies**	V. Siemek/B. Agut	$	283,644
	This adjustment annualizes the O&M synergies resulting from the L&P Merger.			
	Production			
	Transmission			
	Distribution			
	Customer Accounting			
	Customer Service			
	Sales			
	Administrative & General			
	Total			
CS-18	**Insurance Adjustment**		$	917,662
	This adjustment annualizes Director's and Officer's Insurance			
	Propety Insurance			
	Injuries and Damages			
	Total			

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
CS-35	**Bad Debt Expense** This adjusts bad debt expense to an annualized level based on a three year average rate times annualized revenue Customer Accounting Expense	H. Mikkelsen	$	(356,854)
CS-40	**PSC Assessment** This adjustment annualizes the PSC assessment to the most current assessment received. Administrative and General	R. Petersen	$	(15,353)
CS-45	**Customer Deposit Interest** This entry annualizes the interest expense related to customer deposits. Customer Accounting Expense	R. Petersen	$	10,452
CS-50	**Rate Case Expense** This adjustment annualizes the expense related to the preparation of the rate case and amortizes it over 3 years. Administrative and General	R. Petersen	$	88,339
CS-56	**Eliminate TransUCU** This adjustment eliminates test year transportation related expenses allocated to MPS from TransUCU. Office Supplies and Expenses	R. Petersen	$	(89,038)
CS-60	**Dues and Donations** This adjustment eliminates all dues and donations except AGA dues. Administrative and General	R. Petersen	$	(53,452)
CS-65	**Advertising Expense** This adjustment eliminates all advertising except safety and informational . Production Distribution Customer Accounts Customer Service and Informational Expense Sales Expense Administrative & General Total	R. Petersen	$	(39,094)
CS-83	**Write-off Pre-2002 Miscellaneous Payroll Expenses** This adjustment eliminates miscellaneous payroll costs written off in December 2002 associated with time periods prior to 2002 that are included in test year expenses. Office Supplies and Expenses	J. Thomas	$	(121,779)

AQUILA NETWORKS - MPS
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-85	**Payroll Taxes** This adjustment annualizes FICA and Medicare tax expense. Taxes Other Than Income Tax	R. Petersen	$ 12,652
CS-90	**Ad Valorem Taxes** This adjustment annualizes Property taxes based on plant in service adjusted in this case. Taxes Other Than Income Tax	R. Petersen	$ 292,171
CS-95	**Depreciation** This adjustment annualizes depreciation expense for plant additions through the known and measurable test period September 30, 2003. Depreciation Expense	B. Tangeman	$ 632,488
CS-97	**Depreciation - Eastern system** This adjustment annualizes the impact on depreciation expense for the write-down of the Eastern System. Depreciation Expense	J. Bahr	$ (310,972)
TAX-10A	**Current Income Taxes Expense** This adjustment annualizes the current income tax based on adjusted net operating income. Income Taxes, Operating Income	A. Stichler	$ 876,180
TAX-10A	**Deferred Taxes & ITC** This adjustment annualizes deferred income tax associated with tax straight-line vs. tax timing differences. Deferred Income Taxes	A. Stichler	$ 5,431

Aquila Networks - MPS w/o Eastern System
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Revenue Requirement

Line		Mid 9.739% Return
	(a)	(b)
1	Net Orig Cost of Rate Base (Sch 2)	$ 54,107,749
2	Rate of Return	9.739%
3	Net Operating Income Requirement	$ 5,269,283
4	Net Income Available (Sch 7)	$ 1,323,708
5	Additional NOIBT Needed	3,945,575
6	Additional Current Tax Required	$ 2,458,409
7	Required Deferred ITC	
8	Test Year Deferred ITC	
9	Additional Deferred ITC Required	$ -
10	Total Additional Tax Required	2,458,409
11	Gross Revenue Requirement	6,403,984

Schedule RGP-1

Aquila Networks - MPS w/o Eastern System
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Rate Base

Line No.	Line Description		Amount
	(a)		(b)
	Total Plant :		
1	Total Plant in Service-MPS Only (Sch 3)	$	72,801,826
1a	Total Plant in Service-MPS' Share of UCU (Sch 3a)		6,390,590
	Total Plant		79,192,416
	Subtract from Total Plant:		
2	Depr Reserve-MPS & UCU Share (Sch 5)		27,988,418
	Total Depreciation Reserve		27,988,418
3	**Net Plant in Service**	$	51,203,998
	Add to Net Plant in Service		
4	Cash Working Capital		(468,796)
5	Materials and Supplies		1,659,577
6	Gas Storage		3,460,490
7	Prepayments		2,957,237
8	AAO Gas Pipe replacement		1,195,422
9	Regulatory Asset - FAS 109		3,688,910
	Subtract from Net Plant:		
10	Customer Advances for Construction	$	43,496
11	Customer Deposits		168,433
12	Deferred Income Taxes - Depreciation		5,153,466
13	Deferred Income Taxes - AAO		458,923
14	Unamortized Investment Tax Credit		3,748
15	Deferred Income Taxes - Synergies to MPS		72,114
16	FAS 109 - Deferred Tax Liability		3,688,910
17	Total Rate Base	$	54,107,749

Aquila Networks - MPS w/o Eastern System
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Income Statement

Line No.	Description	Total Gas	Adjustment	Gas As Adjusted
	(A)	(B)	(E)	(F)
1	Operating Revenue	41,249,551	4,624,379	45,873,930
2	Operating Expenses:			
3	Production	26,020,206	2,859,715	28,879,921
4	Transmission	178,867	3,437	182,304
5	Distribution	3,260,440	(51,686)	3,208,754
6	Customer Accounting	2,010,199	(342,307)	1,667,892
7	Customer Services	116,038	(9,412)	106,626
8	Sales	60,653	(25,092)	35,561
9	A & G Expenses	5,516,562	666,300	6,182,862
10	Total O & M Expenses	37,162,965	3,100,955	40,263,920
11	Depreciation Expense	2,733,104	537,715	3,270,819
12	Amortization Expense	48,682	869	49,551
13	Taxes other than Income Tax	709,828	319,662	1,029,490
14	Net Operating Income before Ta	594,972	665,178	1,260,150
15	Income Taxes	(1,172,698)	1,019,664	(153,034)
16	Income Taxes Deferred	200,581	(68,613)	131,968
17	Investment Tax Credit	(42,492)	-	(42,492)
18	Total Taxes	(1,014,609)	951,051	(63,558)
19	Total Net Operating Income	1,609,581	(285,873)	1,323,708

AQUILA NETWORKS - MPS w/o Eastern system
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
R-10	**Customer & Weather Adj** This adjusts test period revenues to reflect normal heating degree days and annualizes revenues for 2002 customer level Operating Revenues	Sullivan	$	1,897,980
R-15	**Eliminate Provision for Rate Refund** This adjustment reverses an entry originally booked during 2001 to defer incremental expense incurred and incremental revenues lost pending a decision in case No. GO-2202-175 for recognition of uncollectibles expense under the terms of 4 CSR 240-13.055(10)1. Operating Revenues	R. Petersen	$	500,000
R-20	**Eliminate Unbilled Revenues** This adjusts revenues to a billed basis. Operating Revenues	R. Petersen	$	2,169,946
R-25	**Fee Revenue** This adjustment reflects the addition or increase in service fees for connections, reconnections, special meter reads, collection fees, and charges for bad checks Operating Revenues	B. Amdor	$	56,453
CS-1	**Customer & Weather Adj** This adjusts test period purchases to reflect normal heating degree days and annualizes revenues for 2002 customer level Gas Purchases	T. Sullivan	$	1,351,371
CS-2	**Eliminate Unbilled Purchases** This adjusts test period purchases to match billed revenues. Gas Purchases	R. Petersen	$	1,495,408
CS-4	**Miscellaneous Purchases** This adjusts test period purchases for gas cost omitted from test period expenses related to Interdepartmental Sales, L&U on Small Volume Transportation, and other miscellaneous purchase adjustment. Gas Purchases	R. Petersen	$	12,907
CS-5	**Payroll** This adjustment annualizes payroll expense for the test year. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	A. Stichler	$	76,598

AQUILA NETWORKS - MPS w/o Eastern system
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
CS-6	**Incentive**	R. Petersen	$	54,408
	This adjustment annualizes incentive expenses to be paid at target levels.			
	Production			
	Transmission			
	Distribution			
	Customer Accounting			
	Customer Service			
	Sales			
	Administrative & General			
	Total			
CS-10	**Restructuring**	J. Thomas	$	(218,592)
	This adjustment amortizes restructuring related expenses during the test year over three years.			
	Production			
	Transmission			
	Distribution			
	Administrative & General			
	Taxes Other Than Income Taxes			
	Total			
CS-11	**Employee Benefits**	H. Mikkelsen	$	49,624
	This adjustment annualizes the MPS portion of employee benefits made on behalf of its employees.			
	Administrative and General			
CS-16	**ESF/IBU Adjustments**	B. Agut	$	(304,644)
	This adjustment updates the ESF and IBU corporate allocation factors to January 2003 drivers.			
	Administrative and General			
CS-17	**O&M L&P Merger Synergies**	V. Siemek/B. Agut	$	283,644
	This adjustment annualizes the O&M synergies resulting from the L&P Merger.			
	Production			
	Transmission			
	Distribution			
	Customer Accounting			
	Customer Service			
	Sales			
	Administrative & General			
	Total			
CS-18	Insurance Adjustment		$	917,662
	This adjustment annualizes Director's and Officer's Insurance			
	Propety Insurance			
	Injuries and Damages			

AQUILA NETWORKS - MPS w/o Eastern system
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness	Increase (Decrease) (B)
CS-35	**Bad Debt Expense** This adjusts bad debt expense to an annualized level based on a three year average rate times annualized revenue Customer Accounting Expense	H. Mikkelsen	$ (364,816)
CS-40	**PSC Assessment** This adjustment annualizes the PSC assessment to the most current assessment received. Administrative and General	R. Petersen	$ (15,353)
CS-45	**Customer Deposit Interest** This entry annualizes the interest expense related to customer deposits. Customer Accounting Expense	R. Petersen	$ 10,106
CS-50	**Rate Case Expense** This adjustment annualizes the expense related to the preparation of the rate case and amortizes it over 3 years. Administrative and General	R. Petersen	$ 88,339
CS-56	**Eliminate TransUCU** This adjustment eliminates test year transportation related expenses allocated to MPS from TransUCU. Office Supplies and Expenses	R. Petersen	$ (89,038)
CS-60	**Dues and Donations** This adjustment eliminates all dues and donations except AGA dues. Administrative and General	R. Petersen	$ (53,452)
CS-65	**Advertising Expense** This adjustment eliminates all advertising except safety and informational . Production Distribution Customer Accounts Customer Service and Informational Expense Sales Expense Administrative & General Total	R. Petersen	$ (39,094)
CS-83	**Write-off Pre-2002 Miscellaneous Payroll Expenses** This adjustment eliminates miscellaneous payroll costs written off in December 2002 associated with time periods prior to 2002 that are included in test year expenses. Office Supplies and Expenses	J. Thomas	$ (121,779)

AQUILA NETWORKS - MPS w/o Eastern system
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
CS-85	**Payroll Taxes** This adjustment annualizes FICA and Medicare tax expense. Taxes Other Than Income Tax	R. Petersen	$	12,652
CS-90	**Ad Valorem Taxes** This adjustment annualizes Property taxes based on plant in service adjusted in this case. Taxes Other Than Income Tax	R. Petersen	$	292,171
CS-95	**Depreciation** This adjustment annualizes depreciation expense for plant additions through the known and measurable test period September 30, 2003. Depreciation Expense	B. Tangeman	$	521,079
CS-97	**Depreciation - Eastern system** This adjustment annualizes the impact on depreciation expense for the write-down of the Eastern System. Depreciation Expense	J. Bahr	$	-
TAX-10A	**Current Income Taxes Expense** This adjustment annualizes the current income tax based on adjusted net operating income. Income Taxes, Operating Income	A. Stichler	$	1,019,664
TAX-10A	**Deferred Taxes & ITC** This adjustment annualizes deferred income tax associated with tax straight-line vs. tax timing differences. Deferred Income Taxes	A. Stichler	$	(68,613)

Aquila Networks - L&P
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Revenue Requirement

Line		Mid 10.084% Return
	(a)	(b)
1	Net Orig Cost of Rate Base (Sch 2)	$ 8,449,434
2	Rate of Return	10.084%
3	Net Operating Income Requirement	$ 851,999
4	Net Income Available (Sch 7)	$ 249,570
5	Additional NOIBT Needed	602,429
6	Additional Current Tax Required	$ 375,361
7	Required Deferred ITC	-
8	Test Year Deferred ITC	
9	Additional Deferred ITC Required	$ -
10	Total Additional Tax Required	375,361
11	Gross Revenue Requirement	977,790

Aquila Networks - L&P
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03

Rate Base

Line No.	Line Description		Amount
	(a)		(b)
	Total Plant :		
1	Total Plant in Service-SJLP Only (Sch 3)	$	7,916,225
1a	Total Plant in Service-SJLP' Share of UCU (Sch 3a)		732,861
	Total Plant		8,649,086
	Subtract from Total Plant:		
2	Depr Reserve-SJLP & UCU Share (Sch 5)		3,667,987
	Total Depreciation Reserve		3,667,987
3	**Net Plant in Service**	$	4,981,099
	Add to Net Plant in Service		
4	Cash Working Capital		(48,204)
5	Materials and Supplies		23,702
6	Gas Storage		794,925
7	Prepayments		3,276,772
8	Regulatory Asset - FAS 109		313,692
	Subtract from Net Plant:		
9	Customer Advances for Construction	$	-
10	Customer Deposits		37,206
11	Deferred Income Taxes - Depreciation		541,654
12	Deferred Income Taxes - AAO		-
13	Unamortized Investment Tax Credit		-
14	FAS 109 - Deferred Tax Liability		313,692
15	Total Rate Base	$	8,449,434

Schedule RGP-2

Aquila Networks - L&P
Case No. GR-
Case No. GR-2004-0072
Twelve Months Ended December 31, 2002
UPDATE TO K&M 09/30/03
Income Statement

Line No.	Description	Total Gas	Adjustment	Gas As Adjusted
	(A)	(B)	(E)	(F)
1	Operating Revenue	5,710,328	331,141	6,041,469
2	Operating Expenses:			
3	Production	4,050,181	32,976	4,083,157
4	Transmission	-	-	-
5	Distribution	515,173	(7,159)	508,014
6	Customer Accounting	195,368	(5,592)	189,776
7	Customer Services	18,770	(997)	17,773
8	Sales	12,129	(4,087)	8,042
9	A & G Expenses	(165,303)	698,044	532,741
10	Total O & M Expenses	4,626,318	713,185	5,339,503
11	Depreciation Expense	278,966	89,005	367,971
12	Amortization Expense	5,882	-	5,882
13	Taxes other than Income Tax	135,984	(13,420)	122,564
14	Net Operating Income before Ta	663,178	(457,629)	205,549
15	Income Taxes	85,769	(104,237)	(18,468)
16	Income Taxes Deferred	68,064	(91,374)	(23,310)
17	Investment Tax Credit	(2,243)	-	(2,243)
18	Total Taxes	151,590	(195,611)	(44,021)
19	Total Net Operating Income	511,588	(262,018)	249,570

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
R-10	**Customer & Weather Adj** This adjusts test period revenues to reflect normal heating degree days and annualizes revenues for 2002 customer level Operating Revenues	T. Sullivan	$	244,192
R-20	**Eliminate Unbilled Revenues** This adjusts revenues to a billed basis. Operating Revenues	R. Petersen	$	82,135
R-25	**Fee Revenue** This adjustment reflects the addition or increase in service fees for connections, reconnections, special meter reads, collection fees, and charges for bad checks Operating Revenues	B. Amdor	$	4,814
CS-1	**Customer & Weather Adj** This adjusts test period purchases to reflect normal heating degree days and annualizes revenues for 2002 customer level Gas Purchases	T. Sullivan	$	167,660
CS-4	**Miscellaneous Purchases** This adjusts gas cost per book to gas costs in revenues from revenue reports Gas Purchases	R. Petersen	$	(134,684)
CS-5	**Payroll** This adjustment annualizes payroll expense for the test year. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	A. Stichler	$	(7,177)
CS-6	**Incentive** This adjustment annualizes incentive expenses to be paid at target levels. Production Transmission Distribution Customer Accounting Customer Service Sales Administrative & General Total	R. Petersen	$	7,489

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
CS-10	**Restructuring** This adjustment amortizes restructuring related expenses during the test year over three years. Production Transmission Distribution Administrative & General Taxes Other Than Income Taxes Total	J. Thomas	$	(23,206)
CS-11	**Employee Benefits** This adjustment annualizes the L&P portion of employee benefits made on behalf of its employees. Administrative and General	H. Mikkelsen	$	179,117
CS-16	**ESF/IBU Adjustments** This adjustment updates the ESF and IBU corporate allocation factors to January 2003 drivers. Administrative and General	V. Siemek/B. Agut	$	(35,141)
CS-18	**Insurance Adjustment** This adjustment annualizes Director's and Officer's Insurance Propety Insurance Injuries and Damages Total		$	70,855
CS-30	**Injuries and Damages Expense** This adjusts Injuries and Damages to correct a product classification booked in error during the test period. Administrative and General	J Thomas	$	527,284
CS-35	**Bad Debt Expense** This adjusts bad debt expense to an annualized level based on a three year average rate times annualized revenue Customer Accounting Expense	H. Mikkelsen	$	(5,581)
CS-40	**PSC Assessment** This adjustment annualizes the PSC assessment to the most current assessment received. Administrative and General	R. Petersen	$	2,265
CS-45	**Customer Deposit Interest** This entry annualizes the interest expense related to customer deposits. Customer Accounting Expense	R. Petersen	$	2,232

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
CS-50	**Rate Case Expense** This adjustment annualizes the expense related to the preparation of the rate case and amortizes it over 3 years. Administrative and General	R. Petersen	$	5,097
CS-56	**Eliminate TransUCU** This adjustment eliminates test year transportation related expenses allocated to L&P from TransUCU. Office Supplies and Expenses	R. Petersen	$	(13,319)
CS-60	**Dues and Donations** This adjustment eliminates all dues and donations except AGA and Power Pool dues. Administrative and General	R. Petersen	$	(5,223)
CS-65	**Advertising Expense** This adjustment eliminates all advertising except safety and informational . Production Distribution Customer Accounts Customer Service and Informational Expense Sales Expense Administrative & General Total	R. Petersen	$	(4,581)
CS-83	**Write-off Pre-2002 Miscellaneous Payroll Expenses** This adjustment eliminates miscellaneous payroll costs written off in December 2002 associated with time periods prior to 2002 that are included in test year expenses. Office Supplies and Expenses	J. Thomas	$	(18,770)
CS-85	**Payroll Taxes** This adjustment annualizes FICA and Medicare tax expense. Taxes Other Than Income Tax	R. Petersen	$	(22,416)
CS-90	**Ad Valorem Taxes** This adjustment annualizes Property taxes based on plant in service adjusted in this case. Taxes Other Than Income Tax	R. Petersen	$	7,864
CS-95	**Depreciation - L&P Assets** This adjustment annualizes depreciation expense for plant additions through the known and measurable test period September 30, 2003. Depreciation Expense	B. Tangeman	$	89,005

AQUILA NETWORKS - L&P
DESCRIPTION OF ADJUSTMENTS TO NET OPERATING INCOME
FOR THE YEAR ENDED DECEMBER 31, 2002
UPDATE TO K&M 09/30/03

Adj No.	Description of Adjustment (A)	Witness		Increase (Decrease) (B)
TAX-10A	**Current Income Taxes Expense** This adjustment annualizes the current income tax based on adjusted net operating income. Income Taxes, Operating Income	A. Stichler	$	(104,237)
TAX-10A	**Deferred Taxes & ITC** This adjustment annualizes deferred income tax associated with tax straight-line vs. tax timing differences. Deferred Income Taxes	A.Stichler	$	(91,374)