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Arizona Corporation Commission
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______Cancellation of CC&N	______Formal Complaint
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Application	**Tariff**
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Revised 12/21/03

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Marshall Magruder
Post Office Box 1267
Tubac, Arizona 85646

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March 9, 2004

Chairman Marc Spitzer
Commissioner William Mundell
Commissioner Jeff Hatch-Miller
Commissioner Mike Gleason
Commissioner Kris Mayes

Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED
MAR 1 0 2004
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Subject: Natural Gas Price Issues in UniSource Energy Services' Territory

References: Chairman Spitzer's letters of March 2, 2004 and March 5, 2004

Docket Nos. G-01032A-03-0515, G-01032A-02-0598, G-01032A-02-0914,
E-01032C-00-0751, E-01933A-02-0914, E-01032C-02-0914

Dear Chairman Spitzer and Commissioners:

As a party and ratepayer, I am also concerned about the volatility and instability of natural gas prices. In general, short-term commodity prices are not stable. The present pricing policies have used unsatisfactory methods to account for this with various, delayed pricing adjustments. A new method needs to be implemented.

The "market" determines the purchase price of natural gas. The gas indexes used by the futures natural gas markets provide information for the Commission and gas distribution companies. They reflect real "market" prices.

I recommend we use future natural gas market indexes, with "moving averages," to account for short-term pricing spikes. Ratepayers have a monthly view of billing while actual gas prices maybe per minute. Moving Averages (MA) will account for "spikes and valleys" to fairly average them out.

Future pricing markets forecast price. A distribution utility should use its experience and effective pricing policies, as suggested by Chairman Spitzer's letter of March 5 (hedging future purchases and financial derivatives), to ensure overall "prices" are close to the futures market's moving averages.

The below illustrates that natural gas future pricing data can determine "just and reasonable" rates.

Example: (data collected on March 7, 2004 for April 2004 future prices for one natural gas market)

The variables include (1) market, (2) month, (3) index data date, and (4) moving average (shown on graph). Other factors impact these figures, but not price, include sample interval (in minutes, hours or day) and display characteristics. The price for customers' billings will be that for April 1, determined on March 1.

This series of current NYMEX April 2004 future price data (Henry Hub) provide a way to determine prices that account for spikes by using a moving average (MA). Figures 1 through 5 show daily, weekly and monthly data. These intervals appear too short to determine realistic prices without spikes. Figures 6 and 7 show six-months prices with 50-day and 100-day MA.

Figures 8 through 12 show a one-year view of the futures prices for the month of April 2004, with 10-day to 200-day moving averages. The 10-day and 20-day futures MA very closely follow the daily spikes and peaks, while longer MA give curves with smoothing to reflect fair and reasonable prices. In this example, the 100-day MA appears the best price picture. These are within two months (60 days) of actual future prices. Note in Figures 6 to 12 the price for April 1 to be used for billing.

Figure 1 – One-day prices, 2-hr MA

Figure 2 – One-day prices, 6 hour MA

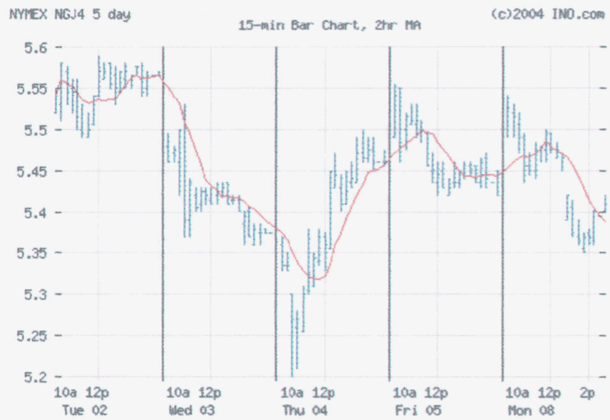

Figure 3 – Five-Day Prices, 2-hr MA

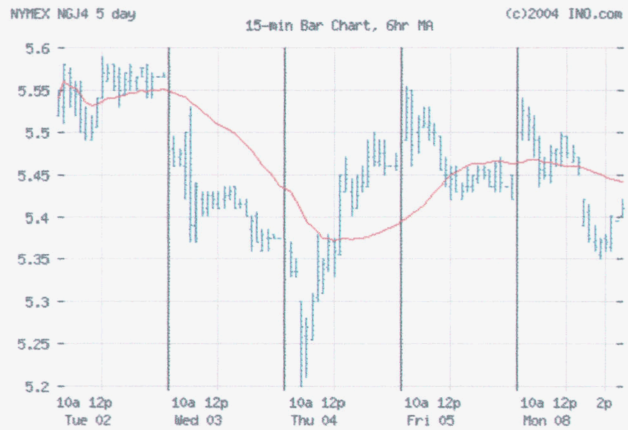

Figure 4 – Five Day Prices, 6-hr MA

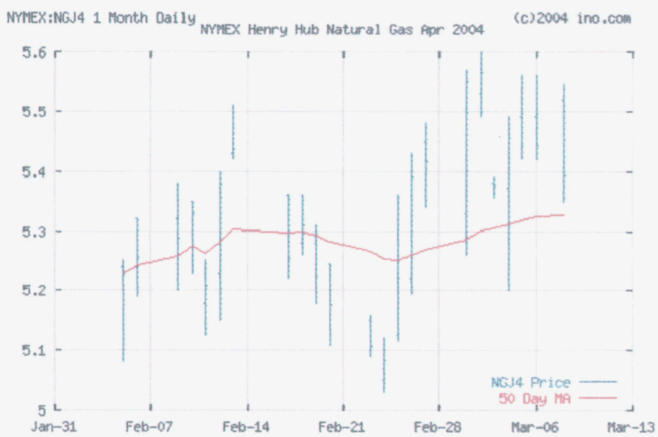

Figure 5 – One-Month Prices, 50-day MA

Figure 6 – Six Month Prices, 50-day MA

Figure 7 – Six Month Prices, 100-day MA

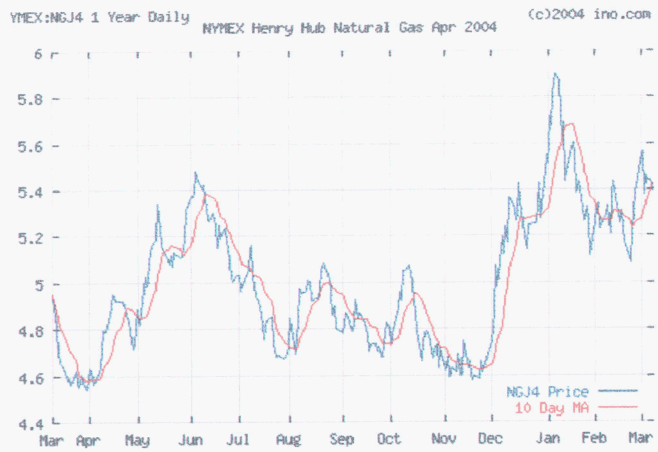

Figure 8 - One Year Prices, 10-day MA

Figure 9 – One Year Prices, 20-day MA

Figure 10 – One Year Prices, 50-day MA

Figure 11 – One Year Prices, 100-day MA

Figure 12 – One Year Prices, 200-day MA

The price will be balance to zero over the long-term in a stable market. When market prices increase, the MA generally lags the real-time costs. The opposite occurs if the market is going down. The long-term outlook for the natural gas market appears as slowly increasing long-term prices, thus, a minor adjustment might be necessary to account for this "lag."

Conclusions.

Market pricing can be based on actual "future" prices for a defined, standard, and realistic lead to actual usage. This standard would reflect "market" price. The utility should be required to use this standard market price as the basis for its billings, after conversion to cents per therm. This price basis will requires the utility to closely monitor the market, use hedging and other techniques to ensure product purchases are below "market" for its customers. This basis should be used for billing customers, not what is actually paid, in order to ensure the utility achieves "average" or better prices for its customers. If the utility cannot purchase at "average" prices, but higher, it will lose money but the incentive to purchase at lower prices will provide a sound profit motive. The ACC should not be involved with the prices paid for natural gas, only with determining "just and reasonable" values of the purchased natural gas.

Recommendations:

1. That consideration of "moving averages" be used to smooth out pricing spikes, with long time periods, at least 100-days be used.

2. That future price indexes be used to reflect the "cost of gas" instead of the actual price paid.

3. That the customers be charged the "future" market with a 100-day moving average priced one month ahead of customer billing, e.g., the April index will be used for the first date of the prior month, March 1, on the 100-day MA curve, as the cost of natural gas for April customer billings.

4. That the ACC initially closely monitor the "future" market to determine "just and reasonable" costs for natural gas. Initially, recommend monthly to see if this pricing mechanism is working properly with some initial adjustments, to ensure a smooth transition from the present gas-pricing scheme.

5. That the utility not be restricted in its natural gas purchases, other than using ACC-approved purchase policies for derivatives and hedging.

6. That the utility purchase natural gas at prices to average less than the 100-day "future" billing prices it bills customers. Any gain will be the incentive for such purchases, and if above, a loss.

Respectfully submitted,

Marshall Magruder

Marshall Magruder

Copies to:
Arizona Corporation Commission (19 copies)

Parties (via email and regular mail):
Thomas H. Campbell and Michael T. Hallam, Lewis & Roca, LLP, 410 N. Central Ave., Phoenix, AZ 85004
Steven W. Cheifetz and Robert J. Metli, Sheifetz & Iannitelli, PC, 3238 N. Central Ave., Phoenix, AZ 85016
Scott Wakefield and Daniel W. Pozefsky, Residential Utility Consumer Office, 1110 W. Washington Suite 220, AZ 85007
Raymond S. Heyman and Michael W. Patten, Roshka Heyman & DeWulf, 400 E. Van Buren Suite 800, Phoenix, AZ 95004
Martha Chase and Holly Hawn, Santa Cruz County Attorneys, 2150 N. Congress Drive Suite 201, Nogales, AZ 85621
John White, Civil Division, Mohave County Attorney, PO Box 7000, Kingman, AZ 86402
Hugh Holub, City of Nogales, 777 N. Grand Ave., Nogales, AZ 85621
Robert A. Taylor, City Attorney, City of Kingman, 310 North 4th Street, Kingman, AZ 86401
Walter W. Meek, Arizona Utility Investor's Association, 2100 N. Central Ave. Suite 210, Phoenix, AZ 85004
Tom Ferry, PO Box 3099, Kingman, AZ 86402
Gary Smith, UNS Gas, Inc., 2901 W. Shamrell Blvd., Flagstaff, AZ 86001
L. Russell Mitten, Staff Counsel, and Raymond Mason, Citizens Communications Co., 3 High Ridge Park, Stamford, CT 06905
Deborah R. Scott, Counsel, UES Attorney, PO Box 710, Tucson, AZ 85710
Andrew Bettwy, Asst. General Counsel, Southwest Gas Company, 5214 Spring Mountain Rd, Las Vegas, NV 89150
Nicholas J. Enoch, Libin & Enoch, PC, 349 N. Fourth Ave., Phoenix, AZ 85003
John D. Draghi and Susan Mikes Doherty, Huber, Lawrence & Abell, 805 3rd Ave., New York, NY 10158