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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

- JEFF HATCH-MILLER, Chairman
- WILLIAM A. MUNDELL
- MARC SPITZER
- MIKE GLEASON
- KRISTIN K. MAYES

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 2006 MAR -8 P 3:14
 ARIZONA CORPORATION COMMISSION
 DOCUMENT CONTROL

IN THE MATTER OF THE APPLICATION OF
DUNCAN RURAL SERVICES CORPORATION
FOR A RATE INCREASE.

DOCKET NO. G-02528A-05-0314

DOCKET NO. G-02528A-03-0205

IN THE MATTER OF THE APPLICATION OF
DUNCAN RURAL SERVICES CORPORATION
FOR APPROVAL OF A LOAN IN THE AMOUNT
OF \$400,000.

EXCEPTIONS

GALLAGHER & KENNEDY, P.A.
 2575 E. CAMELBACK ROAD
 PHOENIX, ARIZONA 85016-9225
 (602) 530-8000

Duncan Rural Services Corporation ("DRSC" or the "Association") submits these exceptions to the Recommended Opinion and Order ("ROO"). DRSC is a small, non-profit association delivering gas service to about 750 members in Greenlee County. Working with the Commission and Duncan Valley Electric Cooperative, Inc. ("DVEC" or the "Cooperative"), it acquired the gas operations of General Utilities in late 1989. In the 2004 test year, it suffered a net loss of more than \$70,000. Attached as Exhibit A are hearing transcript excerpts summarizing some of the key financial and operational difficulties which the Association has faced since inception and continues to face (HR TR, pp. 9-12).

The Association generally supports the ROO. Several of its provisions will help improve DRSC's beleaguered finances and ability to provide safe, reliable and adequate service. The Commission should adopt it with the four changes requested in these exceptions.

1 First, consistent with Staff's recommendation, clarify that the capital improvement
2 requirements do not apply to the debt authorized in this case. Second, consistent with the terms
3 of the debt approved previously in Decision No. 64869, authorize DRSC to borrow the amount
4 recommended in the ROO from DVEC at a variable interest rate equivalent to AEPCO's deposit
5 rate, but not to exceed eight percent (8%). Third, authorize the Association to manage its PGA
6 bank balance as close to zero as possible with monthly adjustments of no more than 10 cents per
7 therm. Fourth and finally, instead of the debt amount recommended, authorize a total of
8 \$600,000 in new debt which will fund past and future capital requirements as well as allow
9 DRSC to repay DVEC at some time in the future monies the Cooperative has advanced to
10 support DRSC's losses from operations. Recommended amendments to the ROO on each of
11 these issues are attached as Exhibit B.

12 On the first issue, DRSC does not object to the capital improvement and reporting
13 requirements described in Finding 28 and ordered at page 17 of the ROO. However, Staff was
14 clear that its equity improvement recommendation was not intended to apply to any debt
15 authorized in this proceeding: "[A]ny debt that's approved in this rate case, be it 330,000 or
16 600,000, that will not be included in the calculation for the five percent." HR TR, p. 131, ll. 4-6.
17 Therefore, to avoid future confusion, the Association would request that the phrase "exclusive of
18 the long-term debt authorized in this Decision" be added after the word "debt" on page 4, l. 26 of
19 the ROO.

20 Second, the ROO recommends approval of additional long-term debt at an interest rate
21 not to exceed five percent per year. While DRSC did discuss the five percent (5%) interest rate
22 as being a more realistic and current long-term rate than Staff's 2.725%, it offered those
23 comments in relation to its revenue requirements position (Exhibit A-3, p. 3, l. 26-p. 4, l. 22).

1 It did not intend the five percent (5%) rate to be a cap for the term of the loan.¹ We apologize if
2 that was not clear. Instead, DRSC requests that the loan authorized here carry the same terms as
3 the Commission authorized in its last rate case in Decision No. 64869, i.e., a variable interest rate
4 equivalent to AEPCO's deposit rate paid to DVEC, but not to exceed eight percent (8%). This
5 will allow the Association to uniformly administer both loans, more fairly compensate DVEC for
6 the monies it lends to the Association and provide a very attractive, but still capped short-term
7 rate for long-term monies to the benefit of DRSC's customers. Recommended amendment
8 language is set forth in Exhibit B.

9 Third, at Finding 64, the ROO rejects DRSC's proposal that it be allowed to manage its
10 PGA bank balance as close to zero as possible by adjusting the PGA rate monthly—up or
11 down—by no more than 10 cents per therm based upon its 12-month rolling average cost of gas.
12 Recently, a primary cash flow and credit strain on the Association has been extremely volatile
13 natural gas prices. While larger companies with greater cash and credit resources may be able to
14 survive under the current system of a 10-cent annual band plus surcharge requests, it just does
15 not work for DRSC or its customers.

16 From the member's standpoint, twice in recent years it has led to sudden jumps of
17 41 cents and 45 cents² in just one month—more than four times the variability allowed under
18 DRSC's proposal. From the Association's standpoint, in November the bank account was
19 \$55,000.³ To place that amount in context, that's about one-and-a-half times the annual net
20

21 _____
22 ¹ At Finding 54, a loan term of 25 years is stated, but the Ordering Paragraph at p. 18, l. 1 states a term of 20 years,
which we believe to be a typo. The amendment on Exhibit B changes the term to 25 years, which will reduce annual
principal payments.

23 ² While gas costs remain very high, price increases have not been as large as expected in the last three months. As a
result, DRSC expects to discontinue the \$0.45 surcharge in April.

24 ³ HR TR, p. 97, ll. 1-5.

1 margins expected under the rates approved in this case and about 70% of the Association's
2 annual capital expenditure requirements.

3 Approval of the 10-cents-per-therm monthly system allows DRSC gradually to move the
4 rate charged closer to its actual cost—reducing considerably the cash strain to carry and finance
5 these large undercollected balances. Consumers benefit in two ways. First, they avoid the
6 interest costs necessary to finance the undercollections and, second, they receive constant,
7 gradual rate signals rather than the abrupt, much larger increases the current system delivers.

8 A two-page schedule attached as Exhibit C illustrates this for 2005. Its first page shows
9 the adjustor, bank and other experience under the current system, while its second page shows
10 what would have happened under DRSC's 10-cents-per-month proposal. Referring to line 9, the
11 adjustor changes would have been much more gradual for the customer and not as high in
12 December. Referring to line 14, both carrying charges and the bank balances would have been
13 greatly reduced. Recommended amendment language is included in Exhibit B.

14 Finally, DRSC asks that the Commission grant its request for \$600,000 in long-term debt
15 including approximately \$171,000 to cover advances from DVEC that were used for operating
16 costs. At Finding 53, the ROO indicates that the Administrative Law Judge is sympathetic to the
17 request, but ultimately rejects it primarily because (1) DRSC could have sought rate relief sooner
18 and (2) the funds have been expended and are no longer needed to fund DRSC's operations.

19 On the first issue, either DVEC or DRSC have been processing cases constantly since
20 1999. The Association has filed two requests for rate relief in the past four years, as well as four
21 surcharge and finance requests. Over roughly the same time, because of the loss of the Phelps
22 Dodge electric supply contract, DVEC has also had to file three rate cases resulting in decisions
23

1 in 1999, 2001 and 2004. In fact, processing the 2004 DVEC rate case delayed somewhat the
2 ability to process this gas case for DRSC.

3 Duncan Valley Electric Cooperative has only 14 employees to run an electric system
4 which serves about 2,500 meters and the DRSC gas system which serves about 750. The
5 preparation of schedules and testimony, research and responses to data requests, meetings with
6 Staff personnel, hearings and the myriad other details associated with processing regulatory
7 filings and rate cases are very time-consuming, expensive and labor intensive. Here, DVEC and
8 DRSC have been involved in five rate cases, two surcharge applications and two debt requests
9 over the past seven years. This record indicates that both DVEC and DRSC and their Boards
10 labored diligently to meet the financial and cash challenges associated with both non-profits
11 within the limits of their capabilities.

12 On the second issue, it's true that the funds have been expended and are no longer needed
13 to fund the Association's operations. But, they were lent to DRSC by DVEC in good faith to
14 cover operating expense shortfalls which allowed the Association to meet its bills as they came
15 due and to continue to provide safe, reliable and adequate service. There are no stockholders or
16 other sources of funds which could have met these obligations.

17 The Commission has the ability under A.R.S. § 40-302.A to authorize borrowings for
18 operating expenses. The Association agrees that this power should be exercised rarely, but
19 strongly believes this case presents both the factual and equitable circumstances which justify its
20 exercise. It simply is not fair to shift these expenses to the members of DVEC. As a fiduciary
21 matter to the members of DVEC, if the Commission does not authorize this debt, Duncan
22 Valley's Board will have to seriously consider whether it can continue to make additional
23 advances to DRSC. Recommended amendment language is included in Exhibit B.

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Conclusion

DRSC requests that the Commission adopt the ROO with the amendments set forth in Exhibit B.

RESPECTFULLY SUBMITTED this 8th day of March, 2006.

GALLAGHER & KENNEDY, P.A.

By Michael M. Grant
Michael M. Grant
Todd C. Wiley
2575 East Camelback Road
Phoenix, Arizona 85016-9225
Attorneys for Duncan Rural Services
Corporation

Original and fifteen copies filed this 8th day of March, 2006, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Two copies of the foregoing delivered this 8th day of March, 2006, to:

Commissioner Jeff Hatch-Miller, Chairman
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Commissioner William A. Mundell
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

1 Commissioner Marc Spitzer
Arizona Corporation Commission
2 1200 West Washington
Phoenix, Arizona 85007

3
4 Commissioner Mike Gleason
Arizona Corporation Commission
1200 West Washington
5 Phoenix, Arizona 85007

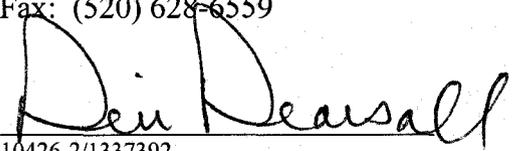
6 Commissioner Kristin K. Mayes
Arizona Corporation Commission
7 1200 West Washington
Phoenix, Arizona 85007

8
9 **Copy of the foregoing delivered this**
8th day of March, 2006, to:

10 Jason Gellman, Legal Division
Arizona Corporation Commission
11 1200 West Washington
Phoenix, Arizona 85007

12
13 **Copy of the foregoing faxed and mailed**
this 8th day of March, 2006, to:

14 Jane L. Rodda
Administrative Law Judge
15 Hearing Division
Arizona Corporation Commission
16 400 West Congress
Tucson, Arizona 85701-1347
17 Fax: (520) 628-6559

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19 10426-2/1337392

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EXHIBIT A

1 BEFORE THE ARIZONA CORPORATION COMMISSION

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3 IN THE MATTER OF THE APPLICATION OF) DOCKET NO.
4 DUNCAN RURAL SERVICES CORPORATION) G-02528A-05-0314
5 FOR A RATE INCREASE.)

6 IN THE MATTER OF THE APPLICATION OF) DOCKET NO.
7 DUNCAN RURAL SERVICES CORPORATION) G-02528A-03-0205
8 FOR APPROVAL OF A LOAN IN THE AMOUNT)
9 OF \$400,000)

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At: Tucson, Arizona

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Date: December 15, 2005

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Filed:

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REPORTER'S TRANSCRIPT OF PROCEEDINGS

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ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite Three
2627 North Third Street
Phoenix, Arizona 85004-1126

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By: CLARK L. EDWARDS, RPR
Certified Court Reporter
Certificate No. 50425

24

Prepared for:

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12 Each one of these recommendations, Ms. Rodda,
13 attempts to bring some financial stability to a system
14 which simply hasn't been able to achieve it despite
15 the best efforts to do so over the past 15 years.

16 This is Duncan Rural's fourth rate case since
17 1993. The three prior decisions, two of which you
18 were the judge on, were 58356 in 1993, 59539 in 1996,
19 and 64869 in 2002.

20 Duncan Rural was formed by Duncan Valley and
21 its members in 1989 to acquire the Greenlee County Gas
22 operations of General Utilities. That gas system had
23 been neglected for years and it was in serious need of
24 upgrades and repairs.

25 Under general ownership the system had been

1 cited many times by the Pipeline Safety Section for
2 violations and was in serious noncompliance. It had
3 been run by the Frederickson family for about
4 60 years, and you may recall from the history that the
5 final sister in the family had died.

6 And actually working with the Commission
7 Duncan Valley moved in to acquire the Greenlee County
8 operations, and Graham Electric moved in to acquire
9 the Graham County operations.

10 The Cooperative was aware of some of the
11 problems and certainly the Commission was aware of
12 many of the problems as well but had no idea as to
13 their magnitude.

14 For example, an escrow fund to finance
15 repairs out of seller's proceeds was negotiated, but
16 the roughly \$180,000 which was reserved for repairs
17 and replacements was quickly exhausted.

18 Once the Greenlee Gas operations Duncan Rural
19 acquired were separated from the much larger Graham
20 County operations, it was learned that line losses
21 were not the eight to nine percent that had been
22 represented at time of sale but instead were
23 36 percent.

24 In a few years Duncan Rural brought the
25 system into substantial compliance with safety

1 standards and reduced those system losses to eight
2 percent, but it seemed as if a dark cloud was hanging
3 over the Duncan Rural system. It of course started
4 100 percent debt financed.

5 Number two, I was reminded in reading your
6 1996 order, you note this on page two, that the 1993
7 rate case did not really deliver very much money
8 ultimately because after the line losses were fixed it
9 was learned that General Utilities had been using the
10 wrong billing factor for a long time.

11 They were billing the gas as if the system
12 were at sea level when in fact it was in excess of
13 3,000 feet. And so, when discovered, the billing
14 factor was adjusted as it should have been but that
15 negated much of the rate relief which had been
16 intended to be associated with the 1993 case.

17 And, Ms. Rodda, simply stated, the
18 Cooperative has never been able to catch up.

19 As Mr. Shilling discusses, from 2001 to 2004,
20 continuing plant repairs and replacements have cost
21 about \$330,000, and capital additions are going to
22 average about the same, \$80,000 per year for the next
23 five years.

24 The Commission is well aware of what's been
25 happening to the cost of natural gas. Carrying that

1 dramatically-increasing cost under the current clause
2 structure together with other cost increases has also
3 strained Duncan Rural's financial resources.

4 Finally, after some modest growth in
5 customers in the 1990s and into the early part of this
6 century, Duncan Rural has been losing customers in
7 recent years. It was serving about 820 customers
8 around the time we last got together in 2002, but as
9 of October of this year that number had dropped to
10 745.

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EXHIBIT B

Requested Amendments to the ROO

Capital Improvement and Reporting Issue

At page 4, l. 26, after the word "debt" insert "exclusive of the long-term debt authorized in this Decision".

Long-Term Interest Rate Issue

At page 12, l. 13, delete the final two sentences of Finding 56 and insert "DRSC's proposal that a 5% rate be used to determine its revenue requirements is fair and reasonable and we authorize DRSC to borrow on the same terms we authorized in Decision No. 64869."

At page 18, ll. 1-2, delete "for a term of twenty years, and at an interest rate not to exceed five percent per year" and insert "for a term of twenty-five years, and at a variable interest rate equivalent to AEPCO's deposit rate, but not to exceed eight percent per year".

Change in PGA Adjustor Issue

At page 15, ll. 9-13, delete Finding 64 and insert:

"64. Under the unique circumstances of this case given DRSC's non-profit nature, small size, negative equity, cash flow difficulties and limited credit resources, we find that the Company's proposal to manage its PGA bank balance as close to zero as possible with monthly adjustors of no more than 10 cents per therm based on its 12-month rolling average cost of gas should be approved."

At page 17, l. 26, insert new Ordering paragraph as follows:

"IT IS FURTHER ORDERED that Duncan Rural Services Corporation is authorized to manage its PGA bank balance as close to zero as possible with monthly adjustors of no more than 10 cents per therm based on its 12-month rolling average cost of gas."

Debt Amount Issue

At page 11, l. 15, delete the final three sentences of Finding 53 and insert "This is a situation where one non-profit cooperative aided another non-profit association as both faced unique financial and operational challenges with limited resources. Further, there is no indication that the sufficiency of rate levels has been neglected. Instead, the record demonstrates that DVEC and DRSC have processed a total of five rate cases in seven years. Given this record, it is appropriate to authorize long-term debt to finance these advances from DVEC."

At page 16, l. 6, delete "34,".

At page 18, l. 1, delete the remainder of the sentence and footnote 5 and insert "aggregate of \$600,000 for a term of twenty years, and at a variable interest rate equivalent to AEPCO's deposit rate, but not to exceed eight percent per year."

EXHIBIT C

Date	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05
1. Beginning Bank Balance	\$22,277.44	\$23,431.78	\$21,371.30	\$17,290.27	\$21,354.72	\$20,727.93	\$19,948.92	\$23,481.92	\$22,259.63	\$23,902.71	\$35,766.57	\$54,957.63
2. Cost of Purchased Gas	\$39,353.22	\$31,479.08	\$21,190.58	\$32,317.64	\$13,079.05	\$17,366.94	\$26,488.46	\$14,500.80	\$14,070.05	\$24,013.76	\$40,441.55	\$56,539.79
3. Transportation Cost	\$3,105.38	\$2,539.92	(\$1,225.34)	\$2,072.06	\$927.06	\$1,415.33	\$1,921.97	\$1,078.02	\$764.74	\$1,109.16	\$1,643.48	\$2,928.32
4. Total Cost to be Recovered	\$64,736.04	\$57,450.78	\$41,336.54	\$51,679.97	\$35,360.83	\$39,510.20	\$48,359.35	\$39,060.74	\$37,094.42	\$49,025.63	\$77,851.60	\$114,425.74
5. Sales in Therms	73,020	63,273	42,112	51,858	24,840	32,508	42,170	27,746	21,746	21,612	36,785	62,028
6. Base Period Fuel Cost per Therm	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600
7. Amount Recovered by Base Period Gas Cost	\$26,287.20	\$22,778.28	\$15,160.32	\$18,668.88	\$8,942.40	\$11,702.88	\$15,181.20	\$9,988.56	\$7,828.56	\$7,780.32	\$13,242.60	\$22,330.08
9. Rolling Average PGA per Therm	\$0.20630	\$0.21100	\$0.21220	\$0.22560	\$0.23130	\$0.23130	\$0.23130	\$0.24810	\$0.24980	\$0.25720	\$0.26580	\$0.72500
10. Amount Recovered from Rolling Average	\$15,064.03	\$13,350.60	\$8,936.17	\$11,699.16	\$5,745.49	\$7,519.10	\$9,753.92	\$6,883.78	\$5,432.15	\$5,558.61	\$9,777.45	\$44,970.30
11. Total Amount Recovered	\$41,351.23	\$36,128.88	\$24,096.49	\$30,368.04	\$14,687.89	\$19,221.98	\$24,935.12	\$16,872.34	\$13,260.71	\$13,338.93	\$23,020.05	\$67,300.38
12. Adjustments												
13. Monthly Subtotal	\$23,384.81	\$21,321.90	\$17,240.05	\$21,311.93	\$20,672.94	\$19,892.44	\$23,424.23	\$22,188.40	\$23,833.71	\$35,686.70	\$54,831.55	\$47,125.36
Monthly Interest Rate	2.53%	2.53%	2.82%	2.97%	3.09%	3.27%	3.47%	3.64%	3.72%	4.01%	4.23%	4.23%
14. Monthly Interest	\$46.97	\$49.40	\$50.22	\$42.79	\$54.99	\$56.48	\$57.69	\$71.23	\$69.00	\$79.87	\$126.08	\$193.73
14. End of Month Bank Balance	\$23,431.78	\$21,371.30	\$17,290.27	\$21,354.72	\$20,727.93	\$19,948.92	\$23,481.92	\$22,259.63	\$23,902.71	\$35,766.57	\$54,957.63	\$47,319.09

(\$395.78)

Date	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05
1. Beginning Bank Balance	\$22,277.44	\$18,415.31	\$12,294.78	\$5,337.23	\$6,032.44	\$3,908.08	\$1,175.02	\$2,178.35	(\$271.12)	\$210.47	\$8,908.97	\$19,390.30
2. Cost of Purchased Gas	\$39,353.22	\$31,479.08	\$21,190.58	\$32,317.64	\$13,079.05	\$17,366.94	\$26,488.46	\$14,500.80	\$14,070.05	\$24,013.76	\$40,441.55	\$56,539.79
3. Transportation Cost	\$3,105.38	\$2,539.92	(\$1,225.34)	\$2,072.06	\$927.06	\$1,415.33	\$1,921.97	\$1,078.02	\$764.74	\$1,109.16	\$1,643.48	\$2,928.32
4. Total Cost to be Recovered	\$64,736.04	\$52,434.31	\$32,260.02	\$39,726.93	\$20,038.55	\$22,690.35	\$29,585.45	\$17,757.17	\$14,563.67	\$25,333.39	\$50,994.00	\$78,858.41
5. Sales in Therms	73,020	63,273	42,112	51,858	24,840	32,508	42,170	27,746	21,746	21,612	36,785	62,028
6. Base Period Fuel Cost per Therm	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600	\$0.3600
7. Amount Recovered by Base Period Gas Cost	\$26,287.20	\$22,778.28	\$15,160.32	\$18,668.88	\$8,942.40	\$11,702.88	\$15,181.20	\$9,988.56	\$7,828.56	\$7,780.32	\$13,242.60	\$22,330.08
9. Rolling Average PGA per Therm	\$0.27500	\$0.27500	\$0.28000	\$0.29000	\$0.29000	\$0.29000	\$0.29000	\$0.29000	\$0.30000	\$0.40000	\$0.50000	\$0.60000
10. Amount Recovered from Rolling Average	\$20,080.50	\$17,400.08	\$11,791.36	\$15,038.82	\$7,203.60	\$9,427.32	\$12,229.30	\$8,046.34	\$6,523.80	\$8,644.80	\$18,392.50	\$37,216.80
11. Total Amount Recovered	\$46,367.70	\$40,178.36	\$26,951.68	\$33,707.70	\$16,146.00	\$21,130.20	\$27,410.50	\$18,034.90	\$14,352.36	\$16,425.12	\$31,635.10	\$59,546.88
12. Adjustments							(\$395.78)					
13. Monthly Subtotal	\$18,368.34	\$12,255.95	\$5,308.34	\$6,019.23	\$3,892.55	\$1,164.37	\$2,174.95	(\$277.73)	\$211.31	\$8,908.27	\$19,358.90	\$19,311.53
Monthly Interest Rate	2.53%	2.53%	2.82%	2.97%	3.09%	3.27%	3.47%	3.64%	3.72%	4.01%	4.23%	4.23%
14. Monthly Interest	\$46.97	\$38.83	\$28.89	\$13.21	\$15.53	\$10.65	\$3.40	\$6.61	(\$0.84)	\$0.70	\$31.40	\$68.35
14. End of Month Bank Balance	\$18,415.31	\$12,294.78	\$5,337.23	\$6,032.44	\$3,908.08	\$1,175.02	\$2,178.35	(\$271.12)	\$210.47	\$8,908.97	\$19,390.30	\$19,379.88