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ARIZONA CORPORATION COMMISSION

May 1, 2006

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2575 East Camelback Rd.
Phoenix, Arizona 85016-9225

John Wallace
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120 North 44th Street, Suite 100
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RE: APPLICATION DUNCAN RURAL SERVICES CORPORATION FOR A RATE INCREASE DOCKET NO. G-02528A-05-0314

* (CONSOLIDATED WITH DOCKET G-02528A-03-0205)

Dear Duncan Rural Services, Inc.:

The purpose of this letter is to respond to Duncan Rural Services Corporation's ("Duncan") letter of April 27, 2006. Particularly this letter is meant to address the statement made in Duncan's letter of April 27 that states, *"It is not clear to DRSC how DRSC's PGA rate would be calculated under Staff's interpretation."* This letter also serves to reiterate Staff's intentions regarding Commission Decision No. 68599 (March 23, 2006) and, specifically, implementation of the fifth ordering paragraph (page 10, lines 26-28) which relates to the operation of the purchased gas adjustor ("PGA") mechanism.

Historically the term PGA rate has been used to describe the portion of rates adjustable outside a rate case that is meant to recover gas costs. In Staff's letter of April 21, 2006, use of the term PGA rate was meant to describe the entire rate used to recover gas costs, consistent with historic use of the term PGA. Staff notes that in the tariff filing of March 31, 2006, Duncan has described a Purchased Gas Adjustor Rate ("PGAR"). The filed tariff proposes a PGAR that would consist of an amount between plus or minus $0.10 that would be added to the rolling average to produce a Monthly Gas Cost Rate ("MGCR"). Staff's letter describing calculation of the PGA rate did not mean to prescribe how Duncan should calculate its proposed PGAR, as Staff's understanding of the order is that no such mechanism (PGAR) is created by the order. Staff's letter was meant to prescribe how to calculate the entire rate adjustable outside a rate case charged to recover gas costs (PGA), akin to Duncan's proposed MGCR. Note that Duncan's proposed MGCR is the entire rate used to recover gas costs and is adjustable outside a rate case. The nomenclature in the proposed tariff fails to recognize that the MGCR is adjustable outside a

* DOCKET ADDED FOR PURPOSES OF FILING IN CONSOLIDATED DOCKETS ON 5-26-06

rate case and reserves use of the word adjustor solely to one component of the adjustable rate (PGAR).

Staff's understanding of the fifth ordering paragraph is as follows: As a result of this ordering paragraph, the monthly PGA rate (whole adjustable rate charged for gas cost recovery) shall be calculated as it has been in the past, relying on the mechanical calculation of the twelve-month rolling average cost. The only change that results from this ordering paragraph is that the previous $0.10 per therm **annual** bandwidth is changed to now limit the change in the **monthly** PGA rate charged to customers to no more than $0.10 per therm different from the previous month's PGA rate charged to customers, i.e., the bandwidth is now a **monthly** bandwidth.

Therefore, per Decision No. 68599, the PGA rate (whole adjustable rate charged for gas cost recovery) should be calculated as it has been in the past with the exception that rather than the $0.10 bandwidth making reference to any PGA rate present in the previous twelve months, the bandwidth makes reference only to the previous month's PGA rate.

Assume that in January the past twelve months' average cost of gas is $1.00 per therm. Also assume that December's PGA rate was $0.99 (referring to the whole adjustable rate used for gas recovery). January's PGA rate would be $1.00 as it is the twelve month rolling average cost of gas and is not more than $0.10 different than the previous month's PGA rate.

Using the same example given a rolling average cost of gas of $1.00 per therm and a December PGA rate of $0.85, Duncan should implement a PGA rate of $0.95. This rate is appropriate as the rolling average is more than $0.10 different than the past PGA rate and thus the final rate is bound by the $0.10 bandwidth. In this case the rate closest to the rolling average but not more than $0.10 different than the past PGA rate should be charged. This number is $0.95 as it is $0.85 + $0.10, the previous PGA rate plus the bandwidth limit.

As stated previously, Staff will review Duncan's next monthly PGA filing to determine whether the filing is consistent with Staff's understanding of how the PGA mechanism works. If Duncan's next monthly PGA filing is not consistent with Staff's understanding of how the PGA mechanism works, Staff will expect Duncan to correct its filing so that the rate comports with Staff's method of calculating the monthly PGA rate.

If you have any questions about this matter, please contact Steve Irvine of our Staff at (602) 542-0824, or me, at (602) 542-0745.

Sincerely,

Ernest G. Johnson
Director
Utilities Division

EGJ:spi