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AZ CORP COMMISSION  
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May 8, 2006

Commissioner Jeff Hatch-Miller, Chairman  
Commissioner William A. Mundell  
Commissioner Marc Spitzer  
Commissioner Mike Gleason  
Commissioner Kristin K. Mayes  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, AZ 85007

**Re: Request that the Commission Clarify Its Intent Regarding Decision No. 68599**

**(March 23, 2006) Duncan Rural Service Corporation's ("DRSC") Application**

**for a Rate Increase; Docket No. G-02528A-05-0314 and DOCKET NO. G-02528A-03-0205**

Dear Commissioners:

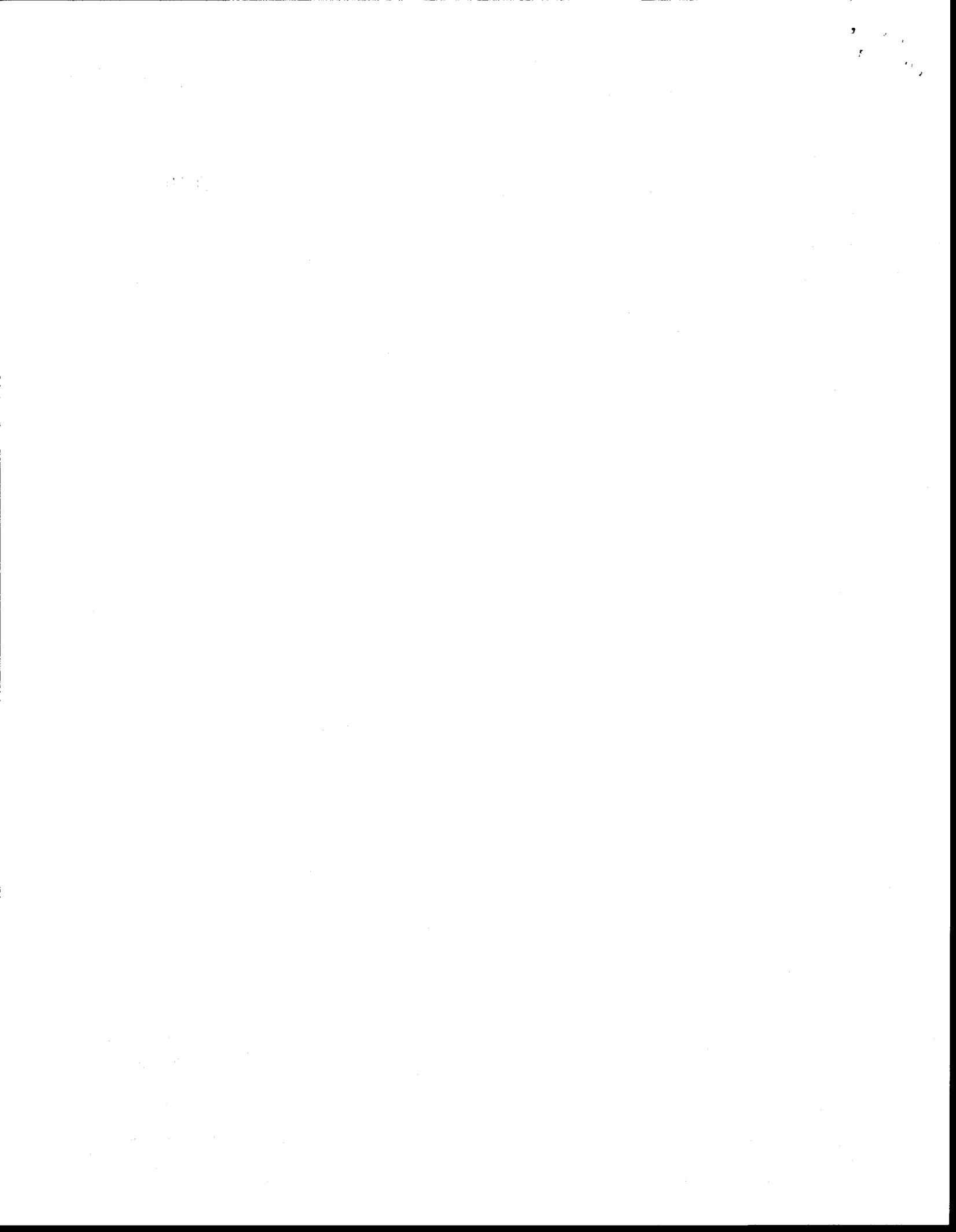
The purpose of this letter is to request that the Commission resolve a disagreement between DRSC and Staff concerning the proper interpretation of your Decision No. 68599 dated March 23, 2006 (copy attached as Exhibit A) as it pertains to gas clause adjustment procedures. Because DRSC's bank balance is currently over-collected and DRSC would like to return more money more rapidly to its members than Staff's interpretation will allow, we would request that you place this matter on an Open Meeting agenda as soon as possible in order to provide us guidance on your intent.

Arizona Corporation Commission

**DOCKETED**

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Letter to Commissioners  
May 8, 2006  
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As background, in the just completed rate case, DRSC asked that “in order to manage its bank balance as close to zero as possible it should be allowed to adjust its PGA monthly, by no more than 10 cents per therm based on its 12 month rolling average cost of gas.” Decision, Finding 48, p. 10. The benefits associated with this proposal included more gradual and accurate price signals than the abrupt, much larger jumps of surcharges, reduced interest charges and an improvement in DRSC’s cash flow. Staff opposed DRSC’s proposal of monthly 10-cents-per-therm adjustments and maintained that the annual 10-cent band should remain in place. Decision, Finding 50, p. 10.

At the March 15, 2006, Open Meeting, Commissioner Gleason offered amendments supporting DRSC’s proposal which the Commission approved:

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 is reasonable and should be approved.

\* \* \*



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.

Decision, p. 17.

On March 31, 2006, DRSC filed its tariff in compliance with Decision No. 68599 (“Decision”). DRSC described its approved Purchased Gas Adjustor (“PGA”) mechanism as follows:

II. Gas Adjustment Procedure

The Utility is authorized to manage its PGA Bank Balance (PGABB) 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. The Monthly Gas Cost Rate (MGCR) is the sum of the Utility’s previous twelve-month rolling average cost of gas plus the Purchased Gas Adjustor Rate (PGAR), if applicable. The PGAR can not exceed plus or minus 10 cents per therm, per month.



DRSC has received a letter from Commission Staff (“Staff”) dated May 1, 2006 explaining its understanding regarding the Decision and specifically the implementation of the ordering paragraph quoted above.\* (Staff’s letter is attached as Exhibit B.) Staff states that “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 12-month rolling average cost. The only change that results from this ordering paragraph [quoted above] is that the previous 10-cents-per-therm annual bandwidth is changed to now limit the change in the monthly PGA rate charged to customers, i.e., the bandwidth is now a monthly bandwidth.”

DRSC disagrees with this interpretation of the Decision—primarily because it virtually ignores the principle thrust of the Decision’s authorization to “manage its PGA bank balance as close to zero as possible.” DRSC believes the correct interpretation of the Finding 64 and Ordering Paragraph is that it may adjust the 12-month rolling average cost by no more than 10 cents monthly so long as the adjustment moves the bank balance closer to zero.

DRSC currently has an over-collected bank balance of approximately \$16,000. Consistent with its filed tariff and interpretation of the Decision, DRSC had reduced its 12-month rolling average cost of \$0.7749/therm by 10 cents, which would have resulted in a PGA rate of \$0.6749 for April gas usage. It did this in order to manage its PGA bank balance as close to zero as possible.

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\* DRSC and Staff discussed this matter in April and exchanged letters in an attempt to resolve this dispute.



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According to Staff's interpretation, however, DRSC can only charge its customers a PGA rate that is equal to its 12-month rolling average cost of gas which was \$0.7749/therm. Staff further requested that DRSC immediately comply with that position. DRSC reluctantly agreed to do so, but seeks Commission clarification of the intent of the Decision.

Attached as Exhibit C are two schedules which show DRSC's PGA bank balance under Staff's and DRSC's interpretation. As these schedules demonstrate, under Staff's interpretation, the over-collected bank balance grows to \$26,492 by May—an increase of more than \$10,000 (Refer to Exhibit C, page 1 of 2). This clearly does not allow DRSC to manage the bank balance as close to zero as possible and also has the effect, in this instance, of requiring DRSC to collect from its members monies not needed to cover its cost of gas. Even under DRSC's interpretation that would reduce the 12-month rolling average cost by 10 cents, the over-collected bank balance is estimated to grow to \$20,000 by the end of May due to significant decreases in DRSC's current purchased gas costs (Refer to Exhibit C, page 2 of 2).

DRSC requests that the Commission schedule this matter for an Open Meeting as promptly as possible to confirm that its interpretation of Decision No. 68599 is correct as reflected in its tariff filed on March 31, 2006.





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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

Arizona Corporation Commission

**DOCKETED**

MAR 23 2006



3 JEFF HATCH-MILLER, Chairman  
4 WILLIAM A. MUNDELL  
5 MARC SPITZER  
6 MIKE GLEASON  
7 KRISTIN K. MAYES

DOCKETED BY *OK*

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

DOCKET NO. G-02528A-05-0314

11 IN THE MATTER OF THE APPLICATION OF  
12 DUNCAL RURAL SERVICES COPORATION  
13 FOR APPROVAL OF A LOAN IN THE AMOUNT  
14 OF \$400,000.

DOCKET NO. G-02528A-03-0205

**68599**

DECISION NO. \_\_\_\_\_

**OPINION AND ORDER**

15 DATE OF HEARING:

December 15, 2005

16 PLACE OF HEARING:

Tucson, Arizona

17 ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

18 APPEARANCES:

Michael Grant, Gallagher & Kennedy,  
P.A., on behalf of Duncan Rural Services  
Corporation; and

Jason Gellman, Staff Attorney, Legal  
Division, on behalf of the Utilities  
Division for the Arizona Corporation  
Commission.

19 **BY THE COMMISSION:**

\* \* \* \* \*

20 Having considered the entire record herein and being fully advised in the premises, the  
21 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

**FINDINGS OF FACT**

22  
23 1. On April 4, 2003, Duncan Rural Services Corporation ("DRSC" or "Company") filed  
24 an application to incur debt with the Commission.

25 2. On May 2, 2005, DRSC filed the above-captioned rate application with the  
26 Commission.

1           3.       On May 26, 2005, the Commission's Utilities Division Staff ("Staff") notified the  
2 Company that its rate application was not sufficient under A.A.C. R14-2-103.

3           4.       On June 9, 2005, DRSC filed revised schedules that essentially comprised a new rate  
4 application.

5           5.       On June 21, 2005, Staff notified the Company that its June 9, 2005, application met  
6 the sufficiency requirements as outlined in A.A.C. R14-2-103, and classified the Company as a Class  
7 C utility.

8           6.       By Procedural Order dated July 13, 2005, the Commission established procedural  
9 guidelines and set the matter for hearing on December 15, 2005, at its Tucson offices.

10          7.       In its rate application, DRSC requested that the finance and rate applications be  
11 consolidated.

12          8.       On October 25, 2005, Staff filed a Motion to Consolidate the two applications.

13          9.       By Procedural Order dated October 28, 2005, the Commission consolidated the two  
14 matters.

15          10.      On August 9, 2005, DRSC mailed notice of the hearing to its customers.

16          11.      On November 8, 2005, Staff filed Direct Testimony. On November 21, 2005, DRSC  
17 filed Rebuttal Testimony. On December 5, 2005, Staff filed Surrebuttal Testimony. On December  
18 12, 2005, DRSC filed Rejoinder Testimony.

19          12.      The hearing convened on December 15, 2005, as scheduled, before a duly authorized  
20 Administrative Law Judge, at the Commission's offices in Tucson, Arizona.

21          13.      DRSC and Staff filed Closing Briefs on January 24, 2006.

22          14.      DRSC is a non-profit corporation that provides service to approximately 760  
23 consumers in Greenlee County, Arizona. In its last rate case, using a test year of 2000, DRSC had  
24 800 customers.

25          15.      DRSC acquired the gas system in 1989 from General Utilities, Inc. ("General  
26 Utilities"). The General Utilities' system at the time of purchase was in serious disrepair. See  
27 Decision No. 58356.

28

1           16.    Duncan Valley Electric Cooperative, Inc. ("DVEC") manages the operations of  
2 DRSC, including its operational and capital expenditures.

3           17.    DRSC's current rates were established in Decision No. 64869 (June 5, 2002) based on  
4 a 2000 test year. In that case, the Commission found that DRSC had suffered a net loss in the test  
5 year of approximately \$19,000, and approved a 24 percent increase in gross annual revenues.

6           18.    In filing the current rate application, DRSC states that its financial condition has not  
7 improved since its last rate case because its purchased gas costs have significantly increased during  
8 the test year and other costs have increased as well. In addition, in the years 2001 to 2004, DRSC  
9 invested over \$331,000 in plant additions. Further exasperating its financial condition, DRSC's  
10 customer base is decreasing.

11           19.    In the test year ended December 31, 2004, DRSC posted adjusted Total Revenue of  
12 \$323,238, which resulted in a negative Operating Margin of \$47,976, and a Net Loss of \$70,958.

13           20.    In this case, DRSC requests approval for total revenues of \$523,488, an increase over  
14 test year revenues of \$200,250, or 61.9 percent. Duncan requests that \$32,437, or 16.2 percent, of the  
15 requested increase be deferred until 2007 and 2008. (Ex A-4 Rejoinder Schedule A-2) In the first  
16 phase of its requested increase, DRSC is requesting a revenue requirement of \$491,051, an increase  
17 of \$167,705, or 51.8 percent, over adjusted test year revenues. Using the Company's schedules, the  
18 first phase revenue increase would produce a net margin of \$39,187 and a Times Interest Earned  
19 Ratio ("TIER") of 2.00 based on the Company's requested debt level. (Ex A-4) DRSC's first phase  
20 increase would produce a 10.30 percent rate of return on its adjusted original cost rate base of  
21 \$758,057. The final phase of DRSC's requested increase would, based on the Company's schedules,  
22 produce an Operating Margin of \$102,774, TIER of 2.63, DSC of 1.61 and a 13.56 percent rate of  
23 return on original cost rate base. (Ex A-4) Under the Company's proposal the first phase of the  
24 increase would become effective immediately; the second phase, a five percent increase, would  
25 become effective a year later, or in 2007; the third phase, an additional five percent increase, would  
26 be effective a year after that, or in 2008.

27           21.    Staff recommends a revenue requirement of \$473,219, a \$149,981, or 46.3 percent,  
28 increase over test year revenues. Under Staff's recommendation, DRSC would have an operating

1 margin of \$65,665, and an 8.66 percent rate or return on an adjusted original cost rate base of  
2 \$758,057. Staff's analysis indicates that under its recommendation, DRSC would have a TIER of  
3 2.28 and a DSC of 1.64.

4 22. The rates DRSC is requesting are attached hereto as Exhibit A.

5 23. The rates Staff recommends are attached as Exhibit B.

6 24. DRSC agreed to Staff's adjustments to the Company's proposed rate base. (Ex A-3 at  
7 1) We concur that Staff's recommended adjusted Original Cost Rate Base ("OCRB") of \$758,057 is  
8 reasonable and should be adopted. DRSC waived a reconstruction cost new rate base and thus, its  
9 OCRB of \$758,057 is deemed to be its fair value rate base.

10 25. There is little or no disagreement over adjusted test year operating expenses. The  
11 small difference of opinion concerning expenses involves rate case expense and income tax expense.  
12 DRSC states that if the Commission does not adopt DRSC's revenue level, it recommends that rate  
13 case expense be amortized over a two year period and Staff's adjustment to rate case expense of  
14 \$4,851 be rejected.

15 26. In this case, DRSC and Staff disagree about the size of the necessary revenue increase,  
16 rate design, the design of the Purchased Gas Adjustor, and the appropriate level of debt.

17 27. At the end of the test year, DRSC had total capital of \$363,884, comprised of long  
18 term debt of \$516,958 and negative equity of \$153,074. (Ex A-6, Sch D-1)

19 28. Staff recommends that DRSC improve its capital structure by five percent each year  
20 until equity comprises at least 30 percent of its total capital. Under Staff's proposal, the amount of  
21 DRSC's total capital would be determined as of the end of 2005; and each year thereafter, DRSC  
22 would be responsible for increasing the dollar amount of its equity by five percent of the year end  
23 2005 figure. Thus if at the end of 2005, DRSC were to have total capital of \$300,000, during 2006,  
24 DRSC would need to increase equity by \$15,000, or five percent of \$300,000. The amount of the  
25 equity increase would not change as capital changed unless DRSC incurred additional long-term debt  
26 exclusive of the long-term debt authorized in this Decision. Thus, if DRSC's total equity were to be  
27 \$315,000 in year two, DRSC would still only need to contribute an additional \$15,000 for that year.  
28 If DRSC contributed \$20,000 in year one, then it would only need to contribute \$10,000 in year two

1 to be in compliance because the Company would have contributed an average of five percent per year  
2 over the two years. Under Staff's proposal, if DRSC were to incur additional long-term debt, it  
3 would be expected to contribute an additional five percent of the new debt. Thus if in year two,  
4 DRSC received \$30,000 in debt financing, then it would be expected to contribute a total of \$16,500  
5 (\$330,000 times five percent) for that year only. In year three the requirement would revert back to  
6 \$15,000, assuming no new additional debt was incurred.

7 29. As discussed later, Staff is recommending that \$171,516 of the \$502,000 advanced by  
8 DVEC not be approved to be converted to long-term debt, but rather be treated as an equity infusion.  
9 Staff recommends that this equity infusion be counted toward the five percent per year benchmark.

10 30. In addition, Staff recommends that its equity improvement recommendation not be  
11 punitive in that there be no automatic punishment should DRSC not achieve the five percent equity  
12 growth target. Instead, Staff recommends that DRSC file a rate case should it not achieve the target.  
13 Staff states that its intent is not to punish DRSC but to ensure that DRSC makes progress towards  
14 improving its capital structure. Staff believes the most important thing is that DRSC and the  
15 Commission institute a concrete plan to improve its financial condition.

16 31. The parties' differences concerning the revenue requirement arise primarily from  
17 DRSC's belief that to build equity as Staff recommends and to fund its capital improvement program,  
18 it requires more revenue than Staff recommends. DRSC believes its proposed three step increase is  
19 consistent with the Commission's preference for smaller and more regular rate increases, and will  
20 save the Commission and DRSC the costs associated with two rate cases. DRSC believes its revenue  
21 level assumes a more realistic interest level of 5 percent, instead of 3 percent, on its borrowings from  
22 DVEC. Furthermore, DRSC states it will require approximately \$80,000 annually to fund its capital  
23 budget, and DRSC believes that Staff's recommended revenue level will not allow it to build capital,  
24 make increased debt service payments and fund its planned capital investments.

25 32. Staff believes that DRSC's request for two 5 percent step increases was based on a  
26 misunderstanding that the total 2005 capital figure would include the \$330,484 portion of the cash  
27 advance from DVEC. Thus, Staff believed DRSC had the impression that it would be required to  
28

1 contribute an additional \$16,525 above what Staff is recommending. Staff believes that DRSC's year  
2 end 2005 capital will be lower than the \$363,884 in total capital as of the end of the test year.

3 33. DRSC is requesting authorization to borrow \$600,000 from DVEC. This amount  
4 reflects the \$502,000 already advanced by DVEC to DRSC and an additional advance of \$98,000 to  
5 fund DRSC's capital budget.

6 34. Staff recommends that the Commission authorize long term borrowings from DVEC  
7 of \$330,484. Of the \$502,000 advanced by DVEC, Staff's audit determined that \$330,484 was used  
8 for capital investments and that \$171,516 was advanced to cover operating expenses. Staff argues  
9 that it is inappropriate to treat funds for operating expenses as long-term debt because it shifts costs,  
10 such that customers in later periods pay for benefits received by customers in earlier periods. Staff  
11 argues that even with a declining customer base, customers are being burdened with operating  
12 expenses of past years. According to Staff, not only is the reclassification of the \$171,516 as equity  
13 in accord with sound financial principles, it helps DRSC meet Staff's recommended annual five  
14 percent equity improvement target.

15 35. Staff believes that it is not in accordance with sound financial principles to approve  
16 any additional long-term debt over what is absolutely necessary at this time. Staff does not  
17 recommend approving the \$98,000 in additional borrowings from DVEC for DRSC's on-going  
18 capital budget. Staff believes that DRSC can fund its annual \$80,000 capital budget and meet the  
19 five percent equity improvement target at Staff's recommended revenue level. Staff argues that  
20 approving additional long-term debt of \$98,000 would exacerbate DRSC's already highly leveraged  
21 capital position.

22 36. Staff recommends that the Commission approve a \$70,000 revolving line of credit  
23 with DVEC to be used to assist DRSC in dealing with the rising cost of natural gas and to help  
24 finance any increase in the under-collected bank balance after the date that new rates become  
25 effective. Staff recommends an interest rate equal to AEPCO's rate of interest paid on "270 Day  
26 Fixed Rate Notes," which at the time of Staff's testimony was 2.725 percent.<sup>1</sup> Staff recommends that  
27

28 <sup>1</sup> At the hearing, testimony from Mr. Wallace on behalf of DRSC indicated that the interest rate on deposits with AEPCO recently increased to 4.8 percent. (TR at 48)

1 the line of credit be used exclusively to fund DRSC's under-collected PGA bank balance. Under  
2 Staff's proposal, DRSC could use the line of credit to finance amounts greater than the balance of the  
3 under-collected PGA bank balance at the time that rates from this proceeding are implemented. For  
4 example, under Staff's recommendation, if DRSC's under-collected bank balance at the  
5 implementation of the approved rates is \$30,000 and then after three months the under-collected PGA  
6 bank balance increased to \$45,000, DRSC would be able to borrow \$15,000 against the line of credit.  
7 If the under-collected bank balance subsequently decreased to \$35,000, DRSC would be required to  
8 repay \$10,000 of the line of credit balance so that the borrowed balance each month is maintained at,  
9 or below, the amount of the bank balance that exceeds \$30,000. In the example, DRSC would not be  
10 able to borrow on the line of credit if the under-collected balance drops below \$30,000 (the balance at  
11 the date the new rates became effective).

12 37. DRSC recognizes that the addition of \$98,000 of long-term debt would not improve its  
13 capital structure, but that nonetheless, the funds are needed now for required repairs and replacements  
14 on its aged system. DRSC argues that denying this request may improve its capital structure on paper  
15 but would jeopardize its ability to provide safe, reliable and adequate service.

16 38. DRSC does not disagree with Staff that as a general principle, long-term loan funds  
17 should not be used to fund operating expenses. DRSC argues, however, that in the case of a non-  
18 profit corporation like DRSC, there are no stockholders or other source of funds for DRSC to  
19 continue to meet its obligations other than the advances it received from DVEC. DRSC asserts that  
20 A.R.S. § 40-302.A gives the Commission authority to authorize debt to cover operating expenses<sup>2</sup>  
21 and argues that this case presents the ideal circumstances for the Commission to exercise such  
22 discretion. The Company states that it has filed four rate cases in 12 years, but each time unexpected  
23 capital requirements have negated the granted rate relief. DRSC states that it filed for timely  
24 approval of the advances, but had to defer its finance case until the rate case could be processed. The  
25 rate case was delayed somewhat by resource constraints. DRSC asserts that many of the advances  
26

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27 <sup>2</sup> A.R.S. § 40-302.A provides that "except as otherwise permitted in the order, such [loan] purposes  
28 are not, wholly or in part, reasonable chargeable to operative expenses or to income." (emphasis  
added).

1 since the last rate case were caused by the high price of natural gas and a PGA mechanism that does  
2 not allow a timely matching of those expenses to the recovery.

3 39. DRSC and Staff agree on the monthly service charges for each service category as  
4 well as the service charges. The parties disagree on the appropriate commodity rates and whether  
5 there should be a summer/winter differential for the commodity rate. Staff advocates that there be  
6 different commodity rates for each customer class and that the current seasonal rate differential be  
7 discontinued. DRSC proposes to maintain the uniformity of commodity charges between customer  
8 classes as well as the seasonable differential in commodity rates.

9 40. DRSC states that the most troubling aspects of Staff's proposed rate design is the  
10 effect on the irrigation class and consequent effect on total revenues. DRSC states that its current and  
11 proposed design recognizes that the irrigation class uses very little gas during the peak winter months  
12 and does not cause capacity and capital investment system costs. DRSC fears that a large increase in  
13 the rates of the irrigation class will cause these customers to drop off the system because they are  
14 extremely price sensitive. DRSC testified that in 2005, it lost three of its 20 irrigation customers  
15 when they switched from natural gas to electricity, and that all of its irrigation customers are dual-  
16 facility customers, with the ability to use either gas or electricity. (Tr. at 76-77)

17 41. DRSC believes another advantage of its proposed rate design is that it has been in  
18 effect for the past four years and meets the key cost of service goal of uniformity. Because the rates  
19 approved in this case would go into effect after the peak winter season, DRSC states that Staff's  
20 concerns about the impact of the seasonal differentiation would be minimized. Furthermore, DRSC  
21 states it has not received any complaints about the seasonal differentiation and offers a levelized bill  
22 payment program that allows customers to even out payments throughout the year.

23 42. Staff believes that its rate design, which employs a year round commodity rate,  
24 mitigates the impact of the rate increase on all customer classes. Staff asserts that the rate design  
25 advocated by DRSC will severely impact residential ratepayers, especially during the winter months  
26 when residential customers use the most gas.

27 43. Staff states that its design does not impact irrigation customers much differently than  
28 under DRSC's proposal. In the summer months, DRSC proposes a commodity rate for irrigation

1 customers of \$0.26000 per therm. Staff proposes irrigation customers pay \$0.28480 per therm. Staff  
2 states that the Company's cost of service study, as modified by Staff, supports separate commodity  
3 rates by class. Staff argues its design distributes the burden of the increase on both irrigation and  
4 residential customers better than under DRSC's proposal that hits residential customers hard in the  
5 high use winter months.

6 44. DRSC's current base cost of gas is \$0.36 per therm. At the time of the hearing,  
7 DRSC's current Purchased Gas Adjustor ("PGA") rate, based on the previous 12 months PGA rate,  
8 was \$.27 per therm, for a total of \$0.63. Currently, DRSC's PGA may not fluctuate by more than  
9 \$0.10 per therm from any rate in the past 12 months.

10 45. Decision No. 61225 (October 30, 1998) set a PGA balance threshold of \$35,000 for  
11 Duncan. The threshold requires that Duncan either seek a surcharge or surcredit upon reaching a  
12 balance of \$35,000 in its PGA bank balance, or alternatively seek a waiver from a surcharge or  
13 surcredit. On September 30, 2005, DRSC filed an application for a surcharge. Its August 2005 bank  
14 balance was under-collected \$22,000. While the balance was within the threshold, Duncan had  
15 expected the balance to reach \$192,000 under-collected by February 2006. In Decision No. 68297  
16 (November 14, 2005) the Commission approved a \$0.45 per therm surcharge. The current surcharge  
17 stays in effect for one year or until the bank balance reaches zero. The surcharge became effective on  
18 December 1, 2005.

19 46. Staff recommends to zero out the base cost of gas and move the entire cost of gas into  
20 Duncan's PGA. Staff believes this will enhance the customer's ability to understand his or her bills,  
21 and better track the cost of natural gas. Under Staff's proposal, if the entire cost of gas is accounted  
22 for in the PGA, the \$0.10 band for the PGA must reference against the previous 12 months total cost  
23 of gas instead the previous 12 months adjustor rate for the first 12 months following the change. In  
24 the thirteenth month, the \$0.10 band must then reference against the adjustor rate for the previous 12  
25 months, since by then the PGA rate will include the entire cost of gas for over a year.

26 47. The parties agree that moving the entire cost of gas to the PGA is a simpler method for  
27 tracking the cost of the gas and will facilitate consumer understanding of bills. They disagree,  
28 however, on how much monthly variation in the price of gas should be allowed.

1           48.     DRSC proposes that in order to manage its bank balance as close to zero as possible, it  
2 should be allowed to adjust its PGA monthly, by no more than 10 cents per therm based on its 12  
3 month rolling average cost of gas. DRSC claims that over time, this will allow it to gradually move  
4 the rate charged closer to its actual cost of gas, which it believes will minimize its need to carry and  
5 finance large under-collected balances. DRSC states that its proposal benefits consumers by avoiding  
6 the interest costs necessary to finance the under-collections and sending them gradual rate signals  
7 rather than the abrupt and much larger increases that result when surcharges are imposed. DRSC  
8 asserts that surcharge applications are costly and time consuming to prepare and argues that  
9 surcharges do not send timely price signals to consumers.

10           49.     DRSC asserts that its current PGA, which allows only a narrow band of adjustment  
11 annually, has aggravated its cash flow. DRSC complains that the current PGA mechanism, which  
12 was designed in the late 1990's when natural gas rates had been stable for several years and were at a  
13 fraction of today's levels, no longer works for a Company of DRSC's size and resources.

14           50.     Staff opposes DRSC's proposal to apply the \$0.10 bandwidth on a monthly basis, as  
15 Staff believes that allowing a 10 cent change in the adjustor rate each month will increase the  
16 volatility in customer bills, especially on top of the \$0.45 surcharge that customers currently pay  
17 pursuant to Decision No. 68297. Staff believes that the current mechanism of an annual 10 cent band  
18 better promotes gradualism and overall rate stability while not eliminating price signals to customers.  
19 As described earlier, to assist finance increases in the PGA account, Staff's recommends a \$70,000  
20 credit line.

21           51.     Staff also recommends that: a) DRSC implement a customer education effort to  
22 inform customers how to read their bills in order to reduce any confusion from the proposed change  
23 to the PGA; b) DRSC's educational materials be submitted to the Director of the Utilities Division  
24 for review at least two weeks prior to release; c) the base cost of gas be reset to zero in the first  
25 complete billing period following a Decision in this case, but no sooner than 30 days to allow for the  
26 preparation and approval of educational materials; and d) to ensure the veracity of the monthly PGA  
27 reports, that a DRSC officer certify, under oath in an affidavit, that the monthly adjustor reports are  
28 true and accurate.

1           52.     Since it acquired the General Utilities system in 1989, DRSC has struggled to find  
2 financial stability. DRSC was completely debt funded at its inception. It acquired a system that was  
3 already showing its age and which had been cited for numerous safety violations. It continues to  
4 have to make significant capital investments to maintain the safety and reliability of the system. In  
5 recent years it has faced a volatile natural gas market which has further aggravated its cash flow.  
6 Adding to the factors conspiring against it, is a declining customer base. It has been forced to borrow  
7 from its affiliate DVEC to meet its on-going obligations. As a non-profit association with no  
8 shareholders, it had no other source of funds. DRSC has always relied on DVEC to provide  
9 financing when needed, but DVEC has its own financial challenges and may not be a reliable source  
10 for funds in the not too distant future. At this juncture, it is critical that the Commission work with  
11 DRSC to reach financial stability as quickly as possible.

12           53.     We are somewhat sympathetic to DRSC's plea that we make an exception in this case  
13 and allow it to authorize long-term debt to finance approximately \$171,000 in advances from DVEC  
14 that were used for operating costs. After all, with a declining customer base, the risk that costs are  
15 being shifted to consumers who did not benefit from the expenditures is minimal. We are also  
16 mindful of the fact that there is not a direct correlation between DVEC customers and DRSC  
17 customers, meaning not all DVEC members take gas service from DRSC. However, although DVEC  
18 may not technically be DRSC's parent, it created and financed DRSC in 1989 and the same  
19 individuals sit on both Board of Directors. The directors must have been aware of DRSC's need for  
20 additional revenue and could have sought rate relief sooner. Given DRSC's precarious financial  
21 position and extremely high leverage, we do not believe that it is prudent to approve additional long  
22 term debt in the amount of \$171,516 as these funds have been expended and are no longer required to  
23 fund DRSC's operations.

24           54.     We agree with Staff that \$330,484 of the \$502,000 already advanced by DVEC should  
25 be authorized as long-term debt for a term of 25 years.

26           55.     Even as we recognize that this Company is already highly leveraged, it still must make  
27 significant capital investments that are expected to average \$80,000 over the next few years. DRSC  
28 requests authorization to incur additional indebtedness of \$98,000 for this purpose. These capital

1 improvements are necessary to the safe and reliable operation of the system, and would not be able to  
2 be funded solely from internal funds. The rate increase that would be required to allow DRSC to  
3 make the needed capital investments without outside financing would be too high to be tenable.  
4 Thus, we authorize DRSC to borrow \$98,000 from DVEC to be used solely for capital  
5 improvements.

6 56. In Decision No. 64869 (June 5, 2002), the Commission approved a \$400,000 loan  
7 from DVEC at a variable interest rate equivalent to AEPCO's deposit rate. At the time of Staff's  
8 testimony, that rate was 2.725 percent. Under the terms of Decision No. 64869, that rate can increase  
9 up to 8 percent. The rate is currently 4.8 percent. But AEPCO's deposit rate is not a long term debt  
10 interest rate. DRSC offered evidence that the current interest rates offered by the National Rural  
11 Utilities Cooperative Finance Corporation ("CFC") for a loan with a 25 year term is 6.25 percent.  
12 Testimony also indicates that the corporate bond rate is approximately 5.4 percent for a corporation  
13 with a rating of Aaa, and 6.36 percent for a corporation with a rating of Baa. DRSC's financial  
14 condition is nowhere near the level necessary for these ratings and would need to borrow at a  
15 significantly higher rate from a third party lender. DRSC's proposal that a five percent rate be used  
16 to determine its revenue requirement is fair and reasonable and we authorize DRSC to borrow on the  
17 same terms we authorized in Decision No. 64869.

18 57. Based on Staff's proposed revenue levels, it appears that with the additional debt  
19 authorized herein, DRSC would have a TIER of 2.17 and DSC of 1.36. Although on their face, the  
20 TIER and DSC ratios appear to indicate that Duncan would have sufficient ability to service its debt,  
21 we are concerned this revenue level would not provide adequate funds to allow for debt service,  
22 unexpected expenses, and to allow DRSC to improve its capital structure. DRSC requested a revenue  
23 level of \$491,051 to be implemented immediately, which is a little higher than the \$473,218  
24 recommended by Staff. Employing the Company's proposed first phase revenues and expenses and  
25 the debt levels approved herein, DRSC would have a TIER of 2.65 and DSC of 1.54. (Ex A-4) At  
26 this revenue level, we would expect DRSC to have approximately \$38,000 available after debt  
27 service for contingencies and equity improvement.

28 ...

Total Revenue	\$491,051
Operating Expenses	<u>412,943</u>
Operating Margin	78,108
Depreciation and Amortization	<u>49,645</u>
Cash available before debt service	127,753
Debt Service (intr. and princ.)	<u>89,715</u>
Cash Available after debt service	38,038

58. Based on the foregoing, we authorize a revenue requirement of \$491,051, as this level allows DRSC to meet its on-going operating expenses and debt service obligations as well as contribute to an equity improvement plan. It represents an increase of \$167,813, or 51.9 percent, over test year revenues, and would produce an Operating Margin before debt service of \$78,108, and a 10.30 percent rate of return on an OCRB of \$758,057. We do not find that the additional five percent step increases as requested by the Company are necessary to provide DRSC with the funds it needs over the next two to three years. We are approving less debt than the Company requested and although we approve an equity improvement target for DRSC, we do not impose penalties for failure to meet that target. Although the Company's requested step increases might be able to avoid the costs of a rate case in two years, it is not certain they would. One of the justifications given for the Company's request is anticipated cost increases. It is not our practice to approve rates based on anticipated future cost increases unless they are known and measurable with reasonable certainty. The Company did not propose pro-forma adjustments to capture post test year expense increases.

59. No party disputes that increasing equity must be a goal for DRSC. We believe the rates we approve herein are sufficient to allow the Company to improve its equity. We will require the DRSC to file an annual report that will keep the Commission informed as to the status of its equity position. The report should include a breakdown of the components of the Company's most recent year-end capitalization, and a comparison with the prior year. In any year in which the Company's equity does not increase by five percent or more of its year-end 2005 level, the Company shall include an explanation why the five percent target increase was not met. In each year, the Company shall include its projection of the equity balance in the next year and a description of any factors that may prevent it from achieving the five percent annual goal. If the Company has been

1 unable to increase equity by an average of five percent annually over three years, the Company shall  
2 file a rate case, or seek a waiver of such requirement.<sup>3</sup>

3 60. The parties also disagree on the appropriate rate design, with Staff favoring different  
4 commodity rates for each class, but a uniform "per therm" charge year round, and the Company  
5 advocating a uniform commodity rate among the customer classes, but a higher "per therm" charge in  
6 the winter than in the summer.

7 61. Under current rates, a residential consumer using 76 therms, the average winter  
8 consumption, would have a monthly bill of \$92.28. Under the Company's proposed rates, a  
9 residential customer using 76 therms in the winter would receive a monthly bill of \$119.13, a \$26.85,  
10 or 29.09 percent, increase. Under Staff's proposed rates the same customer using 76 therms in the  
11 winter would see a bill of \$107.11, a \$14.83, or 16.07 percent, increase.<sup>4</sup> (Ex S-6, SPI-5) In the  
12 summer, a residential customer using 20 therms (the summer average) would see a bill under current  
13 rates of \$29.42. Under DRSC's proposed rates, the same customer would receive a bill for \$36.45, a  
14 \$7.02, or 23.87 percent, increase. Under Staff's recommended rates, the residential customer using  
15 20 therms would receive a bill for \$42.67, a \$13.25, or 45.02 percent, increase. (Ex S-6, SPI-5) In  
16 addition, regardless of the rate design, customers pay a surcharge of \$.45 per therm for a year, or until  
17 its under-collected PGA bank balance reaches zero. In the winter, the surcharge would add an  
18 additional \$34.20 to the monthly bill for the average residential user consuming 76 therms, while in  
19 the summer, the surcharge would add \$9.00 to the monthly bill of a consumer using 20 therms.

20 62. Under the Company proposed design, the impact of the increase on irrigation  
21 customers is minimized. The Company is very concerned that it will lose irrigation customers if the  
22 increase in the summer causes them to switch to electric power. The loss of irrigation customers, who  
23 contribute a large portion of the Company's revenues, would force residential customers to incur a  
24 greater burden. The seasonal rates, which we approved in the last rate case, have not appeared to  
25 have caused customer confusion. When it designed its rates, Staff was not aware that all of the  
26 irrigation customers have the ability to switch between gas and electricity. We find that the  
27

28 <sup>3</sup> The five percent annual increase is based on year end 2005 capital levels as proposed by Staff.

<sup>4</sup> Staff's rates produce revenues of only \$473,218, \$17,833 less than those we approve herein.

1 Company's proposed seasonal rate design continues to be reasonable and should be adopted in this  
 2 case. Although Staff's proposed rates may mitigate the impact of the rate increase on residential  
 3 customers in the winter, we agree with DRSC's position the likely effects of the increase on its total  
 4 revenues. DRSC offers annualized levelized billing which should help consumers in the winter  
 5 months. The higher winter rates should help alleviate the chronic cash flow crunch that has forced  
 6 DRSC's increased borrowings from DVEC.

7 63. We adopt Staff's proposal to include the entire cost of gas in the PGA. This change  
 8 will facilitate Commission oversight and should make bills easier to understand.

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

14 65. Staff recommends a \$70,000 line of credit that the Company could use to finance gas  
 15 purchases when gas prices are rising faster than the PGA rate. By utilizing the line of credit for gas  
 16 purchases, Duncan would be able to utilize its available cash flow for operating expenses.  
 17 Presumably, DVEC would be the source of such line of credit. We do not know if DVEC has the  
 18 resources to make such line of credit available to DRSC, but it appears that such credit facility would  
 19 be beneficial to DRSC. Thus, we authorize DRSC to enter into a revolving line of credit in an  
 20 amount up to \$70,000, from DVEC on the terms as recommended by Staff and at an interest rate  
 21 equivalent to AEPCO's variable deposit rate.

#### 22 CONCLUSIONS OF LAW

23 1. DRSC is a public service corporation pursuant to Article XV of the Arizona  
 24 Constitution and A.R.S. §§ 40-250, 40-251, 40-301, 40-302, and 40-303.

25 2. The Commission has jurisdiction over DRSC and the subject matter of the application.

26 3. Notice of the proceeding was provided in conformance with law.

27 4. The rates and charges approved herein, are reasonable.

28 5. The financing approved herein is compatible with the public interest, with sound

1 financial practices, and with the proper performance by DRSC of service as a public service  
2 corporation, and will not impair DRSC's ability to perform the service.

3 6. The financing approved herein is for the purposes stated in the application, is  
4 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably  
5 chargeable to operating expenses or to income.

6 7. Staff's recommendations, as set forth in Findings of Fact Nos. 34, 36 and 51 are  
7 reasonable and should be adopted.

8 **ORDER**

9 IT IS THEREFORE ORDERED that the rates and charges set forth below are approved and  
10 Duncan Rural Services Corporation shall file on or before March 31, 2006, a tariff that complies with  
11 the rates and charges approved herein:

<u>Meter Sizes</u>	<u>Approved Rates</u>
<u>250 cfh &amp; Below</u>	
Monthly Service Charge	\$20.00
Winter Commodity Rate per Therm	\$0.73000
Summer Commodity Rate per Therm	\$0.26000
<u>Above 250 cfh to 425 cfh</u>	
Monthly Service Charge	\$30.00
Winter Commodity Rate per Therm	\$0.73000
Summer Commodity Rate per Therm	\$0.26000
<u>Above 425 cfh</u>	
Monthly Service Charge	\$40.00
Winter Commodity Rate per Therm	\$0.73000
Summer Commodity Rate per Therm	\$0.26000

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Service Charges:

1	Establishment of Service (Regular Hours)	\$35.00
2	Establishment of Service (After Hours)	\$50.00
3	Re-establishment/Reconnection (Regular Hours)	\$50.00
4	Re-establishment/Reconnection (After Hours)	\$75.00
5	After Hours Service Calls (per hour)*	\$50.00
6	Meter Re-Read Charge (No Charge for Read Error)	\$30.00
7	Meter Test Fee	\$50.00
8	Insufficient Funds Check	\$20.00
9	Interest Rate on Customer Deposit	Variable**
10	Late/Deferred Payment (per month)	1.5%

11 \* One hour minimum

12 \*\* Variable Rate based on the Three Month Non-Financial Commercial Paper Rate as  
13 published by the Federal Reserve.

14 IT IS FURTHER ORDERED that the rates and charges approved herein shall be effective for  
15 all service provided on and after April 1, 2006.

16 IT IS FURTHER ORDERED that within 15 days of the effective date of this Order, Duncan  
17 Rural Services Corporation shall notify its customers of the rates and the effective dates approved  
18 herein, in a form and manner acceptable to the Commission's Utilities Division Staff.

19 IT IS FURTHER ORDERED that commencing in 2007, Duncan Rural Services Corporation  
20 shall file a report as a compliance item in this docket by May 15<sup>th</sup> of each year until it reaches a  
21 capital structure of at least 30 percent equity. The report should include a breakdown of the  
22 components of the Duncan Rural Services Corporation's most recent year-end capitalization, and a  
23 comparison with the prior year. In any year in which the Company's equity does not increase by five  
24 percent or more of its year-end 2005 level, the Company shall include an explanation why the five  
25 percent target increase was not met. In each year the Company shall include its projection of the  
26 equity balance for the next year and a description of any factors that may prevent it from achieving  
27 the five percent annual goal. If the Company has been unable to increase equity by an average of five  
28 percent annually over three years, the Company shall file a rate case, or seek a waiver of such  
requirement.

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.

1 IT IS FURTHER ORDERED that Duncan Rural Service Corporation is authorized to incur  
2 long-term debt from Duncan Valley Electric Cooperative, Inc. in an amount not to exceed an  
3 aggregate of \$428,484<sup>5</sup> for a term of twenty-five years, and at a variable interest rate equivalent to  
4 Arizona Electric Power Cooperative's deposit rate, but not to exceed eight percent per year.

5 IT IS FURTHER ORDERED that Duncan Rural Services Corporation is authorized to enter  
6 into a revolving line of credit with Duncan Valley Electric Corporation in an amount not to exceed  
7 \$70,000 for the purpose of financing increases in its PGA under-collected bank balance after the  
8 effective date of this Order, at an interest rate not to exceed Arizona Electric Power Cooperative's  
9 deposit rate, and in conformance with the conditions as recommended by Staff and discussed herein.

10 IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon  
11 Duncan Rural Service Corporation's use of the proceeds for the purposes stated in its application and  
12 approved herein.

13 IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not  
14 constitute or imply approval or disapproval by the Commission of any particular expenditure of the  
15 proceeds derived thereby for purposes of establishing just and reasonable rates.

16 IT IS FURTHER ORDERED that Duncan Rural Services Corporation shall file copies of all  
17 executed financing documents setting forth the terms of the financing within 90 days of obtaining  
18 such financing.

19 IT IS FURTHER ORDERED that Duncan Rural Services Corporation is authorized to engage  
20 in any transactions and to execute any documentation necessary to effectuate the authorization  
21 granted.

22 IT IS FURTHER ORDERED that Duncan Rural Services Corporation shall implement a  
23 customer education effort that conforms to the recommendations set forth in Findings of Fact No. 51.

24 IT IS FURTHER ORDERED that Duncan Rural Services Corporation's base cost of gas be  
25 reset to zero in the first complete billing period following the effective date of this Decision, or thirty  
26 days following the effective date of this Decision, whichever is later, to allow for the preparation and  
27

28 <sup>5</sup> \$330,484 for the purpose of financing past capital improvements and \$98,000 to finance future capital improvements.

1 approval of educational materials.

2 IT IS FURTHER ORDERED that to ensure the veracity of the monthly PGA reports, a  
3 Duncan Rural Service Corporation officer shall certify, under oath in an affidavit, that the monthly  
4 adjustor reports are true and accurate.

5 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.  
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9 CHAIRMAN

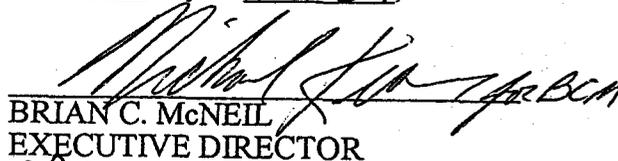
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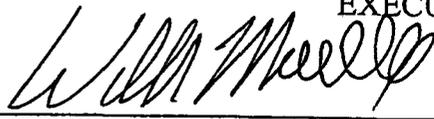
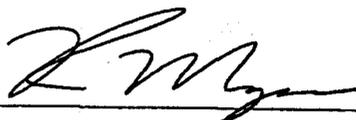
  
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COMMISSIONER

14  
15 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
16 Director of the Arizona Corporation Commission, have  
17 hereunto set my hand and caused the official seal of the  
18 Commission to be affixed at the Capitol, in the City of Phoenix,  
19 this 23<sup>rd</sup> day of March, 2006.

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21 BRIAN C. McNEIL  
22 EXECUTIVE DIRECTOR

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DISSENT   
DISSENT 

JR:mj

1 SERVICE LIST FOR:

DUNCAN RURAL SERVICES CORPORATION

2 DOCKET NO.:

G-02528A-05-0314

G-02528A-03-0205

3

4 Mr. Michael M. Grant  
5 Gallagher & Kennedy, PA  
6 2575 East Camelback Road  
7 Phoenix, Arizona 85016-9225

6 Mr. Jack Shilling  
7 PO Box 440  
8 Duncan, Arizona 85534

8 Christopher Kempley, Chief Counsel  
9 LEGAL DIVISION  
10 Arizona Corporation Commission  
11 1200 W. Washington Street  
12 Phoenix, Arizona 85007

11 Ernest Johnson, Director  
12 Utilities Division  
13 Arizona Corporation Commission  
14 1200 W. Washington Street  
15 Phoenix, Arizona 85007

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EXHIBIT A

Duncanson Rural Service Corporation  
 Docket No. G-02528A-05-0314  
 Test Year Ended December 31, 2004

Rejolinger Schedule H-3

RATE DESIGN

METER SIZES 250 cfm & Below	Present Rates	Proposed Rates	Proposed Rates With 5% Incr.	Proposed Rates With 10% Incr.
	Monthly Service Charge	\$15.00	\$20.00	\$20.00
Winter Commodity Rate per Therm	\$0.44000	\$0.73000	\$0.77000	\$0.81000
Summer Commodity Rate per Therm	\$0.15405	\$0.25000	\$0.27800	\$0.28900
Above 250 cfm to 425 cfm				
Monthly Service Charge	\$22.50	\$30.00	\$30.00	\$30.00
Winter Commodity Rate per Therm	\$0.44000	\$0.73000	\$0.77000	\$0.81000
Summer Commodity Rate per Therm	\$0.15405	\$0.25000	\$0.27800	\$0.28900
Above 425 cfm to 1,000 cfm				
Monthly Service Charge	\$30.00	\$40.00	\$40.00	\$40.00
Winter Commodity Rate per Therm	\$0.44000	\$0.73000	\$0.77000	\$0.81000
Summer Commodity Rate per Therm	\$0.15405	\$0.25000	\$0.27600	\$0.28800

Service Charges:	Present Rates	Proposed Rates	Proposed Rates	Proposed Rates
	Establishment of Service (Regular Hours)	\$ 35.00	\$ 35.00	\$ 35.00
Re-establishment of Service (After Hours)	\$ 50.00	\$ 50.00	\$ 50.00	\$ 50.00
Re-establishment/Reconnection of Service (Regular Hours)	\$ 50.00	\$ 50.00	\$ 50.00	\$ 50.00
Re-establishment/Reconnection of Service (After Hours)	\$ 75.00	\$ 75.00	\$ 75.00	\$ 75.00
After Hours Service Calls - Consumer Caused (Per Hour)*	\$ 50.00	\$ 50.00	\$ 60.00	\$ 50.00
Meter Re-read Charge (No Charge for Read Error)	\$ 30.00	\$ 30.00	\$ 30.00	\$ 30.00
Meter Test Fee	\$ 50.00	\$ 50.00	\$ 50.00	\$ 50.00
Insufficient Funds Check	\$ 20.00	\$ 20.00	\$ 20.00	\$ 20.00
Interest Rate on Customer Deposits**	3.0%	Variable	Variable	Variable
Late/Deferred Payment (Per Month)	0.0%	1.5%	1.5%	1.5%

\* One hour minimum  
 \*\* Variable Rate based on the Three Month Non-Financial Commercial Paper Rate as published by the Federal Reserve  
 Base Cost of Gas & Fuel Adjustor Included in Present Rates \$  
 Base Cost of Gas & Fuel Adjustor Included in Proposed Rates \$

## EXHIBIT B

	<u>Present Rates</u>	<u>Proposed Rates Staff</u>
<u>MONTHLY USAGE CHARGE:</u>		
< 250	\$15.00	\$20.00
250 < 425	22.50	30.00
425 < 1000	30.00	40.00

ENERGY (COMMODITY) RATE -  
PER THERM

<u>&lt;250</u>		
Winter	\$0.80000	\$0.57280
Summer	0.51405	0.57280
<u>250&lt;450</u>		
Winter	\$0.80000	\$0.28480
Summer	\$051405	\$0.28480
<u>425&lt;1000</u>		
Winter	\$0.80000	\$0.74480
Summer	0.51405	0.74480

SERVICE RELATED CHARGES:

Establishment	\$35.00	\$35.00
Establishment (After Hours)	50.00	50.00
Reconnection (Regular Hours)	50.00	50.00
Reconnection (After Hours)	75.00	75.00
After Hours Service Call*	50.00	50.00
Meter Re-read (No charge for read error)	30.00	30.00
Meter Test Fee	50.00	50.00
NSF Check	20.00	20.00
Interest on Consumer Deposits	3.00%	6.00%
Late/Deferred Payment (Per Month)	0.00%	1.50%

\*One hour minimum

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



BRIAN C. McNEIL  
 Executive Director

**ARIZONA CORPORATION COMMISSION**

May 1, 2006

Mike Grant  
 Gallagher & Kennedy, P.A.  
 2575 East Camelback Rd.  
 Phoenix, Arizona 85016-9225

John Wallace  
 GCSECA  
 120 North 44<sup>th</sup> Street, Suite 100  
 Phoenix, Arizona 85034

RE: APPLICATION DUNCAN RURAL SERVICES CORPORATION FOR A RATE  
 INCREASE DOCKET NO. G-02528A-05-0314

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

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

DUNCAN RURAL SERVICES CORPORATION  
PGA BANK BALANCE USING STAFF'S INTERPRETATION

Exhibit C  
Page 1 of 2

Date	Jan-06	Feb-06	Mar-06	Apr-06	May-06
1. Beginning Bank Balance	\$47,319.09	\$29,075.41	\$5,789.48	(\$15,884.92)	(\$22,563.43)
2. Cost of Purchased Gas	\$89,714.56	\$31,222.49	\$27,401.57	\$22,400.00	\$14,300.00
3. Transportation Cost	(\$22,830.79)	\$980.70	\$2,170.87	\$1,800.00	\$1,200.00
4. Total Cost to be Recovered	\$114,202.86	\$61,278.60	\$35,361.92	\$8,315.08	(\$7,063.43)
5. Sales in Therms	76,408	49,598	45,687	39,764	25,000
6. 12 Months Rolling Average per Therm	\$0.3600	\$0.3600	\$0.3600	\$0.7749	\$0.7734
7. Amount Recovered by 12 Months Rolling Ave.	\$27,506.88	\$17,855.28	\$16,447.32	\$30,813.12	\$19,335.00
9. PGA per Therm	\$0.75630	\$0.76100	\$0.76220	\$0.00000	\$0.00000
10. Amount Recovered by PGA	\$57,787.37	\$37,744.08	\$34,822.63	\$0.00	\$0.00
11. Total Amount Recovered by MGCR	\$85,294.25	\$55,599.36	\$51,269.95	\$30,813.12	\$19,335.00
12. Adjustments					
13. Monthly Subtotal	\$28,908.61	\$5,679.24	(\$15,908.03)	(\$22,498.04)	(\$26,398.43)
Monthly Interest Rate	4.23%	4.55%	4.79%	4.94%	5.00%
14. Monthly Interest	\$166.80	\$110.24	\$23.11	(\$65.39)	(\$94.01)
15. End of Month Bank Balance	\$29,075.41	\$5,789.48	(\$15,884.92)	(\$22,563.43)	(\$26,492.44)

DUNCAN RURAL SERVICES CORPORATION  
PGA BANK BALANCE USING DRSC'S INTERPRETATION

Exhibit C  
Page 2 of 2

Date	Jan-06	Feb-06	Mar-06	Apr-06	May-06
1. Beginning Bank Balance	\$47,319.09	\$29,075.41	\$5,789.48	(\$15,884.92)	(\$18,587.03)
2. Cost of Purchased Gas	\$89,714.56	\$31,222.49	\$27,401.57	\$22,400.00	\$14,300.00
3. Transportation Cost	(\$22,830.79)	\$980.70	\$2,170.87	\$1,800.00	\$1,200.00
4. Total Cost to be Recovered	\$114,202.86	\$61,278.60	\$35,361.92	\$8,315.08	(\$3,087.03)
5. Sales in Therms	76,408	49,598	45,687	39,764	25,000
6. 12 Months Rolling Average per Therm	\$0.3600	\$0.3600	\$0.3600	\$0.7749	\$0.7734
7. Amount Recovered by 12 Months Rolling Ave.	\$27,506.88	\$17,855.28	\$16,447.32	\$30,813.12	\$19,335.00
9. PGA per Therm	\$0.75630	\$0.76100	\$0.76220	(\$0.10000)	(\$0.10000)
10. Amount Recovered by PGA	\$57,787.37	\$37,744.08	\$34,822.63	(\$3,976.40)	(\$2,500.00)
11. Total Amount Recovered by MGCR	\$85,294.25	\$55,599.36	\$51,269.95	\$26,836.72	\$16,835.00
12. Adjustments					
13. Monthly Subtotal	\$28,908.61	\$5,679.24	(\$15,908.03)	(\$18,521.64)	(\$19,922.03)
Monthly Interest Rate	4.23%	4.55%	4.79%	4.94%	5.00%
14. Monthly Interest	\$166.80	\$110.24	\$23.11	(\$65.39)	(\$77.45)
15. End of Month Bank Balance	\$29,075.41	\$5,789.48	(\$15,884.92)	(\$18,587.03)	(\$19,999.48)