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ORIGINAL



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**UniSourceEnergy**  
SERVICES

February 25, 2004

The Honorable Jeff Hatch-Miller  
Commissioner  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

RECEIVED  
2004 FEB 26 A 9:18  
AZ CORP COMMISSION  
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Arizona Corporation Commission  
DOCKETED

FEB 26 2004

DOCKETED BY

Re: In the Matter of UNS Gas, Inc. and Citizens Communications Company-Filing  
For Approval of Purchased Gas Adjustor Surcharge  
(Docket No. G-01032E-03-0515)

Dear Commissioner Hatch-Miller:

UniSource Energy Corporation appreciated the opportunity to participate in the Open Meeting held by the Arizona Corporation Commission last night in Prescott. We look forward to developing solutions to the concerns raised by all in attendance. We are committed to ensuring that the questions and concerns raised by our customers and the Commissioners are answered in a prompt and comprehensive manner.

At last night's meeting you requested responses from UniSource Energy Services ("UES") on two matters – the first related to customers who stated that their winter season bills had increased over 100 % and the other related to what UES has done to protect its customers on natural gas prices for this winter season. Our response is as follows:

**Winter Season Bill Analysis**

As a point of reference, the average Prescott area used approximately 118 therms in January. At that usage level, the combined effect of the 21 % base rate increase, the PGA cost and the PGA surcharge would have resulted in a January 2004 bill versus January of 2003 increase of approximately 63 %.

At this time we have identified four customers who spoke at last night's meeting and indicated they had experienced increases of over 100 % this winter as compared to the winter of 2002-2003. Detail on each such customer is enclosed showing a comparison of the bills for this year and last year. We are continuing to review each of these situations to identify possible energy savings solutions – especially in cases of significant usage increases that do not appear to be weather related.

Additionally, inspections that were conducted today have confirmed meter accuracy and system integrity at each customer location.

We are still in the process of reviewing the transcript from last night's meeting and will supplement this response if additional customers in the "over 100 % increase" category are identified.

### **Gas Procurement Policy**

To assist you in understanding our gas procurement policy and its results, we are enclosing a presentation entitled "UNS Gas, Inc. - Stabilization Plan Overview dated February 4, 2004." This presentation provides an overview of our gas price stabilization policy and provides a summary of the results we have achieved to stabilize gas prices for our customers.

By way of background, UniSource Energy inherited gas contracts entered into by Citizens as part of Citizens' price stabilization policy, implemented consistent with Commission workshops and Decision No. 61225. Under this policy, Citizens periodically purchased gas quantities at fixed prices for future month deliveries, with the goal of stabilizing customer prices for the next 12 months. Following the acquisition of the Citizens properties last August, UES expanded this policy and made the decision to increase the amount of fixed-price purchases for the 2003/2004 winter season (November through March) to roughly 70 percent of estimated total purchases, due to the high volatility of gas prices expected in those months. Prices for the remaining 30 percent (adjusted for actual usage differing from estimates) of gas purchases are set at the beginning of the delivery month.

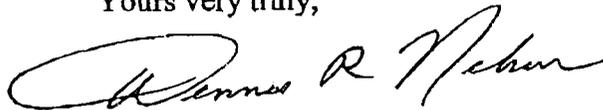
As to results achieved for this winter season, UES was able to save our customers an estimated \$1.9 million dollars in gas costs during December and January as compared to spot market prices in those months. For further detail, I refer you to the enclosed presentation slide entitled "Savings of Hedged Portfolio vs. Spot Prices."

At the end of 2003, UES evaluated and updated the price stabilization policy. To address the recent increases in gas prices and volatility, and their potential effects on our customers, we decided to increase the time horizon of fixed-price purchases from one to three years, and increase the minimum fixed-price purchase volumes from 30 percent to 45 percent.

We are available to you or any of your staff members to provide more detail on any of this information. Specifically, Mr. David Hutchens, TEP's General Manager of Fuels and Wholesale Power, is available for a meeting to answer any additional questions you may have regarding the natural gas procurement policies for UES.

Again, we appreciate the opportunity to work in a cooperative manner with the Commission and our customers towards a comprehensive solution to stability in natural gas pricing for the benefit of all UES customers.

Yours very truly,



Dennis R. Nelson  
Senior Vice President and  
Chief Operating Officer

Original and 13 copies filed this 26<sup>th</sup> day  
of February, 2004 with:

Docket Control  
1200 West Washington Street  
Phoenix, Arizona 85007

Copies of the foregoing hand-delivered/mailed  
this 25<sup>th</sup> day of February, 2004 to:

Chairman Marc Spitzer  
Commissioner William A. Mundell  
Commissioner Mike Gleason  
Commissioner Kristin Mayes

Ernest G. Johnson, Utilities Division Director

William B. Landis  
 1912 Foothill Dr.  
 Prescott AZ  
 Account # 171824

Year	Days of Service	Terms Billed	Month	Rate Billed per Therm	Total Billed
2004	29	182	February		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$127.47
			PGA Cost	\$0.1262	\$22.97
			PGA Surcharge	\$0.1155	\$15.48
			Taxes & Assessments	\$18.34	
				<b>\$0.9421</b>	<b>\$191.26</b>
2004	34	213	January		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$149.19
			PGA Cost	\$0.1043	\$22.22
			PGA Surcharge	\$0.1155	\$17.79
			Taxes & Assessments	\$20.78	
				<b>\$0.9202</b>	<b>\$216.98</b>
2003	29	152	December		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$106.46
			PGA Cost	\$0.0729	\$11.08
			PGA Surcharge	\$0.1155	\$13.51
			Taxes & Assessments	\$14.61	
				<b>\$0.8888</b>	<b>\$152.66</b>

Year	Days of Service	Terms Billed	Month	Rate Billed per Therm	Total Billed
2003	30	111	February		
			Customer Charge	\$5.00	
			Basic Cost of Service	\$0.4414	\$49.00
			PGA Cost	\$0.1174	\$13.03
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$7.04	
				<b>\$0.5588</b>	<b>\$74.07</b>
2003	34	156	January		
			Customer Charge	\$5.00	
			Basic Cost of Service	\$0.4414	\$68.86
			PGA Cost	\$0.1174	\$18.31
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$9.68	
				<b>\$0.5588</b>	<b>\$107.85</b>
2002	29	93	December		
			Customer Charge	\$5.00	
			Basic Cost of Service	\$0.4414	\$41.05
			PGA Cost	\$0.2216	\$20.61
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$7.00	
				<b>\$0.6630</b>	<b>\$73.66</b>

PGA Surcharge Therm Usage Threshold limits:  
 December 117 Mr. Landis exceeded usage threshold. Used 152 therms. PGA Surcharge assessed to 117 therms.  
 January 154 Mr. Landis exceeded usage threshold. Used 213 therms. PGA Surcharge assessed to 154 therms.  
 February 134 Mr. Landis exceeded usage threshold. Used 182 therms. PGA Surcharge assessed to 134 therms.  
 March 121

Mr. Landis's bill amount increase in excess of 100% this December, January and February 2003 from the same months last year is due to a combination of rate increase, PGA cost, PGA surcharge and his increased usage this year.

**Arnulfo Ruiz**  
 4550 N. Lodgepole Court  
 Prescott Valley AZ  
 Account # 400775

Year	Days of Service	Therms Billed	Month	Rate Billed per Therm	Total Billed
2004	29	95	February		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$66.54
			PGA Cost	\$0.1262	\$11.99
			PGA Surcharge	\$0.1155	\$10.97
			Taxes & Assessments	\$10.53	
				<b>\$0.9421</b>	<b>\$107.03</b>
2004	34	153	January		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$107.16
			PGA Cost	\$0.1043	\$15.96
			PGA Surcharge	\$0.1155	\$17.67
			Taxes & Assessments	\$16.14	
				<b>\$0.9202</b>	<b>\$163.93</b>
2003	29	109	December		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$76.34
			PGA Cost	\$0.0729	\$7.95
			PGA Surcharge	\$0.1155	\$12.59
			Taxes & Assessments	\$11.37	
				<b>\$0.8888</b>	<b>\$115.25</b>

Year	Days of Service	Therms Billed	Month	Rate Billed per Therm	Total Billed
2003	32	94	February		
			Customer Charge	\$0.4414	
			Basic Cost of Service	\$0.1174	\$11.14
			PGA Cost	\$0.0000	\$0.00
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$0.5588	
				<b>\$0.5588</b>	<b>\$0.00</b>
2003	35	119	January		
			Customer Charge	\$0.4414	
			Basic Cost of Service	\$0.1174	\$13.97
			PGA Cost	\$0.0000	\$0.00
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$0.5588	
				<b>\$0.5588</b>	<b>\$0.00</b>
2002	29	75	December		
			Customer Charge	\$0.4414	
			Basic Cost of Service	\$0.2216	\$16.63
			PGA Cost	\$0.0000	\$0.00
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$0.6630	
				<b>\$0.6630</b>	<b>\$0.00</b>

**PGA Surcharge Therm Usage Threshold limits:**  
 December 117  
 January 154  
 February 134  
 March 121

Mr. Ruiz started service at this location on March 25, 2003 therefore no comparable billing for Mr. Ruiz for the same time frame last year is available.  
 Billed usage at this premise same time last year has been provided. Mr. Ruiz's consumption is somewhat higher than the previous occupant's usage.

Douglas Folsom  
 817 Country Club Dr.  
 Prescott AZ  
 Account # 168447

Year	Days of Service	Therms Billed	Month	Rate Billed per Therm	Total Billed
2004	28	252	February		
			Customer Charge	\$7.00	\$7.00
			Basic Cost of Service	\$0.7004	\$176.50
			PGA Cost	\$0.1262	\$31.80
			PGA Surcharge	\$0.1155	\$15.48
			Taxes & Assessments	\$24.46	
				\$0.9421	\$255.24
2004	34	313	January		
			Customer Charge	\$7.00	\$7.00
			Basic Cost of Service	\$0.7004	\$219.23
			PGA Cost	\$0.1043	\$32.65
			PGA Surcharge	\$0.1155	\$17.79
			Taxes & Assessments	\$29.30	
				\$0.9202	\$305.97
2003	28	212	December		
			Customer Charge	\$7.00	\$7.00
			Basic Cost of Service	\$0.7004	\$148.48
			PGA Cost	\$0.0729	\$15.45
			PGA Surcharge	\$0.1155	\$13.51
			Taxes & Assessments	\$19.57	
				\$0.8688	\$204.01

Year	Days of Service	Therms Billed	Month	Rate Billed per Therm	Total Billed
2003	31	220	February		
			Customer Charge	\$5.00	\$5.00
			Basic Cost of Service	\$0.4414	\$97.11
			PGA Cost	\$0.1174	\$25.83
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$13.45	
				\$0.5588	\$141.39
2003	32	285	January		
			Customer Charge	\$5.00	\$5.00
			Basic Cost of Service	\$0.4414	\$130.21
			PGA Cost	\$0.1174	\$34.63
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$17.85	
				\$0.5588	\$187.69
2002	31	200	December		
			Customer Charge	\$5.00	\$5.00
			Basic Cost of Service	\$0.4414	\$88.28
			PGA Cost	\$0.2216	\$44.32
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$14.46	
				\$0.6630	\$152.06

PGA Surcharge Therm Usage Threshold limits:  
 December 117 Mrs. Folsom exceeded usage threshold. Used 212 therms. PGA Surcharge assessed to 117 therms.  
 January 154 Mrs. Folsom exceeded usage threshold. Used 313 therms. PGA Surcharge assessed to 154 therms.  
 February 134 Mrs. Folsom exceeded usage threshold. Used 252 therms. PGA Surcharge assessed to 134 therms.  
 March 121

Mrs. Folsom's bill amount increase in excess of 80 % from February 2003 to February 2004 is due to a combination of rate increase, PGA cost, PGA surcharge and increased usage over February 2003.

Fred Kennedy  
 1141 Stetson Road #1  
 Prescott AZ  
 Account # 215951

Year	Days of Service	Therms Billed	Month	Rate Billed per Therm	Total Billed
2004	35	161	February		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$112.76
			PGA Cost	\$0.1262	\$20.32
			PGA Surcharge	\$0.1155	\$15.48
			Taxes & Assessments	\$16.51	
				\$0.9421	\$172.07
2004	29	118	January		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$82.65
			PGA Cost	\$0.1043	\$12.31
			PGA Surcharge	\$0.1155	\$13.63
			Taxes & Assessments	\$12.24	
				\$0.9202	\$127.83
2003	27	69	December		
			Customer Charge	\$7.00	
			Basic Cost of Service	\$0.7004	\$48.33
			PGA Cost	\$0.0729	\$5.03
			PGA Surcharge	\$0.1155	\$7.97
			Taxes & Assessments	\$7.24	
				\$0.8888	\$75.57

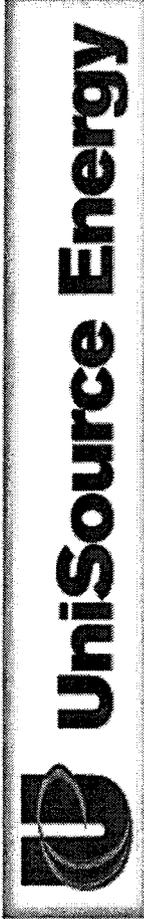
Year	Days of Service	Therms Billed	Month	Rate Billed per Therm	Total Billed
2003	35	122	February		
			Customer Charge	\$5.00	
			Basic Cost of Service	\$0.4414	\$53.85
			PGA Cost	\$0.1174	\$14.32
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$7.68	
				\$0.5588	\$80.85
2003	31	118	January		
			Customer Charge	\$5.00	
			Basic Cost of Service	\$0.4414	\$52.09
			PGA Cost	\$0.1174	\$13.85
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$7.45	
				\$0.5588	\$78.39
2002	28	87	December		
			Customer Charge	\$5.00	
			Basic Cost of Service	\$0.4414	\$38.40
			PGA Cost	\$0.2216	\$19.28
			PGA Surcharge	\$0.0000	\$0.00
			Taxes & Assessments	\$6.58	
				\$0.6630	\$69.26

PGA Surcharge Therm Usage Threshold limits:  
 December 117  
 January 154  
 February 134  
 March 121

Mr. Kennedy exceeded usage threshold. Used 161 therms. PGA Surcharge assessed to 134 therms.

Mr. Kennedy's bill amount increase in excess of 100 % from February 2003 to February 2004 is due to a combination of rate increase, PGA cost, PGA surcharge and his increased usage over February 2003.





*Utility Acquisition*  
**Growth**

*SCS Expansion*  
**Reliability**

*Debt Reduction*  
**Stability**

*Customer Care*  
**Service**

# UNSGas Inc. Stabilization Plan Overview

February 4, 2004

**Growth**

**Reliability**

**Stability**

**Service**



## Stabilization Policy Overview

- ◆ **Overview**
  - UNS inherited Price Stabilization Policy from Citizens
    - December 2000 Policy
    - Developed with outside consultants
    - Utilized Decision 61225 Framework
    - Presented to ACC Staff
    - Goal is to “Stabilize” prices
  - **Policy Highlights**
    - Rolling 12 Month view
    - Minimum Fixed Price Forward Hedges 30%
    - Maximum Fixed Price Forward Hedges 80%
    - Utilized Trigger Dates (3)
      - Mandatory purchase deadlines to meet minimums
    - “Discretionary Purchases”
      - To purchase prior to Trigger Dates
      - Additional fixed price purchases between 30-80%



## Updated UNS Stabilization Policy

- ◆ **Administrative Changes to fit UNS Corporate Risk Policy Framework**
  - Oversight role of Risk Management Committee (RMC)
  - Detailed Responsibilities, Accountability, Authority
  - Recording, Auditing, Reporting Requirements
- ◆ **New Policy Overview**
  - Addresses El Paso Pipeline allocation changes
  - Timeframe covers 3 yrs forward
  - Minimum fixed price hedges of 45%, Maximum 80%
  - Utilizes trigger dates and “discretionary” purchases
  - “discretionary” purchases must be approved by RMC
    - Includes purchases made before trigger dates
    - Includes purchases over 45%
  - Documentation criteria for each transaction
  - Provided to ACC Staff and discussed



## How Trigger Dates Work

### UNS Gas Stabilization

	Trigger Date Minimums		
	1	2	3
First 12 Months	5%	5%	5%
12-24 Months	5%	5%	5%
24-36 Months	5%	5%	5%
<b>After 3 yrs</b>			<b>45%</b>

- ◆ Utilize historical price curve shape and forecast to set
  - Late Winter, Spring, Summer
- ◆ Insures minimum volumes are purchased



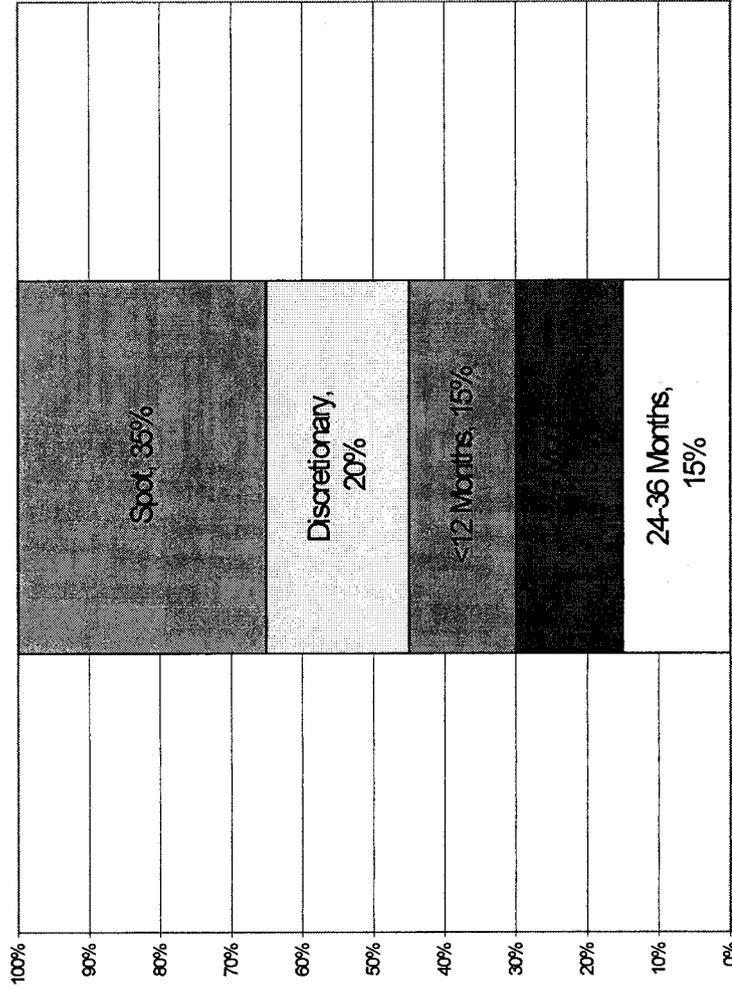
## Market Monitoring & Decision Making

- ◆ **Purchase Decision Input**
  - **Internal**
    - Market Monitoring
    - Live NYMEX Feeds
    - Live OTC Feeds (ICE)
    - Live News Services
    - Brokers
    - Marketers
  - **External**
    - Publications
    - Forecasting Service
    - Fundamental Data
    - Technical Analysis



# Typical Month Portfolio

Typical Month Portfolio

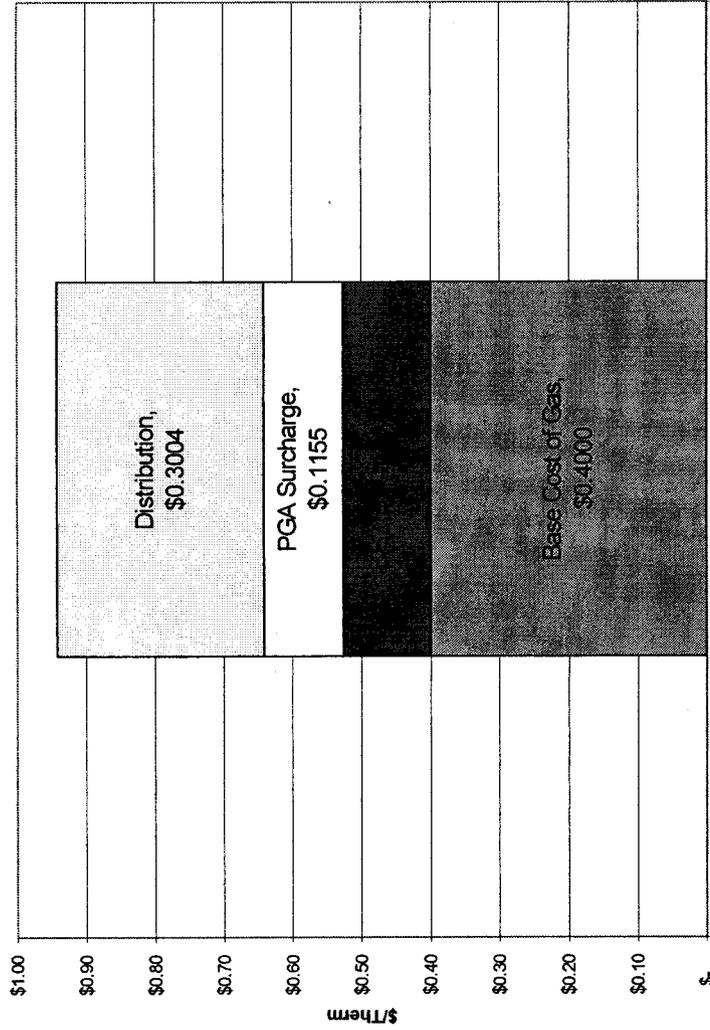


- ◆ Discretionary % shown as an example
- ◆ Spot purchases at “First of the Month” Index
  - Not Subject to intra-month volatility



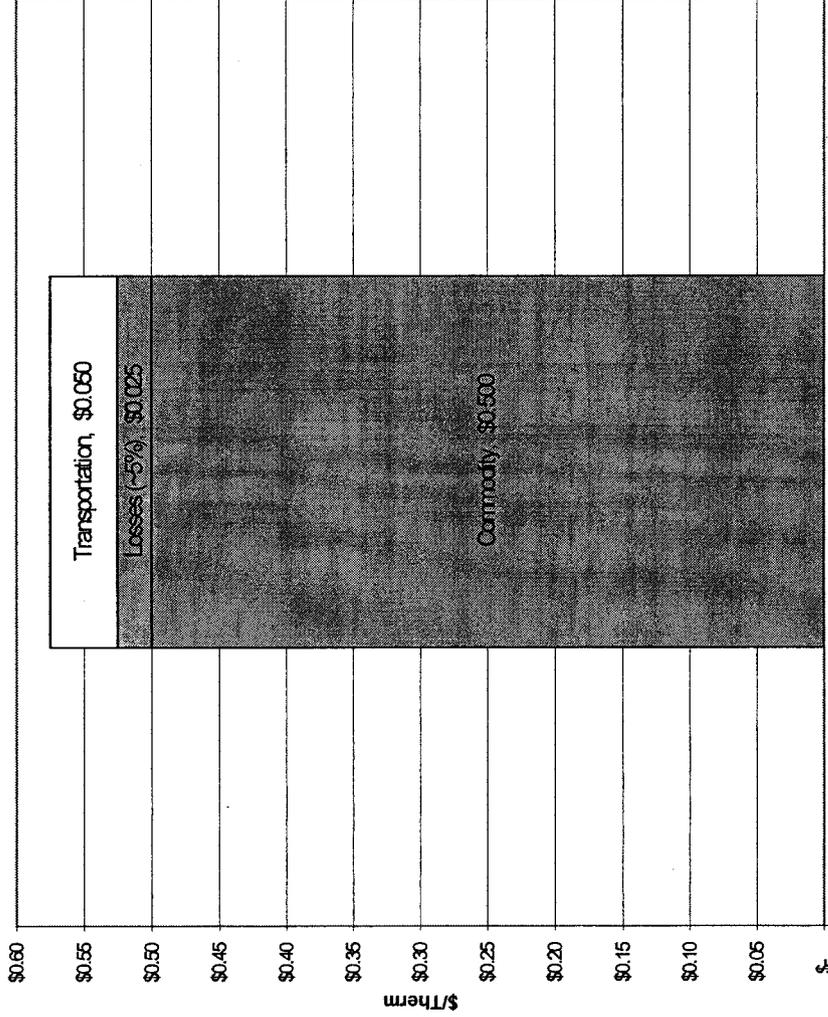
# Gas Bill Components - Residential

- ◆ Distribution - the only charge that is not a pass-through of actual gas costs
- ◆ Base Cost of Gas, PGA Rate, PGA Surcharge are all pass-through of actual gas costs
  - Includes transp ortation costs and losses
  - PG A Rate mechanism moderates cost changes with 12 mo. avg
  - PG A Surcharge recovers bank balance (money spent on gas in the past but not recovered through Base & PGA Rates)





# Gas Cost Components

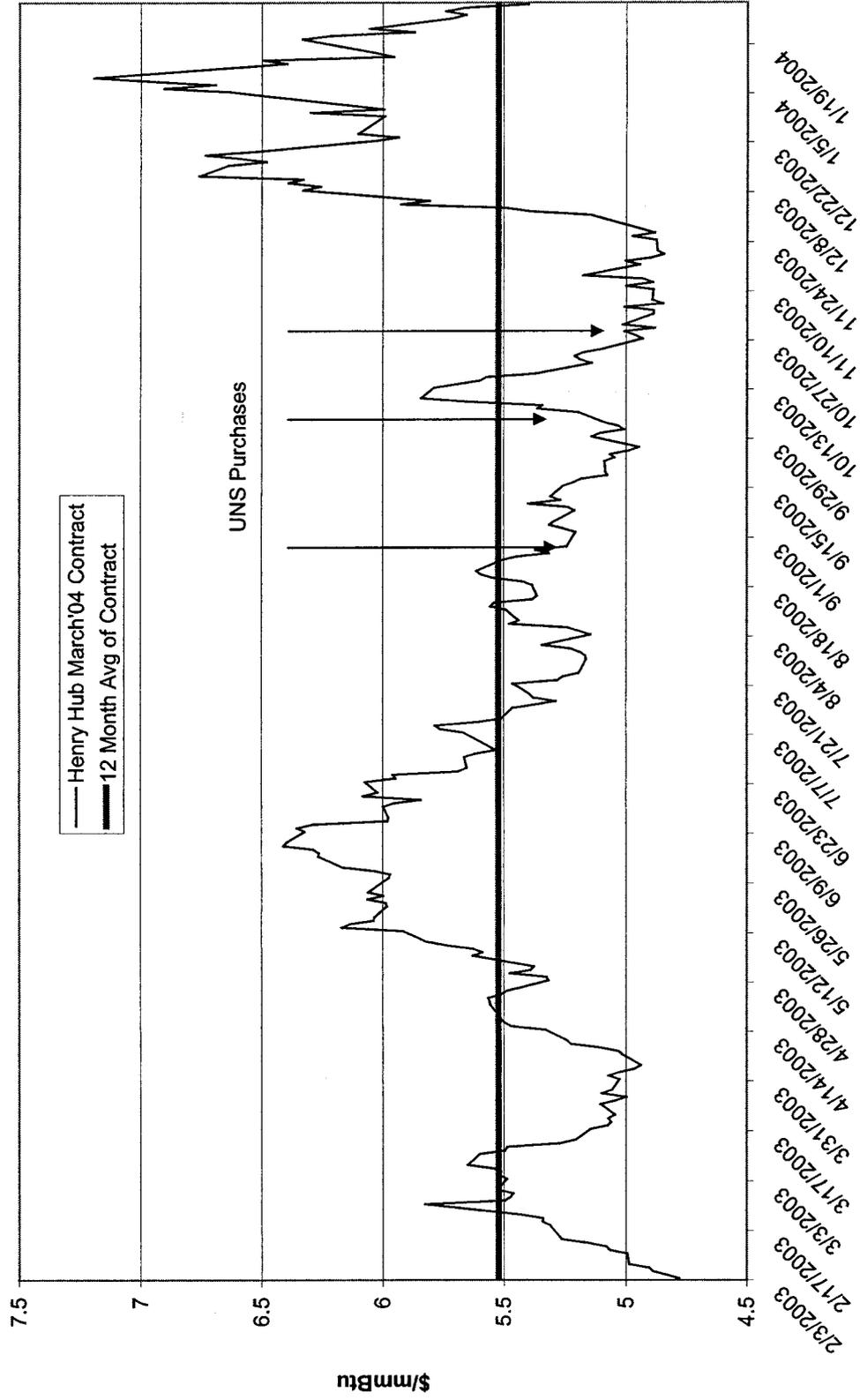


- ◆ Assumes \$5.00/mmBtu gas commodity cost (\$0.50/therm)
- ◆ Typical pipeline and distribution losses (5% total)
- ◆ Approximate average annual pipeline transportation rate
- ◆ Total Gas Cost = \$0.575/therm
- ◆ Base Cost of Gas (\$0.40) + PGA Rate (\$0.1262) = \$0.5262/therm



# What we're up against - Volatility

Nymex March 2004 Contract

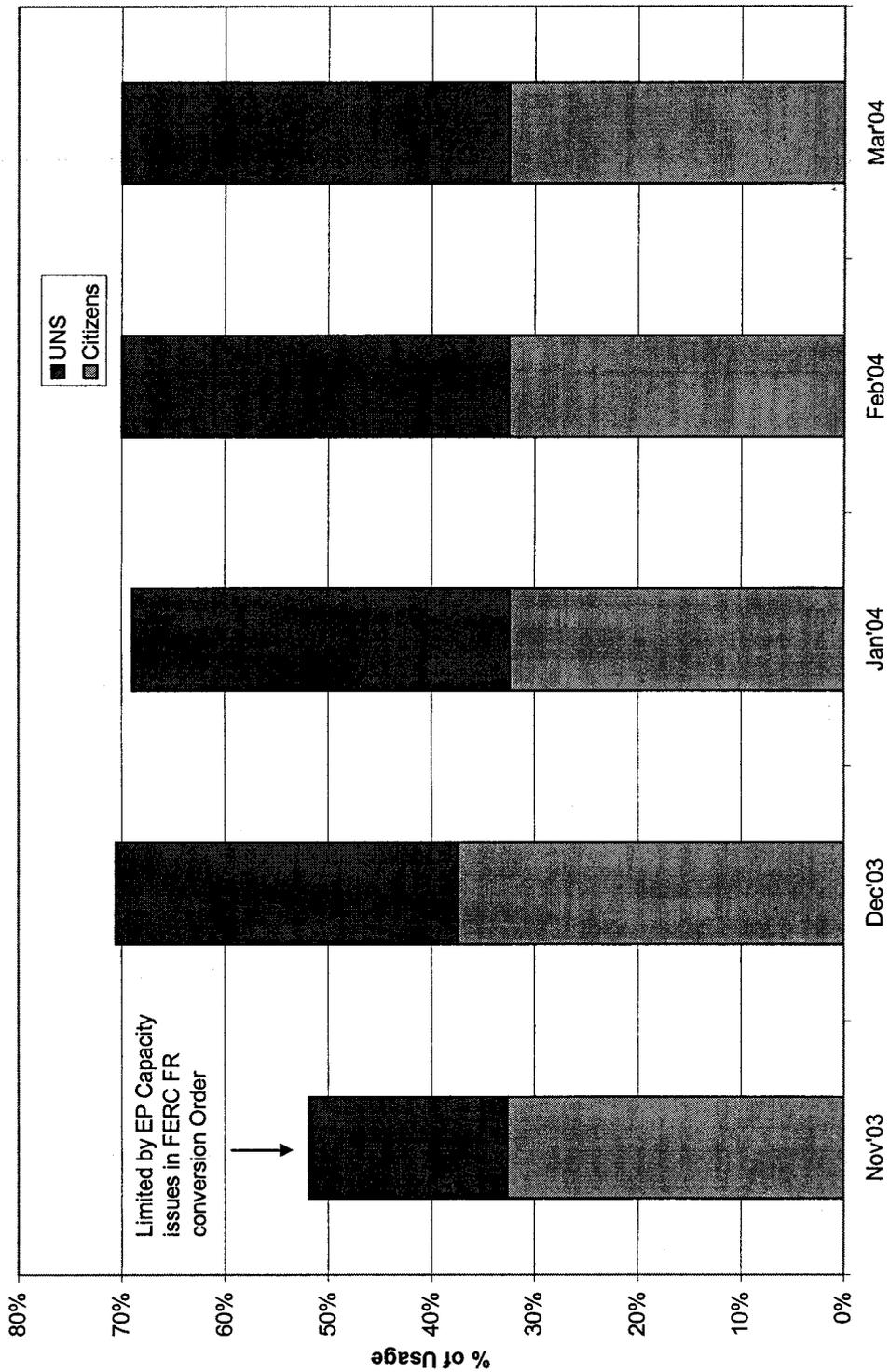




# What we've done

Actuals Nov, Dec  
Estimates for 2004

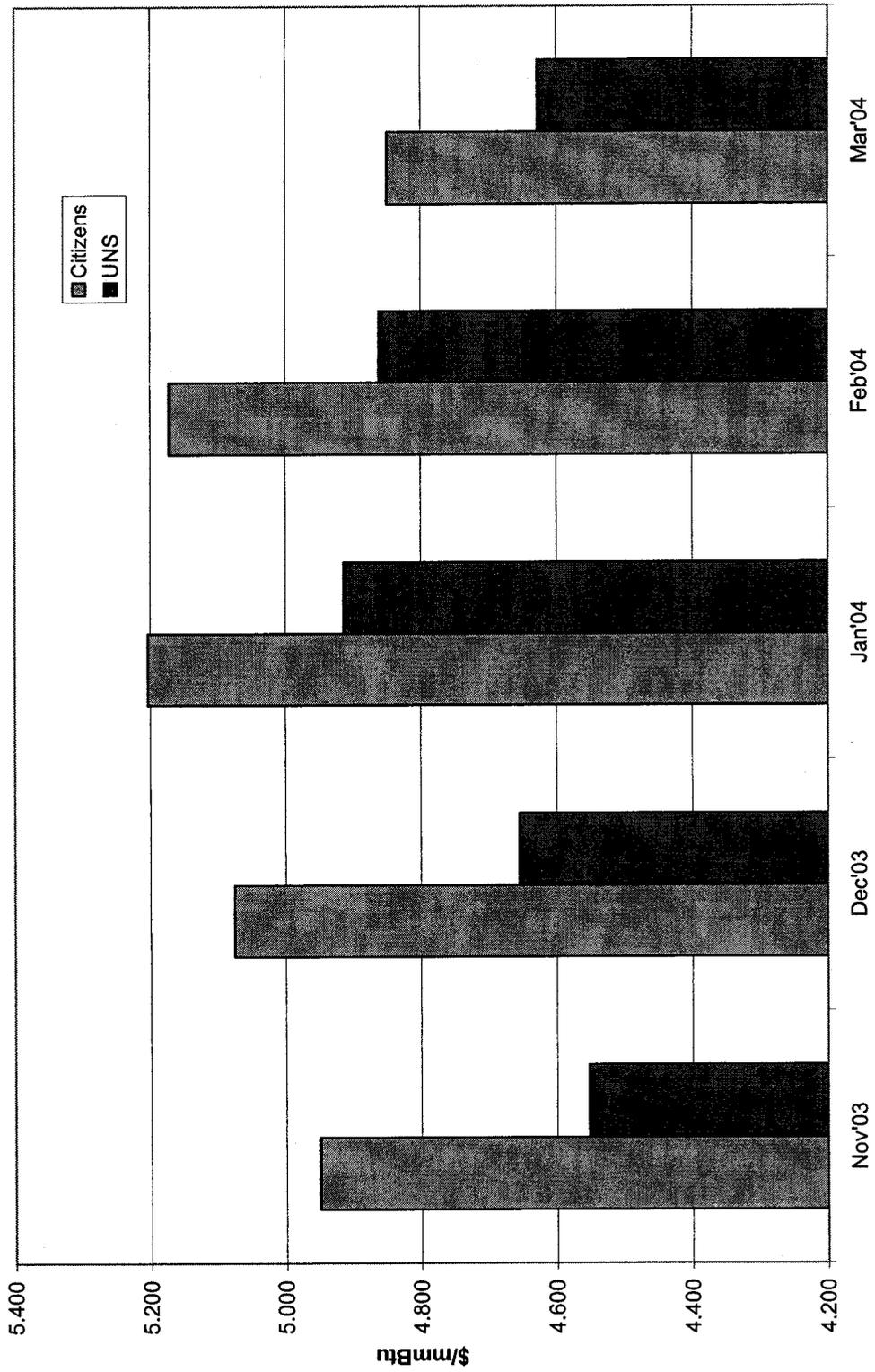
## Gas Hedges for 2003/2004 Winter





# What we've done

Fixed Prices



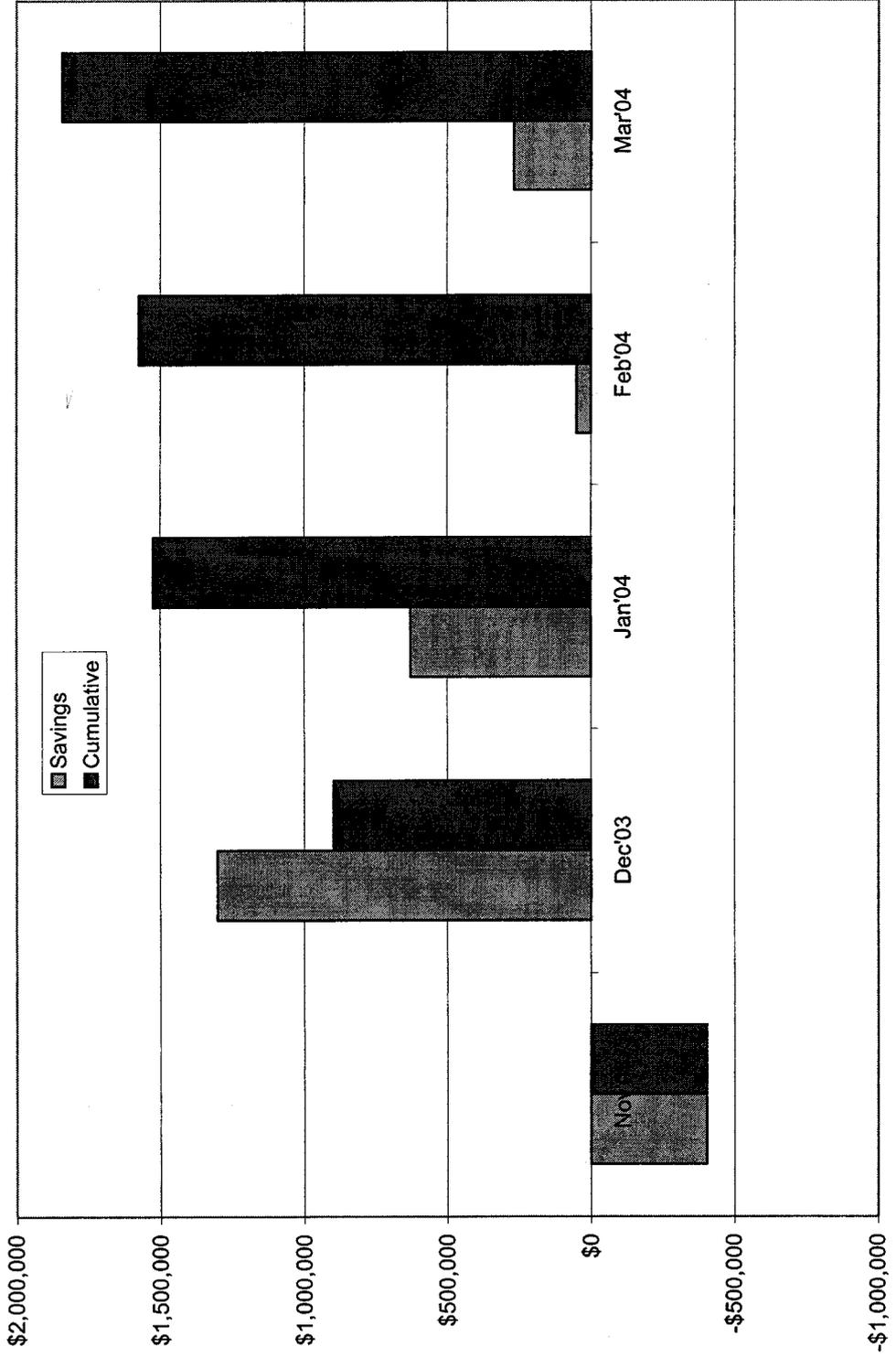


# What we've done

FEB/MAR Market Prices  
as of 1/28/04

## Savings of Hedged Portfolio vs Spot Prices

Actuals Nov, Dec  
Estimates for 2004





# Where we're going

## UNS Gas

Minimum must be met prior to delivery month

