

**ARIZONA CORPORATION COMMISSION**

**UTILITY DIVISION STAFF'S NOTICE OF INQUIRY (NOI) ON NATURAL  
GAS INFRASTRUCURE MATTERS IN ARIZONA**

**September 25, 2003**

**Kinder Morgan, Inc.** )  
 ) **Response to Strawman Proposal**  
**Kinder Morgan Energy Partners, LP** ) **(conveyed by e-mail)**

On April 15, 2003, the Staff of the Arizona Corporation Commission (“Commission”) published a Notice of Inquiry (“NOI”) on the issue of the Commission’s policy and action on natural gas infrastructure matters in Arizona. The NOI solicited comments and suggestions to assist the Commission as it addresses natural gas infrastructure issues in the future. The major areas of inquiry concerned natural gas storage facilities and interstate pipelines. The Staff requested that such comments and suggestions be submitted on or before May 30, 2003. The Kinder Morgan entities filed comments on May 30, 2003.

In order to provide an opportunity for additional discussion of Arizona natural gas infrastructure issues, on August 20, 2003, the Commission issued a notice concerning a workshop to be held September 10, 2003 to discuss a Commission Staff prepared Strawman Proposal, (hereinafter referred to as Proposal) addressing various natural gas infrastructure issues. In its Proposal, distributed September 9, 2003, the Commission Staff noted that the document essentially “...provides a set of possible policy options regarding natural gas infrastructure in Arizona, but does not represent an official policy proposal being put forward by either the Commission or Commission Staff.” Representatives of the Kinder Morgan entities participated in the September 10, 2003 Workshop (hereinafter referred to as Workshop). The Workshop presentation noted the Commission’s intention to accept written comments on the Proposal and Workshop to be e-mailed to a representative of the Commission Staff by September 25, 2003.

As a general matter, the Kinder Morgan entities appreciate the opportunity to participate in the NOI process and scheduled Workshop and look forward to further participation in discussions concerning these issues in whatever forum the Commission deems appropriate. The following specific comments and suggestions are provided by the Kinder Morgan entities for the Commission's consideration in response to the Proposal put forward by Commission Staff and addressed in the Workshop:

### **1. Supply/Infrastructure Diversity**

In general, the Proposal sets forth that both interstate pipeline facilities and natural gas storage facilities are beneficial and should be actively pursued by Arizona utilities in order to enhance supply reliability and flexibility at the lowest possible cost. The Proposal further notes that a diverse natural gas portfolio should include natural gas storage, and that "the current monopoly on interstate pipeline service in central and southern Arizona is not beneficial to the state of Arizona. Further, in the Workshop, Commission Staff clarified that the statement in the Proposal that "natural gas storage will likely require greater consideration by the Commission" did not indicate that the Commission is giving more priority to natural gas storage projects in the state as compared to natural gas pipelines.

The Kinder Morgan entities strongly support the Commission's recognition in its Proposal of the fundamental need for diverse natural gas supply portfolios for local distribution companies in Arizona. The Kinder Morgan entities support the notion that the Commission should encourage local distribution companies to seek to diversify their gas supply portfolios to include safe, reliable access to competitively priced natural gas supplies from the Rocky Mountain and San Juan producing regions in a manner which does not rely upon the same entity that runs the "current monopoly on interstate pipeline service." As such, Kinder Morgan's Silver Canyon pipeline project can meet the diversification needs of the Arizona utilities.

### **2. Supply/Infrastructure Planning**

The Proposal stresses the need for long term planning concerning natural gas infrastructure needs and that such planning should take into account the lead time necessary to construct and put in service such infrastructure. Further, the Commission's Proposal endorsed efforts to "analyze and plan for the present and future natural gas supply needs of Arizona" through active participation of Arizona utilities. In furtherance of such goal, the Proposal encourages greater efforts and coordination among all industry participants and stresses the importance of an "on-going evaluation of natural gas supply and demand issues in Arizona." As an example of such organized effort to assess Arizona's natural gas market, the Proposal noted a

suggestion for a natural gas industry equivalent of the Central Arizona Transmission Study (CATS) group in the electric industry. The notion of an organized effort to address issues concerning natural gas infrastructure needs was also discussed at length at the Workshop.

Kinder Morgan agrees with the Commission's endorsement of long term planning and enhanced coordination among regulatory and industry stakeholders. As echoed by Kinder Morgan and a variety of other participants at the Workshop, the Kinder Morgan entities believe that participation in any industry group formed to address infrastructure needs should be voluntary. Furthermore, the Kinder Morgan entities believe that any consideration given by the Commission regarding the formation of such group should take into account the relevant time constraints concerning widely held expectations of increases in natural gas demand relative to supply and the lead time necessary to construct and place natural gas storage and/or pipeline facilities into service.

### **3. Commission Approach to New Infrastructure Projects**

The Commission generally sets forth in its Proposal that it will not endorse specific infrastructure projects, and that the region's consumers and infrastructure developers will fundamentally decide how best to address the region's infrastructure needs. The Commission also stresses the importance of continued active involvement in FERC proceedings related to Arizona's natural gas infrastructure.

The Kinder Morgan entities recognize the Commission's position as it relates to endorsement of individual infrastructure projects. Notwithstanding such, given the Commission's acknowledgement of the fundamental role of Arizona's consumers in determining what project(s) will ultimately go forward, the Kinder Morgan entities encourage the Commission to actively engage customers to ascertain feedback concerning the relative merits of competing infrastructure projects. Through such substantive communication between Arizona utilities and the Commission, the Commission may gain further insight into the diversification needs of a given utility and why and how a given utility made the decision to pursue a particular infrastructure option. Further, such information may assist the Commission in its case-by-case analysis concerning the possible pre-approval of prudent up-front costs incurred by Arizona utilities and in determining prudence generally. Likewise, the Commission's continued active involvement in FERC proceedings will also prove beneficial as it relates to assessing the basis for a given utility's preferences concerning infrastructure alternatives.

#### **4. General Commission Approach**

The Proposal sets forth that the best method to address natural gas infrastructure matters involves the adoption by the Commission of informal guidelines. This approach gives the Commission the ability to adapt such guidelines to changing circumstances. Further, this section of the proposal recognizes the central role of FERC in the development of new natural gas infrastructure and encourages substantive communication between Arizona utilities and the Commission as such infrastructure is developed.

Kinder Morgan generally sees merit in the adoption of informal guidelines so as to provide for flexibility as circumstances change. In particular, Kinder Morgan stresses that such flexibility should extend to consideration of rapidly changing market dynamics in the context of utility acquisition of storage and/or transportation services obtained to serve their customers.

#### **5. Cost Recovery / Review**

In its Proposal, the Commission recognizes the importance of cost recovery issues in the development of Arizona's natural gas infrastructure. Further, the Commission raises the possibility that prudently incurred up-front costs incurred by Arizona utilities in the development of natural gas infrastructure will be considered on a case-by-case basis. Ongoing costs associated with the acquisition of additional interstate pipeline and/or storage services should be consistent with existing cost recovery procedures for such existing services. The Proposal also sets forth the standard to be applied for prudence in terms of natural gas procurement activities. Further, in the Workshop, based on statements and inquiries of the participants, the Commission Staff generally clarified that the noted "up-front" costs do not concern the project costs borne by the developers of natural gas infrastructure.

The Kinder Morgan entities appreciate the Commission's recognition of the importance of the cost recovery issue and well understand that, to the extent Kinder Morgan invests in project development, such costs are borne at its own risk. However, the Kinder Morgan entities believe that, in order to encourage the timely development of natural gas infrastructure in Arizona, the Arizona utilities need a greater measure of certainty that the substantial real cost outlays associated with the prudent acquisition of new interstate pipeline/storage capacity will be recoverable through rates.

More specifically, in addition to the possible pre-approval of certain up-front development costs borne by Arizona utilities, Kinder Morgan urges the Commission to consider a process whereby it would grant pre-approval of prudent utility transportation/storage contracts for pass-through as part of future gas cost adjustment filings. This pre-approval process would take into

account the Commission's stated prudence standards. In order to quickly address the need for additional natural gas infrastructure in the state, such process, to the extent adopted by the Commission, would encourage market participants to sort out the variety of new infrastructure project options resulting in the most favorable, well-timed benefits to Arizona's customers.

## **6. Individual Utility Circumstances**

The Proposal recognizes that each utility's circumstances and needs are different and that participation in natural gas infrastructure projects will vary accordingly.

The Kinder Morgan entities strongly support the Commission's view concerning the unique nature of individual utility needs in the state of Arizona, and does not have any additional comments on this aspect of the Proposal.

## **7. Reporting Requirements**

In the Proposal, the Commission states that reporting for any additional pipeline services should be consistent with the method and content of current reporting. Further, however, the Commission recognizes that reporting requirements concerning natural gas storage activities will need to be developed. Also, the Policy sets forth the Commission's desire that utilities should work with the Commission Staff to develop the proper reporting format and content to be included in reports to the Commission.

The Kinder Morgan entities support the view that their does not seem to be a compelling reason to change existing reporting requirements related to pipeline capacity acquisition by utilities. Beyond this observation, the Kinder Morgan entities do not have any further comments on this aspect of the Proposal.