

## **Comments and Responses of North Baja Pipeline**

North Baja Pipeline, LP (North Baja) respectfully submits these comments and responses to the Arizona Corporation Commission (Commission), Utilities Division Staff's Notice of Inquiry (NOI) on the issue of natural gas infrastructure matters in Arizona. North Baja applauds the Commission and the Staff for seeking input from the natural gas industry regarding natural gas infrastructure. North Baja is owned by PG&E Gas Transmission Northwest Corporation, a PG&E National Energy Group (PG&E NEG) company. PG&E NEG is owned by PG&E Corporation. Please send all communications regarding this NOI to:

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North Baja is an interstate natural gas pipeline regulated by the Federal Energy Regulatory Commission (FERC), that transports gas supplies 80 miles from an interconnection with El Paso Natural Gas Company (El Paso) at Ehrenberg, Arizona, to an interconnection with Gasoducto Bajanorte (GB) at the California-Baja California border near Ogilby, California. GB then transports the gas supplies for delivery to electric generators near Mexicali, and for deliveries into the Transportadora de Gas Natural de Baja California (TGN) pipeline. TGN transports gas for deliveries to electric generators in Rosarito, Baja California. GB and TGN are subsidiaries of Sempra Energy. Service on North Baja and GB commenced in September 2002. The total firm capacity on the North Baja-GB system is about 500 MMcf per day. Under an operating agreement between the two pipelines, North Baja provides all gas control, dispatching and operating services for the combined system.

To meet the future gas supply requirements of northern Mexico, California and the Southwest, several proponents of liquefied natural gas (LNG) are developing LNG regasification terminals in Baja California. At an LNG terminal, LNG is unloaded from a ship and stored in an onshore tank. Upon demand, the LNG is regasified, the process by which LNG is returned back into its gaseous state, and enters the natural gas pipeline system for delivery to customers. Consequently, North Baja and GB ("the pipelines") are considering an expansion to provide access to markets (including Arizona) for the LNG developers, and access to LNG supplies for gas markets, such as utilities and generators. In order to meet the gas transportation needs of these LNG proponents, the pipelines have initiated a joint open season. (In an open season, shippers are invited to submit bids for new capacity on the pipeline.) This non-binding open season will be used to solicit interest from potential and existing shippers for gas transportation services. The open season is scheduled to end on June

30, 2003. Later this year the pipelines and shippers will enter into binding firm transportation precedent agreements. Permits for additional pipeline facilities will be obtained in 2004 and 2005, with pipeline construction expected in 2006. New pipeline facilities are projected to enter into service in December 2006 to correspond with completion of the LNG storage and regasification terminal(s). When service commences for LNG developers, the pipelines will reverse their flow direction. That is, a new connecting pipeline would deliver gas from the LNG terminal(s) to GB, which would deliver supplies to North Baja. In turn, North Baja may deliver supplies for end-use in Arizona, either through El Paso or through a new extension of the North Baja system, or it may deliver supplies into the Southern California Gas Company system, or some combination.

Potential sources of gas supplies are Alaska, Sakhalin (Russia), Indonesia, Brunei, Malaysia, Australia, Bolivia and Peru. It is estimated that LNG regasification terminals in Baja California would provide access to 325 Tcf of stranded gas reserves in the Pacific Basin alone. This LNG resource could be the single greatest introduction of direct incremental gas supply to the state of Arizona in several decades.

More information about North Baja, and the ongoing open season can be found at its web site (<http://www.pge-northbaja.com>).

Attachment 1 is a map of the North Baja/GB pipeline systems. Attachment 2 is a listing of LNG developers and related information about each proposed project. Below are responses to some of the specific questions in the NOI. At this time, North Baja is not responding to Questions 1 to 9.

**10. Should the Commission develop formal or informal policies regarding the use of interstate pipelines by Arizona utilities? If so, what areas should such policies address?**

Strict, formal standards may not provide utilities the flexibility to respond to rapid changes in energy markets. Therefore, it may be more appropriate for the Commission to develop informal policies regarding the use of interstate pipelines by Arizona utilities. If the Commission decides to develop formal policies, general guidance should be provided to the utilities, rather than the Commission ordering specific actions. Areas that should be addressed include reliability standards, criteria for firm capacity holdings, and cost allocation and rate treatment for pipeline charges.

**11. Are there ways the Commission could encourage use of interstate pipelines in ways that could enhance the reliability and reduce the cost of natural gas service in Arizona?**

See response to Question 16.

12. **How should the Commission balance goals such as reliability, cost, portfolio diversity, and operational flexibility as it considers the use of interstate pipeline facilities by Arizona utilities?**

See response to Question 16.

13. **Previously the Commission has recognized the benefit of having Arizona local distribution companies have a diversified gas supply portfolio. Should the Commission encourage Arizona utilities to diversify their sources of interstate pipeline capacity, rather than relying on a single interstate pipeline for all pipeline capacity?**

See response to Question 16.

14. **Are there other areas where the concept of a diversified supply portfolio can and should be applied by the Commission?**

See response to Question 16.

15. **Should the Commission address proposals for new pipelines, expansions of existing pipeline, or new storage facilities? If so, how should the proposals be addressed by the Commission?**

See response to Question 16.

16. **Are there other natural gas infrastructure issues which the Commission should be addressing?**

Questions 11 to 16 are interrelated. Rather than trying to answer each of these questions narrowly, North Baja will provide one response that touches on many of the issues brought up in these questions.

As the Commission recognizes, Arizona's utilities and consumers have been largely dependent on El Paso for gas pipeline service. Through this service, Arizona is able to access gas supplies in the San Juan, Permian and Anadarko basins, so that utilities have been able to construct a diversified supply portfolio. Now the Commission asks whether utilities should diversify their sources of interstate pipeline capacity (Q. 13), and whether there are other areas where the concept of a diversified supply portfolio should be applied (Q. 14).

These two questions in particular must be considered in tandem, keeping in mind that a large majority of gas cost to an Arizona utility is for the commodity itself. The pipeline transportation costs are a much smaller component of overall cost. An affiliate of North Baja, Pacific Gas and Electric Company (PG&E), faced a similar situation over 40 years ago. Rather than increasing pipeline capacity to its historic supply areas, PG&E decided to build a brand new interstate pipeline

system from Northern California to western Canada, an entirely new supply area. The rationale for that decision was not really to diversify its interstate pipeline capacity, but rather to diversify its gas supply. That is, PG&E provided its customers access to a new, competitively priced, reliable gas supply. As gas markets became deregulated, Northern California consumers have generally had lower gas costs than Southern California and Arizona consumers whose utilities were largely dependent on gas supplies from the U.S. Southwest. So while there may be some appeal to a new interstate pipeline through Arizona, the benefits to the utilities and consumers are greater when the new pipeline provides access to a new gas supply source.

In fact, future reserves and production from the southwest U.S. are widely recognized as being in a state of decline, further argument against construction of a new pipeline from this area to Arizona. Additional pipeline capacity from the same source often results in an increase in price at the supply source, and therefore to consumers reliant upon that source. On the other hand, if a new pipeline to or through Arizona provides a direct route to a new or different source of supply, the benefits to utilities and consumers are likely to be very significant. While the concerns from the Commission and Staff about natural gas infrastructure are valid, new capital-intensive infrastructure only makes sense when it provides access to supplies that will provide consumer benefits. This is exactly what North Baja will be able to provide to Arizona, by connecting the state to a new source of natural gas, namely the proposed LNG regasification terminals in Baja California.

North Baja expects gas supplies to be available from at least one LNG terminal by the end of 2006. This important infrastructure development will provide significant long-term opportunities for Arizona's utilities to better manage their gas supply portfolios, increase reliability and decrease overall gas costs. At a minimum, Arizona's utilities will be able to purchase spot market supplies at a receipt point on the El Paso system, just as they can now. However, under this strategy, the utilities would not be making long-term commitments and would be subject to the sometimes volatile wholesale market. Alternatively, North Baja recommends that Arizona's utilities should be encouraged now to start considering the benefits of buying LNG supplies on a long-term basis, and holding firm pipeline capacity to transport those supplies from the LNG terminal(s) to their service territories or gas-fired generating plants. Implementing this type of strategy is consistent with several public policy goals including improved reliability, enhanced gas-on-gas competition, greater gas supply portfolio diversity, and development of energy infrastructure. This type of strategy will also result in more predictable and less volatile gas costs. It is also important that gas users in Arizona provide tangible market support for LNG infrastructure as the developers go through the permitting and financing stages of their projects.

The last piece of the transportation path for LNG to Arizona customers, including utilities and generators, will be service on El Paso from Ehrenberg at the North Baja-El Paso interconnection point, to a delivery point off the El Paso system in Arizona. This service could be a backhaul. (A backhaul involves transportation of gas from a receipt point to a delivery point such that the contractual direction of movement on a pipeline is opposite to the actual flow of gas.) It is also possible that market dynamics will result in El Paso eventually reversing the flow of gas on parts of its system in western Arizona, such that gas will physically move from Ehrenberg to the Phoenix area in a west to east direction. No matter what the case, the Commission, utilities and other stakeholders will have to work with El Paso to ensure reasonable rates, terms and conditions for service on El Paso from Ehrenberg to any particular delivery point.

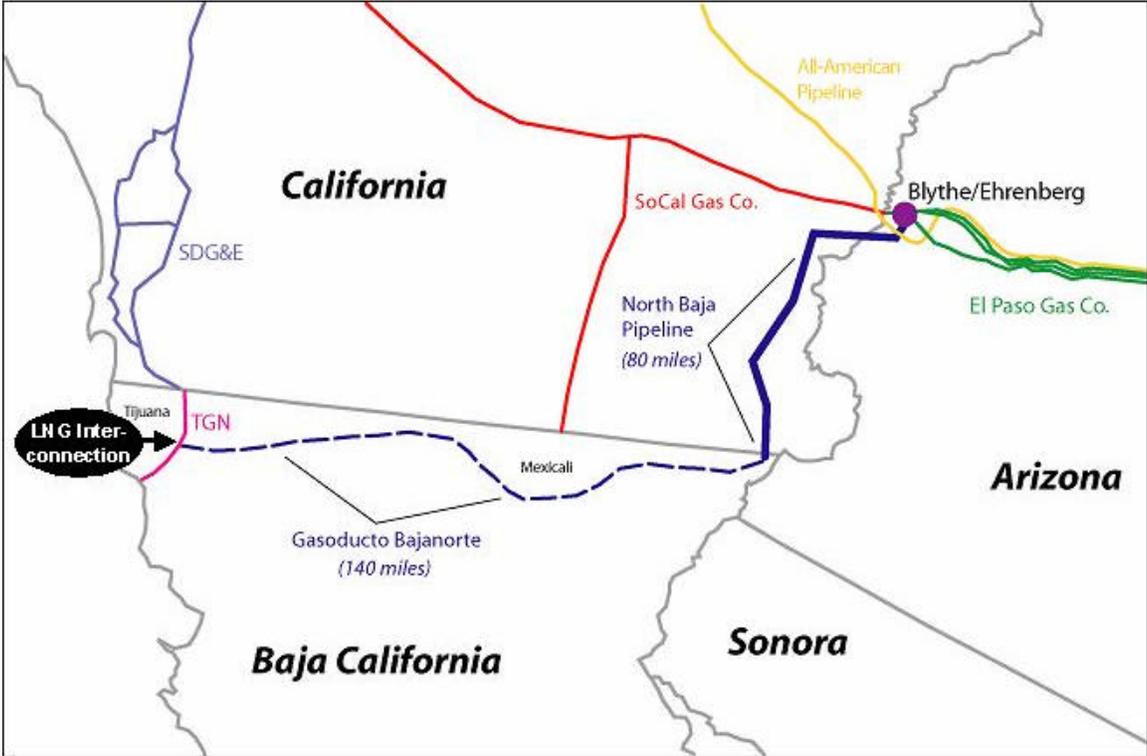
North Baja is currently conducting a feasibility study and is evaluating potential routes for a proposed pipeline lateral project into the Yuma area. As the feasibility study is conducted, the company will work with local governments, communities, and all appropriate agencies. If this lateral is constructed, firm pipeline transportation service could be available to Southwest Gas and its customers, as well as to generators (including the proposed 600 MW Wellton-Mohawk Generating Facility) in the Yuma area. Any pipeline facilities constructed by North Baja to the Yuma area will be subject to FERC jurisdiction.

**17. Should the Commission hold one or more workshops to further investigate natural gas storage and interstate pipeline issues?**

North Baja would encourage the Commission to hold at least one workshop. This would allow the Commission and the Staff to ask questions of all stakeholders, and gain a better understanding of storage and pipeline issues. North Baja commits to actively participating in workshops in this inquiry where it can provide meaningful input.

ATTACHMENT 1

Map of North Baja Pipeline and Gasoducto Bajanorte



ATTACHMENT 2

Currently Active LNG Terminal Developers

<b>Developer</b>	<b>Project Size</b>	<b>Completion Date</b>	<b>Proposed Source(s) of LNG</b>
Marathon	750 MMcfd Average 1 Bcfd peak	Late 2006 to 2007	Alaska, Indonesia, Other
Sempra	1 Bcfd	Late 2006 to 2007	Bolivia, Other
Chevron Texaco	700 MMcfd	2007	Australia, Other
Shell	1.3 Bcfd	2007	Brunei, Malaysia, Australia, Sakhalin
Conoco Phillips	680 MMcfd	2007	Australia, Sakhalin
BP	500 MMcfd	2007	Indonesia