

# **ARIZONA CORPORATION COMMISSION UTILITIES DIVISION STAFF'S**

## **NOTICE OF INQUIRY**

### **ON THE ISSUE OF: ARIZONA CORPORATION COMMISSION POLICY AND ACTION ON NATURAL GAS INFRASTRUCTURE MATTERS IN ARIZONA**

May 22, 2003

The following is a request for comments from Staff of the Arizona Corporation Commission on natural gas infrastructure.

1. Should the Commission develop formal or informal policies regarding the use of natural gas storage by Arizona Utilities?

Informal policies regarding the use of natural gas storage by Arizona utilities should only be utilized if the Commission can be satisfied that all transactions are transparent and the Commission can insist on changes when necessary. Presently we have only one gas distributor in the State. If sufficient gas is not coming, in the storage of gas is mute. An additional issue to deal with is who will store the gas, El Paso or the individual utilities? If the Commission has oversight on El Paso as it does on Arizona utilities then informal policies may work.

2. Should natural gas storage use by electric utilities be viewed and treated differently than natural gas storage used by natural gas local distribution companies? Please Explain.

Natural gas storage by electric utilities are somewhat different than natural gas local distribution companies in as much as utility storage is to be used in specific circumstances and not for resale as such.

3. What issues should the Commission address in creating a Commission policy on natural gas storage?

Where are we going to locate the storage facilities so as not to impact negatively any community? Can the Commission guarantee that a sufficient amount of gas comes into the State? What will be the impact of building new facilities on the price paid by consumers?

4. If Arizona utilities utilize natural gas storage, how should the Commission address the recovery of costs for such storage and what costs should be considered?

The construction of new facilities for natural gas storage will have a negative impact on rates as they represent a significant investment by the utilities. Perhaps getting El Paso to build these facilities would have a lesser impact on rates. If that were not feasible, the new facilities would have to be seen as a long-term investment so as to have the least impact on rates.

5. Should the Commission encourage the use of natural gas storage for addressing natural gas price volatility, reliability of natural gas supply and/or other possible goals of natural gas storage? Please indicate which goals should be pursued as well as the relative importance of each goal?

With sufficient storage capability in place, the goals of lessening price volatility, reliability and safety may be addressed in a positive manner. Of course reliability and safety can almost be assumed if the storage facilities to be built can handle a reasonable amount of natural gas for future use. It will depend upon the cost of the gas and the cost of storage and further transportation to the site of use. If these are excessive the final cost to consumers will be higher than purchasing on the spot market through El Paso. Storage will lessen the volatility of gas prices because the gas in storage will enable the utilities to draw down on the stored gas. In any case the Commission will have to deal with a monopoly in supply whether for immediate use or for storage. Monopolies are notorious for attempting to sell at the highest price possible.

6. How should the Commission address the goal of maximizing consumer benefits from natural gas storage while minimizing the cost to consumers of utilizing such storage?

A crystal ball would be beneficial at this point. The introduction of competition would be the best way to assure the Commission that the price paid for natural gas would reflect more accurately the true production, transportation and storage costs, which would be reflected in the total price paid by utilities. Unfortunately, even if competition could be introduced into this market, it would be a very long-term solution. Long-term contracts may be a solution. But, we must remember the California problem. When the state of California signed long-term contracts for electricity to keep the lights on, they paid an exorbitant price because of the manipulation of the market. The Commission must insist that any long-term contract reflect the true cost of natural gas over the long run.

7. How does the use of natural gas storage relate to other methods of reducing price volatility, such as the use of longer term supply contracts and financial hedging?

Natural gas storage will enable utilities to accumulate natural gas in sufficient quantities to act as a hedge against short-term price increases. This holds true only if the natural gas can be purchased at reasonable prices. Long-term contracts can only be profitable if the contract purchased the natural gas at a low price. Another hedge would be the use of clean coal, oil, sun, new technologies or other sources, if available.

8. Is there a relationship between the use of natural gas storage and what interstate pipeline capacity right a utility holds? And if so, how should the Commission address this relationship?

If this is generally a legal question, we do not have the expertise to answer it. We would assume that the contracts entered into between the pipeline company and the utilities would call for specific amounts of natural gas to be delivered at specific prices. It would depend upon the validity of those contracts and if they called for adjustments in prices and amounts of deliverable gas. The Commission may have the ability to monitor and enforce specific contracts. The question remains, does the pipeline company have the capacity to deliver the needed natural gas to all of its customers on the system and does the Commission have the ability to force the pipeline company to either supply Arizona customers before others on the line or ensure that sufficient capacity is available to all customers.

9. What monitoring, reporting and evaluation should the Commission undertake in regard to Arizona utilities' use of natural gas storage?

The first agreement would be the size of the natural gas storage necessary for each individual utility to insure that there is sufficient supply for a specific period of time. After the building of the facility the Commission would have to monitor when the utility wants to draw down on that natural gas in storage and for what purpose. The utility in question would have to report why they needed to draw down that supply and if there is an alternative supply source to run the facility. There should be clear reasons to use the stored natural gas, i.e. higher than normal pricing, shortage of natural gas, etc.

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?

It would depend upon which type of policy is enforceable and the time it would take to enforce such policies. It appears that formal policies may have a more immediate impact on the market than informal policies. As stated above, such policies should include the size of the storage facilities taking into account the cost of such facilities and its impact upon rates; the availability of alternate sources of fuel; when the storage facilities should start filling; when and how much could a utility draw down on its stored supply; and how to

figure the cost when the draw down applies. A corollary is the contracts signed between the pipeline company and the utility.

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

Since we are dealing with market power and monopoly pricing of the pipeline company, there is little the Commission can do unless it has the power and authority to force the pipeline company to service all of the needs of Arizona utilities and consumers. The use of CNN's by encouraging other suppliers to bring natural gas into the state may be an option. Price caps if legal may be an alternative. A similar alternative would be to require utilities to expand the use of other sources of fuel including solar, biomass, fuel cell technology etc.

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

Encourage the use of all acceptable fuel sources consistent with cost and environmental standards. Encourage the utilities to invest in new technologies that will help them balance the fuel necessary to serve business and residential customer interests. Too much reliance on one source of fuel today will spell higher costs and shortages in the future.

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 capacity?

Yes. Diversification can be a key to keeping prices down and supply adequate to meet the needs of Arizona utilities and customers.

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

If by diversification we mean other sources of fuel or other suppliers of natural gas, it stands to reason in a market economy the more players selling the better chance of obtaining lower costs and supply. With a company exercising market power that company can easily set monopoly rates or withhold supply.

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?

Expansion of existing pipelines will not solve the problem of market or monopoly power. Only new pipelines and/or alternate sources of fuel will lessen the market power of the current provider of natural gas. The Commission must use its regulatory power and/or work with the Legislature to build new pipeline supply and encourage the use of environmentally friendly fuel sources.

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

We have no comment on this question.

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

The more information that can be gathered the more sure the Commission will be in crafting its rules and decisions. We need to discover the long range implications of the present infrastructure on supply and price as well what alternatives are available and feasible to insure long range price stability and reliable supply.

Sincerely

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