

September 25, 2003

Mr. Robert G. Gray
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Subject: Notice of Inquiry, Gas Infrastructure Matters in Arizona

Dear Mr. Gray,

By this letter, the City of Mesa Utility Department (COM) provides its comments to the Arizona Corporation Commission (Commission) on the Staff Strawman Proposal. COM appreciates the opportunity to comment on the Staff's proposed Strawman. The natural gas industry is facing very difficult decisions necessary to meet the growing energy needs of the country. The Commission's efforts and a willingness to spear head these discussions are to be commended and your efforts demonstrate leadership, genuine concern and willingness to work with the natural gas industry.

Although natural gas infrastructure and associated federal regulatory policies and decisions often appear to be the largest issue facing Arizona, they pale in comparison to the impacts of natural gas price instability and volatility. The recent failures of index pricing mechanisms have contributed to, if not caused, unprecedented volatility in the supply and prices of natural gas. COM suggests that the Commission account for these market conditions when considering the adoption of policies and regulations and pursue opportunities to address these issues with other stakeholders and colleagues at the federal level.

COM's specific comments are:

- The Commission Staff Strawman is a satisfactory method to initiate discussion and identification of critical issues.
- The comments at the September 10, 2003 workshop made it clear there is not likely sufficient need for all of the current planned projects to reach development in the near term.
- Market forces should be the driver of which projects proceed to development and how interstate pipeline/storage infrastructure develops. The economics of the various projects and the value to the customers should be the determining factors for which projects get developed.
- Some of the major participants of the market are within the Commission's regulatory jurisdiction for recovery of costs incurred to meet the needs of customers. The Commission's policies and regulations may have substantive impacts on the manner in which jurisdictional utilities decide to plan, acquire, and manage (including recovery of costs from their customers) their interstate pipeline capacity and storage resources.

- Commission policies, regulations and decisions which take into account the net life-cycle costs/benefits can enhance the development of new projects particularly with pre-approval of resource/service acquisitions and alternative cost recovery mechanisms.
- As a smaller non-jurisdictional participant in the natural gas markets of the Southwest, COM's resource options will likely be influenced (i.e. expanded or limited) by the decisions of other participants, some of which are regulated by the Commission.
- For these reasons, it is imperative that the COM understand the Commission's policies and regulations and participate where/when participate in Commission proceedings where the Commission's policy, formal or informal, may impact decisions by the market participants that are regulated by the Commission.
- In general, the COM supports:
 1. The expansion of natural gas infrastructure projects that enhance access to more geographically diverse supplies of natural gas, increases deliverability from existing competitively priced resources, maintains reliability at historical levels and provides maximum operational flexibility.
 2. The interest of new participants in the development/construction of competitively priced interstate pipeline/storage services to the southwest markets.
 3. The establishment of a voluntary CAPS type organization made up of Local Distribution Company's, merchant plants, industrial customers and UDC's, to identify and assess gas infrastructure needs, supply resource requirements and options, and preliminary project/resource development requirements.
- The development of new gas infrastructure that expands access to new, geographically diverse natural gas resources, or increases deliverability from existing resources, requires a delicate balance of financing and risk management by natural gas producers/suppliers/marketers, interstate natural gas pipelines and natural gas customers. One segment of the natural gas market (e.g. an interstate natural gas pipeline) may be required to have long-term binding agreements in order to finance the capital investment necessary to build the infrastructure. The other segments of the market (i.e. the producers and/or the customers) may be reluctant or financially impaired from entering into the long-term agreements needed by the interstate natural gas pipeline.
- The value of storage for COM is likely to be different than the value of storage for an industrial customer such as an electric generator. The value of storage for the COM would be the ability buy natural gas in the off-peak times (non-winter season) at lower prices so that they can withdraw when prices rise during peak winter heating periods to minimize the volatility of fuel costs. The COM will assess the economics of the cost of storage service (including the time value of money, costs of cushion gas, storage O&M, and Lost & Unaccounted for natural gas) with the availability and price risks of acquiring supplies during peak demand periods. Storage will not likely increase the supply of natural gas, but rather move the supply from the production area closer to the consumer.
- As stated often at the September 10, 2003 workshop, time is of the essence. Actions, if any, by the Commission need to be taken in the near future. A Variety of natural gas infrastructure projects are on the table and time is ticking for potential customers to make decisions that will impact natural gas purchasing strategies for the next 15 to 20 years.

I would like to again commend the Commission for initiating this Notice of Inquiry and reiterate that the Staff Strawman is a satisfactory mechanism to initiate the discussion and identify key policy issues that

may effect the development of a variety of Natural Gas infrastructure projects that are currently being explored. Please do not hesitate to contact me at 480.644.2273 or frank.mcrae@cityofmesa.org if you have any questions or wish to discuss COM's comments.

Sincerely,

Frank A. McRae
Director, Resources Division
City of Mesa

cc: Dave Plumb, COM
Gerald Paulus, COM
Randy Bee, COM
Jeff Jacobson, Consultant