

Staff Strawman Proposal for Notice of Inquiry on
Natural Gas Infrastructure

Arizona Corporation Commission

September 9, 2003

Introduction

Recent events from the northeastern blackouts to the recent gasoline shortages have focused a great deal of attention on the energy infrastructure both nationally and in the southwest. In the natural gas industry, where interstate pipeline service by El Paso Natural Gas Company (El Paso) currently dominates service in Arizona, events in recent years have led to a widespread recognition that natural gas infrastructure issues in the Southwest must be addressed if the region is to have a reliable supply of natural gas. The long-running service reliability concerns on the El Paso pipeline system, the 2001 Carlsbad explosion on El Paso's southern system, and increased reliance on natural gas as the fuel source of choice for electricity generation have all pointed to a need for a heightened level of attention to Arizona's natural gas infrastructure.

On April 15, 2003, the Arizona Corporation Commission (Commission) Staff issued a Notice of Inquiry (NOI) on natural gas infrastructure in Arizona. The NOI contained a variety of questions regarding the Commission's approach to natural gas infrastructure issues. The Commission has received a number of responses to the NOI. The Commission has scheduled a workshop on September 10, 2003, from 1:00 p.m. to 5:00 p.m. in the Commission's hearing room to provide the opportunity for additional discussion of Arizona natural gas infrastructure issues. Staff has indicated that it will develop a strawman proposal for discussion at the September 10, 2003 workshop. The following strawman proposal 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. These policy statements are intended to provide Arizona utilities with greater clarity regarding the Commission's view of natural gas infrastructure related matters, thereby enhancing the utilities' ability to plan for future natural gas supply acquisitions.

Additionally, while these proposals are focused on jurisdictional Arizona utilities, the Commission strongly believes that all participants in the Arizona natural gas marketplace must play a role in addressing natural gas infrastructure needs. An important example of this is the many merchant electricity generators which represent much of the growing natural gas demand in Arizona. Participation of these generators in addressing natural gas infrastructure needs in Arizona is both important and necessary.

Proposals

Supply/Infrastructure Diversity

1. Diversity in Arizona's natural gas infrastructure, including both interstate pipeline facilities and natural gas storage facilities, is beneficial and should be actively pursued by Arizona utilities as a way of providing greater supply reliability and flexibility and possible lower costs.

2. Arizona utilities as a general principle should pursue a diverse natural gas supply portfolio which takes into account relevant factors including cost, reliability, flexibility, safety, and price stability.
3. Arizona utilities should include natural gas storage as an integral component of their efforts to develop a diverse natural gas supply portfolio, recognizing the variety of potential benefits of natural gas storage, including enhanced reliability, operational flexibility, more efficient use of pipeline capacity assets, and reduced natural gas price volatility.
4. The current monopoly on interstate pipeline service in central and southern Arizona is not beneficial to the state of Arizona. The Commission encourages development of alternative natural gas supply options, including one or more new interstate pipelines and natural gas storage facilities. Reduction over time of Arizona's reliance on a single pipeline system reduces the risk to Arizona of operational, regulatory, or other problems which may occur in regard to any given pipeline system.

Discussion - The Commission has previously recognized the benefits of a diverse natural gas supply portfolio for local distribution companies in Arizona (Decision No. 61225, October 30, 1998). While natural gas infrastructure was not specifically addressed in this prior policy statement, consideration of natural gas infrastructure options is nevertheless an integral part of compiling a diverse natural gas supply portfolio. Diversification is a basic fundamental of risk management and its application to Arizona's natural gas supplies and infrastructure will reduce the risk of a major supply disruption to Arizona and the Southwest. Given the lack of natural gas storage in Arizona currently, issues related to natural gas storage will likely require greater consideration by the Commission in many cases than issues related to interstate pipeline service.

Supply/Infrastructure Planning

1. Arizona utilities should plan for natural gas infrastructure needs on a long term basis, recognizing that some decisions may not necessarily lead to the lowest cost in the short term. Such planning should take into account the lead time necessary to construct and put in service natural gas infrastructure in Arizona.
2. The Commission endorses efforts to analyze and plan for the present and future natural gas supply needs of Arizona and encourages Arizona utilities and others to actively participate in such activities.

Discussion – It is important to recognize and address not only the short term natural gas issues facing Arizona and its natural gas consumers, but also the long term natural gas issues and circumstances. Greater efforts and coordination on the part of the Commission, federal regulators, pipelines, utilities, merchant generators, and other interested parties will be important in ensuring a reliable and reasonably priced supply of natural gas to Arizona and the Southwest. On-going evaluation of natural gas supply and

demand issues in Arizona is important for individual entities and jointly for all parties with an interest in the Arizona natural gas market. Some form of organized effort to assess conditions in the Arizona natural gas market, such as Salt River Project's suggestion for a natural gas industry equivalent of the Central Arizona Transmission Study (CATS) group in the electric industry should be seriously considered.

Commission Approach to New Infrastructure Projects

1. The Commission, as a general proposition chooses not to endorse specific infrastructure projects. The Commission believes that the region's natural gas consumers and infrastructure developers play a fundamental role in determining how to best address the region's infrastructure needs. The Commission anticipates continued active involvement in FERC proceedings related to Arizona's natural gas infrastructure, as the Commission deems appropriate.

Discussion – It is important for the Commission, in promoting the public interest in Arizona, to be actively involved in natural gas infrastructure matters before FERC, where new FERC jurisdictional pipelines and natural gas storage projects must be certificated.

General Commission Approach

1. The Commission NOI on natural gas infrastructure activities recognizes the jurisdiction and central role of FERC in developing new natural gas infrastructure in the Southwest and anticipates the Commission's NOI initiative as being complementary to FERC's activities, recognizing that both state and federal regulators can play a role in Arizona's natural gas infrastructure development.
2. The Commission encourages open, on-going and substantive communication between Arizona utilities and the Commission as Arizona's natural gas infrastructure is developed in the coming years.
3. At this time the Commission believes that the best method for the Commission to address natural gas infrastructure matters is to adopt informal guidelines, providing the Commission with the ability to adjust such guidelines as circumstances change in the future.

Cost-Recovery/Review

1. The Commission recognizes the importance of cost-recovery issues in the development of Arizona's natural gas infrastructure. Given the criticality of Arizona's current natural gas supply circumstances, the Commission will consider on a case-by-case basis the possible pre-approval of specific prudent up-front costs incurred by Arizona utilities while participating in the development of natural gas infrastructure.
2. Cost recovery for on-going costs related to additional interstate pipeline services should be consistent with existing cost recovery procedures for existing interstate pipeline service costs.
3. Cost recovery procedures for on-going costs related to natural gas storage activities will need to be developed, given the lack of current natural gas storage activity in Arizona.
4. As a general matter on the recovery of natural gas infrastructure costs, the Commission anticipates reviewing the prudence of such costs by Arizona utilities on the basis of the following standard: "In determining the prudence of natural gas procurement activities, the standard to be applied is whether each individual action, and/or the utility's actions taken as a whole, given the specific circumstances at the time, is/are reasonable in light of what the utility knew or should have known at that time."

Discussion – The topic of how the costs of new natural gas infrastructure are recovered by Arizona utilities is important to the utilities, the Commission, and Arizona ratepayers. Cost recovery issues will need to be considered in greater detail and the potential problems and benefits of different cost recovery methods will need to be identified. An important aspect of cost recovery is that the utility retain documentation of the resource acquisition process, identifying such matters as the need for the new infrastructure, what other options were considered, and why and how the decision was made to pursue a certain infrastructure option.

Individual Utility Circumstances

1. As individual Arizona utilities consider their participation in the development of natural gas infrastructure, the Commission recognizes that each utility's circumstances and needs are unique and participation in natural gas infrastructure projects will vary accordingly.

Discussion - The Commission recognizes that each utility is uniquely situated due to a variety of factors including geographic location, size, financial standing, operating circumstances, and customer demand characteristics. Therefore each utility should tailor its application of the proposals as is fitting given its individual circumstances. The Commission also recognizes that there are differences between the electric and natural gas utility sectors and among utilities in each sector.

Reporting Requirements

1. Reporting for any additional pipeline services should be consistent with the method and content of current reporting by utilities for their current pipeline services.
2. Reporting requirements for natural gas storage activities will need to be developed, given the lack of current natural gas storage availability in Arizona. Utilities should work with Staff to develop the proper reporting format and content to be included in reports to the Commission, including possibly through existing monthly adjustor reports or other reporting methods as deemed appropriate.

Discussion - The Commission has traditionally required some form of reporting on gas purchasing activities by utilities, whether electric or natural gas. Such utilities have for many years acquired interstate pipeline capacity and the possible addition of any new pipeline capacity from other sources does not appear to fundamentally change the need for reporting pipeline capacity acquisition related information, other than possibly differentiating between purchases from different entities. Therefore there does not appear to be a need to change existing reporting requirements for utilities with interstate pipeline capacity. In contrast, there is no natural gas storage in Arizona, so currently utilities do not have storage related information to report to the Commission, but as utilities begin to utilize natural gas storage in the future, reporting requirements will need to be developed.