

Red Lake Gas Storage, L.P.
909 Fannin, Suite 1575
Houston, TX 77010

May 29 2003

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

Re: Red Lake Gas Storage Responses to Notice of Inquiry

Dear Mr. Gray:

I am writing in response to your Notice of Inquiry dated April 15th, 2003 concerning possible action on Natural Gas Infrastructure Matters in Arizona. I am not in a position to answer all of the questions but will address those where I can contribute.

1. The ACC should adopt policies similar to those that currently have where they oversee utilities acquisition and use of natural gas, natural gas transportation, coal, fuel oil, etc. Storage serves to protect against high gas prices, increases reliability, and helps to “right size” transportation and supply portfolios. Storage should not be singled out for oversight but should be part of the overall supply review.
2. Both gas and electric utilities can benefit from storage services. Electric generators may have more “short notice” needs and pressure requirements that the long haul interstate pipelines can be challenged to provide. The tug of war between east of California and California markets makes it difficult for the pipelines to meet the supply and pressure needs of the growth in electric generation. Electric generators definitely have a need for storage and can benefit greatly from its protection from short notice daily gas prices and help support the pipeline supplies and pressure needs. The generators need to only run 8, 12, or 16 hours a day cause problems in balancing pipeline supplies and storage can take the excess when generation is not running and deliver when needs are greater than available pipeline supply. Electric utilities like gas should be able to recover the cost of storage services in the supply portfolio.
3. I think it might be worthwhile for the ACC to look to the Texas Railroad Commission for guidance on developing rules for storage development, testing and operations. The FERC oversees and has jurisdiction over “interstate” facilities and Texas has jurisdiction over “intrastate” facilities. In recovery of cost issues you might look to the Northeast or Michigan as examples. Those areas of the country cannot meet annual needs with flowing supplies they must have storage to meet winter peak needs. The utilities either built their own storage or lease it from pipelines or independent storage providers. It is standard operating procedure in those states for their utilities to contract or own storage. With AZ’s

incredible growth you may well be in a similar position where storage may be required to meet the energy needs in the state.

4. Storage costs consist of monthly demand charges and usage charges such as compression fees and fuel recovery. Rates vary throughout the US but the basics are the same. All charges should be recoverable in the PGA. Utilities should be encouraged to contract for storage services. It will reduce the overall supply costs and reduce the costs passed on to ratepayers. Also independent storage facilities are normally financed on the backs of long-term service contracts. To insure adequate development of storage the ACC should assure utilities of full cost recovery and encourage long-term service contracts so that adequate facilities can be developed.
5. One end of the spectrum is that natural gas storage can be an insurance policy. You put gas in and hold it until a need arises. The other end of the spectrum is where a utility could actively manage their storage services in a manner that would not only reduce the overall supply costs but allow utilities to profit by providing excess gas or beneficial services to industrial or commercial customers on their system. Storage has many valuable uses in an energy portfolio from force majeure protection, increased reliability, and right sizing transportation and firm supplies, and price arbitrage or protection from runaway daily prices. Storage provides many benefits that protect the ratepayer from the volatility in energy prices.
6. Storage does and will consistently reduce the overall energy costs to any utility. If utilities have multicycle storage in the portfolio the overall energy costs to the ratepayer will be reduced. It will not be incremental cost from which you need to protect the ratepayer.
7. You can look at California to get an example of the success of entering into really long term contracts. All of the utilities are now wanting out of contracts they just signed a couple of years ago because the market, for the time being, has changed. Hedging is picking a price on the forward market where you agree to buy natural gas. It will assure you a price but not assure you of supply. Responsible hedging and financial trading requires storage to allow you to roll contract forward and put gas in storage roll contracts further out to reduce costs and pull gas from storage. Storage is a highly flexible tool or “option” where utilities have the right to “put” or “call” gas over the entire life of the storage service. It is the most responsible way to purchase supply and run a responsible financial book. With storage in the portfolio utilities may be able to reduce the amount of “firm” or “Premium” supplies they purchase. Also, instead of dumping gas into the daily market when weather is cooler than forecasted they can put it in storage and protect the price they paid instead of losing money in the daily market.
8. Storage allows a utility to “right size” firm transportation. Instead of buying transportation equal to your absolute worst-case weather day (100 year event) you purchase transport for you 90% day and use the storage to balance the daily difference. The days you need more you pull from storage, the days you burn less you put it in storage and save it for that day you need more. It increases the load

factor on firm transportation and therefore you are getting more bang for your buck for your transportation dollar.

9. The activity should not require much in the way of individual reporting. Whatever AZ utilities report today in respect to transport owned, used, etc. would work for storage.

In summary, I believe the ACC should do everything in its power to encourage competition and support the development of energy infrastructure in Arizona. Storage facilities serve to increase the efficiency of the existing energy infrastructure and may allow existing pipelines to operate more effectively and reduce the need for new long haul transportation pipelines. It is similar to the hub and spoke system-a storage facility interconnected to Transwestern and El Paso will serve to increase reliability and increase the reserve margin from both-basically $1+1 = 3$. Thank you for the opportunity to respond to your notice.

Mark D. Cook
Red Lake Gas Storage, L. P.

Ps. Support Red Lake!