

May 30, 2003

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

Re: Notice of Inquiry ("NOI") on Natural Gas Infrastructure Matters

Dear Mr. Gray:

#### INTRODUCTION

This letter is submitted on behalf of Southwestern Power Group II ("SWPG") in response to the Commission's April 15, 2003 NOI on the above-referenced matters. At the outset, SWPG wishes to express its support for the Commission's conduct of one or more workshops in the future to further consider natural gas storage and interstate pipeline issues as they become further refined. At this juncture, SWPG perceives the questions set forth in the NOI, and the responses the Commission may receive, to be only the beginning of what could be a very instructive and constructive dialogue among various categories of natural gas consumers within the State of Arizona. In that regard, because many of the current questions appear to be primarily addressed to the operating circumstances and needs of natural gas Local Distribution Companies ("LDC"), SWPG's comments will be of a general and overview nature at this time.

#### THE COMMISSION'S RESPONSIBILITY TO CONSIDER RETAIL ELECTRIC CONSUMER INTERESTS

It is important for the Commission to remember that any policy directives which it might ultimately adopt, and any specific actions it may undertake, specifically addressed to natural gas

storage and interstate pipeline issues could ultimately impact Arizona electric consumers as well. As the supply of electricity generated at natural gas-fired facilities located in Arizona increases with each new plant that is placed in service, the potential ramifications from such impact increase accordingly. This is true in terms of both reliability of supply and cost.

Consistent with this viewpoint are the following comments from the responses to the NOI which were submitted by Southwest Gas Corporation ("SWG") on May 20, 2003:

"While the end uses of LDC's and electric utilities differ significantly, both types of utilities face the same challenges related to substantial seasonal fluctuations in loads over the course of the year, uneven intra-day load profiles, and the need for a high degree of supply reliability. . . Whether these similarities and differences translate into different approaches in the evaluation and acquisition of natural gas storage facilities could be a topic of further review if the Commission elects to pursue establishing formal or informal policies regarding the use of natural gas storage by Arizona utilities." [SWG Response to NOI-1- 2]

Further, given the Commission's goal of a competitive wholesale electric market in Arizona, it should be noted that there is not a meaningful distinction between a merchant power generator (such as SWPG) and a local electric Utility Distribution Company ("UDC") (such as APS or TEP) for purposes of the subjects addressed in the NOI. Thus, SWG's use of the term "electric utilities" in the above-quotation is effectively inclusive of both merchant generators and UDC's.

Accordingly, in reviewing the responses to the NOI which it receives, and in determining how and when to proceed as it addresses natural gas infrastructure issues in the future, the Commission must conscientiously strive to avoid biasing its approach and proposed manner of resolution in favor of natural gas retail consumers. As noted above, the interests of retail electric consumers are also involved.

#### RECOGNITION OF JURISDICTIONAL INTERFACE WITH FEDERAL ENERGY REGULATORY COMMISSION

As indicated in the "Introduction" section of the NOI, the Commission's issuance of the same is in part occasioned by anticipated changes in the transportation contracting practices of El Paso Natural Gas Company ("El Paso") necessitated by a May 30, 2002 order of the Federal Energy Regulatory Commission ("FERC"). Both Arizona LDC's and wholesale electric power generators obtain their supplies of natural gas through interstate pipeline facilities operated by El Paso. Thus, they will be directly affected by these FERC-driven changes in contracting practice. In addition, in all likelihood, FERC jurisdiction will be involved to some degree in the use of natural gas storage facilities incident to the operation of El Paso's interstate pipeline system, regardless of whether those storage facilities are located in Arizona or in other states. Thus, as the Commission begins to consider policies (formal and informal) and practices regarding the use of natural gas storage facilities by LDC and wholesale electric generator customers of El

Paso, and any other interstate pipeline serving Arizona, it is imperative that the Commission be fully informed as to the actual and potential effect of FERC orders, rules and regulations upon such contemplated policies and practices. Otherwise, there is the risk that the Commission's goals would not be achieved, and that Arizona's LDC's and wholesale electric generators could be placed in an untenable position.

#### PROPER ALLOCATION OF COST RECOVERY RESPONSIBILITY

As SWG correctly notes in its response to NOI - 1 - 4:

"The recovery of costs associated with natural gas storage should be addressed in the same manner costs for interstate pipeline transportation is recovered... All costs of storage, including reservation charges, injection charges and withdrawal charges should be recovered through the gas cost component of rates."

In addition, SWPG believes that rate design should allocate the responsibility for recovery of such costs to the customer classes and customers who cause the incurrence of the costs to be recovered. There should not be any subsidization of costs by one or more categories of customers for the benefit of others.

Thus, for example, wholesale electric generator customers should not bear cost recovery responsibility for costs associated with the storage and delivery of natural gas for the benefit of retail natural gas consumers. Similarly, such natural gas customers should not be burdened with the recovery of costs occasioned by wholesale electric generator use of natural gas pipeline and storage facilities.

#### RELATIONSHIP BETWEEN USE OF NATURAL GAS STORAGE AND INTERSTATE PIPELINE CAPACITY RIGHTS

As indicated in the preceding sections, SWPG believes that (i) any policies and practices to be considered by the Commission must take into account existing or proposed orders, rules and regulations of the FERC which may be applicable to the circumstances, and (ii) cost recovery responsibility for the use of interstate pipeline and natural gas storage capacity should be allocated on the basis of cost causation. In addition, and as a logical extension of these views, SWPG believes that the Commission should not consider or adopt any policy(ies) or practice(s) which would interfere with what would otherwise be the normal (and FERC approved) contracting practices of interstate pipelines with regard to the transportation and storage of natural gas. In particular, they believe that the Commission should not do anything which could intentionally or inadvertently create a capacity preference for retail natural gas consumers vis-a-vis retail electric consumers.

#### CONCLUSION

SWPG appreciates the opportunity to submit these general comments in response to the NOI. In the event the Commission continues with its indicated intent to address natural gas infrastructure issues, and as such issues become further refined, SWPG will continue to participate in the Commission's process as their respective interests warrant.

Sincerely,

Lawrence V. Robertson, Jr.

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