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December 22, 2004

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Arizona Corporation Commission
Utilities Division – Docket Control
1200 W. Washington Street
Phoenix, Arizona 85008

Re: *Compliance Filing*
Duke Energy Arlington Valley L.L.C. CEC Application
Docket No: L-00000P-01-0117

Pursuant to Condition No. 15 in Arizona Corporation Commission Decision No. 64717, Duke convened a workshop to address gas transportation issues. The workshop was part of the November 16, 2004 AAI Energy Summit. Enclosed is a "Report on Arizona Workshop on Natural Gas Transportation Reliability and Capacity," that describes the November 16th workshop.

Very truly yours,

LEWIS AND ROCA LLP

Thomas H. Campbell

THC/mjh
Enclosure

cc: Brian K. Bozzo ACC Compliance Manager (w/enc.)
Laurie Woodall (w/enc.)

REPORT ON ARIZONA WORKSHOP ON NATURAL GAS TRANSPORATION RELIABILITY AND CAPACITY

November 16, 2004
Scottsdale Radisson
Scottsdale, Arizona

Duke Energy North America

REPORT ON ARIZONA WORKSHOP ON NATURAL GAS TRANSPORTATION AND RELIABILITY

November 16, 2003

Pursuant to Arizona Corporation Commission ("ACC") Decision No. 64495, as amended in ACC Decision No. 64717, Duke Energy North America held the third of three annual workshops to discuss natural gas transportation and reliability in Arizona. Duke again incorporated its gas workshop into an Energy Summit co-sponsored with the Arizona Association of Industries. The Energy Summit was held at the Scottsdale Radisson with approximately 130 attendees from Arizona and other states. Local, state, and federal government officials spoke, as did many industry leaders.

The workshop consisted of two panels discussing Natural Gas Today: Pipeline & Distribution, and Natural Gas Tomorrow: Pipeline, Storage, LNG. The session was moderated by Tom Campbell of Lewis and Roca LLP.

Speaking on the "North America Demand Outlook," Don Zinko, VP of Business Development for El Paso Western Pipelines, presented information on the current and future supplies of natural gas. While supplies in the lower 48 states, in general, will decrease over the next ten years, the Rockies and Canadian Non-Arctic areas should see an increase in supply. The San Juan basin and Permian basin supplies to El Paso are in a slight decline but the supply from the Rockies will pick up growth to complement what El Paso brings to Arizona from Texas. The Cheyenne Plains hub will direct gas to Arizona through the Kern River line and the extension of the 1903 project to Ehrenberg, California. El Paso also is developing Liquid Natural Gas ("LNG") connectivity through hubs in Baja and Sonora. From El Paso's perspective, however, the key issue remains market area storage. With significant swings in hourly generation produced by gas-fired power plants, the rapid growth in Arizona's population, the volatility in gas prices, and Arizona's dependence on imported natural gas, market area storage is the critical factor to controlling and balancing gas prices for both residential and business consumers. Impediments remain in the siting of such storage facilities. Urban growth and public misconceptions on safety issues hinder placement of natural gas storage in the very areas it is needed most.

Larry Black, Senior Manager of Gas Supply for Southwest Gas, spoke about "Upstream Infrastructure." Southwest Gas is the only distribution company in Arizona and it relies on El Paso as the sole supplier of natural gas pipeline capacity. Southwest Gas puts infrastructure in the ground as the population grows. The recent loss in full requirement service by local distribution companies meant the company was assigned a fixed amount of capacity on El Paso's system and opened the door for other suppliers of capacity. For the residential and business consumer the figures are significant: up to 20,000 dth/day each year in growth, requiring 750,000 dth/day on a peak winter day. And the natural gas-fired power plants have changed the pattern of demand; summer no longer is a low demand season. The power plants usurp the supplies of the residential and business consumers and may require additional capacity. While Southwest Gas has meet the supplies to date in Arizona, more is needed for the future. Several projects, including the Silver Canyon Pipeline, the El Paso 1903 extension, the Transwestern Pipeline and

the Pacific Texas Pipeline will increase reliability from El Paso as well as add capacity from new suppliers. The Arizona Corporation Commission's forward-looking policy on pre-approval of infrastructure provides incentive to these new projects. Southwest Gas will be building 27,000 miles of infrastructure for local users so they need be assured that there are adequate upstream requirements to meet their demands. Southwest Gas also supports market area storage to help the company be more flexible in meeting the demands of all consumers.

Michael Owens, President of the Pacific Texas Pipeline Company, discussed the status of his companies "Picacho Natural Gas Pipeline." The project consists of 825 miles of 36" OD natural gas pipeline from the Waha Hub in west Texas through New Mexico, Arizona, and ending at Ehrenberg, CA on the Colorado River. The line will function bi-laterally to bring back LNG from Ehrenberg to Phoenix and will have a one billion cubic feet/day delivery capacity. Pacific Texas works with local companies, such as Honeywell and Malcolm Pirnie, to complete its work in Arizona. All of the right of way work is completed. They are continuing discussions with state and federal agencies and, as of the workshop, had secured all of their funding. They also are working with Pinal County on educational initiatives, anticipating the need for 700 full time employees with a variety of skills.

Tom Shaw, Manager of Business Development for Unocal Midsteam & Trade, spoke on "Gas Storage in Arizona: Why? Where? How?" A tight supply-demand market occurs when well capacity utilization is greater than 85%. The build out in gas-fired generation in 1995 absorbed the summer gas production and, when coupled with the population shift, utilization capacity eroded. Arizona is using 90% of its capacity, making it even more sensitive to supply chain breaks and destroying any chance for price stability. Market area storage is the missing link in the energy chain in Arizona. Currently the El Paso pipelines are packed and gas is stored in Texas and California. To provide supply security and reliability, 80% of consumers need storage less than 100 miles from point of use. There are three known salt basins in the Phoenix/Tucson market area: Luke, Higley, and Picacho. There are an additional seven possible storage areas but these will require $7million of investment and two years worth of investigation to prove-up. Taking such risks must be rewarded by rate-makers. While the industry acknowledges there are safety concerns, only nine significant incidents have occurred nationwide since 1918. Of these cases, three involved temporary evacuations of residents and only one caused damage or injuries outside of the facility boundaries. Of the 16,584 facility years between 1918 and 2004, the calculation breaks down to one incident per 1,835 facility/years. Compatible land use occurs in other regions of the country and needs to be better investigated and communicated to the residents of Arizona. Industry, government and community leaders need to work together to make the appropriate trade-offs to prudently site facilities to meet the public's expectation for reliability and rational pricing.

Making a "Case for LNG," Dorothy Rothrock, VP for Government Relations at the California Manufacturers & Technology Association ("CMTA"), discussed the work of CalCase: Californians for Clean, Affordable, Safe Energy. As North American supplies of natural gas decrease, new sources of imports can be made available through shipping Liquid Natural Gas ("LNG"). A supply of LNG would increase diversity and security of supply, help decrease and stabilize prices, increase supplies as the economy grows, and limit reliance on pipeline sources. There are no LNG terminals on the West Coast. Companies have proposed building terminals in

California and Baja, Mexico and five terminals have been sited. Each project has local support but CalCase is coordinating a statewide campaign to offset the protests by opposition organizations. They recruit allies willing to publicly support LNG; the governor of California supports the development of LNG. CalCase also provides media and policymakers with facts on LNG, describes the environmental benefits of natural gas, and quantifies the economic benefits of reliable energy supplies. They have not chosen to support any one site over another but rather unite their efforts to help all of the projects. Manufacturers are sensitive to the cost and availability of natural gas and electricity and it is the mission of CMTA to expand manufacturing in California.

"Addressing the Supply and Infrastructure Challenges in North America," Rich Asheim, Commercial Manager for BP Gas & Power, stated that the long term demand for natural gas is increasing 18 billion cubic feet per day at a rate of 1% per year. The traditional supplies from North American basins cannot meet this demand. Instead, incremental sources of supply will be needed. Price will be the major component that manages the supply and demand as we continue to spend more money to find new supplies of gas. The volatility in this tight gas market is here to stay but companies and consumers can use physical and financial means to manage this. There are cheaper gas reserves offshore in North America for which there are 45 regasification sites existing and proposed along the Northeast and Mid-Atlantic coasts, the Gulf of Mexico coastline, and both the Southern California and Pacific Northwest coasts. BP also is working on an Alaskan Gas Pipeline as a key basin-opening infrastructure development to bring natural gas to the Albert Hub and from there to California, Chicago and eastern Canada. A $125 million study completed in 2002 determined that it would cost $20 billion to build a 4.5 billion cubic foot pipeline, expandable to 5.6 billion cubic feet. United States and Canadian officials are making some progress on the details addressing federal regulatory requirement for both nations. Along with this project, BP is investing in natural gas supplies from the Rockies and San Juan basins, from the deep water Gulf of Mexico, LNG from the Atlantic, and LNG from the Pacific through the Baja, Mexico terminal.