

ORIGINAL  
OPEN MEETING



0000043844

MEMORANDUM

410

TO: THE COMMISSION

FROM: Utilities Division

DATE: March 2, 2006

RE: ARIZONA PUBLIC SERVICE COMPANY'S FILING FOR PRE-APPROVAL OF  
COST RECOVERY FOR PARTICIPATION IN THE TRANSWESTERN PIPELINE  
PHOENIX PROJECT (DOCKET NO. E-01345A-05-0895)

Please find attached the Staff Report and Recommended Opinion and Order for the above  
referenced matter. Staff recommends approval with conditions.

Ernest G. Johnson  
Director  
Utilities Division

EGJ:RGG:lh\KL

ORIGINATOR: Robert G. Gray

AZ CORP COMMISSION  
DOCUMENT CONTROL

2006 MAR -2 P 4: 08

RECEIVED

Arizona Corporation Commission  
DOCKETED

MAR 02 2006

DOCKETED BY

Staff Report on Arizona Public Service Company Filing for Pre-  
Approval of Cost Recovery for Participation in the Transwestern  
Pipeline Phoenix Project

March 2, 2006

**REDACTED VERSION**

Docket No. E-01345A-05-0895

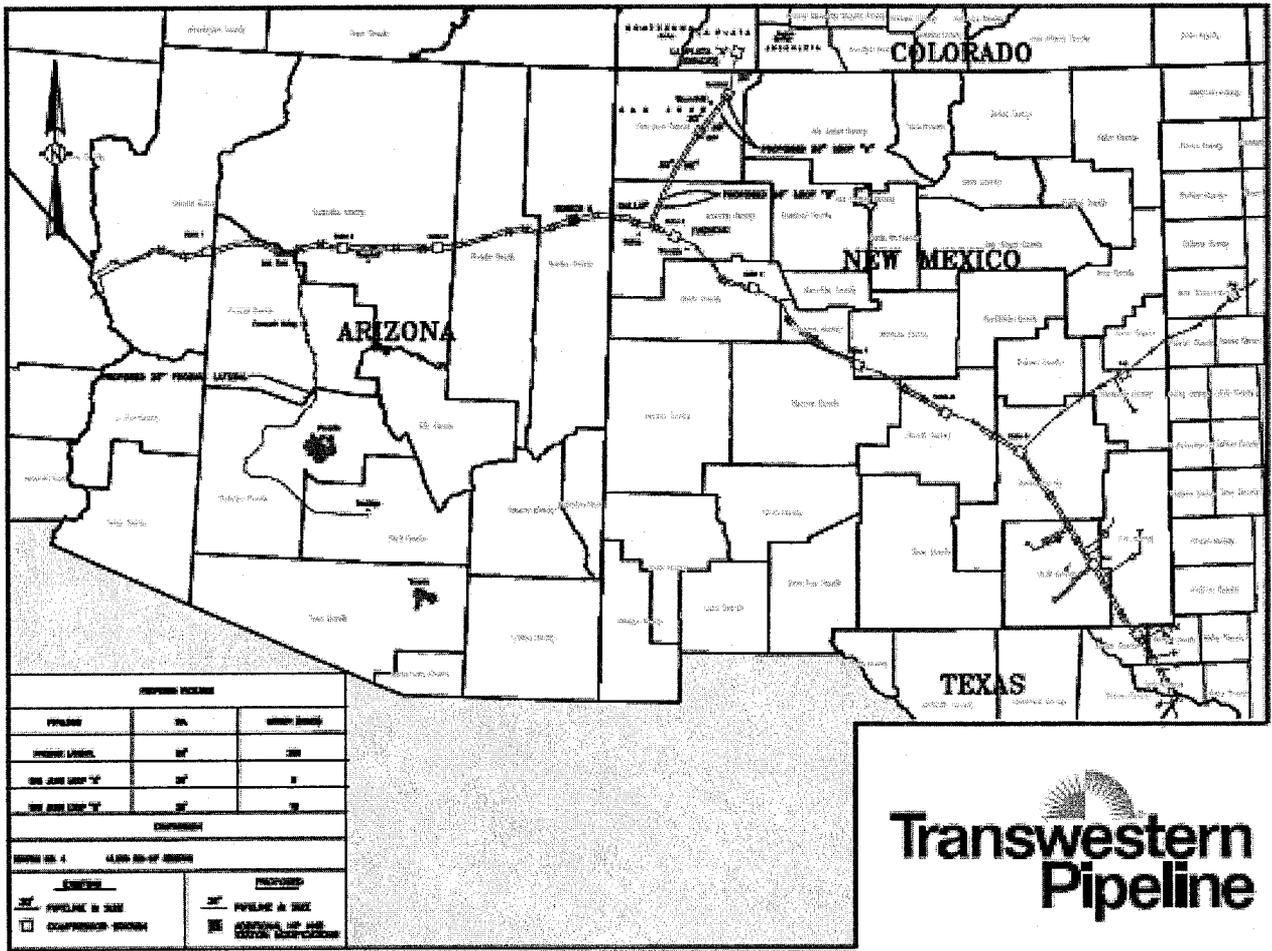
## Table of Contents

Introduction .....	1
Map of Transwestern Phoenix Project .....	2
Description of Phoenix Project .....	3
Background .....	4
Arizona's Competitive Position in the Southwestern Natural Gas Market .....	5
Impact on Arizona's Access to Natural Gas Supplies .....	6
Considerations Regarding El Paso's Current Rate Proceeding Before FERC .....	7
Pipeline Service Reliability .....	8
Description of the Phoenix Project Expansion Agreement Between APS and Transwestern .....	9
APS Natural Gas Generating Capacity and Pipeline Capacity .....	11
Cost Analysis of Transwestern Service to APS .....	12
APS Method for Recovering Transwestern Costs .....	16
Right-of-Way Issues and Construction of New Pipelines in Arizona .....	16
Comments and Filings by Interested Parties .....	17
APS Application As Part of the Broader Scope of the Transwestern Project .....	18
The Commission Notice of Inquiry on Natural Gas Infrastructure .....	18
What Does Pre-approval Mean and Why Pre-approve? .....	21
APS Participation in the Transwestern Project in Light of the Commission's December 18, 2003 Policy Statement .....	24
Impact of Pre-approval on APS' Level of Risk .....	25
Conclusions and Recommendations .....	26
Appendix A – Summary of Processes Related to Siting of the Proposed Transwestern Pipeline .....	28
Appendix B – Sensitivity Analysis of Cost Components and Other Factors In Transwestern and El Paso Service .....	29

## **Introduction**

On December 16, 2005, Arizona Public Service Company ("APS" or "Company") filed for Commission pre-approval of cost recovery for participation in the Transwestern natural gas pipeline project ("Phoenix Project"). Transwestern Pipeline's ("Transwestern") proposed Phoenix Project would build from the San Juan supply basin in northwest New Mexico to the Phoenix metro area. APS' filing is pursuant to the Commission's on-going Notice of Inquiry on Natural Gas Infrastructure, which the Commission initiated in April, 2003, to consider issues related to natural gas infrastructure and their impact on natural gas service in Arizona. APS' application is the first request for pre-approval related to the Phoenix Project. APS has provided Staff with certain confidential information related to its application. This Staff Report represents Staff's evaluation and recommendations regarding this APS filing. Separate unredacted and redacted versions of this Staff Report were prepared.

Staff recommends that the Commission approve the APS filing, subject to a number of conditions.



Source: Transwestern

## **Description of Phoenix Project**

The proposed Phoenix Project would run from the San Juan supply basin in northwest New Mexico to central Arizona, providing shippers with additional access to San Juan basin natural gas and indirect access to additional Rockies supplies. The Phoenix Project entails three contiguous segments. The first segment of the project entails a 375,000 dth/day expansion of Transwestern's existing pipeline system running out of the San Juan basin along with some utilization of unsubscribed capacity on the San Juan laterals. The second segment of the project will utilize unsubscribed capacity on Transwestern's existing mainline which runs across northern Arizona. The third segment will begin west of Flagstaff, running south through Yavapai County, skirting the Phoenix metro area to the west, and ending near Coolidge, Arizona. The Phoenix Project would have some ability to add additional capacity in the future if such growth is warranted. Projected dates in the progress of the Project include Transwestern making a filing with FERC in August 2006, beginning construction in July 2007, and commencing operation on April 30, 2008.

Siting of the proposed Phoenix Project is not at issue in this proceeding, as FERC has primary siting authority for natural gas interstate pipelines. This proceeding addresses cost recovery by APS of costs related to the Phoenix Project pipeline capacity. However, to provide a general overview of the siting and related processes, attached as Appendix A is a summary which APS provided to Staff of the various FERC and other processes the proposed pipeline would be subject to, as well as opportunities which Arizona entities would have to provide input in those processes.

## Background

The increasing reliance on natural gas for electric generation both locally and nationally at a time of sustained high natural gas prices and limited domestic production has raised a number of questions regarding the efficacy of increasing reliance on natural gas as a fuel for electric generation. Given the pace of growth in Arizona, such questions are particularly pertinent. There are good reasons to look to diversify the electric generation mix away from continued growing reliance on natural gas in Arizona, particularly in regard to baseload generation. At the same time, it must be recognized that there are significant natural gas-fired generation assets in Arizona, and that these assets will play a key role in meeting the future electricity needs of Arizonans. Particularly in the short-term future, there are not a lot of options beyond natural gas-fired generation to meet the level of growth in electricity demand expected in Arizona. Therefore, despite concerns about the growing reliance on natural gas for electric generation, it is important that Arizona's needs for a vibrant, flexible, reliable natural gas infrastructure continue to be addressed. Primarily, such infrastructure needs would consist of the development of natural gas storage facilities and additional pipeline infrastructure in Arizona. Additionally, the likely growth in liquid natural gas (LNG), both in the Southwest and nationally, will play a significant role in shaping natural gas markets and infrastructure needs, although it is still not clear how LNG imports will impact the North American natural gas market in the coming years.

According to the recently completed "Arizona Natural Gas Market and Infrastructure Study" by Energy and Environmental Analysis, Arizona is served by El Paso's northern pipeline system with a capacity of 2.2 billion cubic feet (bcf)/day, El Paso's southern system with a capacity of 2.5 bcf/day, Transwestern's northern Arizona pipeline with a capacity of 1.2 bcf/day, and Questar's Southern Trails pipeline in northern Arizona with a capacity of 80 million cubic feet (mmcf)/day. Most of Transwestern's capacity, and a large portion of El Paso's capacity, has traditionally served California, although California has in recent years reduced its reliance on these pipelines running through Arizona. Arizona shippers in northern Arizona have some ability to access supplies from different pipelines, but shippers in central and southern Arizona, including APS' natural gas consumption, are at this time totally reliant on service from El Paso to meet their needs. Until FERC action in recent years, many Arizona shippers were contractually bound to take all of their interstate pipeline service from El Paso.

Service on El Paso has undergone a great deal of change and uncertainty in recent years, and such change is likely to continue in the near future as FERC considers El Paso's current rate proceeding and other matters. Issues of debate in recent years on the El Paso system include the allocation of delivery rights at Topock, elimination of full requirements rights for large East-of-California (EOC) shippers, California's pursuit of market manipulation allegations against El Paso and others, implementation of Order 637 provisions on El Paso's system, and a host of issues being addressed in the current El Paso rate proceeding at FERC. Such continued upheaval on El Paso's system has created a more difficult environment to operate in for all Southwestern natural gas market participants, including APS. A major contributor to upheaval in the Southwestern markets has been major shifts in utilization of El Paso's pipeline system by California shippers, exemplified by Pacific Gas and Electric's (PG&E) turn back of capacity in

the mid 1990's and Southern California Gas' (SoCal) recently announced turnback of capacity. Such major shifts in pipeline utilization create difficult circumstances for both El Paso and for other shippers in the region. This unsettled situation has been further exacerbated by the recent discounted contracts El Paso has negotiated with California shippers, including PG&E and SoCal, which provide for discounted pipeline capacity charges for such shippers and exempt them from potential cost increases in the current El Paso rate proceeding. Additionally, the other shippers on El Paso's system, including APS, may have to bear some or all of the cost burden for large blocks of unsubscribed capacity formerly held by California shippers, as well as the revenues lost by El Paso due to the discounted contracts with California shippers.

A fundamental difference in the circumstances of California shippers and Arizona shippers is that California shippers have a diversity of supply options beyond El Paso, from instate production to the recently expanded Kern River pipeline accessing Rockies gas, to the Pacific Gas Transmission pipeline accessing Canadian gas, to the likely introduction of LNG supplies into the California market in the near future. Most Arizona shippers, including APS, do not currently have such supply options. It is no coincidence that Arizona shippers have not been offered capacity discounts by El Paso as California shippers have, but rather stand to likely pay for those California discounts. It would appear that one of FERC's charges is to protect captive shippers such as Arizona shippers from having to pay for the discounts given to more advantageously situated shippers such as SoCal and PG&E. Whether such protection will in fact be afforded to Arizona shippers in the current El Paso rate proceeding or in future FERC proceedings is yet to be determined.

One benefit of the introduction of interstate pipeline service into central Arizona by a competitive pipeline is that it will diversify the risk of adverse regulatory rulings at FERC for Arizona. Due to the dominant position of El Paso in Arizona currently, an adverse regulatory ruling in regard to El Paso's pipeline system can have an enormous impact on Arizona natural gas service. To the extent Arizona shippers take service from multiple pipeline companies or future storage providers, the potential impact of adverse regulatory rulings on any one pipeline system is lessened.

Realistically, Arizona will always be dependent to a significant degree on El Paso and its considerable lateral system for natural gas service in Arizona. However, construction of a competing pipeline into central and/or southern Arizona would provide at least a modicum of potential pipeline competition for El Paso and would make it more difficult for El Paso to look to captive Arizona customers to cover the costs of discounted contracts for California shippers.

### **Arizona's Competitive Position in the Southwestern Natural Gas Market**

An important but difficult to quantify factor in evaluating a possible new market entrant such as the Transwestern Project is what the value of having pipe-on-pipe competition is in a given market area. Many major markets in the United States have multiple pipelines servicing them and over time shippers have some level of flexibility to shift their pipeline service from one pipeline to another. Under the current approach to pipeline regulation at FERC, markets which have the ability to take service from multiple pipelines are at a significant advantage to those

who have a single monopoly service provider, despite assurances that captive shippers will be afforded protections against the exercise of market power.

A prime example of such an advantage is the recent signing of discounted pipeline capacity contracts by El Paso with SoCal and PG&E. These contracts both provide these shippers with below tariffed rate discounts, and largely shield them from the negative impacts of El Paso's on-going rate proceeding at FERC. These California utilities have multiple pipeline options, enhanced by the recent Kern River Pipeline expansions and looming LNG imports. Therefore, they have some ability to take service from providers other than El Paso. In contrast, Arizona shippers have not received such discounted contracts from El Paso, likely because Arizona shippers in central and southern Arizona currently have no pipeline options, but rather must take all their service from El Paso. Further, it can be expected that the revenues lost by El Paso through the discounts to the California shippers will likely land on the shoulders of Arizona shippers who have no ability to avoid them. While such action by FERC is not certain, El Paso is unlikely to willingly swallow the revenue loss from California, but rather will look to recoup such revenues from other shippers, including the largely captive Arizona market. Arizona is always likely to be at some level of disadvantage to California in regards to natural gas supply diversity, but expansion of a competing pipeline in Arizona, along with other infrastructure developments and possible LNG import impacts stand to potentially enhance and diversify Arizona's natural gas infrastructure and supply options.

The ability of California shippers to receive discounts from El Paso and the lack of such discounts for Arizona shippers is a stark example of the impact of diversified pipeline options for shippers. Staff believes that the benefits of pipe-on-pipe competition would be far from inconsequential and should be an important factor in considering pre-approval of Arizona utilities acquisition of capacity on a potential new pipeline in Arizona. The opportunity to bring some level of pipe-on-pipe competition to the central Arizona market is significant and of long-term importance. The proposed Transwestern pipeline project represents such an opportunity to bring pipeline competition to central Arizona.

Another potential benefit of the Transwestern project is that it could eventually lead to the establishment of a new pricing point in central Arizona for natural gas spot market prices and other pricing instruments. Such market centers often form where multiple pipelines interconnect, possibly with gas storage in the area. A benefit of such a market center formation would be that Arizona entities would have the opportunity to buy and sell and hedge gas at a price that is more closely reflective of their local market conditions. If a natural gas storage facility is built in central Arizona, the Transwestern line could potentially interconnect with such a facility, providing further options for APS and other Arizona shippers to manage their natural gas supplies.

### **Impact on Arizona's Access to Natural Gas Supplies**

The Phoenix Project would significantly increase APS' and Arizona's access to the San Juan supply basin in northwest New Mexico and indirectly to growing and prolific Rocky Mountain production areas in Colorado and Utah, north of the San Juan basin. One result of the

end of full requirements service for Arizona shippers and the resulting pipeline capacity allocation is that Arizona shippers' access to the San Juan basin was noticeably reduced. On a contractual basis, APS estimates that its contract volumes are currently 58 percent San Juan gas and 42 percent Permian gas. The addition of the Transwestern capacity is anticipated to shift this balance to 75 percent San Juan gas and 25 percent Permian gas. As discussed elsewhere, given that San Juan gas is typically cheaper, such a shift likely represents a savings to APS on its commodity costs.

Looking at a total physical delivery capability basis of the existing interstate pipeline infrastructure in the Southwest, there is currently much more physical pipeline delivery capability into central and southern Arizona from the Permian basin, via El Paso's southern system, than there is from the San Juan basin via the Maricopa lateral, the Havasu crossover, and El Paso's Line 1903 project. Addition of the Transwestern project to the Southwest's infrastructure would provide an additional avenue for San Juan gas to enter central and southern Arizona. Even with the addition of the Transwestern project, there would be more physical delivery capability from the Permian basin, but the balance of physical capacity from the two basins would be much closer, enhancing the diversity of possible supplies coming into central and southern Arizona.

### **Considerations Regarding El Paso's Current Rate Proceeding Before FERC**

As has been the case for a number of years, there is currently a good deal of uncertainty regarding important service issues on the El Paso pipeline system. The current El Paso rate proceeding before FERC encompasses many of these uncertainties. El Paso has put forward a variety of proposals in the rate proceeding which, if adopted, will greatly change the operation of its pipeline in the Southwest and will both increase cost and reduce operational flexibility for Arizona shippers, and particularly electric generators such as APS. Major issues in the rate proceeding (beyond typical rate case issues such as cost of service, etc.) include existence and structure of a short haul rate, the need for and design of a variety of potential new services El Paso has proposed, El Paso's proposal to shift from monthly balancing to daily and hourly balancing and associated penalty provisions, El Paso's proposals regarding delivery codes (D-Codes) and related delivery issues, pressure guarantees, applicability of Section 11.2 provisions from the 1996 settlement agreement, restrictions on FT-2 service, and other issues. Some of these issues are currently under consideration by FERC in the technical conference phase of the rate case, while others will be considered in the upcoming hearing phase of the rate case.

FERC has held two technical conferences, and El Paso has held shipper meetings to discuss how El Paso's proposals would work and possible changes to such proposals. El Paso has made some changes to its proposals in response to shipper discussions, but many shippers have indicated a continued high level of concern regarding El Paso's proposals and also some level of continued difficulty in understanding how things would work under El Paso's proposals. The sheer complexity of the many proposals in total and how they would impact all the contracts and volumes shippers hold on the El Paso system creates both uncertainty and an expectation that it will be more difficult for a shipper to operate on the El Paso system. For example, hourly and daily balancing within tight operating bounds would make it challenging for an electric

generator such as APS to avoid penalties while adjusting to changing electricity demand and operational needs on its system. Some of these issues reflect larger national discussions taking place at the North American Energy Standards Board (NAESB) and in other forums. It is possible that an end result of El Paso's rate proceeding could be that APS will be forced to seek additional pipeline capacity to maintain its current quality and quantity of service from El Paso.

The continued uncertainty regarding service on the El Paso system contrasts with the opportunity to largely define specific costs and operating conditions on the Transwestern system for the 15-year length of APS' contract with Transwestern. For example, APS can lock in a fixed reservation rate for the 15-year period with Transwestern, while on El Paso it is far from clear what will happen to El Paso's rates over the next 15-year period. Regarding balancing, Transwestern would allow APS to balance monthly with a ■ percent tolerance. This is in marked contrast to El Paso's much more stringent proposals to have hourly balancing within 100 dth/hr and daily balancing within 2000 dth/day, possibly for each of the many contracts APS would have with El Paso. Even if El Paso's proposals are not adopted by FERC, it appears likely that operating conditions on El Paso's system over the next 15 years will not likely provide the same level of flexibility as the Transwestern project would provide APS. The basic certainty of knowing service conditions, particularly if they are more favorable, for a long period of time is valuable to APS both in terms of current operations and in planning for the future. Such certainty may develop on El Paso's system in the future, but then again, El Paso's system has often seen much contention for many years and it is never clear when California shippers may take further action to upset El Paso's system with another capacity turnback or other action. Because the Transwestern Phoenix Project does not continue on to California, it is much less subject to actions taken by California parties.

In the on-going El Paso rate case before FERC, various parties, including the ACC, APS, and Transwestern, have raised concerns regarding certain actions by El Paso in the proceeding that may have anti-competitive impacts in Arizona. Issues include El Paso's elimination of its short-haul rate, the bundled nature of the proposed new services El Paso has proposed, and El Paso's elimination of its backhaul service. These matters remain to be resolved by FERC. Uncertainty regarding how and when these issues will be resolved by FERC has created a more difficult environment in Arizona for infrastructure developers other than El Paso. For example, El Paso's elimination of the short-haul rate in Arizona and failure to offer a reasonably priced alternative makes it very difficult for gas flowing on any pipeline other than El Paso's to be reliably delivered to the many end-users fed through El Paso's extensive Phoenix lateral system as well as customers served through other laterals in Arizona.

### **Pipeline Service Reliability**

Regarding reliability of pipeline service, Staff does not believe there are any major disparities in pipeline service reliability between service from the proposed Phoenix Project in comparison to service from El Paso. Transwestern's proposed project would use multiple pipes from the San Juan basin to the Ashfork area and would use a single line from Ashfork into



The specific cost components APS is seeking pre-approval of recovery for are the reservation charge, volumetric variable usage rate, miscellaneous surcharges, and fuel and lost and unaccounted for gas. For the reservation rate, the agreement contains a number of options APS may choose at it sees fit in determining what its reservation rate will be on Transwestern. The first option is to pay a fixed [REDACTED] per dth rate for receipt on the San Juan lateral for the 15-year term of the contract. This appears to be the most likely option for APS at this time, as it provides for access to lower priced San Juan gas. A second option is APS could choose to pay a fixed [REDACTED] per dth rate for receipt on the portion of Transwestern's pipeline which is East-of-Thoreau. This would in effect enable APS to switch its receipts from the San Juan basin to an area further east such as the Permian basin if APS so wished. Further, at the time the Phoenix Project would go into service, APS could opt to take service at the reservation rate established by FERC as it varies over time. Or at the in-service date APS could take service at a negotiated rate that would be fixed at the initial reservation rate established by FERC. APS can choose between these various rate options at the time it initiates service with Transwestern.

[REDACTED]

The precedent agreement contains a variety of termination rights for both APS and Transwestern if either party fails to take certain actions or meet certain criteria. Of note, one provision enables APS to terminate the precedent agreement if "the Arizona Corporation Commission has not issued an order on or prior to [REDACTED] authorizing the recovery by Shipper for ratemaking purposes of the costs to be incurred by Shipper under the Transportation Agreement." Staff believes that the end of [REDACTED] deadline does not create any timing difficulties for processing APS' application unless some form of major disruption to the normal flow of the proceeding were to occur. Another termination provision gives Transwestern the right to terminate the agreement if APS "fails, at any time during the term of this Expansion Agreement, to demonstrate and maintain creditworthiness in accordance with the provisions set forth on Attachment B." Additionally, if APS fails to maintain creditworthiness, APS could be responsible for a share of costs incurred by Transwestern up to the time of termination of the Project.

**APS Natural Gas Generating Capacity and Pipeline Capacity**

APS' generation mix has shifted noticeably in recent years, with natural gas-fired generation reflecting a greater portion of total generation capacity. APS' current generation mix includes the following megawatts (MW) for each type of generation: coal – 1,731 MW; oil – 70 MW; natural gas – 3,214 MW; nuclear – 1,127 MW; and wind/other – 4 MW. As APS's reliance on natural gas has grown, its portfolio of pipeline capacity has grown to meet its needs. In the 1996 El Paso rate case settlement agreement, APS' billing determinant on the El Paso system was set at 66,042 dth/day. While this was a negotiated number not directly reflecting APS' specific capacity needs at the time, it nevertheless is generally reflective of the fact that in the mid-1990s, APS' natural gas demand was relatively small in comparison to later years. By comparison, the monthly volumes APS currently holds on El Paso, largely reflective of the capacity reallocation proceeding at FERC which culminated in 2003, are much higher, as shown in the table below.

[REDACTED]						
[REDACTED]						
[REDACTED]						
[REDACTED]						

APS' current potential maximum daily natural gas consumption by generating station is shown below.

Generating Station	[REDACTED]
West Phoenix	[REDACTED]
Redhawk	[REDACTED]
Saguaro	[REDACTED]
Sundance	[REDACTED]
Ocotillo	[REDACTED]
Yucca	[REDACTED]
Total	[REDACTED]

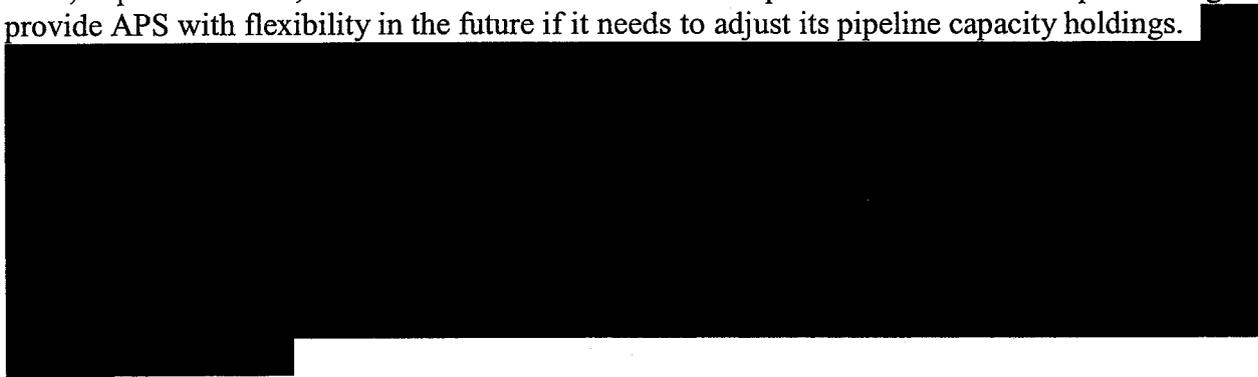
Note: 1 MMcf/day equals approximately 1,000 dth.

APS' total natural gas burns in 2004 and 2005 and projected gas burns for 2006-2010 are shown in the table below.

Year	Historic/Projected Annual Gas Burn (dth)
[REDACTED]	[REDACTED]


APS' peak daily burn in 2005 was [REDACTED], and APS projects its peak day burn to increase to [REDACTED] in 2009. Thus both APS' total annual burn and peak day burn are expected to grow significantly, highlighting APS' growing need for pipeline capacity to ensure reliable delivery of fuel to its natural gas-fired power plants.

The significant projected growth in natural gas consumption by APS, highlighted in the tables above, indicates that APS will need additional pipeline capacity to meet its natural gas needs in the coming years. APS' full requirements contract with El Paso contained step-down rights which allowed APS to step-down its pipeline capacity amount with El Paso in August 2006, September 2008, and at the end of the contract in September 2013. Such step-down rights provide APS with flexibility in the future if it needs to adjust its pipeline capacity holdings.



Since the conversion of full requirements customers to contract demand customers in September 2003, APS and other East-of-California shippers have not signed new contracts reflecting the conversion, due to a number of factors, including disagreement with El Paso on various contract terms. It is unclear whether terms and conditions of a new contract with El Paso would impact APS' currently held step-down rights.

**Cost Analysis of Transwestern Service to APS**

APS' application contains a comparison of the cost of taking service from Transwestern compared to the cost of taking service from El Paso in 2009 and 2015. The discussions herein will focus on the 2009 projected costs, as the 2015 projected costs are quite similar to those in 2009. APS analysis shows that the reservation charge cost is higher with Transwestern, but the commodity cost is lower with Transwestern, resulting in an overall projected cost with Transwestern which is slightly higher, by less than one percent annually. Given the scope of the projected costs, over \$300 million annually, the projected costs of service on El Paso and

Transwestern are virtually the same. Appendix B in this report contains a sensitivity analysis if a number of parameters on the cost comparison are adjusted to reflect changed conditions.

As with any projection, APS' projections in this proceeding are based upon a variety of assumptions. APS' projections compare El Paso's proposed rates in its on-going rate proceeding before FERC to the reservation rate and fuel rate contained in the APS agreement with Transwestern and the variable rate contained in Transwestern's current tariffs. Regarding El Paso's rates, use of the proposed rates in the current rate proceeding appears to be the best available information regarding what the cost of service on El Paso's pipeline may be in future years.

The table below provides a comparison of the various rate elements between El Paso and Transwestern.

Rate Element	Proposed El Paso Service	Transwestern Service
Reservation Charge (\$/dth)		
Volumetric Rate (\$/dth)		
Fuel Rate		
Surcharges		

In the comparisons of costs, the commodity cost dwarfs the other costs to be incurred on either El Paso or Transwestern. Of the approximately \$300 million in total costs, \$270 million, or 90 percent, are for commodity costs. The table below shows the cost comparisons provided by APS for 2009 and 2015 for taking service from either Transwestern or El Paso.

2009 Scenario	Fixed Costs <sup>4</sup>	Variable Costs <sup>5</sup>	Commodity Costs	Total Costs
El Paso			\$271,616,101	\$303,261,705
Transwestern			\$267,887,832	\$305,268,984
Difference			-\$3,728,269	+\$2,007,279 (+0.66%)

2015 Scenario	Fixed Costs	Variable Costs	Commodity Costs	Total Costs
El Paso			\$277,114,373	\$309,036,109
Transwestern			\$272,576,168	\$310,176,799
Difference			-\$4,538,205	\$1,140,690 (+0.37%)

<sup>1</sup> APS may opt for one of the other reservation rate options contained in the precedent agreement

<sup>2</sup> GRI refers to the Gas Research Institute (now known as the Gas Technology Institute). This surcharge has been phased out and should not be in effect by the time the Transwestern project becomes operational.

<sup>3</sup> ACA refers to the annual charge assessment, which is the FERC regulatory assessment

<sup>4</sup> Includes the reservation charge

<sup>5</sup> Includes the volumetric rate, the fuel rate, and applicable surcharges.

Therefore any difference in commodity costs between service from El Paso and Transwestern would play a very important role in assessing the comparative costs of the two projects. In APS' projections, it assumes that additional pipeline capacity from El Paso would access the Permian basin, while the Transwestern project would provide access to the San Juan basin. While APS theoretically could acquire some amount of San Juan access on El Paso's system in the future, historically San Juan access has been highly valued, and it does not appear likely that any substantive amount of San Juan capacity will be available for APS to pick up on a long-term basis in the near future. When capacity is turned back to El Paso, it is typically Permian capacity, such as the current turn back taking place where Southern California Gas is turning back Permian capacity but keeping San Juan capacity. It is possible El Paso could also build additional access from the San Juan basin to the Phoenix area, but Staff is not aware of any such El Paso project and in recent years, El Paso has pursued other options, such as Line 2000 and Line 1903 to add increased pipeline capacity in Arizona. Therefore, Staff believes comparing Transwestern's San Juan access to El Paso Permian access is a reasonable way of comparing possible service on the two pipelines in the future.

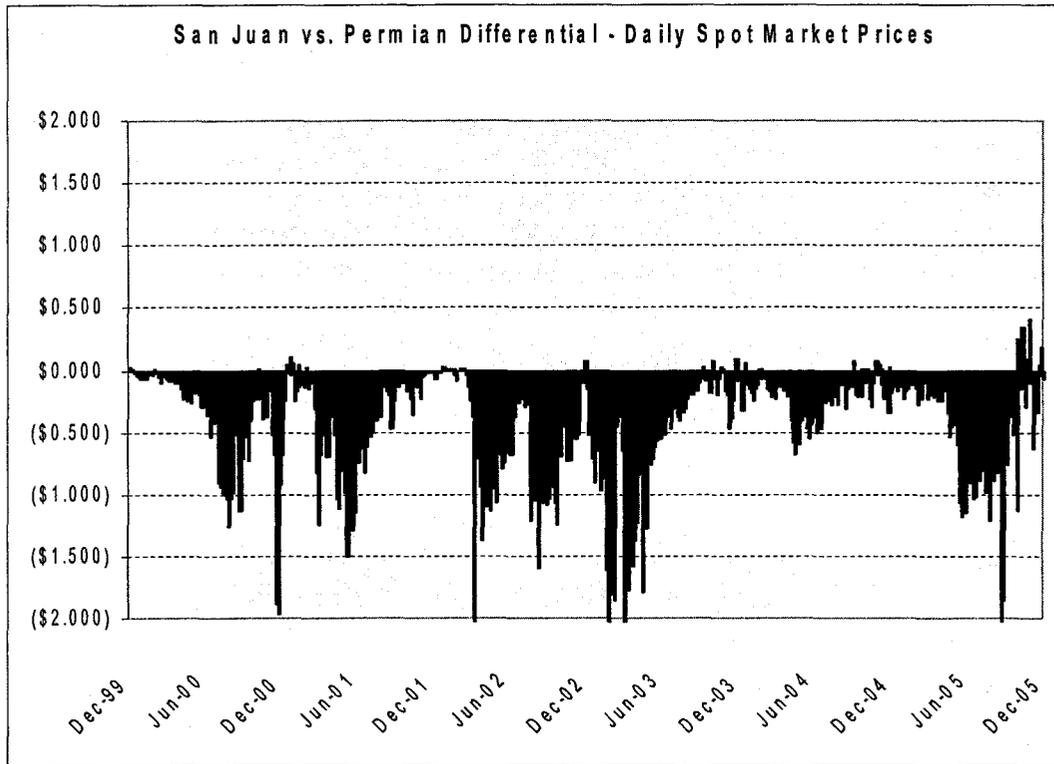


The average difference in daily spot market prices between the San Juan and Permian basins in recent years is shown in the table below:

Year	2000	2001	2002	2003	2004	2005
Differential \$/dth	\$0.315	\$0.329	\$0.416	\$0.510	\$0.165	\$0.356

Source: Gas Daily

The chart below shows the daily spot market price differential (\$/dth) between the El Paso – Permian Basin and El Paso – San Juan Basin pricing points in recent years. While the future difference in prices between the two basins is unknown, San Juan gas appears to be remaining the lower priced natural gas option most of the time. Negative numbers indicate that San Juan gas is cheaper than Permian gas.



Source: Gas Daily

It is true that when new pipelines are built into a supply area, there may be some reduction in the differential between that supply area and other supply areas, as the new pipeline creates an additional outlet for natural gas supplies from the given supply area. Thus, the very construction of the Transwestern project may result in some additional competition to purchase San Juan gas, possibly impacting the basin differential between San Juan and Permian gas. However, other expansions into the San Juan basin have been undertaken in the past, and the San Juan basin has continued to generally exhibit lower prices than the Permian basin. Staff believes that the \$0.10 per therm differential employed by APS is reasonable and relatively conservative. As shown in Appendix B, if the differential in APS' cost comparisons is expanded to [REDACTED] per therm, the total cost for service on Transwestern is actually projected to be less than for service on El Paso.

Further sensitivity analysis contained in Appendix B varied El Paso costs in the future, the level of natural gas prices, and the level of utilization of APS' proposed contract volume on the Transwestern project. While variation in these other factors altered the cost balance between El Paso and Transwestern modestly in certain cases, for the most part such variations did not approach the impact of the basin differential. The only cases where such variations approached the impact of the basin differentials is if El Paso's rates were either significantly higher or lower than those proposed by El Paso in its current rate proceeding. Staff believes that regarding El Paso's rates, there is likely to be more upward pressure than downward pressure, given upcoming capacity turnbacks from California, likely higher pipeline maintenance costs, higher right-of-way costs over tribal lands, and other factors.

In El Paso's filing for intervention, El Paso discusses the "premium" that APS would pay for service on Transwestern in comparison to service from El Paso. In a narrow sense El Paso is

correct, as APS will likely pay more for its fixed reservation charges to Transwestern in comparison to the reservation charges it would pay El Paso for similar service. However, the reservation charge cannot be viewed in isolation. The totality of costs related to service from either Transwestern or El Paso must be considered, including the very significant commodity costs and other pipeline-related charges. Taken as a whole, it is far from clear whether the total pipeline and commodity costs related to service from Transwestern would contain any "premium" or whether APS may actually save money by taking service from Transwestern. Further, one of the express purposes of the Commission's December 18, 2003, policy statement on natural gas infrastructure was to encourage Arizona utilities to consider natural gas infrastructure projects that might not have the lowest up-front cost, but for other reasons might be considered preferable for the long-term public good in Arizona or might reduce costs over a longer time frame.

In summary, given the relative similarity of the projected costs for APS to take service from El Paso or Transwestern, intangible benefits, such as the introduction of pipeline competition into central Arizona, weigh heavily in deciding whether pre-approval is warranted in the proceeding.



#### **APS Method for Recovering Transwestern Costs**

The Transwestern costs proposed for recovery are standard pipeline service related costs. APS currently recovers its costs related to pipeline service from El Paso via its base rates and power supply adjustor (PSA) mechanism. APS' costs related to taking pipeline service from Transwestern should be recovered in the same manner, through the base rates and PSA or whatever mechanism is used in the future by APS to recover pipeline service costs. APS would not incur costs for service on Transwestern until APS would begin to take service from Transwestern, likely sometime in 2008 based upon current projections, so Staff believes such costs would not likely begin to be passed along to APS customers until possibly 2009.

#### **Right-of-Way Issues and Construction of New Pipelines in Arizona**

Siting a major new pipeline in Arizona requires the securing of many miles of right-of-way access and given the many entities which hold land in Arizona and numerous potential restrictions, it can be difficult to secure the necessary right-of-way to construct new

infrastructure in Arizona. The Transwestern project would require right-of-way in fast-growing areas, including in the Prescott and Phoenix metro areas. It appears that Transwestern should be able to secure the necessary right-of-ways to move forward with the Phoenix lateral. However, if for some reason this Transwestern project does not move forward or is delayed significantly, it will become increasingly difficult for Transwestern or another entity to secure the necessary right-of-way access to build a new pipeline into central Arizona, due to growing encroachments from development. APS has indicated that it believes the ability to site a new pipeline will be significantly diminished in the near future and that it may become impractical or economically prohibitive in the coming years to build such a new pipeline. While not a compelling reason to approve APS' application in and of itself, the increasing difficulty of siting infrastructure does indicate there is some benefit in moving forward with such a project in a timely manner.

### **Comments and Filings by Interested Parties**

Apart from the applicant, two parties, Transwestern and El Paso, have made filings in this docket. On January 9, 2006, Transwestern filed comments supporting APS' application for pre-approval. Transwestern states that it believes the proposed Phoenix project would provide APS and other shippers with a variety of benefits, including market diversification, improved access to gas supplies, pipeline competition, flexible and competitively priced service, guaranteed delivery pressures, hourly flow flexibility, and rate options. Transwestern also requests that the Commission give APS' application timely consideration given the various time constraints Transwestern faces in moving forward with the project.

On January 13, 2006, El Paso filed for intervention in this proceeding. El Paso indicates in its application that the Commission's action on APS' application could impact El Paso in a variety of ways, including its planning and development of infrastructure in Arizona. El Paso indicated that it does not believe its involvement in this proceeding would broaden or unduly delay this proceeding. El Paso's filing for intervention raises issues it believes the Commission should consider in evaluating APS' application. El Paso cites a number of provisions in the Commission's December 18, 2003, Policy Statement Regarding New Natural Gas Pipeline and Storage Costs. El Paso also expresses concerns regarding a possible premium APS might pay for service from Transwestern in comparison to service that El Paso could provide.

El Paso also expresses an interest in acquiring information that was redacted from the publicly filed version of the precedent agreement between APS and Transwestern. El Paso indicates that it wishes to acquire such information to provide its own assessment of APS' application for pre-approval. El Paso is an important player in Arizona natural gas markets and Arizona's natural gas infrastructure. Staff believes that in general El Paso's participation in Commission matters related to natural gas infrastructure is positive and helpful and should be encouraged. The difficulty in this proceeding is that El Paso wishes to have access to confidential, competitively sensitive information regarding an agreement between a shipper who currently takes all of its service from El Paso and a prospective pipeline which would enter a market where El Paso is currently the only interstate pipeline. While El Paso certainly has every reason to take an interest in this matter involving a potential competing pipeline in central Arizona, it must be taken into consideration that El Paso has a vested interest in not seeing

competitors enter markets where currently El Paso is the monopoly service provider. It does not seem to be reasonable to expect Transwestern to allow an incumbent competitor access to the confidential terms, conditions, and details of the agreement Transwestern entered into with a potential shipper, in this case APS. Staff does not believe El Paso's lack of access to confidential information related to the APS-Transwestern agreement will materially impact the Commission's ability to assess the veracity of APS' application. As part of Staff's analysis in this case, Staff has carefully considered the issues El Paso identifies in its application to intervene.

### **APS' Application as Part of the Broader Scope of the Transwestern Project**



### **The Commission Notice of Inquiry on Natural Gas Infrastructure**

On April 15, 2003, the Commission initiated its Notice of Inquiry (NOI) on natural gas infrastructure, issuing a list of questions to solicit input from interested parties. A total of 20 parties provided responses to the NOI questions. On September 10, 2003, the Commission held a workshop regarding the NOI on natural gas infrastructure. Prior to the workshop, Commission Staff had circulated a strawman proposal for discussion at the workshop. Following the September 10, 2003, workshop, the Commission solicited an additional round of comments from interested parties regarding the strawman proposal and other issues discussed at the workshop. Comments were received from 17 parties following the September 10, 2003, workshop.

On December 18, 2003, the Commission issued its Policy Statement Regarding New Natural Gas Pipeline and Storage Costs. In this document, the Commission made specific policy statements about supply/infrastructure diversity, supply/infrastructure planning, the Commission approach to new infrastructure projects, the general Commission approach, individual utility circumstances, and reporting.

The policy statements included in the December 18, 2003 document, are as follows:

### **I. Supply/Infrastructure Diversity**

- 1. Diversity in Arizona's natural gas infrastructure, including interstate pipeline facilities, natural gas storage facilities, and related aspects of natural gas service, 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 consider 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.*

### **II. 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 voluntary 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.*

### **III. 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.*

### **IV. 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 encourage utilities to file applications, including requests for alternate cost treatment, in order that the Commission can consider specific requests for cost recovery proposals appropriate to the circumstances for each individual application.*

### **V. 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.*

### **VI. Reporting**

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.*

The document also discusses the Commission's consideration of alternate cost recovery methods, such as pre-approval, as well as the way such costs have traditionally been considered and that the traditional method is the preferred way.

On February 13, 2004, the Commission held another workshop regarding the NOI on natural gas infrastructure. Topics of discussion at the workshop included Arizona natural gas infrastructure issues, updates on pending pipeline and gas storage projects, and the National Petroleum Council study, *Balancing Natural Gas Policy: Fueling Demands of a Growing Economy*, which was issued in September 2003.

Previously both APS and Southwest Gas made pre-approval filings related to Kinder Morgan's proposed Silver Canyon pipeline project with the Commission in Docket Nos. G-01551A-04-0192 and G-01345A-04-0273. In Decision Nos. 67091 (June 29, 2004) and 67239 (September 15, 2004), the Commission approved the Southwest Gas and APS applications respectively, subject to a number of conditions.

### **What Does Pre-approval Mean and Why Pre-approve?**

APS' application in this matter specifically requests Commission pre-approval of the costs identified in the application for recovery. As stated in the December 18, 2003 Commission Policy Statement Regarding New Natural Gas Pipeline and Storage Costs:

"Traditionally Arizona entities have not sought and the Commission has not granted pre-approval of cost recovery from participation in infrastructure projects or other projects. Rather utilities made their own business decisions on those projects. At a later time the Commission addressed cost recovery in proceedings such as rate cases and adjustor mechanisms. One important reason for this traditional approach has been to ensure that the Commission has a full opportunity to evaluate the actions taken and costs incurred by the utility for prudence and in the best interest of Arizona's utility consumers. This approach provided incentive to utilities to pick the most cost-effective project. This traditional approach to utility participation in infrastructure projects, including natural gas pipeline and storage projects, is still available to utilities that wish to continue using this method."

While the traditional method should still be the standard way to address participation in such infrastructure or other projects, the unique and extraordinary circumstances present in Arizona's natural gas infrastructure at this time support Commission consideration of new methods which may enhance the state's ability to address natural gas infrastructure concerns in a more timely manner.

One concern that is expressed at times regarding the traditional method is that a utility will have a strong inclination to always pick the least cost option because it is often considered

the easiest to justify in the future when the Commission scrutinizes its actions, even if there are strong considerations which indicate that an option other than the least cost option may be a reasonable and viable course of action. Recognizing that each case must be measured on its own merits, there certainly are cases where less tangible benefits may be substantial and outweigh a higher cost, at least in the short term. One can argue that such a case currently exists in considering the development of Arizona's natural gas infrastructure.

For example, it is widely recognized in the natural gas industry that having competition between multiple pipelines to serve a given area is a positive benefit. This harks back to basic economics as a seller of a good in a market with no competitors is not likely to have the same motivation to reduce the price of the good as that seller would have if there was one or more other competing sellers of the same good in the same market. Applying this reasoning to the Southwestern natural gas market, one could make the argument that El Paso does not have the same motivation to reduce the cost of service to its Arizona shippers (with no pipeline competition in Arizona) as it does to reduce the cost of service to its California shippers (who have multiple pipeline options, including the recently concluded expansion of the Kern River pipeline). The introduction of another pipeline to central and southern Arizona, such as the Transwestern pipeline, would introduce at least some level of pipeline competition to the major Arizona markets.

Certainly, utilities may choose to pursue other pipeline options absent pre-approval of such actions, but taking such action is likely more difficult in the current market with so much uncertainty. Also, it would appear that the financial difficulties being experienced by many entities in the energy business would lessen the industry's appetite as a whole to participate in new infrastructure projects, even if they are needed and beneficial. Given the unique circumstances and needs of the Arizona natural gas market at this time, providing properly conditioned pre-approval in the current circumstance could provide an additional incentive for Arizona utilities to participate in infrastructure projects which at least on an up-front cost basis may appear more costly than the existing infrastructure option.

APS' application specifically requests pre-approval for recovery of the reservation charges, volumetric rate, fuel rate, and applicable surcharges associated with the Transwestern project. Other potential costs APS could incur are not being considered for pre-approval in this proceeding. Pre-approval in this case would reflect Commission approval to recover those previously identified specific costs for the 15-year period of the initial contract with Transwestern. Such costs would not begin to be incurred until such time as the pipeline project is built and APS begins taking service through the pipeline, currently projected to be in 2008. APS is currently incurring similar pipeline capacity costs for its pipeline capacity on the El Paso system. As a general principal, pipeline capacity costs on different pipelines should be recovered in a similar manner to avoid providing an artificial incentive to favor pipeline capacity on one pipeline over another.

However, while pre-approval would provide for the recovery of these costs to ratepayers, it would not in any way reduce the Commission's ability to determine the prudence of the operation and use of APS' pipeline capacity rights, whether on the Transwestern pipeline or other pipelines. APS still has a standing obligation to maximize the value of all its pipeline

capacity assets for the benefit of the APS ratepayers who pay for the capacity. So if the Commission in the future determined that APS had not prudently managed its Transwestern or other pipeline capacity, it could take action to disallow such costs, just as the Commission can do with APS' present pipeline capacity.

It should be noted that even if the Commission provides pre-approval of APS' participation in the Transwestern project, the project, for a variety of reasons, could still end up not being constructed. However, it does appear that Commission pre-approval would positively impact the Transwestern project's likelihood of moving forward.

## **APS' Participation in the Transwestern Project in Light of the Commission's December 18, 2003 Policy Statement**

The Commission's December 18, 2003 policy statement addressed a number of policy issues related to new natural gas infrastructure in Arizona. This section of the Staff Report considers how APS' application conforms to the Commission's December 18, 2003 policy statement.

Section one of the policy statement addresses supply/infrastructure diversity. APS' Transwestern capacity would provide additional natural gas infrastructure diversity, would enhance Arizona's access to San Juan and Rockies gas, and would help reduce the current monopoly pipeline service situation existing in central and southern Arizona.

Section two of the policy statement addresses supply/infrastructure planning. APS' participation in the Transwestern project does represent an effort to undertake long-term planning for APS' natural gas needs, recognizing that a great deal of uncertainty exists regarding pipeline service in the Southwest in the coming years.

Section three of the policy statement addresses the Commission's approach to new infrastructure projects. As previously noted, the Commission in this proceeding is in no way providing a specific endorsement of the Transwestern pipeline project in comparison to other projects, but is rather assessing the individual circumstances represented in APS' filing.

Section four of the policy statement addresses the general Commission approach. APS' application is consistent with the Commission's indication that it would consider specific requests by utilities for cost treatment of new infrastructure costs.

Section five of the policy statement addresses individual utility circumstances. APS' application is reflective of the individual pipeline capacity and service needs of APS and its customers through such features as seasonal capacity focused on summer cooling season months as well as daily operational flexibility.

Section six of the policy statement addresses reporting requirements. APS has indicated a willingness to provide information to the Commission regarding its Transwestern capacity.

In summary, APS' filing addresses a number of the policy issues which the Commission's December 18, 2003 policy statement identifies for Arizona energy consumers.

## **Impact of Pre-approval on APS' Level of Risk**

APS, as a public service corporation providing electricity service in Arizona, is subject to a variety of risks as it conducts its business. As a general principal, utilities such as APS attempt to reduce the level of risk they face, as a reduced risk level is looked upon favorably for a variety of reasons. APS' risk is typically one factor which is considered in certain Commission proceedings, including general rate proceedings. Pre-approval of the cost of acquiring a given asset, would seem to shift some level of risk from the Company to the ratepayers. In this case, if the Commission grants pre-approval of APS' acquisition of Transwestern capacity, it would seem to reduce APS' risk in relation to this particular asset. The question of what this apparent reduction of risk means to APS' overall level of risk is a more difficult question, as APS faces a variety of different risks, both in its gas supply acquisition activities, and in various other segments of its business. APS has indicated that it does not believe that Commission pre-approval of the acquisition of Transwestern capacity has a discernable impact on APS' level of risk. Whether there is a discernable impact on APS' risk and if so, what the proper treatment of the shift in risk would be are issues which are more properly considered in future APS rate proceedings, when risk and other matters are considered in setting APS' rates. In such future rate proceedings, all parties can review this issue and make recommendations as to the proper treatment of any shift of risk resulting from Commission pre-approval in this proceeding. Therefore, Staff recommends that any effect pre-approval of this project may have on APS' risk be determined in a future rate proceeding.

## Conclusions and Recommendations

There is little doubt that APS' consumption of natural gas for electric generation will continue to grow and that APS will need to acquire additional pipeline capacity to ensure reliable fuel supplies for its natural gas-fired power plants. The primary options for such additional capacity are to acquire more pipeline capacity as it becomes available on the El Paso system or to contract with a new pipeline developer such as Transwestern. The proposed Transwestern project provides a number of benefits to APS, including greater supply diversity, a competitive pipeline in central Arizona, the potential formation of a market center in Arizona, a good deal of operational flexibility, and a good measure of rate and operational certainty. The risk of paying higher costs from taking service from Transwestern instead of El Paso is relatively limited and could swing the opposite direction if the basin differentials of recent years continue. Staff believes that there is a strong potential that over time that the cumulative effects of the construction of the Transwestern pipeline could actually lead to lower overall natural gas costs for APS, benefiting the utility's customers.

Given the comparability of total costs from taking service from El Paso or Transwestern, Staff believes that the many other benefits of the Transwestern project, both tangible and intangible, argue strongly for Commission pre-approval of cost recovery for APS' participation in the Transwestern project as outlined in APS' application and discussed herein. APS acquisition of capacity on the Transwestern project addresses a number of policy goals contained in the Commission's December 18, 2003 policy statement. The end result of construction of the Transwestern project would be a more vibrant, more diverse, more competitive natural gas infrastructure in Arizona which would benefit APS. Such developments would also benefit other central Arizona shippers including local distribution companies, municipal utilities, incumbent electric utilities, merchant power generators, and end-users.

Staff believes that APS' participation in the Transwestern project is reasonable given the information available at this time. Staff recommends that the Commission pre-approve APS' specific costs (reservation charges, volumetric rate, fuel rate, and applicable surcharges) discussed herein related to the proposed Transwestern pipeline project, subject to the conditions listed below.

### Proposed Conditions to Pre-approval:

1. The Commission retains full authority to review APS' gas procurement activities, including its management of all pipeline capacity and related activities, recognizing that the Commission is pre-approving the underlying acquisition of the Transwestern capacity during the initial 15-year term of the agreement with Transwestern. The pre-approval being granted in this proceeding would expire upon completion of the initial 15-year term.

2. The impact, if any, on APS' risk profile resulting from pre-approval of costs related to Transwestern Phoenix Project capacity would be considered within the context of future APS rate proceedings.
3. APS shall file a status report on the Transwestern Phoenix Project and APS' participation in the project with the Commission every six months until either APS begins taking service from Transwestern or APS' participation in the project is terminated.
4. APS shall notify the Commission, within ten days of when the exact volumetric and fuel rates, applicable for APS when APS begins service with Transwestern, are set for the Transwestern pipeline.
5. APS shall notify the Commission within ten days of each of the following events regarding the Transwestern Phoenix Project: a) Transwestern filing with FERC for approval of the Phoenix Project, b) FERC granting approval of the Phoenix Project, c) Transwestern beginning construction of the Phoenix Project, d) Transwestern completing construction of the Phoenix Project, and e) APS beginning to take service from the Transwestern Phoenix Project.
6. APS shall notify the Commission if at any time either APS or Transwestern exercises termination rights pursuant to the precedent agreement or if any other events significantly impact APS' participation in the Transwestern Phoenix Project, within ten days of any such action.
7. Pre-approval of the specific costs related to APS' acquisition of capacity on the Transwestern Phoenix Project is granted based upon the specific and unique conditions considered in this application and will in no way commit or predispose the Commission regarding any future considerations of pre-approval of costs. Rather, the standing presumption would be that the Commission would not grant pre-approval in future proceedings, absent a careful consideration of unique, serious, and important circumstances which would require such action.
8. None of the pre-approved costs will be passed on to APS' ratepayers until all of the following occur:
  - The Transwestern Phoenix Project is built and operational.
  - APS is receiving service on the Transwestern project consistent with the precedent agreement and this order.

Appendix A – Summary of Processes Related to Siting of the  
Proposed Transwestern Pipeline

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE  
COMPANY FOR DETERMINATION OF PRUDENCE AND APPROVAL OF  
RATEMAKING TREATMENT RELATING TO NATURAL GAS  
INFRASTRUCTURE  
Docket No. E-01345A-05-0895

BG 1.27 Please describe the permitting process which the Transwestern pipeline project would go through at FERC and other relevant agencies and the opportunities for public involvement by interested Arizona entities in these processes.

Response:

The Phoenix lateral will be required to meet all the permitting requirements of the FERC under the Natural Gas Act ("NGA"). The process leading to a NGA Section 7C filing at FERC requires extensive environmental and cultural resource impact evaluations and many opportunities for stakeholder input. APS has developed this response based on the Company's general understanding of the FERC permitting process and how it would apply in this particular case. Actual permitting specifics are the responsibility of Transwestern and may vary from this description.

- I. The permitting process for the Phoenix lateral before FERC most likely would follow the following process:
  1. Request the use of the NEPA Pre-Filing Process with the FERC.
  2. Regulatory /Environmental will contact all Federal, State & Local elected officials and agency representatives for purpose of introducing project and to open avenues of communication
  3. Hold a pre-filing meeting between representatives of Transwestern and the FERC Staff.
  4. Land & Right of Way will develop a landowner list of all affected owners from county tax roll records, covering an approximate 300' wide corridor along the proposed pipeline route. Affected owners include those whose land will be affected by the right-of-way, access roads, temporary workspace, pipe storage or contractor lay down yards, and those parties residing within 1/2 mile of a proposed new compressor station site. Company contacts landowners for permission to survey, then conducts field surveys, agency consultation and public outreach meetings.
  5. FERC consults with other cooperating federal agencies.
  6. FERC Staff conducts public scoping meetings to determine environmental issues.
  7. Application is filed with the FERC pursuant to Section 7(c) of the Natural Gas Act requesting a certificate of public convenience and necessity to construct and operate the pipeline. Land & ROW must provide final landowner list within 3 days of filing, typically will also have a ROW office established with single contact; 800 telephone number established to receive comments enabling landowners & stakeholders to have open lines of communication with Company.

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE  
COMPANY FOR DETERMINATION OF PRUDENCE AND APPROVAL OF  
RATEMAKING TREATMENT RELATING TO NATURAL GAS  
INFRASTRUCTURE

Docket No. E-01345A-05-0895

8. Application is noticed in the Federal Register explaining the application and indicating the deadline for filing comments, protests and/or interventions in the proceeding.
9. FERC issues a preliminary determination of need based on non-environmental factors.
10. FERC Staff issues Draft Environmental Assessment ("DEA") or Draft Environmental Impact Statement ("DEIS") for public comment.
11. Resolve environmental issues and/or respond to environmental comments.
12. FERC Staff issues Final EA or EIS.
13. FERC issues final order approving the application and granting the Certificate of Public Convenience and Necessity.

II. Approvals required from any other agencies: See attached APS07214.

III. Opportunities for public involvement by interested Arizona entities would include the following events:

1. Accessing and inspecting all public documents associated with the proposed project.
2. Providing comments during survey permission process.
3. Making concerns known in writing during the processing of the application to the FERC and its Staff. Contact FERC Hotline: 1-800 number. Landowner brochure distributed by FERC: "An Interstate Natural Gas Facility on My Land? What Do I Need To Know?"
4. Participating in open house meetings conducted by Transwestern and held in the vicinity of the proposed project area.
5. Participating in NEPA scoping meetings conducted by FERC Staff.
6. Participating in site visits in the vicinity of the proposed project area; Landowners are notified that an EA or EIS will be prepared which seeks comments normally within 30 days; typically, a draft EA or EIS is issued which allows for comments over an additional 45 day period. Comments are addressed in the Final EA or EIS.
7. Filing comments on draft EA or EIS.
8. Providing feedback during the local "Permit Review Process." Public notice is provided through public hearings held at various County and Municipal Planning & Zoning Commission levels in both Arizona and New Mexico. Notice of such hearings is provided to landowners, fire & school districts, neighborhood associations, and other interested parties.
9. Providing comments during actual right-of way acquisition by communicating with Company's field land agents.
10. Submitting public comment periods prior to issuance of air permits;
11. Becoming an "intervener" or "party" in the proposed project:

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE  
COMPANY FOR DETERMINATION OF PRUDENCE AND APPROVAL OF  
RATEMAKING TREATMENT RELATING TO NATURAL GAS  
INFRASTRUCTURE

Docket No. E-01345A-05-0895

12. Having the FERC decision reviewed in federal court (must be an intervener to do this).

Additional information on the permitting process can be found at the FERC website at <http://www.ferc.gov/industries/gas/enviro/stakeholder.pdf>.

Table 1-8.1

Environmental Permits, Approvals, and Consultations

Agency	Permit/Approval/Consultations	Status
--------	-------------------------------	--------

**FEDERAL**

Federal Energy Regulatory Commission	Certificate of Public Convenience and Necessity under Section 7 of the NGA	Pre-Filing Application filed November 2005
Advisory Council of Historians Association	Comment on the Project and its effect on historic properties under Section 10 of the National Historic Preservation Act, Including MOA and UDP	
U.S. Army Corps of Engineers	Permit under Section 404 of the Clean Water Act (CWA)	Application to be filed xxx2006
U.S. Army Corps of Engineers	Permit under Section 404 of the Clean Water Act (CWA)	Application to be filed xxx2006
U.S. Fish and Wildlife Service	Consultations under Section 7 of the Endangered Species Act, the Migratory Bird Treaty Act, and the Fish and Wildlife Coordination Act	
U.S. Environmental Protection Agency Region 6 & 9	Storm Water Construction Permit and permit for discharge of hydrostatic test water under Section 402, CWA, National Pollutant Discharge Elimination System	Applications to be filed xxx 2006
U.S. Environmental Protection Agency Region 9	Water Quality Certification under Section 401 of CWA on Navajo Nation Lands	
Federal Highway Administration	Encroachment Permits	Application to be filed prior to construction
U.S. Department of Interior, Bureau of Indian Affairs	Comment on Project and effect on tribal lands; Right-of-way grant (Tribal Trust and Allotted lands); Special Use; and Archaeological Permit	

Table 1-8.1

## Environmental Permits, Approvals, and Consultations

Agency	Permit/Approval/Consultations	Status
U. S. Department in Interior, Bureau of Land Management	Comment on Project and effect on BLM lands; Right-of-way Grant, and Temporary Use Permit	Application filed November 2005
U. S. Department of Agriculture, Forest Service	Comment on Project and effect on USDA lands; Special Use Permit	
Bureau of Alcohol, Tobacco, and Firearms	Explosives User's Permit	Application to be filed as necessary prior to construction
<b>STATE</b>		
Arizona Game and Fish Department	Threatened and endangered species clearance for state- ??? species	
Arizona State Land Department	Issues right-of-way casement; establish pricelist for plants covered from destruction on State Lands	
Arizona State Historical Preservation Office	Review, comment, and approval route under Section 106 of the National Historic Preservation Act	
Arizona Department of Agriculture	Regulates movement of protected plants in Arizona for commercial resale	
Arizona Department of Environmental Quality	Section 401 of CWA water quality certification; Section 404 coordination; reuse of wastewater for hydrotesting; permit to discharge hydotest water; permit to construct equipment with potential for air emissions	
New Mexico Environmental Department	Water Quality hydrofication under Section 401 of the CWA Consumption Water Use Permit	Application to be filed April 2004
New Mexico Oil Conservation Division	Hydrostatic Test Water Discharge Permit under National Pollutant Discharge Elimination System	Application to be filed as necessary
New Mexico Game and Fish Department	Consultations for State-listed threatened and endangered species under Endangered Species Act or State Law	
New Mexico State Land Office	Comment on Project and effect on New Mexico lands	
New Mexico State Historic Prevention Division	Consultations for cultural resources under Section 106 of the National Historic Preservation Act or State Law, including MOA and UDP	

Table 1-8.1

Environmental Permits, Approvals, and Consultations

Agency	Permit/Approval/Consultations	Status
--------	-------------------------------	--------

**NAVAJO NATION**

Navajo Nation Environmental Protection Agency	Review hydrostatic test water discharge plans under us EPA National Pollutant Discharge System, and solid waste management plans under Resource Conservation and Recovery Act (RCRA)	Application to be filed
---	--	-------------------------

Navajo Nation Water Quality Program	Review section 404 and 401 of the CWA. Review SWPPP prior to submittal on NO1 to use General Construction Permit	
-------------------------------------	--	--

Navajo Nation Historic Preservation Department	Comment on the Project and its effect on historic properties under Section 106 of the National Historic Preservation Act, including MOA and UDP	
--	---	--

Navajo Nation Department of Fish and Wildlife	Consultations under Section 7 of the Endangered Species Act and Navajo Nation Endangered Species List	
---	---	--

**OTHER TRIBAL NATIONS**

**COUNTY AND LOCAL**

Maricopa County, Air Quality Division	Air permits (dust control) are secured by contractor	
---------------------------------------	--	--

Maricopa County	Ground disturbance permit.	
-----------------	----------------------------	--

Appendix B – Sensitivity Analysis of Cost Components in  
Transwestern and El Paso Service

The following pages contain a number of sensitivity analyses, in which various cost components are adjusted to see how such changes impact the comparison of costs between taking service on the Transwestern project in comparison to taking service from El Paso. Factors which are varied include the basin differential between San Juan and Permian gas, the level of cost for service on the El Paso system, the commodity cost of gas, and the level of utilization by APS of the proposed contract demand (CD) with Transwestern.

Sensitivity Analysis for APS' Comparison of Transwestern and El Paso Costs - Varying Commodity Prices  
 E-01345A-05-0895

**NOTE: CONTAINS CONFIDENTIAL INFORMATION**

CD Level	dth/day	Annual El Paso Cost	Annual Transwestern Cost
CD Utilization	[REDACTED]	[REDACTED]	[REDACTED]
Reservation Charge	Transwestern	[REDACTED]	[REDACTED]
Usage Charge		\$/dth	[REDACTED]
Fuel Charge		\$/dth	[REDACTED]
Commodity		\$/dth	[REDACTED]
Commodity Differential (Permian vs. San Juan)		\$/dth	[REDACTED]
Total Cost		[REDACTED]	[REDACTED]

The level of commodity prices is varied, maintaining the \$0.10 basin differential (San Juan is \$0.10 more than Permian)

Permian Price	El Paso Cost	Transwestern Cost	Dollar Difference	Percentage Difference
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Sensitivity Analysis for APS' Comparison of Transwestern and El Paso Costs - Varying El Paso Rates  
 E-01345A-05-0895

NOTE: CONTAINS CONFIDENTIAL INFORMATION

CD Level	dth/day	Annual El Paso Cost	Annual Transwestern Cost
CD Utilization	%		
Reservation Charge	Transwestern		
Usage Charge	\$/dth		
Fuel Charge	\$/dth		
Commodity	\$/dth		
Commodity Differential (Permian vs. San Juan)	\$/dth		
Total Cost			

Percentage Variation in El Paso Rates

Variance in El Paso Costs from Default Level Contained in Current El Paso Rate Proceeding

Variance	El Paso Cost	Transwestern Cost	Dollar Difference	Percentage Difference

Exhibit A

Sensitivity Analysis for APS' Comparison of Transwestern and El Paso Costs - Varying Basin Differentials  
 E-01345A-05-0895

**NOTE: CONTAINS CONFIDENTIAL INFORMATION**

CD Level CD Utilization	dth/day %		Annual El Paso Cost	Annual Transwestern Cost
	El Paso	Transwestern		
Reservation Charge				
Usage Charge				
Fuel Charge				
Commodity				
Commodity Differential (Permian vs. San Juan)				
Total Cost				

Commodity Differentials (positive number indicates San Juan gas is cheaper)  
 (San Juan price is varied)

El Paso Cost	Transwestern Cost	Dollar Difference	Percentage Difference

Sensitivity Analysis for APS' Comparison of Transwestern and El Paso Costs - APS Base Case  
 E-01345A-05-0895

**NOTE: CONTAINS CONFIDENTIAL INFORMATION**

	El Paso	Transwestern	dth/day	Annual El Paso Cost	Annual Transwestern Cost
CD Level					
CD Utilization					
Reservation Charge					
Usage Charge					
Fuel Charge					
Commodity					
Commodity Differential (Permian vs. San Juan)					
Total Cost					

Sensitivity Analysis for APS' Comparison of Transwestern and El Paso Costs - Varying Contract Demand (CD) Utilization  
 E-01345A-05-0895

**NOTE: CONTAINS CONFIDENTIAL INFORMATION**

CD Level CD Utilization	dth/day %		Annual El Paso Cost	Annual Transwestern Cost
	El Paso	Transwestern		
Reservation Charge				
Usage Charge				
Fuel Charge				
Commodity				
Commodity Differential (Permian vs. San Juan)				
Total Cost				

CD Utilization Variation	dth/day		\$/dth	\$/dth	\$/dth	\$/dth	\$/dth
	El Paso	Transwestern					
CD Utilization Percentage							
El Paso Cost							
Transwestern Cost							
Dollar Difference							
Percentage Difference							

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**BEFORE THE ARIZONA CORPORATION COMMISSION**

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE APPLICATION  
OF ARIZONA PUBLIC SERVICE  
COMPANY FOR PRE-APPROVAL OF  
COST RECOVERY FOR PARTICIPATION  
IN THE TRANSWESTERN PIPELINE  
PHOENIX PROJECT

DOCKET NO. E-01345A-05-0895  
DECISION NO. \_\_\_\_\_  
ORDER

Open Meeting  
March 15 and 16, 2006  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona Public Service Company ("APS") is engaged in providing electricity service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission ("Commission").

2. On December 16, 2005, APS filed for Commission pre-approval of cost recovery for participation in the Transwestern Pipeline Phoenix natural gas pipeline project ("Phoenix Project"). APS has provided certain information to the Commission pursuant to a confidentiality agreement.

3. The Phoenix Project is a new project which Transwestern would undertake, comprising a combination of some existing pipeline capacity in some segments, and some new construction, including a lateral running down into the Phoenix metro area.

...

...

1           4.        APS' filing is pursuant to the Commission's Notice of Inquiry on Natural Gas  
2 Infrastructure ("NOI"), which the Commission initiated in April, 2003, to consider issues related to  
3 natural gas infrastructure and their impact on natural gas service in Arizona.

4           5.        On February XX, 2006, Staff filed its Staff Report in this matter, containing Staff's  
5 evaluation and recommendations regarding the APS filing. A confidential and a redacted version  
6 of the Staff Report have been put forth.

7           6.        Traditionally, Arizona shippers have received virtually all of their interstate  
8 pipeline service on the El Paso Natural Gas Company ("El Paso") pipeline system, comprising a  
9 northern system, a southern system, and a number of laterals. A small amount of northern Arizona  
10 demand is serviced via the existing Transwestern and Southern Trails pipelines, but El Paso has a  
11 monopoly on natural gas service in central and southern Arizona, including the Phoenix metro  
12 area.

13           7.        Service on El Paso has undergone a great deal of change and uncertainty in recent  
14 years and such change is likely to continue in the near future as FERC considers El Paso's current  
15 rate proceeding and other matters. Issues of debate in recent years on the El Paso system include  
16 the allocation of delivery rights at Topock, elimination of full requirements rights for large East-  
17 of-California shippers, California's pursuit of market manipulation allegations against El Paso and  
18 others, implementation of Order 637 provisions on the El Paso system, and a host of issues being  
19 addressed in the current El Paso rate proceeding at FERC.

20           8.        A fundamental difference in circumstances between California and Arizona  
21 shippers is that California shippers have a variety supply options beyond El Paso, while Arizona  
22 shippers, including APS, generally do not have such options. Such an advantageous position for  
23 California has resulted in California shippers being able to negotiate discounted rates with El Paso,  
24 with Arizona shippers, including APS, likely to be looked upon to pay for such discounts.

25           9.        Introduction of some level of pipeline competition into central Arizona, via a  
26 project such as the proposed Transwestern Phoenix Project, would diversify Arizona's natural gas  
27 infrastructure, would provide Phoenix area shippers with a competitive option, would provide

28 ...

1 additional access to cheaper San Juan gas, could lead to creation of a market center for natural gas  
2 pricing in Arizona.

3 10. The Staff Report discusses a variety of issues including the details of the proposed  
4 Phoenix lateral, background information, Arizona's competitive position in the Southwestern  
5 natural gas market, the impact of the proposed project on Arizona natural gas supplies,  
6 implications of El Paso's current rate proceeding before FERC, reliability issues, the agreement  
7 between APS and Transwestern, a cost analysis of Transwestern service to APS, cost recovery for  
8 APS, right-of-way and construction issues in Arizona, comments and filing by parties, APS'  
9 application in the broader scope of the Transwestern project, the Commission's NOI and its  
10 relationship to APS' application, what pre-approval means, the impact of pre-approval on APS'  
11 level of risk, and Staff's conclusions and recommendations. Several appendices are attached to the  
12 Staff Report, discussing the siting process for an interstate pipeline in Arizona and providing a  
13 sensitivity analysis regarding the cost of Transwestern service to APS.

14 11. In response to the serious issues facing Arizona's natural gas service both now and  
15 in the future, the Commission initiated the NOI in April 2003. Through the NOI, the Commission  
16 has conducted several workshops and has received a good deal of input at a number of points in  
17 the process from a variety of interested parties.

18 12. On December 18, 2003, the Commission issued its Policy Statement Regarding  
19 New Natural Gas Pipeline and Storage Costs. This policy statement addressed a number of issues  
20 including supply/infrastructure diversity, supply/infrastructure planning, the Commission's  
21 approach to new infrastructure projects, the general Commission approach, individual utility  
22 circumstances, and reporting. The policy statement also indicated that the traditional method of  
23 utilities participating in infrastructure projects and then later having the Commission review such  
24 participation is the preferred method, but given Arizona's natural gas infrastructure circumstances,  
25 the Commission would consider applications for alternate cost recovery treatment, including pre-  
26 approval.

27 13. APS' filing addresses many of the topics which the Commission's December 18,  
28 2003, Policy Statement Regarding New Natural Gas Pipeline and Storage Costs identifies.

1           14.    APS' application requests pre-approval of specific costs related to the Transwestern  
2 capacity, including the reservation charge, volumetric rate, fuel rate, and applicable surcharges.

3           15.    On December 14, 2005, APS entered into the Phoenix Project expansion agreement  
4 with Transwestern. The currently projected timeline for the Transwestern project is that  
5 Transwestern would file for FERC in August 2006, begin construction in July 2007, and  
6 commence operations in April 2008.

7           16.    The precedent agreement contains a variety of termination rights for both APS and  
8 Transwestern, which either party can exercise at various points in the process.

9           17.    Inherently any assessment of the relative merits of a new pipeline into central  
10 Arizona is difficult due to a variety of uncertainties regarding future costs and operational  
11 conditions on the El Paso system, future commodity costs, cost differentials between supply  
12 basins, and other factors, some of which are not easily quantified, including the benefits of pipe-  
13 on-pipe competition.

14           18.    APS has estimated that acquisition of the Transwestern capacity, in comparison to  
15 taking service from El Paso, would result in additional costs of approximately \$2 million, or 0.66  
16 percent, in 2009, and approximately \$1.1 million, or 0.37 percent, in 2015. Such estimates are  
17 based upon a number of assumptions, including an assumed differential of \$0.10 per decatherm  
18 between the San Juan and Permian basins. Variations in the assumptions could change the  
19 comparative costs, possibly making the total gas supply cost from taking service from  
20 Transwestern less than the total gas supply cost from taking service from El Paso.

21           19.    Using APS' base case projections, the additional cost of taking service from  
22 Transwestern would result in a customer impact on a average E-12 residential customer of  
23 approximately \$0.58 annually, or less than five cents per month.

24           20.    The Commission has previously pre-approved recovery of costs for pipeline  
25 capacity on a new pipeline in Arizona for APS and Southwest Gas on the previously proposed  
26 Kinder Morgan Silver Canyon pipeline, a project which was eventually discontinued.

27           21.    Acquisition of capacity on the proposed Phoenix Project by APS would play a  
28 significant role in moving the proposed project forward.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

22. The Staff Report contains the following proposed conditions:

- The Commission retains full authority to review APS' gas procurement activities, including its management of all pipeline capacity and related activities, recognizing that the Commission is pre-approving the underlying acquisition of the Transwestern capacity during the initial 15-year term of the agreement with Transwestern. The pre-approval being granted in this proceeding would expire upon completion of the initial 15-year term.
- The impact, if any, on APS' risk profile resulting from pre-approval of costs related to Transwestern Phoenix Project capacity would be considered within the context of future APS rate proceedings.
- APS shall file a status report on the Transwestern Phoenix Project and APS' participation in the project with the Commission every six months until either APS begins taking service from Transwestern or APS' participation in the project is terminated.
- APS shall notify the Commission, within ten day of when the exact volumetric and fuel rates, applicable for APS when APS begins service with Transwestern, are set for the Transwestern pipeline.
- APS shall notify the Commission within ten days of each of the following events regarding the Transwestern project: a) Transwestern filing with FERC for approval of the Phoenix Project, b) FERC granting approval of the Phoenix Project, c) Transwestern beginning construction of the Phoenix Project, d) Transwestern completing construction of the Phoenix Project, and e) APS beginning to take service from the Transwestern Phoenix Project.
- APS shall notify the Commission if at any time either APS or Transwestern exercises termination rights pursuant to the precedent agreement or if any other events significantly impact APS' participation in the Transwestern Phoenix Project, within ten days of any such action.
- Pre-approval of the specific costs related to APS' acquisition of capacity on the Transwestern Phoenix Project is granted based upon the specific and unique conditions considered in this application and will in no way commit or predispose the Commission regarding any future considerations of pre-approval of costs. Rather, the standing presumption would be that the Commission would not grant pre-approval in future proceedings, absent a careful consideration of unique, serious, and important circumstances which would require such action.
- None of the pre-approved costs will be passed on to APS' ratepayers until all of the following occur:

...  
...

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

- The Transwestern Phoenix Project is built and operational.
- APS is receiving service on the Transwestern project consistent with the precedent agreement and this order.

23. On January 9, 2006, Transwestern filed comments in this proceeding, supporting APS' application.

24. On January 13, 2006, El Paso filed for intervention in this proceeding. On January 26, 2006, El Paso was granted intervention in this proceeding.

25. Staff believes that APS' participation in the Phoenix Project is reasonable given information available at this time.

26. Staff has recommended that the Commission pre-approve recovery of APS' reservation specific costs related to the Transwestern capacity at issue in this proceeding, including the reservation charge, volumetric rate, fuel rate, and applicable surcharges, subject to certain conditions.

CONCLUSIONS OF LAW

1. APS is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over APS and over the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated March 2, 2006, concludes that it is in the public interest to approve the request for pre-approval of the reservation charges, volumetric rate, fuel rate, and applicable surcharges related to the Transwestern capacity at issue in this proceeding.

...  
...  
...  
...  
...  
...  
...

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

ORDER

IT IS THEREFORE ORDERED that APS' recovery of the reservation charges, volumetric rate, fuel rate, and applicable surcharges related to the Transwestern pipeline capacity at issue in this proceeding be and hereby is pre-approved for cost recovery.

IT IS FURTHER ORDERED that this Order shall be effective immediately.

**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

\_\_\_\_\_  
BRIAN C. McNEIL  
Executive Director

DISSENT: \_\_\_\_\_

DISSENT: \_\_\_\_\_

EGJ:RGG:lh\KL

1 SERVICE LIST FOR: Arizona Public Service Company  
2 DOCKET NO. E-01345A-05-0895

3 Ms. Karilee Ramaley  
4 Arizona Public Service Company  
400 North Fifth Street  
5 Mailstop 8695  
6 Phoenix, Arizona 85004

7 Mr. Norman D. James  
8 Attorney for El Paso Natural Gas Company  
3003 North Central Avenue, Suite 2600  
9 Phoenix, Arizona 85012

10 Mr. Ernest G. Johnson  
11 Director, Utilities Division  
12 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

13 Mr. Christopher C. Kempley  
14 Chief Counsel  
15 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

Sensitivity Analysis for APS' Comparison of Transwestern and El Paso Costs - Varying El Paso Rates  
 E-01345A-05-0895

**NOTE: CONTAINS CONFIDENTIAL INFORMATION**

CD Level	dth/day	Annual	Annual
CD Utilization	%	El Paso	Transwestern
		Cost	Cost
Reservation Charge	Transwestern		
Usage Charge	\$/dth		
Fuel Charge	\$/dth		
Commodity	\$/dth		
Commodity Differential	\$/dth		
(Permian vs. San Juan			
Total Cost			

Percentage Variation in El Paso Rates

Variance in El Paso Costs from Default Level Contained in Current El Paso Rate Proceeding

Variance	El Paso	Transwestern	Dollar	Percentage
Cost	Cost	Cost	Difference	Difference