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FENNEMORE CRAIG
Norman D. James (No. 006901)
Jay L. Shapiro (No. 014650)
Patrick J. Black (No. 017141)
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Telephone (602) 916-5000

Attorneys for El Paso Natural Gas Company

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR DETERMINATION OF PRUDENCE AND APPROVAL OF RATEMAKING TREATMENT RELATED TO NATURAL GAS INFRASTRUCTURE	DOCKET NO. E-01345A-05-0895 **EL PASO NATURAL GAS COMPANY'S APPLICATION FOR LIMITED REHEARING OF DECISION NO. 68597**

Pursuant to A.R.S. § 40-253(A) and A.A.C. R14-3-111, El Paso Natural Gas Company ("EPNG") submits its Application for Limited Rehearing ("Application") of Decision No. 68597, issued by the Arizona Corporation Commission ("Commission") on March 23, 2006. In addition to and in support of this Application, EPNG incorporates by reference the matters set forth in its Exceptions filed in this docket on March 13, 2006. For the reason set forth below, EPNG requests that the Commission grant this Application.

The United States and Arizona Constitutions prohibit the state from depriving any person "life, liberty or property without due process." U.S. Const. Amend. XIV; *see also* Ariz. Const. Art. II, § 4. Due process requires, in part, that a party receive adequate notice and have the opportunity to be heard at a meaningful time and in a meaningful manner. *Hall v. Lalli*, 194 Ariz. 54, ¶ 6, 977 P.2d 776, 779 (1999); *Comeau v. Ariz. State Bd. of Dental Exam'rs,* 196 Ariz. 102, ¶ 20, 993 P.2d 1066, 1070-71 (App.1999); *see also In re Hamm,* 211 Ariz. 458, ¶ 41, 123 P.3d 652, 662 (2005).

EPNG asserts that it was not allowed to meaningfully participate in the above-captioned proceeding due to the severe time constraints that resulted from: 1) Arizona

Public Service Company's ("APS") unwillingness to provide confidential information in a timely manner; and 2) the short time period between Staff's issuance of its Report and Recommended Order ("Report"), and the Commission's March 15, 2006 Open Meeting.

The Commission, as is standard throughout the United States, usually reviews the costs associated with contracts for prudence when a utility seeks approval to recover the costs. This is the Commission's preferred method. *See* ACC Policy Statement (December 18, 2003). In this proceeding, however, APS seeks to have the Commission determine that the costs associated with the subject transportation service agreement are prudent even before the contract in question becomes effective. Despite the extraordinary and unusual relief sought by APS in this proceeding, the Commission processed and approved APS's application within a matter of 90 days. APS filed its application on December 16, 2005, and EPNG filed its Application for Leave to Intervene on January 13, 2006. EPNG's application went unchallenged, and once intervention was granted on January 26, 2006, EPNG served its First Set of Data Requests to APS on February 3, 2006. APS did not provide its objections to EPNG's request for confidential information until February 10, 2006 – despite the fact EPNG had submitted a form of protective agreement to facilitate discovery on a timely basis. EPNG attempted to resolve the discovery dispute informally, and it was not until EPNG filed a Motion to Compel Production of Documents on February 22, 2006, that APS finally agreed to provide meaningful responses to EPNG's First Set of Data Requests.

EPNG was provided confidential information by APS on March 1, 2006. On the next day, March 2, 2006, Staff filed its Report. Despite the fact that the matter had been scheduled for the Commission's March 15, 2006, Open Meeting, the Report was mailed to EPNG. Consequently, EPNG did not receive the Report until March 6, 2006. This provided EPNG with less than 10 days to critically review and analyze information that had been available to APS and Staff for 75 days. EPNG asked the Commissioners to postpone their consideration of this matter for only 20 days, but the request was rejected. Significantly, this additional 20 days would have been without delay to the project. *See* March 15, 2006, Open Meeting Transcript ("Tr.") at 47. There simply was nothing to warrant this unusual haste to judgment on such an extraordinary request. In short, EPNG was not provided an opportunity to meaningfully participate in the review and approval process, or the Commission's deliberations of March 15, 2006, as required by both federal and Arizona law.

The extraordinary relief granted in this proceeding occurred in an unusually short amount of time as even recognized by the Commissioners themselves. Tr. at 18. This relief may confer an artificially regulatory advantage to the subject contract by deeming it "prudent" now. APS may have a bias to use this contract because it has been declared prudent by the Commission. Significantly, this determination of prudency at this time transfers the usual risk associated with prudence reviews of contracts from APS to Arizona ratepayers. Additionally, the actions of APS and the Commission may cause additional filings at the Federal Energy Regulatory Commission that could negatively impact Arizona ratepayers. Accordingly, the extraordinary relief sought in this proceeding should have only been granted after a full consideration of all relevant facts.

Attached hereto as Exhibit 1 is EPNG's comments to the redacted version of the Staff Report filed on March 2, 2006.[1] This document contains analysis and information that, had it been available during the Commission's deliberations, would have provided EPNG with an opportunity to meaningfully participate in the Commission's determination of whether approving APS's application would serve the public interest. At a minimum, this information corrects inaccuracies and omissions created by the record in this proceeding. In light of this new evidence, EPNG requests that the Commission grant this Application and review and consider the attached comments.

[1] EPNG is also providing its consultant's report, which analyzes the confidential information provided by APS, to ACC Staff and APS pursuant to the Protective Agreement.

RESPECTUFLLY SUBMITTED this 12th day of April, 2006.

FENNEMORE CRAIG, P.C.

By:
Norman D. James (No. 006901)
Jay L. Shapiro (No. 014650)
Patrick L. Black (No. 017141)
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012
Attorneys for El Paso Natural Gas Company

ORIGINAL of the foregoing hand-delivered for filing this 12th day of April, 2006, to:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

COPY of the foregoing hand-delivered this 12th day of April, 2006, to:

Chairman Jeff Hatch Miller
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Commissioner Marc Spitzer
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Commissioner William Mundell
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Commissioner Mike Gleason
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Commissioner Kristin Mayes
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Lyn Farmer, Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Robert Gray
Utilities Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Keith Layton
Legal Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Thomas L. Mumaw
Karilee S. Ramalay
Pinnacle West Capital Corporation
400 North 5th Street
P.O. Box 53999 MS 8695
Phoenix, AZ 85072-3999

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EXHIBIT
1

EL PASO NATURAL GAS COMPANY'S COMMENTS REGARDING STAFF REPORT ON ARIZONA PUBLIC SERVICE COMPANY'S APPLICATION FOR DETERMINATION OF PRUDENCE AND APPROVAL OF RATEMAKING TREATING RELATING TO NATURAL GAS INFRASTRUCTURE

(April 12, 2006)

INTRODUCTION

El Paso Natural Gas Company ("EPNG") hereby submits these comments in response to the Staff Report, which was filed on March 2, 2006 ("Report"), in the above-captioned matter. This Report served as the basis for the Arizona Corporation Commission's ("ACC") approval of the application in this proceeding. Due to the extremely compressed time schedule in this proceeding, EPNG recognizes at the outset that when drafting the Report, Staff did not have an opportunity to evaluate background information and data relative to EPNG's system. These comments are provided to clarify the record, and address three general areas of concern highlighted in the Report: 1) the relationship between California and Arizona shippers, and the effect of EPNG discounting policies on both parties; 2) access to natural gas supply from the San Juan basin, and the cost differential relative to other supply alternatives; and 3) the level of uncertainty regarding important service issues on EPNG's pipeline system. These comments also put into broader perspective certain policy and factual issues addressed in the Report, particularly Arizona shippers' access to flexible and reliable natural gas service in both the short and long term.

DISCUSSION

As discussed in detail below, certain of the underlying presumptions, statements and analysis in the Report are either factually incorrect or, present an incomplete representation of the situation on EPNG's system and impacts on the Arizona consumer. While it is the ACC's ultimate responsibility to determine what is in the public interest for Arizona on these matters, EPNG believes it should do so on a complete and accurate record. The decision in this proceeding may have ramifications (both positive and negative) for future filings before the ACC and the Federal Energy Regulatory Commission ("FERC").[1] Finally, EPNG addresses continuing misconceptions in the hope that they will be more fully addressed in future proceedings before the ACC.

1. **The Descriptions of the California Shippers and the Arizona Shippers.**

The Report identifies major shifts in the use of EPNG's pipeline system by California shippers as a major contributing factor in the upheaval of the Southwestern natural gas market. Citing Pacific Gas and Electric's ("PG&E") turn-back of capacity in the mid-1990s, and the more recently announced turn-back by Southern California Gas Company ("SoCal"), the Report concludes that other shippers on EPNG's system, including Arizona Public Service Company ("APS"), may have to bear some or all of the cost burden for large blocks of this unsubscribed capacity, in addition to lost revenues. Report at 5. Unfortunately, the Report relies on the mistaken impression that the actions of the California shippers always have and will negatively impact the Arizona shippers.[2] For

[1] For example, by taking the extraordinary step of approving a contract is prudent before a request is made to pass along the costs of the contract, the ACC may be conferring a significant bias of the utility towards the use of that contract. Additionally, there may be filings in the future at the FERC to allocate the costs created by the actions of the Arizona shippers and the ACC. Given the significant consequences of this decision, EPNG believes that the record must be accurate and complete.

[2] The Staff Report also refers to market manipulation allegations against EPNG, among other things, as a source of upheaval on EPNG's pipeline system. However, FERC has flatly *rejected* the basis for the claim that EPNG withheld capacity, as well as claims that EPNG was otherwise at fault for capacity curtailments on its system. *See El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at 62-80, 103-108, 126, 141, 158 (2003). FERC's rejection of the basis for those claims and claims that EPNG was otherwise at fault was affirmed by the United States Court of Appeals for the District of Columbia Circuit. *See Arizona Corp. Comm'n. v. Federal Energy Reg. Comm'n*, 397 F.3d 952, 955 (D.C. Cir.

example, the Report does not explain that EPNG chose not to reflect the SoCal turn-back in setting rates in its 2006 rate proceeding at FERC.

Also absent from the Report is any acknowledgment that the turnback of capacity from California shippers may actually benefit Arizona shippers. While the turnback by PG&E was a traumatic event for EPNG and its shippers, it served as a source of capacity for the astounding growth in the use of capacity by Arizona shippers. Indeed, the growth of demand in Arizona has been staggering; since the mid-1990s, consumption of natural gas has grown by nearly 300% for APS, 600% for Salt River Project ("SRP") and 150% for Southwest Gas Corporation ("SWG"). Added to this growth is the fact that Arizona shippers now require service with a much greater degree of variation in their hourly takes than prior to 1995. Also conspicuous in its absence in the Report is any reference to this tremendous growth and change in the nature of the service required by Arizona shippers as the major cause in the shift of use on EPNG's system. As a result, the Report creates the impression that the California shippers are the only shippers on EPNG's system that have caused changes on EPNG's system. This is simply incorrect.

In contrast to the speculation on the impact of turnbacks from California shippers, the Report does not discuss the impact on Arizona ratepayers (other than APS ratepayers) from the possible future turnback of capacity by APS to EPNG. Apparently based on the mere assertions of APS,[3] the Report assumes that there will be no turnback of capacity to EPNG from APS as a result of APS contracting with Transwestern Pipeline Company, LLC ("Transwestern"). Given APS'

2005) ("Nor do petitioners persuade us that El Paso improperly withheld capacity. FERC observed, and petitioners did not disprove, that El Paso operated its 'dynamic' pipelines at reasonable levels of capacity") (citations omitted).

[3] After being specifically asked by a Commissioner at the public meeting, APS refused to confirm representations it had apparently made to the ACC Staff that it would not turn back any capacity on EPNG. Tr. at 14-15.

refusal at the ACC's March 15, 2006, Open Meeting to confirm that it would not turn back any capacity on EPNG, this appears to be a weak assumption – one that the Report acknowledges might warrant a different analysis if incorrect. Thus, the Report does not analyze the consequences to Arizona ratepayers if there are turnbacks by APS. The Report also leaves the impression that only the California shippers may turnback capacity and only their actions may be detrimental to the ratepayers of Arizona.[4] The Report states that APS and other shippers may have to bear additional costs from the discounts obtained by PG&E and SoCal. Report at 5 & 6. This creates the presumption that APS' ratepayers will be harmed by any discounts to California shippers. This view misunderstands the facts of EPNG's current rate case and the nature of discounting on interstate pipelines.

Interstate pipelines throughout the United States selectively discount capacity to prevent the costs of unsubscribed capacity being borne by other shippers. By using selective discounting, pipelines like EPNG spread their fixed costs over a wider shipper base by increasing throughput and contract volume. As a result, EPNG may charge lower rates to other shippers than if the shipper receiving the discount simply left the system. This use of selective discount is consistent with the FERC's policies for maximizing benefits for "captive" customers and has been affirmed by the courts. The Report also does not mention that before FERC will allow a discount to affect a maximum rate, the pipeline must meet the criteria established by FERC to ensure that the other customers benefit from the discount. Finally, the Report does not reflect that the California discount term periods are for relatively short periods of time (between 2-3 years for PG&E and 3-6 years for SoCal), and can be adjusted as the capacity situation

[4] Curiously, if the Report is correct that there will be no turnback because of APS's contract with Transwestern is for the future growth in APS's needs, the Report fails to address the *positive* impact on EPNG's rates to Arizona ratepayers (i.e., lowering the rate) that could occur if APS contracted with EPNG for the volumes associated with the growth in APS's requirements.

changes for the benefit EPNG's shippers.

The Report relies heavily on contentions that Arizona shippers have not been offered discounts by EPNG, as have California shippers, because of the lack of diversity of supply options beyond EPNG in Arizona. *Id.* This contention is also incorrect. EPNG offered a discounted fixed rate in association with its Line 1903 expansion project. APS, SRP and SWG currently hold a limited discount in their contracts associated with their Line 1903 capacity.[5] Moreover, Arizona shippers have received EPNG service on a deeply discounted basis since 2003 as a result of FERC's Capacity Allocation proceedings. For instance, APS received a "discount" rate of approximately 8 cents per Dth on a 100% load factor equivalent basis for more than two years, as compared to the maximum Arizona rate of approximately 26 cents per Dth. Thus, it is simply incorrect to state that EPNG has not offered discounts to Arizona shippers, or that they have not received rates less than the applicable maximum rate.

Furthermore, while EPNG does not currently have discounted service for any major Arizona shipper (except those Line 1903 Agreements), EPNG provides a sculpted volume profile for its Arizona Rate Schedule FT-1 service. Rate discounts given to California shippers are applied against an essentially flat contract quantity each month. By contrast, Arizona shippers receive service on a varying monthly quantity that results in lower cost responsibility, as opposed to a discount rate multiplied against a peak month volume. ***See* Attachment A**. This monthly sculpting results in a significant financial benefit and is the functional equivalent of a discount when compared to most pipeline systems in the United States which sell capacity only on an annual basis. Certainly, the California shippers are receiving economic benefit from their discounted contracts. The

[5] The Report does not discuss the possibility that EPNG might have agreed to a discount for expansion projects as it did for the Line 1903 project.

Report, however, creates the impression that because EPNG is the sole pipeline in parts of Arizona, the Arizona shippers have not obtained benefits on EPNG's system such as monthly sculpting, effective unit rate discounts, and discounts associated with expansion capacity.

2. **<u>Access to San Juan Basin and Cost Differential of Natural Gas Supply.</u>**

One of the primary reasons expressed in the Report to support the construction of new infrastructure in Arizona is to increase access to the San Juan basin gas supply, where commodity costs are lower than alternative supply basins such as the Permian basin. However, Staff understates in its analysis the amount of San Juan basin natural gas EPNG can actually transport into central and southern Arizona. The Report states:

> 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.

Report at 7. In reality, the EPNG San Juan-Permian crossover is also used to transport volumes from the San Juan basin to the EPNG southern mainline. When this north-to-south crossover capacity is included in evaluating the EPNG system, EPNG can transport almost 2 Bcf/day from the San Juan basin to the southern system in many operating modes. Furthermore, approximately 450 Mcf/day of capacity was made available to East-of-California ("EOC") shippers in the allocation process, including capacity associated with contracts rejected by the Enron Corporation in its bankruptcy proceeding. Much of this capacity had San Juan receipt rights. Of the 1.6 Bcf/day currently held by EOC shippers, approximately 60% provides access to the San Juan basin. Because most Arizona customers do not operate even close to a 100% daily load factor basis, they actually achieve a higher daily percentage of volumes from San Juan than the 60% annual contract level. Thus, the actual amount of gas from San Juan that EPNG can and does deliver may be understated by the Report.

As for the price differential in commodity costs between the San Juan and Permian basins, the Report and APS used a 10 cent price differential in their analyses. This figure is conservative historically, and based on the assumption that San Juan gas will remain less expensive throughout the term of the Agreement between APS and Transwestern. The Report suggests that the commodity savings will outweigh higher transportation costs over the long term. This assumes that the price differential will not decrease or reverse due to greater access by others to the San Juan basin or changes in the Permian Basin. The Report correctly concedes that Transwestern's Phoenix Expansion project alone is likely to reduce the current price differential. Report at 15. Significant, however, is the absence of any reference to the TransColorado Gas Transmission Company ("TransColorado") recently announced a 250 Mcf/day expansion out of the San Juan basin into the Piceance basin of Colorado. If built, TransColorado's project will cause undoubtedly further upward pressure on the commodity price of San Juan natural gas. EPNG asserts that any current price differential between the San Juan and Permian basins will probably shrink as more infrastructure is built to access the San Juan supply.

3. Uncertaintly Due to EPNG's Pending Rate Application at FERC.

The Report indicates that EPNG "has put forward a variety of proposals in the [FERC] rate proceeding which, if adopted, will greatly change the operation of its pipeline in the Southwest and will increase cost and reduce flexibility for Arizona shippers…" It also briefly describes the potential that "APS [may] be forced to seek additional pipeline capacity to maintain current levels of quality and quantity of service from El Paso." *Id.* While both statements focus on this perceived uncertainty about EPNG's services, the Report does not acknowledge any of the potential benefits from EPNG's rate case filing, and thereby presents an incomplete picture.

The Report ignores key features of EPNG's rate proposal: firm rights for hourly service and the option of firm daily balancing services. These service options would essentially "firm up" or contractually allow a firm right for uneven hourly takes or a firm right to not be in daily balance where none currently exists. For example, APS currently takes gas from the EPNG system in uneven amounts over the course of the day, but has no contractual right, such as a firm contract peak hour right, to do so. Excess lateral capacity, coupled with good fortune, has allowed EPNG to meet APS' requirements to date. However, given the likelihood of continuing rapid growth in Central Arizona over the next several years, it would appear to be critical for human needs requirements to have defined firm contractual rights. Because APS today has only interruptible use of hourly variations or daily balancing service, APS and its shippers cannot rely on the availability in all operational conditions of any hourly fluctuations or daily balancing.

In its pending rate case, EPNG has proposed to provide Arizona shippers with the option to secure firm rights to hourly service and/or firm rights to daily balancing service, providing basic certainty of service terms. This option compares favorably in light of the Report's assertion that "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 planning for the future." Report at 8. The prospect and benefits of certainty on EPNG's pipeline system should be acknowledged in the Report rather than discussing only the prospect and benefits of certainty on Transwestern's proposed lateral.

Finally, the Report identifies concerns raised by intervening parties in EPNG's pending FERC rate case, including the elimination of EPNG's short-haul rate. Report at 8. However, the only short-haul rate EPNG has had in the past on its system was a short haul rate tied to the "with-in basin" rate, which was not applicable within Arizona. Twice the FERC has found that there is no FERC "policy that would require El Paso to provide a short-haul rate to its customers."[6] The criticism leveled against EPNG in this regard is especially surprising since Transwestern does not offer a short-haul rate in its current tariff, and is not likely to offer one on its Phoenix lateral expansion. Thus, any implication by the Report that somehow EPNG's lack of a short-haul rate is somehow improper is misplaced.

CONCLUSION

Even though it has submitted these comments to complete the record in this proceeding, EPNG recognizes the Commission's commitment to increasing natural gas infrastructure and supply diversity for Arizona consumers. To the extent that it can assist the Commission in addressing natural gas price volatility and service reliability issues, EPNG will continue to plan for the construction of new pipeline and storage capacity in Arizona.

[6] El Paso Natural Gas Co., 114 FERC ¶ 61,305, P. 296 (2006).

Attachment
A

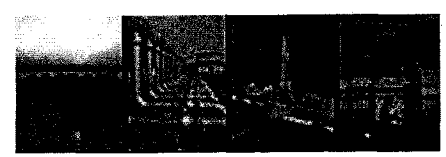
Demonstration of the impact of monthly sculpting

Assume a 200,000 Dth/d contract:

Let's compare an even monthly volume at a discounted demand rate ($0.27)

vs.

A monthly sculpted volume at max demand rate ($0.3078)



Demonstration of the impact of monthly sculpting (continued)

Even Volume

Volume = 200,000 Dth

Rate = $0.27

Annual Cost =

$19.7 million

Monthly Sculpted

Volume:

Max = 200,000 Dth

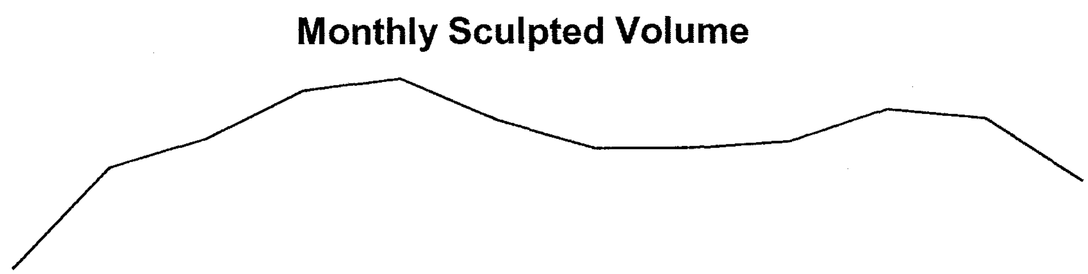
Min = 83,693 Dth

Ave = 159,853 Dth

Rate = $0.3078

Annual Cost =

$17.9 million



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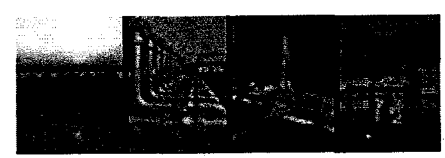

Demonstration of the impact of monthly sculpting (continued)

- A monthly sculpted volume provides a greater cost reduction than a discounted even monthly volume
  - And favorable priority secondary point access