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MEMORANDUM

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TO: AZ CORP COMMISSION  
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THE COMMISSION

Arizona Corporation Commission

DOCKETED

FROM: Utilities Division

JUL 07 2006

DATE: July 7, 2006

DOCKETED BY [Signature]

RE: IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR APPROVAL OF A CLARIFICATION OF A SPECIAL GAS PROCUREMENT AGREEMENT WITH TUCSON ELECTRIC POWER COMPANY (DOCKET NOS. G-01551A-05-0885 AND E-01933A-05-0885)

On June 30, 2006, Southwest Gas Corporation ("Southwest") filed for Commission approval of a clarification of a special gas procurement agreement ("SGPA") with Tucson Electric Power Company ("TEP"). TEP uses natural gas to generate electricity.

Southwest has served TEP through SGPAs for a number of years. In Decision No. 68390 (January 5, 2006), the Commission approved the most recent SGPA between Southwest and TEP. The agreement between Southwest and TEP is currently being extended on a month-to-month basis, with either party able to terminate the agreement with 30 days notice. Under the SGPA, Southwest purchases natural gas for TEP and uses Southwest's interstate pipeline capacity portfolio to deliver natural gas to TEP.

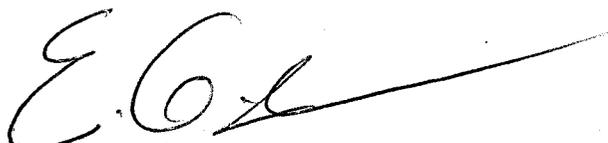
Southwest's filing in this application requests approval of a clarification of the existing SGPA with TEP to recognize penalties on the El Paso Natural Gas Company ("El Paso") pipeline system that Southwest may incur while providing service to TEP under the SGPA. Currently the SGPA contains a number of pricing and other terms and conditions defining how Southwest provides service to TEP. However, the SGPA does not specifically indicate if or how Southwest is to pass along to TEP the penalties Southwest incurs from El Paso to provide service to TEP.

In the current El Paso rate proceeding before the Federal Energy Regulatory Commission ("FERC"), El Paso has proposed a variety of new services and related penalty provisions that significantly reduce the flexibility shippers such as Southwest have on the interstate pipeline system. Under the new service regime on El Paso, which has been largely accepted by FERC, (subject to requests for rehearing by the ACC and a variety of other parties), Arizona shippers on El Paso are exposed to significant risk of incurring penalties on the El Paso system if their daily deliveries of natural gas off the El Paso system do not fall within a variety of parameters. Southwest and TEP coordinate the scheduling of natural gas supplies to try to avoid any penalties being incurred. But TEP could cause Southwest to incur penalties on the El Paso system if TEP's consumption varies from expected levels due to changing weather conditions, plant outages, or other reasons. The massive changes taking place on the El Paso system are

having and will continue to have a variety of implications for Arizona utility customers, with this application by Southwest reflecting one such implication.

In light of the changing operational conditions on the El Paso pipeline system, Southwest and TEP have jointly signed a letter indicating that they agree that Southwest can pass along penalties to TEP which are directly related to TEP's gas supply service provided by Southwest and that such penalties will be recognized as part of the gas cost component under the SGPA. A copy of this letter is attached to Southwest's application in this proceeding.

Staff has reviewed Southwest's application and the attached letter. Staff believes that the agreement between Southwest and TEP, allowing Southwest to pass to TEP applicable penalties incurred by Southwest as a result of its gas supply service to TEP is a reasonable solution to dealing with the risk of penalties being incurred on the El Paso pipeline system. Staff recommends approval of the letter agreement between Southwest and TEP.



Ernest G. Johnson

Director

Utilities Division

EGJ:RGG:lhm\JMA

ORIGINATOR: Robert Gray

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**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 SOUTHWEST GAS CORPORATION  
FOR APPROVAL OF A CLARIFICATION  
OF A SPECIAL GAS PROCUREMENT  
AGREEMENT WITH TUCSON ELECTRIC  
POWER COMPANY.

DOCKET NOS. G-01551A-05-0885,  
E-01933A-05-0885

DECISION NO. \_\_\_\_\_

ORDER

Open Meeting  
July 25 and 26, 2006  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Southwest Gas Corporation ("Southwest") is engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission ("Commission").

2. On June 30, 2006, Southwest filed for Commission approval of a clarification of a special gas procurement agreement ("SGPA") with Tucson Electric Power Company ("TEP"). TEP uses natural gas to generate electricity.

3. Southwest has served TEP through SGPAs for a number of years. In Decision No. 68390 (January 5, 2006), the Commission approved the most recent SGPA between Southwest and TEP. The agreement between Southwest and TEP is currently being extended on a month-to-month basis, with either party able to terminate the agreement with 30 days notice. Under the SGPA, Southwest purchases natural gas for TEP and uses Southwest's interstate pipeline capacity portfolio to deliver natural gas to TEP.

1           4.       Southwest's filing in this application requests approval of a clarification of the  
2 existing SGPA with TEP to recognize penalties on the El Paso Natural Gas Company ("El Paso")  
3 pipeline system that Southwest may incur while providing service to TEP under the SGPA.  
4 Currently the SGPA contains a number of pricing and other terms and conditions defining how  
5 Southwest provides service to TEP. However, the SGPA does not specifically indicate if or how  
6 Southwest is to pass along to TEP the penalties Southwest incurs from El Paso to provide service  
7 to TEP.

8           5.       In the current El Paso rate proceeding before the Federal Energy Regulatory  
9 Commission ("FERC"), El Paso has proposed a variety of new services and related penalty  
10 provisions that significantly reduce the flexibility shippers such as Southwest have on the interstate  
11 pipeline system. Under the new service regime on El Paso, which has been largely accepted by  
12 FERC (subject to requests for rehearing by the ACC and a variety of other parties), Arizona  
13 shippers on El Paso are exposed to significant risk of incurring penalties on the El Paso system if  
14 their daily deliveries of natural gas off the El Paso system do not fall within a variety of  
15 parameters.

16           6.       Southwest and TEP coordinate the scheduling of natural gas supplies to try to avoid  
17 any penalties being incurred. But TEP could cause Southwest to incur penalties on the El Paso  
18 system if TEP's consumption varies from expected levels due to changing weather conditions,  
19 plant outages, or other reasons. The massive changes taking place on the El Paso system are  
20 having and will continue to have a variety of implications for Arizona utility customers, with this  
21 application by Southwest reflecting one such implication.

22           7.       In light of the changing operational conditions on the El Paso pipeline system,  
23 Southwest and TEP have jointly signed a letter indicating that they agree that Southwest can pass  
24 along penalties to TEP which are directly related to TEP's gas supply service provided by  
25 Southwest and that such penalties will be recognized as part of the gas cost component under the  
26 SGPA. A copy of this letter is attached to Southwest's application in this proceeding.

27           8.       Staff has reviewed Southwest's application and the attached letter. Staff believes  
28 that the agreement between Southwest and TEP, allowing Southwest to pass to TEP applicable

1 penalties incurred by Southwest as a result of its gas supply service to TEP is a reasonable solution  
2 to dealing with the risk of penalties being incurred on the El Paso pipeline system.

3 9. Staff has recommended approval of the letter agreement between Southwest and  
4 TEP.

5 CONCLUSIONS OF LAW

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

8 2. The Commission has jurisdiction over Southwest and over the subject matter of the  
9 application.

10 3. The Commission, having reviewed the application and Staff's Memorandum dated  
11 July 7, 2006, concludes that it is in the public interest to approve the letter agreement between  
12 Southwest and TEP.

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ORDER

IT IS THEREFORE ORDERED that the letter agreement between Southwest and TEP be and hereby is approved.

IT IS FURTHER ORDERED that this Order shall become 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 \_\_\_\_\_, 2006.

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

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

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

EGJ:RGG:lm\JMA

1 SERVICE LIST FOR: Southwest Gas Corporation and Tucson Electric Power Company  
2 DOCKET NOS. G-01551A-05-0885 and E-01551A-05-0885

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17 Arizona Corporation Commission  
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