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BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

Arizona Corporation Commission
DOCKETED
JUL - 3 2008
DOCKETED BY MN

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR APPROVAL OF ITS SPECIAL GAS PROCUREMENT AGREEMENT WITH YUMA COGENERATION ASSOCIATES

DOCKET NO. G-01551A-08-0143

DECISION NO. **70404**

ORDER

Open Meeting
July 1 and 2, 2008
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

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

2. On March 10, 2008 Southwest filed an application with the Commission in Docket No. G-01551A-08-0143 for approval of a new special gas procurement agreement ("SGPA") with Yuma Cogeneration Associates ("Yuma Cogen" or "the facility"). Southwest is currently delivering gas to Yuma Cogen under the terms of an SGPA approved by the Arizona Corporation Commission on May 21, 2007, in Decision No. 69572.

3. On March 11, 2008, Southwest also filed a motion to continue providing service under the terms of the 2007 SGPA with Yuma Cogen, pending a Commission decision regarding the proposed new SGPA, or until July 31, 2008. On April 24, 2008, the Commission approved Southwest's motion to continue service (Decision No. 70296).

4. Yuma Cogen is an approximately 57 MW cogeneration facility located in Yuma. Southwest has provided natural gas to the facility through SGPAs for approximately 15 years.

Yuma Cogen has a 30-year power purchase agreement with San Diego Gas & Electric for up to 56.5 MW, and a 30-year agreement with a nearby industrial company, Shaw Diversified Services, for up to 15,000 pounds per house of process steam and 35,000 pounds per hour of chilling steam.

5. Yuma Cogen was formed in 1991 and is operated by Falcon Power Operating Company ("Falcon"), which employs 13 employees at the facility. Yuma Cogen is an Arizona general partnership, consisting of California Energy Development Corporation ("CEDC") and California Energy Yuma Corporation ("CEYC"). CEDC, CEYC and Falcon are wholly-owned subsidiaries of CE Generation LLC ("CEG"), which is, in turn, owned equally by MidAmerican Energy Holding Company ("MidAmerican") and TransAlta Corporation ("TransAlta").

6. Under the proposed SGPA, Southwest would purchase natural gas supplies for Yuma Cogen and use its interstate pipeline capacity to deliver the gas to Yuma Cogen. The natural gas supplies purchased for Yuma Cogen would be specific and separate from Southwest's purchases for its core customers, and accounted for separately.

7. The Company has stated that it has sufficient pipeline capacity and other rights to serve its core customers and Yuma Cogen on non-peak days. During extreme cold weather, Yuma Cogen and other lower priority customers would be curtailed as necessary to serve Priority 1 and 2 customers. (A small amount of Yuma Cogen's load goes to a manufacturing facility and is designated as Priority 2, while the larger power generation load is designated as Priority 3. Any curtailment would take this mix into account.) The proposed SGPA also continues to include a provision allowing Southwest to divert gas supplies and capacity from Yuma Cogen for up to ten days from October through April, to accommodate core customer service needs. Southwest has not, to date, made any such diversion.[1]

8. Under a contract clarification approved in Decision No. 68851, Southwest has been passing through charges and penalties from El Paso Natural Gas Company ("El Paso") that are attributable to Yuma Cogen. Under the proposed SGPA, Southwest would continue to pass through these charges and penalties to Yuma Cogen.

[1] Southwest state that, although the interruptible nature of this service is considered in determining Yuma Cogen's margin rate, the primary driver in setting the margin rate is the facility's ability to bypass Southwest.

9. *Feasibility of Bypass*

Southwest's filing in this application requests approval of a new SGPA with Yuma Cogen. Southwest's SGPA service to Yuma Cogen is pursuant to Schedule G-30, which provides gas service at a lower rate than would be available under the G-60 rate usually applicable to electric generation facilities. Schedule G-30 is available to customers who can demonstrate that bypassing Southwest is "economically, operationally and physically feasible and imminent."

10. With respect to economic feasibility, Southwest has supplied information indicating that the G-60 rate would cost Yuma Cogen approximately 44% more than the G-30 rate, with an average increase of more than $1 million per month. Southwest does not believe that service under the G-60 rate would be viable for Yuma Cogen, and that the facility would, instead, utilize either transportation service or physical bypass. Yuma Cogen informed Staff that it is willing and able to bypass Southwest if it does not receive the rate proposed in the SGPA, and that it has "sufficient credit support to immediately bypass Southwest Gas."

11. Also with respect to economic feasibility, under the terms of the June 30, 1993, Master Agreement, Yuma Cogen has the right to purchase the on-site distribution system constructed by Southwest for $300,000 and to receive access to the El Paso tap. Given Yuma Cogen's therm usage, Southwest estimates that Yuma Cogen could achieve simple payback on the cost of acquiring the distribution system in less than four months.

12. Regarding physical and operational feasibility, El Paso's Yuma lateral is capacity constrained, raising some question as to whether a bypass is operationally feasible. Southwest addressed this issue in its application, stating that, if Southwest no longer used part of its capacity to service Yuma Cogen, the resulting capacity on the El Paso lateral could be made available to another shipper for use on an alternate or interruptible basis. Southwest believes that Yuma Cogen would then have a "fairly reliable opportunity to receive service directly from El Paso." Also addressing the issue of constrained capacity, Yuma Cogen states that the Yuma lateral is constrained only with respect its contractual capacity, and is operating well within its physical capacity.

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13. Another consideration concerning physical/operational feasibility is that Yuma Cogen's facilities are only approximately 100 feet away from El Paso's lateral. Southwest believes that little or no additional work would be required to effect a bypass, once Yuma Cogen purchased the distribution system.

14. Interruptible Service /Alternate Fuel Capability

Southwest states that it maintains an interruptible contract with Yuma Cogen because the facility is a large customer and Southwest wants a mechanism in place that would allow diversion of the facility's gas supplies to Priority 1 and 2 customers, if necessary, to meet peak-day or near peak-day requirements. Southwest also indicates that being able to sell unused capacity under the SGPA offsets capacity and margin costs to core customers. Under the current and proposed SGPAs, Southwest is allowed to interrupt gas service to Yuma Cogen for up to ten days each year. Yuma Cogen and Southwest have both informed Staff that, during the 14 to 15 years Yuma Cogen has received service from Southwest, its gas supplies have never actually been interrupted. Yuma Cogen has also acknowledged that the risks of interruption are greater if the facility takes service directly from El Paso.[2]

15. The application asserts that Yuma Cogen's ability to switch to an alternate fuel supports the feasibility of bypass. While this would mitigate the increased risk of interruption, Staff notes that the facility would not be able to make the switch on an immediate basis. Yuma Cogen maintains a 525,000-gallon fuel oil storage tank, and operational pumps, but does not keep alternate fuel supplies on-site. The Yuma Cogeneration facility could be recommissioned to run on fuel oil in approximately two weeks, but that once this process was complete the facility would be able, in the future, to switch fuels immediately in the event of an interruption in natural gas service. Yuma Cogen also maintains the required permit from the Arizona Department of Environmental Quality ("ADEQ") to use fuel oil for electric generation.

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[2] If Yuma Cogen is interrupted, the primary financial consequence would be the loss of normal energy and capacity revenues; however, should the facility fail to generate 80% of the peak hours during each peak month (May through September) Yuma Cogen could be placed on probationary status and face the possibility of contractual default under its purchase power agreement with San Diego Gas and Electric.

16. The increased risk of interruption and the time required for Yuma Cogen to convert to fuel oil raise some question about the difficulty and potential consequences of bypassing Southwest. Nevertheless, Staff believes that Yuma Cogen's maintenance of the equipment and permit required to convert to fuel oil support the contention that the facility would be willing and able to bypass Southwest, particularly in light of the increase in cost it would experience under the G-60 tariff

17. Staff Analysis

Based on the application, data responses and communications with both Southwest and Yuma Cogen, Staff believes that bypass is feasible in accordance with the requirements of the G-30 tariff. Staff also believes that service to Yuma Cogen under the G-30 tariff is reasonable, both in light of the potential for bypass and because Yuma Cogen makes significant contributions to margin and capacity costs, benefits to core customers that would be lost should Yuma Cogen start taking service directly from El Paso.

18. Charges under the SGPA would include a monthly basic service charge, applicable upstream pipeline costs, and volumetric charges including the gas cost. The proposed agreement also contains provisions for cashing out daily imbalances experienced by Yuma Cogen. In addition, the agreement contains provisions detailing how Yuma Cogen and Southwest would coordinate various operational issues. Staff has reviewed the rates and terms of service under the SGPA and believes that they are consistent with the G-30 tariff.

19. The proposed SGPA would set a primary term of two years for the agreement, and would continue on a month-to-month basis thereafter. The month-to-month extensions would be subject to termination by either party upon ninety days notice. Staff has recommended that the Commission approve Southwest's new SGPA with Yuma Cogen for a period of two years, effective on the first of the month following approval and extending for two years, but has also recommended that month-to-month extensions be limited to no more than twelve additional months without Commission approval. Limiting the period for extensions would allow the Commission the opportunity to determine whether bypass is, in fact, still feasible following the end of the proposed agreement.

20. Under the proposed SGPA, Yuma Cogen would pay the El Paso FT-1 reservation rate. Southwest has indicated that the capacity and other El Paso charges that it receives are credited to the bank balance. Staff has recommended that the capacity costs credited to the Purchased Gas Adjustor bank balance continue to be equivalent to El Paso's FT-1 reservation rate.

21. Because core customers should not bear the risks of this agreement, Staff has recommended that Southwest be prohibited from passing any negative margin that may result from this agreement to Southwest's core customers in any future proceeding.

CONCLUSIONS OF LAW

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

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

3. The Commission, having reviewed the application and Staff's Memorandum dated June17, 2008, concludes that it is in the public interest to approve the Special Gas Procurement Agreement between Southwest Gas and Yuma Cogen.

ORDER

IT IS THEREFORE ORDERED that the Special Gas Procurement Agreement between Southwest and Yuma Cogen be and herby is approved, for a period of two years, effective on the first of the month following approval and extending for two years, with the modifications indicated below.

IT IS FURTHER ORDERED that month-to-month extensions of the Special Gas Procurement Agreement be limited to no more than twelve additional months without Commission approval.

IT IS FURTHER ORDERED that the capacity costs credited to the Purchased Gas Adjustor bank balance continue to be equivalent to El Paso's FT-1 reservation rate.

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IT IS FURTHER ORDERED that Southwest be prohibited from passing any negative margin that may result from this agreement to Southwest's core customers in any future proceeding.

IT IS FURTHER ORDERED that this Decision 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 3rd day of July, 2008.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT: ____________________

DISSENT: ____________________

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