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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION) DOCKET NO. G-01551A-04-0192
OF SOUTHWEST GAS CORPORATION)
FOR PRE-APPROVAL OF COST) DECISION NO. _____
RECOVERY FOR PARTICIPATION IN THE) ORDER
KINDER MORGAN SILVER CANYON)
PIPELINE PROJECT)

Open Meeting
June 24, 2004
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Southwest Gas Corporation (“Southwest” or “Company”) is engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.
2. On March 12, 2004, Southwest filed for Commission pre-approval of cost recovery for participation in the Kinder Morgan Silver Canyon pipeline project. Southwest has provided certain information to the Commission pursuant to a confidentiality agreement.
3. The Silver Canyon pipeline project is a proposed new pipeline which Kinder Morgan Energy Partners would build from the San Juan supply basin in northwest New Mexico to Phoenix and then to the California border at Ehrenberg.
4. Southwest’s filing is pursuant to the Commission’s on-going Notice of Inquiry on Natural Gas Infrastructure (“NOI”), which the Commission initiated in April, 2003 to consider issues related to natural gas infrastructure and their impact on natural gas service in Arizona.

1 5. On June 1, 2004, Staff filed its Staff Report in this matter, containing Staff's
2 evaluation and recommendations regarding this Southwest filing. A confidential and a redacted
3 version of the Staff Report have been put forth.

4 6. Traditionally, Arizona shippers had received virtually all of their natural gas service
5 on the El Paso Natural Gas ("El Paso") pipeline system. A small amount of service in northern
6 Arizona is provided from the Transwestern pipeline, but El Paso has a monopoly on natural gas
7 service in central and southern Arizona, including the Phoenix and Tucson metropolitan areas.

8 7. Natural gas service in Arizona has experienced a great deal of uncertainty and has
9 changed in many ways in recent years. Natural gas demand has grown significantly in Arizona
10 and the Southwest, particularly in the electric generation sector. At the same time traditional
11 Arizona shippers, including Southwest and other utilities regulated by the Commission, have
12 experienced the loss of full requirements rights and other related circumstances which have raised
13 serious concerns about the ability of Arizona to have continued reliable natural gas service (and by
14 proxy electricity service) in the future.

15 8. Additionally, the net effect of the full requirements conversion and other Federal
16 Energy Regulatory Commission ("FERC") actions has been a significant shift of Arizona natural
17 gas sourcing from the San Juan supply basin to the higher cost Permian basin.

18 9. The Staff Report discusses a number of specific concerns that exist with regard to
19 Arizona's natural gas supplies, including: reduced access to San Juan gas, questionable firmness
20 and accessibility of some El Paso capacity serving Arizona, reduced operational flexibility at
21 higher cost, the failure of natural gas infrastructure in the Southwest to grow in proportion to
22 natural gas demand, the California settlement with El Paso regarding market manipulation
23 allegations, current and future El Paso pipeline proceedings, the current concentration of Arizona
24 regulatory risk at FERC on natural gas matters, uncertainty regarding future regional natural gas
25 market dynamics, and the national concern over natural gas supplies and prices.

26 10. In response to the serious issues facing Arizona's natural gas service both now and
27 in the future, the Commission initiated the NOI in April 2003. Through the NOI, the Commission
28 has conducted several workshops and has received a good deal of input at a number of points in

1 the process from a variety of interested parties.

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

11 12. Southwest's filing addresses many of the topics which the Commission's December
12 18, 2003, Policy Statement Regarding New Natural Gas Pipeline and Storage Costs identifies.

13 13. Southwest's filing requests pre-approval of the specific reservation charges,
14 volumetric charges, fuel charges, and applicable surcharges related to the specific block of pipeline
15 capacity it plans to acquire on the Silver Canyon pipeline project. Southwest's filing contemplates
16 these specific charges being recovered through Southwest's existing purchased gas adjustor (PGA)
17 mechanism, as Southwest currently recovers these types of costs for its El Paso pipeline capacity.
18 Such costs would not be recovered through Southwest's PGA mechanism until Southwest begins
19 taking service on the Silver Canyon project, likely in the latter part of 2006.

20 14. On January 9, 2004, Southwest entered into a precedent agreement with Silver
21 Canyon for pipeline capacity. The currently projected timeline for the Silver Canyon project is
22 that it would file with FERC in the fourth quarter of 2004, begin construction in the fourth quarter
23 of 2005, and begin service in the third quarter of 2006.

24 15. The precedent agreement contains a variety of termination rights which the parties
25 can exercise at various points in the process. Under the precedent agreement, Silver Canyon
26 would provide Southwest with certain operational flexibilities which enhance the value of the
27 pipeline capacity to Southwest.

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1 16. In a situation such as the Southwestern natural gas market, where there is
2 uncertainty about so many issues, it is difficult to assess with certainty the relative benefits of one
3 pipeline project, such as the Silver Canyon project, with other new pipeline projects or existing
4 service options such as El Paso service, particularly as some benefits are difficult if not impossible
5 to quantify.

6 17. In comparison to service on El Paso, it appears that Silver Canyon service may be
7 somewhat more expensive, based solely on comparing Silver Canyon rates with existing El Paso
8 rates. However, with the likelihood of higher rates on the El Paso system, along with the access to
9 San Juan gas Silver Canyon provides, as well as the greater operational flexibility on the Silver
10 Canyon pipeline, it is possible that the Silver Canyon line may prove to be as cheap or cheaper
11 than El Paso service.

12 18. Additionally, introduction of a second pipeline into a region where one pipeline has
13 had a monopolistic position is likely to create a more competitive marketplace for pipeline service,
14 which should be beneficial to Arizona in the long term.

15 19. The estimated impact of the cost of Silver Canyon capacity on a typical residential
16 customer bill is quite small, likely less than \$0.01 per therm. Further, in light of high natural gas
17 commodity costs, the cost of pipeline capacity has become less important in the overall cost of gas
18 and the possibility of new natural gas infrastructure enabling Southwest or other utilities to reduce
19 their natural gas commodity costs has become more important.

20 20. It appears likely that a good deal of uncertainty will continue to exist regarding
21 natural gas supply issues in Arizona and the Southwest, given current circumstances in the region.
22 However, there is little doubt that given the burgeoning natural gas demand in Arizona and
23 elsewhere in the Southwest that additional natural gas infrastructure will be needed to ensure
24 continued reliable natural gas service.

25 21. While the Commission traditionally has not pre-approved recovery of costs related
26 to the acquisition of pipeline capacity, the present, serious conditions existing in regard to
27 Arizona's natural gas infrastructure argue for action beyond the normal course of business at the
28 Commission, in this case.

1 22. Southwest's acquisition of Silver Canyon capacity can play a role in moving toward
2 a more robust natural gas infrastructure in Arizona and reducing the possibility of natural gas
3 service disruptions in the future. Further, Southwest's acquisition of Silver Canyon capacity will
4 likely only have a very minimal upward impact on Southwest's customers bills and could under
5 certain circumstances actually reduce the overall cost of gas.

6 23. The Staff Report contains the following conditions:

- 7 • The Commission retains full authority to review Southwest's gas procurement activities,
8 including its management of all pipeline capacity and related activities, recognizing that the
9 Commission is pre-approving the underlying acquisition of the Silver Canyon capacity
10 during the initial ten year term of the agreement with Silver Canyon. The pre-approval
11 being granted in this proceeding would expire upon completion of the initial 10 year term.
- 12 • Any impact on Southwest's risk profile resulting from pre-approval of costs related to
13 Silver Canyon pipeline capacity would be considered within the context of future
14 Southwest rate proceedings.
- 15 • Southwest shall file a status report on the Silver Canyon project and Southwest's
16 participation in the project with the Commission every six months until either Southwest
17 begins taking service from Silver Canyon or Southwest's participation in the project is
18 terminated.
- 19 • Southwest shall notify the Commission when the exact volumetric and fuel rates are set for
20 the Silver Canyon pipeline, within ten days of such rates being set.
- 21 • Southwest shall notify the Commission within ten days of when the Company knows with
22 certainty that it will participate in the pipeline capacity volumes identified in the
23 application.
- 24 • Southwest shall notify the Commission within ten days of each of the following events
25 regarding the Silver Canyon project: Silver Canyon filing with FERC for approval of the
26 pipeline, FERC granting approval of the pipeline, Silver Canyon beginning construction of
27 the pipeline, Silver Canyon completing construction of the pipeline, and Southwest
28 beginning to take service from the Silver Canyon pipeline.
- Southwest shall notify to the Commission if at any time either Southwest or Silver Canyon
exercise termination rights pursuant to the precedent agreement or any other events
significantly impact Southwest's participation in the Silver Canyon project, within ten days
of any such action.

- 1 • Pre-approval of the specific costs related to Southwest's acquisition of capacity on the
2 Silver Canyon pipeline is granted based upon the specific and unique conditions considered
3 in this application and will in no way commit or predispose the Commission regarding any
4 future considerations of pre-approval of costs. Rather, the standing presumption would be
5 that the Commission would not grant pre-approval in future proceedings, absent a careful
6 consideration of unique, serious, and important circumstances which would require such
7 action.
- 8 • None of the pre-approved costs will be passed on to Southwest's ratepayers until all of the
9 following occur:
 - 10 ○ The Silver Canyon pipeline is built and operational.
 - 11 ○ Southwest is receiving service on the Silver Canyon project consistent with the
12 precedent agreement and this order.
 - 13 ○ Southwest shall submit for Staff approval the format and content of Silver Canyon
14 related information to be reported in Southwest's monthly PGA report.

15 24. Staff, Southwest, and the Residential Utility Consumer Office ("RUCO") have met
16 a number of times to discuss this matter. It is Staff's understanding that both RUCO and
17 Southwest generally support the Staff Report and the accompanying proposed order, based on
18 discussions with those parties. Staff has sent an e-mail to all parties on the e-mail distribution list
19 for the Commission's Notice of Inquiry on Natural Gas Infrastructure, indicating that Southwest
20 has made the filing in this proceeding. Staff has placed the Southwest application on the
21 Commission's website to facilitate public access and contemplates placing further documents
22 related to this proceeding on the Commission's website. Staff will also notify parties on the NOI
23 e-mail distribution list as matters develop further in this proceeding.

24 25. Staff believes that Southwest's participation in the Silver Canyon project is
25 reasonable given the information available at this time.

26 26. Staff has recommended that the Commission pre-approve Southwest's specific
27 costs (reservation charges, volumetric rate, fuel rate, and applicable surcharges) discussed herein
28 related to the proposed Silver Canyon pipeline project, for recovery through Southwest's PGA
mechanism.

29 27. Staff has further recommended a set of conditions contained in Finding of Fact
Number 23.

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CONCLUSIONS OF LAW

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

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

6 3. The Commission, having reviewed the application and Staff's Memorandum dated
7 June 2, 2004, concludes that it is in the public interest to approve the filing as discussed herein.

ORDER

9 IT IS THEREFORE ORDERED that this filing be and is hereby approved, as per the
10 discussion herein and subject to the conditions identified in Finding of Fact Number 23.

11 IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

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15 CHAIRMAN

COMMISSIONER

COMMISSIONER

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18 COMMISSIONER

COMMISSIONER

19 IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive
20 Secretary of the Arizona Corporation Commission, have
21 hereunto, set my hand and caused the official seal of this
22 Commission to be affixed at the Capitol, in the City of
23 Phoenix, this ____ day of _____, 2004.

24 _____
BRIAN C. McNEIL
Executive Secretary

25 DISSENT: _____

26 DISSENT: _____

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28 EGJ:RGG:rdp/JMA

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