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AZ CORPORATION COMMISSION  
DIRECTOR OF UTILITIES

June 27, 2003

Mr. Bob Gray  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

**Reference: Arizona Corporation Commission Notice of Inquiry on April 15, 2003 regarding the "Policy and Action on Natural Gas Infrastructure Matters in Arizona".**

**Enclosure: Copper Eagle Gas Storage, LLC Response to Notice of Inquiry dated April 15, 2003 regarding the "Policy and Action on Natural Gas Infrastructure Matters in Arizona."**

Dear Bob,

The enclosed document is the response of Copper Eagle Gas Storage LLC, to the Notice of Inquiry issued by the Utilities Division Staff of the Arizona Corporation Commission on April 15, 2003 regarding the "Policy and Action on Natural Gas Infrastructure Matters in Arizona."

We appreciate the opportunity to provide input on these important issues and thank the Commission for recognition of the importance of natural gas infrastructure to Arizona and the Southwestern United States. We realize our response does not meet the requested timeframe of the Notice but are hopeful that the Commission will give due consideration to the response.

Sincerely,

Matt Reid  
General Manager  
Copper Eagle Gas Storage, LLC.

**COPPER EAGLE GAS STORAGE, LLC  
RESPONSE TO NOTICE OF INQUIRY ON THE ISSUE  
OF  
ARIZONA CORPORATION COMMISSION  
POLICY AND ACTION ON  
NATURAL GAS INFRASTRUCTURE MATTERS  
IN ARIZONA**

Submitted to the Arizona Corporation Commission  
Utilities Division Staff  
June 27, 2003

## **I. INTRODUCTION**

Copper Eagle Gas Storage, LLC (“CEGS” or “Company”) hereby responds to the Notice of Inquiry (“Notice”) issued by the Utilities Division Staff (“Staff”) of the Arizona Corporation Commission (“Commission”) on April 15, 2003 regarding the “Policy and Action on Natural Gas Infrastructure Matters in Arizona.”

Copper Eagle supports the Commission’s consideration and implementation of means and options to encourage the development and construction of new supply infrastructure, notably gas storage facilities, to serve Arizona. The addition of storage capacity not only will increase reliability and deliverability, but it also will reduce the State’s dependence on the existing pipeline network serving the bulk of Arizona users. Those benefits ultimately should result in lower costs for Arizona customers. To further such result, however, it is important to avoid duplicative or conflicting regulation that easily could negate the benefits of having gas storage facilities. Instead, the coordination of any policies implemented by the Commission with the Federal Energy Regulatory Commission’s (“FERC”) siting and operational requirements would enhance efficiency of regulation and reduce regulatory costs.

The need for expansion and improvements in Arizona’s gas delivery infrastructure is becoming ever more apparent, as the demand for electricity is increasingly served by gas-fired generation. At the same time, the future health and nature of competitive markets is uncertain. This uncertainty is reflected in the reluctance of the capital markets to supply needed investment dollars to fund necessary infrastructure. We are at a critical juncture where the question of how to build infrastructure today to ensure reliable and economic energy in the future needs to be addressed at a policy level. Gas storage should to be an important part of that policy discussion.

Section II of this Response addresses the specific questions posed by Staff in the Notice.

## II. QUESTIONS AND RESPONSES

### 1. Should the Commission develop formal or informal policies regarding the use of natural gas storage by Arizona utilities?

Under the Natural Gas Act, the FERC has jurisdiction over “the transportation of natural gas in interstate commerce” 15 U.S.C. § 717c(a). Because storage of natural gas originating out of state and delivered by pipelines to storage facilities in Arizona is within the definition of “transportation” (see 18 C.F.R. § 284.1(a)), FERC is primarily responsible for the siting, certification, development and regulation of such facilities. Copper Eagle encourages the Commission, to the extent that it can, to foster an environment through formal or informal policies that will lead to the development of natural gas storage facilities in Arizona. Copper Eagle also cautions the Commission to avoid, where reasonably possible, duplicative or conflicting regulation over such facilities.

Arizona has natural resources that are conducive to the construction of gas storage facilities. The ability to store gas in close proximity to the growing Phoenix market area would provide increased reliability of gas supply and improve the operational flexibility of the pipeline system. Gas storage can be used by local distribution companies (“LDCs”) and electric utilities to better manage risk associated with the cost of gas supply through an optimization of pipeline capacity and storage costs.

Unfortunately, gas storage and pipeline projects involve investment of significant capital in advance of in-service dates. Capital markets are not willing to advance the significant funds needed for build-out based solely on the theory that “if we build it, they will come.” Attracting adequate capital at reasonable rates requires gas storage developers to manage the financial risk with advance commitments through long-term contracts sufficient to justify the economics of facility development. At the same time, however, LDCs and electric utilities are equally hesitant to enter into such long-term contracts without some assurance that they will be able to recover the costs of such contracts. Consequently, we are left with a situation where needed facilities, such as gas storage, either cannot attract capital, or cannot attract it at a reasonable cost. The potential consequences are reduced reliability and higher costs for consumers.

Sound public policy would encourage both LDCs and electric utilities to thoroughly evaluate gas storage as part of their overall resource planning process. They would receive prompt review of the prudence of such contracts and consequent assurance of full cost recovery. This would encourage the market to supply adequate capital and reasonable rates, thereby facilitating

the construction of gas storage facilities as part of the needed infrastructure in Arizona.

**2. Should natural gas storage use by electric utilities be viewed and treated differently than natural gas storage used by natural gas local distribution companies? Please explain.**

As a storage developer, Copper Eagle is open to any type of party that contracts for capacity in the storage facility. Ultimately, the storage capacity developed and the use of storage services will be determined by the market place. Copper Eagle encourages the Commission to promote favorable treatment of the cost of prudent use of storage services by utilities under their jurisdiction.

**3. What issues should the Commission address in creating any Commission policy on natural gas storage?**

First, utilities should be encouraged to evaluate gas storage as part of their overall resource planning. Second, the Commission should do what it can to assist in educating the public on the benefits of gas storage as part of the overall energy infrastructure in Arizona. Third, if the Commission believes a particular storage project is in the public interest, it should consider supporting an application at FERC to allow construction of the facility. Fourth, Commission policy should support recovery of costs prudently incurred by utilities under their jurisdiction that utilize storage as a portion of their gas supply infrastructure. The more confident an LDC or electric utility is that it will receive prompt review and recovery of prudent costs incurred, the more likely it is to invest in the development of such infrastructure by ultimately entering into long-term contracts for natural gas storage.

**4. If Arizona utilities utilize natural gas storage, how should the Commission address the recovery of costs for such storage and what costs should be considered?**

To answer this question, several factors need to be taken into account. Because of the weather patterns in Arizona, particularly in the summer, electric utilities are faced with relatively low annual load factors and high volumetric variations in electricity. The price of gas is among the most volatile of any commodity. Compared with other jurisdictions, the gas pipeline infrastructure in Arizona is currently somewhat limited. For these reasons, consideration of cost recovery needs to encompass more than the cost savings realized by utilizing gas storage. It must also take into account the

benefits associated with managing volumetric and price risk of gas and gas transportation, as well as valuing the need for reliability. In evaluating the prudence of a storage investment or contract, the Commission should not only evaluate the immediate implications of the contract but also the long-term reliability and value that having an alternate source of supply will provide. Copper Eagle believes that each user of storage services should identify the value of gas storage based on the specific characteristics of their natural gas requirements. The Commission should ensure that all factors are taken into account in validating that value.

**5. Should the Commission encourage the use of natural gas storage for addressing natural gas price volatility, reliability of natural gas supply and/or other possible goals of natural gas storage? Please indicate which goals should be pursued as well as the relative importance of each goal.**

As stated above, Copper Eagle supports the Commission's efforts to encourage use of natural gas storage to promote the goals of: (i) reliability; (ii) managing volumetric risk; (iii) managing price risk; and (iv) lowering costs to the consumer. We believe each goal carries equal weight in determining the value of gas storage.

**6. How should the Commission address the goal of maximizing customer benefits from natural gas storage while minimizing the cost to consumers of utilizing such storage?**

Basically, Copper Eagle believes that two general policies will assist the Commission in meeting these objectives. First, the Commission should facilitate investment through allowing quick and certain prudency review, as discussed above. Second, infrastructure such as gas storage and pipelines, much like electric generation and transmission, needs to be planned and built in advance of its need. Waiting until the need becomes critical not only risks reliability, but also increases the cost significantly. A major contributing factor in this cost increase is unique to Arizona. The rate of population growth and development makes siting facilities more difficult and expensive. Earlier development offers the best opportunity to secure sites before urban development creates incompatible land use issues and increases the costs of land and siting requirements.

**7. How does the use of natural gas storage relate to other methods of reducing price volatility, such as the use of longer term supply contracts and financial hedging?**

Hedging and long-term contracts are useful tools for managing gas price volatility. However, the use of physical natural gas storage will actually increase the value and decrease the cost and risk associated with these hedging strategies. For example, the use of long term contracts can lock in a fixed volume at a fixed price, but at the same time may increase the liquidation risk associated with any amount that is in excess of needs on the day of delivery. Storage provides a means of “parking” gas to better time the market and allows the user to reduce the risk of being at the mercy of the spot market. This allows base needs to be managed by contract, while storage serves to mitigate the risk associated with more extreme and immediate term variations in supply needs. Market area gas storage may also facilitate the formation of a market hub, and lead to increased liquidity for trading activity and use of financial hedging tools for controlling price volatility.

In addition, long-term contracts and hedging strategies are not effective in managing reliability risk, particularly with respect to transportation issues. Storage increases delivery reliability and, as discussed below, allows the ability to reduce pipeline reservations for extreme peak requirements.

**8. Is there a relationship between the use of natural gas storage and what interstate pipeline capacity rights a utility holds? And if so, how should the Commission address this relationship?**

A utility’s interstate pipeline capacity rights will bear a relationship to its use of storage. For example, absent a direct interconnect from the storage facility to the utility, pipeline capacity is needed to inject gas into and withdraw gas from storage. The existence of storage capacity, however, can reduce a utility’s dependence on pipeline capacity. This is because market area storage capacity can act as surrogate for additional capacity adding to the deliverability in constrained periods and peak seasons. Since most pipelines sell pipeline capacity in annual quantities, a utility with an obligation to serve must hold enough firm pipeline capacity to meet the consumers peak needs. That can be very costly, especially when the peak demand is several times the average demand. With the availability of high deliverability market based gas storage services, utility planners may be able to determine an optimum combination of pipeline capacity and storage services to meet their unique needs at a cost below that of the equivalent pipeline capacity alone.

Commission policy should support recovery of costs prudently incurred by utilities under their jurisdiction that utilize storage as a portion of their gas supply infrastructure.

**9. What monitoring, reporting, and evaluation should the Commission undertake in regard to Arizona utilities’ use of natural gas storage?**

Copper Eagle encourages the Commission to promote favorable treatment of the cost of storage services used by electric utilities and LDCs to encourage prudent use of storage services.

**10. Should the Commission develop formal or informal policies regarding the use of interstate pipelines by Arizona utilities? If so, what areas should policies address?**

Copper Eagle has no position on this.

**11. Are there ways the Commission could encourage use of interstate pipelines in ways that would enhance the reliability and reduce the costs of natural gas service in Arizona?**

Copper Eagle has no position on this.

**12. How should the Commission balance goals such as reliability, cost, portfolio diversity, and operational flexibility as it considers the use of interstate pipeline facilities by Arizona utilities?**

Copper Eagle has no position on this.

**13. Previously the Commission has recognized the benefit of having Arizona local distribution companies have a diversified gas supply portfolio. Should the Commission encourage Arizona utilities to diversify their sources of interstate pipeline capacity, rather than relying on a single interstate pipeline for all pipeline capacity?**

Copper Eagle has no position on this.

**14. Are there other areas where the concept of a diversified supply portfolio can and should be applied by the Commission?**

Copper Eagle believes storage should be a key element of gas supply infrastructure. The ability to inject gas when demand is low, and withdraw market-area gas when demand is high provides a more diversified supply portfolio. Therefore, the Commission should adopt consistent supporting regulatory policies that facilitate the proper level of development of the gas supply infrastructure.

**15. Should the Commission address proposals for new pipelines, expansions of existing pipelines, or new storage facilities? If so, how should the proposals be addressed by the Commission?**

Because the jurisdiction over such facilities lies with the FERC, the FERC ultimately will determine which pipelines or gas storage facilities are approved. However, Copper Eagle believes the Commission should: 1) be an active participant in FERC certification proceedings by supporting the requisite demonstration of need, which is heavily relied upon by the FERC; 2) facilitate to the extent it can a “one-stop shopping” process to accelerate the requisite local and state approvals; and 3) institute an appropriate pre-approval/cost recovery mechanism for prudently incurred costs to encourage the contracting of capacity and thus the investment in such ventures.

**16. Are there other natural gas infrastructure issues which the Commission should be addressing?**

Copper Eagle has no position on this.

**17. Should the Commission hold one or more workshops to further investigate natural gas storage and interstate pipeline issues?**

Yes, because regional planning and coordination on the issues raised by Staff in the Notice will benefit Arizona, Copper Eagle supports the Commission’s holding of one or more workshops to discuss the issues raised.