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ARIZONA CORPORATION COMMISSION

December 18, 2003

ACC Policy Statement Regarding New Natural Gas Pipeline and Storage Costs

A variety of factors have brought attention to the need for additional natural gas infrastructure in Arizona. These factors include growing demand for natural gas across all sectors, the construction of numerous new gas-fired electric generation facilities, the recent limitations placed on traditional Arizona shippers on the El Paso pipeline system, concerns with the national supply/demand balance in natural gas markets, and the heightened interest nationally in infrastructure security and reliability.

Since April 2003 the Commission, through the Notice of Inquiry (NOI) on Gas Infrastructure process, has been considering how it can address issues related to Arizona's current and future natural gas infrastructure. A variety of pipeline and storage projects have been proposed by various developers in recent years. These projects have engendered significant interest by Arizona parties who would seek to acquire capacity on such projects. At this time it is unclear which project(s) will eventually be built in Arizona. A significant issue for the Commission in regard to such projects is the cost recovery treatment of Arizona utilities' participation in one or more projects. Such utility participation could take a variety of forms, from acquiring pipeline or storage capacity on a new project to the utilities taking an equity position in one or more projects.

Properly addressing cost issues is important to the Commission, the companies involved, and Arizona's utility consumers. Traditionally Arizona entities have not sought and the Commission has not granted pre-approval of cost recovery from participation in infrastructure projects or other projects. Rather utilities made their own business decisions on those projects. At a later time the Commission addressed cost recovery in proceedings such as rate cases and adjustor mechanisms. One important reason for this traditional approach has been to ensure that the Commission has a full opportunity to evaluate the actions taken and costs incurred by the utility for prudence and in the best interest of Arizona's utility consumers. This approach provided incentive to utilities to pick the most cost-effective project. This traditional approach to utility participation in infrastructure projects, including natural gas pipeline and storage projects, is still available to utilities that wish to continue using this method. This is the preferred method.

In recognition of the current need for natural gas infrastructure in Arizona, the Commission has also been considering alternate approaches to encourage the development of infrastructure in Arizona. Pre-approval of cost recovery would be one possible mechanism. The alternative recovery mechanism should incite utilities to invest in the infrastructure they need to provide the best service to their customers. Such a mechanism should also be designed so that it will not cause utilities to behave in such a way as to maximize their benefit to the detriment of

their customers through increased costs or degradation of service. The equal yoking of company and ratepayer interests is a challenging endeavor when creating a new mechanism. Changing the dynamics of cost recovery is therefore something which should be done very carefully, as it can have a variety of impacts, including some possibly unexpected side effects. The pros and cons of adopting some form of alternative cost recovery beyond the traditional method(s) should be considered carefully as utility company needs and ratepayer interests are balanced.

POLICY STATEMENTS

I. Supply/Infrastructure Diversity

1. Diversity in Arizona's natural gas infrastructure, including interstate pipeline facilities, natural gas storage facilities, and related aspects of natural gas service, is beneficial and should be actively pursued by Arizona utilities as a way of providing greater supply reliability and flexibility and possible lower costs.
2. Arizona utilities as a general principle should pursue a diverse natural gas supply portfolio which takes into account relevant factors including cost, reliability, flexibility, safety, and price stability.
3. Arizona utilities should consider natural gas storage as an integral component of their efforts to develop a diverse natural gas supply portfolio, recognizing the variety of potential benefits of natural gas storage, including enhanced reliability, operational flexibility, more efficient use of pipeline capacity assets, and reduced natural gas price volatility.
4. The current monopoly on interstate pipeline service in central and southern Arizona is not beneficial to the state of Arizona. The Commission encourages development of alternative natural gas supply options, including one or more new interstate pipelines and natural gas storage facilities. Reduction over time of Arizona's reliance on a single pipeline system reduces the risk to Arizona of operational, regulatory, or other problems which may occur in regard to any given pipeline system.

II. Supply/Infrastructure Planning

1. Arizona utilities should plan for natural gas infrastructure needs on a long term basis, recognizing that some decisions may not necessarily lead to the lowest cost in the short term. Such planning should take into account the lead time necessary to construct and put in service natural gas infrastructure in Arizona.
2. The Commission endorses voluntary efforts to analyze and plan for the present and future natural gas supply needs of Arizona and encourages Arizona utilities and others to actively participate in such activities.

III. Commission Approach to New Infrastructure Projects

1. The Commission, as a general proposition chooses not to endorse specific infrastructure projects. The Commission believes that the region's natural gas consumers and infrastructure developers play a fundamental role in determining how to best address the region's infrastructure needs. The Commission anticipates continued active involvement in FERC proceedings related to Arizona's natural gas infrastructure, as the Commission deems appropriate.

IV. General Commission Approach

1. The Commission NOI on natural gas infrastructure activities recognizes the jurisdiction and central role of FERC in developing new natural gas infrastructure in the Southwest and anticipates the Commission's NOI initiative as being complementary to FERC's activities, recognizing that both state and federal regulators can play a role in Arizona's natural gas infrastructure development.
2. The Commission encourages open, on-going and substantive communication between Arizona utilities and the Commission as Arizona's natural gas infrastructure is developed in the coming years.
3. At this time the Commission believes that the best method for the Commission to address natural gas infrastructure matters is to encourage utilities to file applications, including requests for alternate cost treatment, in order that the Commission can consider specific requests for cost recovery proposals appropriate to the circumstances for each individual application.

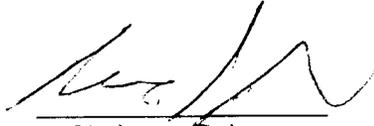
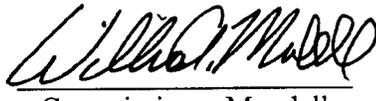
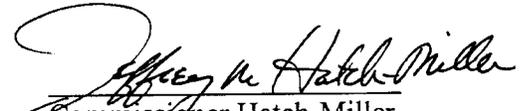
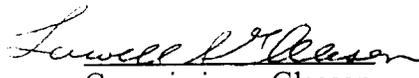
V. Individual Utility Circumstances

1. As individual Arizona utilities consider their participation in the development of natural gas infrastructure, the Commission recognizes that each utility's circumstances and needs are unique and participation in natural gas infrastructure projects will vary accordingly.

VI. Reporting

1. Reporting for any additional pipeline services should be consistent with the method and content of current reporting by utilities for their current pipeline services.
2. Reporting requirements for natural gas storage activities will need to be developed, given the lack of current natural gas storage availability in Arizona. Utilities should work with Staff to develop the proper reporting format and content to be included in reports to the Commission, including possibly through existing monthly adjustor reports or other reporting methods as deemed appropriate.

In light of the need to develop natural gas infrastructure to ensure that Arizona ratepayers receive reliable natural gas service, the undersigned Commissioners hereby endorse the policies discussed above. Endorsement of these policies will send a clear signal to Arizonans, the energy industry, and others that the Arizona Corporation Commission is addressing the natural gas infrastructure needs of Arizona.


Chairman Spitzer
Commissioner Mundell
Commissioner Hatch-Miller
Commissioner Gleason
Commissioner Mayes