City Council Report

Date: May 19, 2014

To: City Council

Through: Kari Kent, Deputy City Manager

From: Frank McRae, Energy Resources Department Director
Pedro Serrano, Energy Resources Program Manager

Subject: Natural Gas Transportation Service Agreements
Approval of Agreement for Ten (10) Years of Natural Gas Transportation
Council District #1, 2, 3, 4, 5 & 6

Strategic Initiatives

Purpose and Recommendation

The Energy Resources Department ("ERD") recommends that the City Council authorize the City Manager or his designee to execute an agreement with a term of ten (10) years ("Supply Period") for the transportation of natural gas with El Paso Natural Gas, A Kinder Morgan Company ("EPNG"). The agreement is EPNG's standard Transportation Service Agreement ("TSA") as found in their Tariff that is approved by the Federal Energy Regulatory Commission.

Background

Mesa operates a natural gas, local distribution utility that provides service to two major service areas: 1) the City Service Area, approximately 90-square miles primarily within City limits, and 2) the Magma Service Area, a 236-square mile system located southeast of the City in Pinal County. Mesa's combined natural gas system is comprised of approximately 1,264 miles of distribution mains and, as of December 31, 2014, served approximately 58,200 customer accounts. Mesa's historic annual natural gas supply requirements range between approximately 3,000,000 Dekatherms (DTh) and 3,200,000 DTh, depending most significantly on weather.

All of the natural gas provided by the ERD Natural Gas Utility ("Gas Utility") is delivered to the Gas Utility by EPNG under the terms and conditions of two TSAs that were last amended and effective February 1, 2013. The TSA's provide the Gas

Utility with the ability to transport its total daily natural gas supplies from production areas in Texas and New Mexico to its five (5) Gas Utility-owned city gate stations located in both the City Service Area and Magma Service Area.

The two TSAs enumerate Mesa's total Transportation Contract Demand ("TCD"), which is the reserved capacity on EPNG's pipeline that Mesa purchases every month. Mesa operates with two separate TSA's because its TCD is split between two different tariff structures. One TSA (FT2AF000) provides service under rates that were stipulated to as part of a rate case settlement in 1996 between EPNG and its customers, including Mesa ("Article 11.2 Rates").[1] The other TSA (FT2AE000) provides service pursuant to EPNG's current and future tariff rates and is the subject TSA of this memo.[2]

Discussion

TSA FT2AE000 expires in June of 2014 and it is recommended that this Agreement be renewed in order to retain EPNG as our natural gas transportation supplier. The renewal period will be for an initial term of ten (10) years. The Agreement does not result in any new charges to Mesa; rather, it provides the regulated rates and terms and conditions of service of EPNG to Mesa. The Agreement is in EPNG's standard format which is similar to the TSA's that were executed for the addition of Mesa Gate Station Number 3 in 2013. Therefore, it is recommended that Mesa execute the TSA.

Alternatives

EPNG and Transwestern Corporation jointly own the "East Valley Lateral". EPNG currently delivers some of our natural gas supplies to two "city-gate stations" via the East Valley Lateral. Transwestern's capacity on the East Valley Lateral is currently insufficient to deliver our natural gas supplies to the Gas Utility. The limited access to two of Mesa's five City-Gate stations prevents Transwestern from being able to provide year-round reliable access to our natural gas supplies. Contracting with Transwestern does not enhance our reliability of service given that it relies upon the same East Valley Lateral that already delivers our supplies to two of our City-Gate

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1 The rates in FT2AF000 are significantly lower than EPNG's published tariff rate. However, the 1996 Settlement limits the amount Mesa's TCD provided under these special "Article 11.2 Rates." Additionally, on March 26th, EPNG sent a letter to Mesa purporting to provide notice of termination of Mesa's FT2AF000 contract in 2015. On April 25th, City and other similarly situated EPNG customers filed a joint complaint against EPNG's actions at FERC. Discussions with EPNG regarding a comprehensive resolution of the outstanding issues have not been successful to date. Therefore the ERD recommends proceeding with renewal of FT2AE000.

2 The 1996 Settlement does provide some rate protection to Mesa regarding the remainder of its capacity under FT2AE000 that is subject to a Supplemental Hearing in Docket No. RP10-1398 in June before the FERC.

stations. Additionally, Transwestern only provides access to the San Juan production basin while El Paso Natural Gas also provides access to the Permian Basin as well. A request from Mesa to discuss the availability of additional capacity with Transwestern was not returned. Additionally, in order to enable the ability to serve the Gas Utility's gate stations with supplies from multiple transportation providers, the Gas Utility would require significant infrastructure additions of fully automated flow control valves and actuators at those city-gate stations where Transwestern could provide gas.

If ERD were to not execute the TSA, it would be unable to serve its customers without significant penalties from EPNG which would be passed on to the Gas Utility customers and could face the potential for wide scale natural gas outages.

Fiscal Impact

The execution of this TSA will not result in any new or additional costs to Gas Utility customers, rather, this is the renewal of an existing contract that retains the same rate structure as the previous TSA. The costs of natural gas transportation (as dictated by this agreement) are passed through to the Gas Utility customers, including the City, through the Purchased Natural Gas Cost Adjustment Factor ("PNGCAF") which is adjusted monthly along with the cost to purchase the natural gas commodity.

Coordinated With

The Agreement has been reviewed by Bill Taebel, Assistant City Attorney for the Energy Resources and Water Resources Departments and by Mesa's FERC Washington, D.C. counsel for these matters, John P. Gregg with McCarter and English (formerly Miller, Balis & O'Neil).