City Council Report

Date: September 8, 2025

To: City Council

Through: Marc Heirshberg, Assistant City Manager

From: Scott Bouchie, Energy and Sustainability Director
Anthony Cadorin, Energy Resources Program Manager
Giao Tran, Energy Resources Coordinator

Subject: Approval of a Resolution authorizing the acquisition of up to 8,000 dekatherms per day of interstate natural gas pipeline transmission capacity, and authorizing entering into and approving associated agreements.

Purpose and Recommendation

The City of Mesa Energy Resources Department recommends that the City Council authorize the City Manager or his designee to acquire additional natural gas firm transportation service either directly with the Transwestern Pipeline Company, LLC (“Transwestern”) or through participation in the Arizona Electric Power Cooperative’s (“AEPCO”) aggregated pipeline subscription, and recommends Mesa’s entry into associated legal agreements for that capacity (collectively, the “Agreements”).

Background

The City of Mesa (“Mesa”) purchases most of its natural gas supplies from the Permian Basin in west Texas and with lesser amounts from the San Juan Basin in the Four-Corners area. These natural gas supplies are then transported through the El Paso Natural Gas (“EPNG”) network of transmission pipelines (owned by Kinder Morgan, Inc) to Mesa’s natural gas distribution system. Mesa’s transportation contracts attempt to reserve enough pipeline capacity on EPNG’s pipeline (measured in Dekatherms per day or Dth/day) to be able to serve Mesa’s customers on “design day” weather events while minimizing the risk of penalties. Currently, Mesa has a reserved pipeline capacity that ranges from 9,568 to 32,134 Dth/day on EPNG’s system, depending on the month, but generally, it is highest in the winter months and lowest in the summer months. When Mesa uses more gas than its contracted pipeline capacity, EPNG can assess a penalty on the volumes that were flowed above the Mesa’s pipeline capacity rights. As Mesa’s natural gas customer count, and therefore demand, continues to grow, additional pipeline capacity on the interstate gas transportation system is required to continue reliable delivery of gas to Mesa’s system and to avoid expensive penalties.

Mesa also has limited access to gas transported through the pipeline system owned and operated by Transwestern, which is another interstate natural gas transmission company that serves the metro Phoenix area. However, Mesa currently has no transportation contract with Transwestern because Mesa's capacity on EPNG has historically met the entirety of the customers' needs.

Recently, Transwestern, Mesa, and AEPCO have discussed the opportunity to participate in a large interstate pipeline project known as the Desert Southwest pipeline (the "Project") along with other utilities in the region. The Project will consist of 516 miles of 42-inch pipeline with a design capacity of approximately 1.5 billion cubic feet per day. The Project will approximately follow EPNG's existing south mainline (roughly following the Interstate-10 corridor) and will create a loop with Transwestern's existing pipeline that follows a northern path through Arizona (roughly following the Interstate 40 and Interstate 17 corridors).[1]

Discussion

Interstate natural gas transmission companies are regulated by the Federal Energy Regulatory Commission (FERC). Transmission companies periodically post transportation capacity from expiring contracts and planned system expansion for bidding. Because of the size and scope of these transmission pipelines, only certain contracts and capacities meet the required paths on the EPNG and Transwestern's system to deliver gas specifically to Mesa's distribution system. These opportunities (where the flow paths provide the ability to deliver gas to Mesa) are rare in occurrence and at times can be of a quantity or shape that is not suitable to Mesa's growth needs.

Transmission companies evaluate bids for pipeline capacity based on a strict present value calculation of the value of each bid. Transmission companies cannot ask for bids above the maximum tariff rate set by FERC for any expiring transmission contracts. Because the bids are all offered at the maximum tariff rate for the particular capacity under consideration, the present value calculation to determine the winning bidder comes down to the length of the bid provided. Over the past decade, bids have been steadily increasing in length to where winning bids above 20 years are most common. If Mesa expects to win capacity through an expiring contract, a very long bid, exceeding 20 years, perhaps up to 50 years, will be required. To illustrate the competitiveness of these contracts, Mesa bid 35 years on an expiring contract in May 2022 but did not win. The original holder of the contract matched Mesa's bid to retain that capacity (using what's known as their "right of first refusal").

For new expansion projects, transmission companies can set a rate above the maximum tariff rate and then set a minimum contract term to ensure adequate funding for the project. The Project will therefore have higher transmission rates than Mesa's current transmission contracts with EPNG. Transwestern estimates that the Project will begin operation and natural gas deliveries in approximately the fourth quarter of 2029.

Mesa's interstate transmission capacity was set during the deregulation of the natural gas industry in the 1980's and 1990's. Mesa has maintained the same capacity throughout these decades with EPNG despite almost quadrupling the number of customers on the gas system. In 1990 Mesa had 22,213 customers and sold

1 https://ir.energytransfer.com/news-releases/news-release-details/energy-transfer-announces-natural-gas-pipeline-project-serve

28,160,850 Therms whereas in FY24/25 Mesa eclipsed 80,000 customers and sold 41,652,848 Therms. This capacity has served to minimize penalties throughout this time period; however, Mesa's capacity is no longer adequate in the face of a rapidly expanding Magma system, steady growth in Mesa, and increasing commercial development in both territories. Mesa's "full-build" customer count for the Mesa and Magma systems combined is estimated to be approximately 275,000 customers, or over three times the current customer count (largely due to the vast vacant land available in Magma). At full-build, Mesa estimates that up to 144,000 Dth/day of additional capacity will be needed. Mesa is requesting 8,000 Dth/day that will allow Mesa to serve its growth needs through approximately 2040, depending on the type of customers that are added to the system. This capacity may also enable participation in natural-gas-fired electric generation projects through AEPCO in the future.

Execution of the Agreements will secure the capacity for Mesa once the pipeline begins operation. Mesa will pay monthly rates for the capacity and will pay a smaller amount for the gas that is flowed through the pipeline (to cover Transwestern's variable costs). The capacity acquired through the Agreements lasts twenty-five (25) years and Transwestern has offered the right of first refusal following the expiration of the initial term.

At a future time, Mesa may have to pay Transwestern to construct one half of the city gate station where the natural gas will be received by Mesa and Mesa will also have to initiate a capital project to construct the customer-side of the city gate station. The agreement for Transwestern's construction of the city gate station may be referred to as a "Cost of Facilities Agreement" or "Interconnection Facilities Agreement" and will be brought to council at a later date.

Alternatives

Mesa could choose not to acquire additional transportation capacity rights. If this is chosen, Mesa will be continually exposed to greater risks of penalties by EPNG due to inadequate pipeline capacity to meet the customers' natural gas demand. Penalties are assessed by multiplying that day's spot market price by a factor of 150% or more and typically this occurs at a time when the spot market price is spiked much higher than monthly averages.

Fiscal Impact

The costs of the Agreements are recovered though the purchased natural gas cost adjustment factor (PNGCAF) and are adjusted as frequently as monthly as costs increase or decrease throughout the year.

Coordinated With

The Council Resolution was coordinated and the negotiation of the Agreements will be coordinated with the City Attorney's Office.