

April 7, 2014

Pima County Board of Supervisors
Sharon Bronson, Chair
Ray Carroll, Supervisor
Ally Miller, Supervisor
Ramon Valadez, Supervisor
Richard Elias, Supervisor
130 W. Congress 11th Floor
Tucson, AZ 85701

Re: Sierrita Gas Pipeline LLC

Dear Madam Chairwoman and Members of the Pima County Board of Supervisors:

Sierrita Gas Pipeline LLC (“Sierrita”) takes this opportunity to communicate directly with the Board regarding various matters relating to the development of its proposed natural gas pipeline project from an interconnection with the existing pipeline facilities of El Paso Natural Gas Company, L.L.C. near Tucson, and extending to a point on the United States – Mexico border near Sasabe (the “Sierrita Pipeline”).

Sierrita understands that the Board and its members recently received a memorandum from Mr. Huckelberry, the County Administrator, dated March 21, 2014 (hereinafter referred to as the “Administrator Memo”). Sierrita now provides additional information to the Board on various points addressed in the Administrator Memo, and addresses certain statements in the Administrator Memo which Sierrita believes to be misleading or inaccurate.

The Administrator Memo devotes considerable attention to certain costs that it characterizes as being imposed on Pima County as a result of the Sierrita Pipeline. Sierrita believes the presence of the pipeline in Pima County will be a positive influence on the County, primarily as the result of the approximately \$1.6 million of annual property tax revenues that will be received directly by the County from Sierrita, and by approximately \$3.3 million of additional annual property tax payments that will benefit local fire and school districts in Pima County.

Sierrita believes that these tax payments, coupled with the various other tax payments and fees to be paid by Sierrita will more than cover any incremental expense that may be realized by Pima County as a result of the construction, operation and maintenance of the Sierrita Pipeline. A detailed analysis of the costs identified in the Administrator Memo and the revenue streams that will be generated by the pipeline is presented below.

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For your convenience, the remainder of this letter is organized to track the Administrator Memo.

Sierrita requests that the Board work with it to complete the negotiations on the points discussed in the Administrator Memo within the month of April. We are prepared to immediately meet with the Board or its representatives to complete the negotiations in a mutually beneficial way. Sierrita wants to thank the County for the work performed to date on the various applications and requests that have been submitted by Sierrita and urges the County to work toward a May 15, 2014 issuance date for the remaining requested County permits.

Background and Regulatory Jurisdiction:

The Sierrita Pipeline project is an international project that is under review by the Federal Energy Regulatory Commission ("FERC") and by the offices of the United States Secretaries of State and Defense, and the International Boundary and Water Commission of the United States and Mexico.

In August of 2012, the staff of the FERC issued a notice of intent to prepare an environmental impact statement for the proposed "Sasabe Lateral Project" (due to a conflict with an unrelated entity that had reserved the name "Sasabe Pipeline", the project was subsequently renamed the Sierrita Gas Pipeline). On February 7 and 8, 2013, Sierrita filed applications with the FERC for authority to construct and operate the pipeline and for the related facilities at the United States – Mexico border. Under Federal law, FERC is responsible for evaluating applications to construct and operate interstate natural gas pipelines, applications for facilities that will be used to export natural gas from the United States and for Presidential Permits for facilities at the border of the United States and Mexico. The FERC is also the lead federal agency for the preparation of the Environmental Impact Statement for this project.

The Sierrita Pipeline will be subject to the regulatory authority of the FERC and the Pipeline and Hazardous Materials Safety Administration ("PHMSA") of United States Department of Transportation ("USDOT"). The regulatory authority of FERC derives from the provisions of the Natural Gas Act ("NGA"), 15 U.S.C. §717, *et seq.*, and the regulatory authority of PHMSA derives from the Pipeline Safety Act ("PSA"), 49 U.S.C.

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§60101, *et seq.* Under the provisions of the NGA, FERC has exclusive regulatory authority over the siting of interstate natural gas pipeline facilities. Under the provisions of the PSA, USDOT and PHMSA have exclusive jurisdiction with regard to safety standards that apply to the design, installation, inspection, operation and maintenance of the pipeline facilities.

The Administrator Memo describes the environmental review process and states that the anticipated date for the issuance of the Final Environmental Impact Statement (“FEIS”) for the project was March 28, 2014. Sierrita is pleased to inform the Board that the FERC did issue the FEIS on that date. You may find it interesting and informative that the FEIS concludes that:

We determined that construction and operation of the Project would result in limited adverse environmental impacts. This determination is based on a review of the information provided by Sierrita and further development from data requests; field investigations; scoping; literature research; alternatives analyses; and contacts with federal, state, and local agencies, Native American tribes, and other stakeholders. **We conclude that the approval of the Project would have some adverse environmental impacts, but, with the exception of the Pima pineapple cactus, these impacts would be reduced to less-than-significant levels.”**

Final Environmental Impact Statement, Issued March 28, 2014, Executive Summary, ES-9 (emphasis added).

Status of Permits Needed from Pima County:

The Administrator Memo states there are a number of permits, rights-of-way and other assistance that Sierrita requires¹ from Pima County. The permits and authorizations that Sierrita is requesting from the County include:

¹ As a point of clarification, it should be noted that under the doctrine of federal preemption, state and local agencies may not prohibit or unreasonably delay the construction or operation of facilities that have been approved by FERC. Pipeline companies are encouraged to cooperate with state and local permitting agencies and Sierrita has and fully intends to continue to do so, but the regulatory authority of the FERC and the DOT are exclusive. While Sierrita does seek the issuance of these permits, in some cases the permits may not be technically “required” for the further development of the project.

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- Floodplain Use Permit from Pima County Regional Flood Control District.
 - o As is noted in the Administrator Memo, the application for this permit was submitted in July of 2013. Sierrita's engineering consultants have worked diligently with the District on this matter and have submitted engineering data on each of the proposed wash crossings. A sediment transport analysis on the Altar Wash will be completed by the end of April. Sierrita has agreed to fund habitat restoration in the amount of \$2.3 million through the Flood Control District as a condition for the issuance of the Floodplain Use Permit.
- Pima County Public Utility License Agreement.
 - o It is the understanding of Sierrita that Pima County Real Property Services will not process this License for Board of Supervisor approval until directed to do so by County Administrator.
- Department of Transportation Permits
 - o Right of Way Use Permit.
 - Submitted March 3, 2014. To date the Pima County Department of Transportation has not responded with comments or approval.
 - o Blasting Permit(s).
 - Not yet requested by Sierrita – this permit will be requested by the construction contractor when and if it is determined that any blasting will be required.
 - o Oversize/Overweight Permit.
 - To be acquired by the construction contractor when vehicle loads and routes are determined.
- Regional Wastewater Reclamation Department Small Activity Permit.
 - o As is noted in the Administrator Memo, Sierrita is working with the Regional Wastewater Reclamation Department engineering group and will be submitting a formal application shortly.
- Rights-of-Way Easements and Temporary Use Permits on Pima County Land and a Franchise Agreement.

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- The Administrator Memo notes that Sierrita made an offer of \$19,600 for these easements and permits. The memo does not include information on the counter-offer by Pima County dated February 25, 2014 for \$32,270 which was accepted by Sierrita on March 4 2014. Based on that acceptance, Sierrita has understood that this item was resolved, subject only to any necessary documentation and formal presentation to the Board.
- Department of Environmental Quality Fugitive Dust Permit.
 - The application for this permit will be submitted prior to anticipated date of construction.

Note: the Administrator Memo describes another authorization that it suggests Sierrita will be seeking from the County – an Information Technology License Agreement for use of space on a communications tower on Keystone Peak that is owned by Pima County. Sierrita can now inform the County that it has identified an alternate location and process for satisfying its communications requirements and is no longer seeking this authorization from Pima County.

Sierrita looks forward to working with the County to secure these permits and approvals on or before May 15, 2014.

General Stakeholder Recommendations:

Proposals by various parties related to the construction and operation of the Sierrita Pipeline have been considered in the FEIS and will be further considered by the FERC in its consideration of Sierrita's application for a Certificate of Public Convenience and Necessity for the construction, ownership and operation of the pipeline.

Notwithstanding this fact, the Administrator Memo included observations and proposals regarding some of these third-party concerns. Sierrita provides these clarifying comments in reply to these comments in the Administrator Memo:

- Detailed Assessment/Restoration Plans: Comments in the Administrator Memo suggest that resource information is incomplete and restoration plans are not consistent with the area's ecology. This opinion is inconsistent with the efforts and

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conclusions of the FERC staff as expressed in the FEIS. The purpose and scope of the environmental review undertaken by the FERC staff, as described in the FEIS, was to:

- Identify and assess potential impacts on the natural and human environment that would result from the implementation of the proposed Project;
- Describe and evaluate reasonable alternatives to the Project that would avoid or minimize adverse effects to the environment;
- Identify and recommend specific mitigation measures, as necessary, to minimize environmental impacts; and
- Encourage and facilitate involvement by the public and interested agencies in the environmental review process.

Cooperating agencies in the preparation of the FEIS included the U.S. Fish and Wildlife Service (“USFWS”) – Arizona Ecological Services Office, the Buenos Aires National Wildlife Refuge, Arizona Game and Fish Department and the U.S. Customs and Border Protection.

The FEIS was issued only after extensive analysis from FERC and the incorporation and consideration of numerous stakeholders, including Pima County. Indeed, since Sierrita filed its initial certificate application more than a year ago, FERC issued more than 250 data request questions, at times in direct response to stakeholder comments. Sierrita has exhaustively and satisfactorily responded to each data request question.

In addition, FERC has received and reviewed more than 130 separate comments filed by landowners, agencies, and other stakeholders as part of the FEIS development. Sierrita has responded to each material comment filed by stakeholders.

- Oversight Committee. The Administrator Memo suggests that an independent project monitoring committee should be created. Sierrita believes that in light of the fact that FERC will already be assuming the responsibility of tracking the effectiveness of Sierrita’s remediation and reclamation efforts and has sole regulatory authority to do so, the creation of another entity would be cumbersome, expensive and inefficient.

As described in detail in the multiple Sierrita project-specific plans, Sierrita will be required to successfully revegetate and restore the right-of-way. FERC will

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determine when the right-of-way has been successfully restored. Sierrita will be required to file quarterly reports with FERC, which will be publicly available, and it is also anticipated that FERC personnel will visit the right-of-way to determine restoration success. The filing requirements and monitoring efforts will continue for several years after the pipeline is placed into service.

- Mitigation Endowment Fund. The Administrator Memo suggests that a mitigation fund should be created to provide annual revenue for ongoing monitoring and mitigation of the impacts of the Sierrita Pipeline. As is discussed in more detail below, a condition for the Certificate of Public Convenience and Necessity authorizing the construction of the Sierrita Pipeline will be just such ongoing monitoring and mitigation efforts. These will be obligations of Sierrita, and compliance with those obligations will be enforced by FERC.

Altar Valley Conservation Alliance:

The Administrator Memo describes the goals and accomplishments of the Altar Valley Conservation Alliance ("AVCA"). Sierrita agrees with that description and is fully supportive of the activities of the AVCA. However, as was described above and as will be discussed in more detail below, the responsibility for monitoring remediation and revegetation efforts will be imposed on Sierrita by the FERC (in any authorization for the construction and operation of the pipeline), and FERC will enforce that obligation.

Costs to Pima County and Mitigation Issues:

The Administrator Memo estimates that the construction and operation of the Sierrita Pipeline will result in additional annual expense to Pima County of \$1,020,686. This consists of additional sheriff department costs of \$461,436 per year, and a cumulative total of \$559,250 per year for: (i) additional expense (\$174,000 - \$261,000) associated with a possible increase demand on Medical Examiner and Public Fiduciary services resulting from increased migrant deaths that are somehow related to the construction of the Sierrita Pipeline; (ii) access road maintenance expense (\$98,250) for existing roads that are already used by the public and that will be restored to equal to or better than pre-

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construction condition²; (iii) incremental open space management costs (\$200,000) for additional fencing, water repair, trash pickup and incident response on public lands along the route (notwithstanding the fact that more than 92% of this public land is owned by the Arizona State Land Department (“ASLD”) and only 2.2% is owned by the County); and (iv) repair of damage to ranchlands (which does not appear to actually be an expense of the County). While Sierrita believes these amounts are highly speculative and greatly overstated, even if all of these costs are actually incurred by Pima County, the revenue derived by the County from annual property taxes on the Sierrita Pipeline will more than cover these expenses. The initial property tax revenue is approximately \$1.6 million per year, leaving an excess contribution to the County of over \$500,000 per year (which could be used in lieu of the proceeds from an endowment fund), based on this revenue stream alone.³

In addition to the annual Pima County expenses described above, there are several other expenses which the Administrator Memo says should be the responsibility of Sierrita, totaling over \$16 million. The suggested \$16 million cost responsibility is made up of a number of items, including:

- \$2,300,000 for mitigation of the impacts of the project on riparian habitat;
- \$3,792,000 to purchase land to offset impacts to land and vegetation;
- \$1,600,000 for the purchase of mitigation credits for impacts to Pima Pineapple Cactus;
- \$7,000,000 to cover the cost of long-term monitoring and repair of environmental impacts of the pipeline;

² For some unexplained reason the Administrator Memo presumes this expense will continue indefinitely even after the construction efforts are completed.

³ It is important also to note that the \$1.6 million of property taxes the County will receive is only part of the property taxes that Sierrita will pay. The Administrator Memo calculates the total property tax payments of Sierrita will be approximately \$4.9 million per year. The \$3.3 million difference between the amount paid by Sierrita and the amount received by the County will be enjoyed by the local fire and school districts.

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- \$1,500,000 for “Altar Valley watershed improvements”; and
- \$274,040 for additional vehicles for the Pima County Sheriff (four 4WD vehicles and two ATVs).

Sierrita’s position on each of these items is set forth below:

The \$2.3 million for riparian habitat restoration will be fully covered by the anticipated \$2.3 million fee for the Floodplain Use Permit from the Regional Flood Control District, and thus is a cost to Sierrita and not to the county. These funds cover the approximately 250 wash crossings and Pima County designated flood plains along the entire 60+ mile route, of which only 1.26 miles is located on Pima County owned lands. It should be noted that Sierrita is also paying \$4.7 million to the ASLD for native plant fees and rights-of-way on land owned by the State. The effect of this fee, coupled with the Pima County Floodplain Use Permit Fee, is that Sierrita will pay fees to both the State and Pima County for riparian habitat located on lands owned by ASLD.

The Administrator Memo catalogues \$3.7 million for land purchases based on an estimate of 860 acres of impacted land and a determination that approximately 2,530 acres should be purchased to mitigate the impacts on those 860 acres. This recommendation disregards the significant mitigation requirements that have already been proposed by Sierrita, and which will be required as a condition of any authorization to proceed with the project that will reduce the impacts of the project to “less-than-significant levels.”⁴

The \$1.6 million for the purchase of mitigation credits for impacts to the Pima Pineapple Cactus (PPC) is not correctly characterized as a cost to the county – it is a required mitigation measure expected to be imposed by the USFWS which Sierrita acknowledges and which Sierrita will incur. Sierrita would consider purchasing the credits from Pima County if the County has the necessary authority to make such sales and if the credits are offered at a market price. It should also be noted that in addition to the

⁴ FEIS, Executive Summary at page ES-9.

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purchase of PPC mitigation credits, Sierrita has agreed to transplant and monitor PPC that would be directly impacted by construction.⁵

The \$7 million endowment fund to generate ongoing funds to monitor and repair impacts resulting from the construction and operation of the Sierrita Pipeline also fails to recognize the restrictions and requirements that will already be imposed on Sierrita and the role that will be played by FERC in monitoring the compliance of Sierrita with these requirements. The Administrator Memo states that this “mitigation fund” will “generate sufficient annual funds to maintain and cover the costs of long-term monitoring and repair of environmental damage.”⁶ In fact, however, Sierrita will be required to monitor revegetation and restoration efforts and will be obligated to make reports to the FERC on the success of those efforts. FERC will make periodic inspections of the right-of-way to independently assess Sierrita’s compliance with these requirements and the success of the remediation efforts. Sierrita will be required to continue revegetation efforts until “revegetation is successful.”⁷

The \$1.5 million of matching funds for Altar Valley watershed improvements is not justified anywhere as an additional expense that would be incurred by the County, and there is certainly no explanation of how this cost item differs from those discussed above. As was previously explained, Sierrita will have the obligation to reclaim the right-of-way following completion of the construction activities. As Sierrita explained in its Reclamation Plan, attached as Appendix G to the FEIS, erosion control measures were developed with the assistance of the Pima County Regional Flood Control District (PCRFCDD). While there may be some expense that has been and/or will be incurred by PCRFCDD in this effort, the \$2.3 million fee for the Floodplain Use Permit should compensate the County for this expense.

Finally, the \$274,040 for additional vehicles for the Pima County Sheriff (four 4WD vehicles and two ATVs) appears grossly excessive given the fact this project will

⁵ FEIS, Executive Summary at page ES-6.

⁶ In the earlier version of the Administrator Memo, dated November 4, 2013, the basis of the \$7 million amount is explained as “a minimum of \$200,000 per year is estimated as necessary to maintain and expand these conservation efforts as possible. Assuming an annual 3 percent return on any investment, establishing a mitigation fund of \$7,000,000 is recommended to meet this goal.”

⁷ Sierrita’s Upland Erosion Control, Revegetation, and Maintenance Plan at p.E-16, Appendix E to the FEIS.

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result in only 60 miles of pipeline right-of-way, which will include measures to restrict unauthorized use of the right-of-way.

Sierrita will be making direct payments covering several of these expenses. Sierrita anticipates a payment of approximately \$2.3 million for the Floodplain Use Permit. It will be acquiring Pima Pineapple Cactus Credits, either from the County or another source, in an amount of approximately \$1.6 million. This leaves the CLMS land purchase offsets and the Pima County Sheriff expenses. Disregarding for the moment the concerns Sierrita has with the accuracy or appropriateness of these costs, it is important to recognize that these amounts will be fully covered by the property tax revenues that will be received by Pima County. Attached hereto as Attachment A is an Excel Spreadsheet showing the cumulative cashflow to Pima County from project ad valorem taxes. It shows that even if all of the annual expenses suggested in the Administrator Memo are experienced, and the \$3.7 million expense for CLS land offsets and the additional vehicles for the Sheriff department are purchased, Pima County will recover a positive \$11 million revenue gain over the next 25 years (which is the length of the Transportation Service Agreement underwriting the construction of the Project, although it is expected that the pipeline will continue to provide natural gas transportation service well past the initial contract term). The total cash payments from Sierrita to the County associated with the ad valorem tax revenues will total almost \$53 million over the 25 year period (as depicted in Attachment B).

Assurance of Pipeline Safety Design for Maximum Wall Thickness:

The Administrator Memo includes a recommendation regarding wall thickness in particular areas. This is an issue of pipeline safety that is reserved exclusively to the DOT and FERC (through PHMSA regulations and through conditions to Certificates of Public Convenience and Necessity incorporating DOT/PHMSA standards). Sierrita would welcome an opportunity to discuss the extensive pipeline safety regulations and requirements that are imposed on interstate natural gas pipelines by PHMSA, to provide comfort to the County regarding the safety of the proposed pipeline.

Kinder Morgan Meeting with US Fish and Wildlife Service Administrators:

The Administrator Memo describes the consideration of a pipeline route through the Buenos Aires National Wildlife Refuge, and generally disagrees with the conclusions of

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the USFW that the location of the pipeline in the refuge is inconsistent with the mission of the refuge. Sierrita takes no position on this issue other than to say that the USFWS decision has been made and the route through the refuge is no longer a potential route.

Discussion of Tax Revenues:

The Administrator Memo devotes substantial attention to the share of TPT revenues that will be received by Pima County, but very little attention to the nearly \$5 million in property taxes that Sierrita will be paying. Pima County's share of the TPT taxes is not an issue over which Sierrita has any control, and if Pima County believes it is receiving an unfair allocation of those revenues it is an issue that Pima County must raise with the State of Arizona. What is significantly more important, however, is the amount of property taxes that Sierrita will be paying to the County and to the school and fire districts that are located in the County. Table 4 of the Administrator Memo shows \$1.6 million in property taxes will be paid by Sierrita to Pima County annually. Another \$3.3 million will be paid each year to the school and fire districts within Pima County.

Sierrita believes that underground natural gas pipelines consume far fewer county resources that do most other types of businesses that contribute this level of tax revenue to the county. Accordingly, we hope the County will agree that our presence, and tax base, will provide a benefit to Pima County.

Funds Established for Other Pipelines:

The Administrator Memo closes with a description of mitigation payments that have been made in other pipeline projects, particularly the Ruby Pipeline. Sierrita notes there are significant differences between the Ruby and Sierrita projects. The Ruby Pipeline was developed by and under the leadership of the El Paso Corporation, which was acquired by KinderMorgan in 2012. Decisions and approaches that were taken by that team cannot be attributed to the management team for Sierrita. Also, the Ruby project involved nearly 700 miles of 42-inch diameter pipeline crossing four states with a transportation capacity of 1,500,000 Dth/day, while the Sierrita Pipeline will be only be 60 miles of 36-inch pipe, with a capacity of approximately 200,000 Dth/day. The total cost of the Ruby Project exceeded \$3.7 billion dollars, while the Sierrita Pipeline is currently projected to cost approximately \$200 million.

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Perhaps the most significant factor related to this discussion is the fact that the various mitigation funds and payments that are discussed in the Administrator Memo were made to entities that were not receiving any ongoing substantial tax payments from the pipeline (none of the payments were made to local governmental agencies). Most of the amounts listed as having been paid out in connection with the Ruby Project are overstated, and represent the total of a series of much smaller annual payments to the funds. Despite the much greater size and scope of the Ruby Project, those annual payments are much smaller (by an order of magnitude) than the nearly \$5 million annual property tax payments that Sierrita will be making to Pima County and its school and fire districts.

Conclusion:

Sierrita appreciates this opportunity to directly communicate with the Board regarding this important energy infrastructure project. Sierrita believes this project will provide significant benefits to Pima County, the State of Arizona, the United States and to Mexico. We look forward to continued communications with the County and are willing to meet at any time, and at any level, to discuss the project, the impacts of federal regulation and jurisdiction over the pipeline and its permitting, construction and operating practices, construction, mitigation and remediation efforts that will be adopted by Sierrita and the tax benefits the County will recognize from the Sierrita project. Sierrita respectfully requests that the Board confirm the intention of the County to proceed with the diligent and timely processing of the various approvals and permits that are being sought by Sierrita so that the pipeline can proceed on its current schedule.

Sincerely,



Mark A. Kissel
President, Sierrita Gas Pipeline LLC.