

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Kern River Gas Transmission Company

Docket No. RP06-151-000

ORDER ON TECHNICAL CONFERENCE

(Issued September 1, 2006)

1. On February 15, 2006, the Commission accepted Kern River Gas Transmission Company's (Kern River) proposed prior-period adjustments to the gas compressor fuel (fuel) and lost and unaccounted-for gas (L&U) balances, subject to the outcome of a technical conference.¹ On March 21, 2006, the Commission convened a technical conference to further explore the issues pertaining to Kern River's prior-period adjustments to its fuel and L&U balances. The instant order addresses the comments filed after the technical conference, and accepts Kern River's proposed prior-period adjustments to its fuel and L&U balances and its plan to recover these amounts.

Background

2. On December 21, 2005, Kern River filed to recover certain prior-period adjustments, which affect the level of fuel from 2001 through 2004, system-wide L&U from 1999 through 2004, and High Desert Lateral L&U for 2003 and 2004. Kern River stated that these adjustments increase Kern River's underrecovery of fuel by 809,802 Dth, decrease the system-wide L&U gain by 309,790 Dth, and decrease the High Desert Lateral L&U loss by 11,679 Dth. Kern River contended that its tariff permits recovery of prior-period fuel and L&U and that it has demonstrated its fuel and L&U adjustments with reasonable accuracy. Kern River added that it has not deliberately created the under-collections, been grossly negligent, or inordinately delayed seeking recovery.

3. The protestors argued that the Commission should reject the proposed adjustments because Kern River's tariff does not permit such prior-period adjustments, the adjustments violate the filed rate doctrine and collections resulting from the adjustments

¹ *Kern River Gas Transmission Co.*, 114 FERC ¶ 61,162 (2006).

would constitute retroactive ratemaking. The protestors also argued that Kern River has been grossly negligent in the management of its system. Furthermore, the protestors argued that shippers should not be required to nominate fuel in-kind at today's gas prices, when the alleged undercollections of fuel occurred during periods when gas prices were much lower.

4. On February 15, 2006, the Commission accepted Kern River's proposed prior-period adjustments to the fuel and L&U balances, subject to the outcome of a technical conference to further explore the issues pertaining to Kern River's prior-period adjustments to its gas compressor fuel and L&U balances. The technical conference was held on March 21, 2006.

Comments on Technical Conference

5. On May 5, 2006, Nevada Power Company (Nevada Power), BP Energy Company (BP Energy), Rolled-In Customer Group (Rolled-In Customers),² Southern California Generation Coalition (SCGC), Reliant Energy Services, Inc. (Reliant), and Kern River filed initial comments on the technical conference. On May 17, 2006, Kern River, Rolled-In Customers, SCGC, BP Energy, and Nevada Power filed reply comments.

6. Kern River states that the Commission will permit the recovery of prior-period fuel and L&U if the underlying tariff can be read to permit fuel and L&U recovery and the pipeline establishes that its losses are of the type for which recovery was contemplated and demonstrates with reasonable accuracy the amount of the adjustments it seeks to recover.³ Kern River states that it satisfies the first requirement, because since 1999, section 12 of its General Terms and Conditions (GT&C), entitled Reimbursement of Fuel Used and Lost and Unaccounted-For Gas, has described the monthly true-up adjustments for both fuel and L&U. Kern River explains that the calculation of the current month's compressor fuel factors includes a true-up adjustment for each compressor based on the difference between the total fuel used at that compressor and the net fuel reimbursed by customers at that compressor two months earlier. Additionally, Kern River states that since 1993, article 1.2 of its Forms of Service Agreements has

² The Rolled-In Customers include: Aera Energy, LLC; Anadarko E & P Company LP; Anadarko Petroleum Corporation; Chevron U.S.A., Inc.; Coral Energy Resources, L.P.; Occidental Energy Marketing, Inc.; Southwest Gas Corporation; and Shell Rocky Mountain Production LLC.

³ Citing *TransColorado Gas Transmission Co.*, 112 FERC ¶ 61,135 (2005) (TransColorado).

expressly provided: "Shipper will reimburse Transporter for fuel used and lost and unaccounted-for [g]as on an in-kind basis." To satisfy the second requirement, Kern River states that it has described the timing, cause, and magnitude of the prior-period adjustments and that its supporting data sets forth with reasonable accuracy the adjustments required to correct each of the errors.

7. Rolled-In Customers state that Kern River's tariff establishes that: (1) Kern River will determine the fuel reimbursement factors for fuel and L&U on a monthly basis; (2) the fuel reimbursement factors for fuel and L&U are prospective and are based on projected use and projected receipt point quantities; and (3) any required true-up adjustments for fuel or L&U are only for the previous two months.

8. Nevada Power states that section 12 of Kern River's GT&C provides for the recovery of only current compressor fuel factors, which are posted on Kern River's internet site prior to the beginning of each month. Nevada Power notes that compressor fuel factors are based on historic fuel usage, adjusted for known and expected operational changes to determine projected fuel usage. Commenters point out that the only true-up adjustment for each compressor is limited by section 12.3 of the GT&C to reconciling the difference between total fuel used by each compressor and net fuel reimbursed two months earlier.

9. SCGC adds that Kern River has no history of making prior-period adjustments beyond two-months, or agreements with its customers that contemplate Kern River's proposed prior-period adjustments. SCGC argues that approving prior-period adjustments going back as much as seven years would not encourage pipelines to correct measurement data or to resolve disputes arising out of measurement errors within six months in accordance with the North American Energy Standards Board (NAESB) standards.⁴ SCGC contends that the Commission should establish appropriate time frames for making prior-period adjustments and should follow the NAESB standards and only allow Kern River to limit the recovery of losses from a prior period to six months.

10. Nevada Power and Rolled-In Customers argue that Kern River did not adequately support its original filing. Nevada Power states that Kern River's support consists solely of unverified numbers set forth in its filing and the supplemental information provided by Kern River, which it states were the result of an internal audit, but were not supported by a certificate, nor sponsored and sworn to by a witness or by sworn affidavit.

⁴ Citing, NAESB Standards 2.3.14 and 2.3.26.

11. BP Energy and SCGC state that the underrecoveries are the direct result of Kern River's own negligence. Several commenters note that even where a pipeline has satisfied the Commission's two-part test for prior-period adjustments, if the pipeline has been grossly negligent in the management of its system and thereby caused the fuel and L&U differential, the requested prior-period adjustments will be prohibited.⁵ Nevada Power contends that the adjustments Kern River proposed resulted from not doing enough verification of data, data entry errors, lack of written procedures, use of an erroneous gas compressibility formula, and use of the wrong method for calculating compressibility, not any malfunction of any physical measurements facilities. Reliant adds that Kern River waited an unreasonable amount of time before bringing the errors to the attention of the Commission and shippers.

12. SCGC notes that each month Kern River determines the appropriate fuel factor to be applied for the next month, including a true-up of the fuel and L&U gas volumes from two months prior to the current month. Thus, SCGC states that Kern River has had numerous opportunities since 1999 to review its accounting, reporting, and measurement processes to determine whether its processes were accurate.

13. Nevada Power contends that Kern River failed to show that it incurred a real physical loss of gas that should be recouped or that Kern River needs the gas to operate its compressors in the future. Rolled-In Customers add that Kern River did not explain why its claimed adjustments for errors were not self-correcting by flowing through its L&U amounts. Rolled-In Customers also state that Kern River has not proposed a specific methodology for recovering the contested fuel amounts and rather plans to adjust shipper billing determinants at its sole discretion when excess gas can be accommodated on its system.

14. BP Energy argues that granting the prior-period adjustments would create a windfall for Kern River explaining that there is a significant differential between the price of gas at today's rates and the price of gas at the time the alleged imbalances arose and that the shippers bearing this cost burden are not necessarily the same shippers from whom the alleged underrecoveries resulted.

15. Rolled-In Customers and SCGC state that Kern River should only be allowed to recover the value of gas at the prevailing prices at the time of the claimed losses. SCGC also asserts that Kern River should be required to update its gas balance after the issuance

⁵ Citing, *e.g.*, *Northern Natural Gas Co.*, 110 FERC ¶ 61,253 (2005).

of the Commission's order in this proceeding, but before commencing recovery of gas from customers to assure that the physical recovery of gas from customers is still required.

Discussion

16. In its analysis here, the Commission will apply the two-part test established in *TransColorado*.⁶ In *TransColorado*, the Commission addressed at length its policy on prior-period adjustments. The Commission found that *TransColorado*'s tariff indicated the intent to provide a true-up mechanism so as not to over-recover or under-recover the costs in question in that case and that the prior-period adjustments were consistent with its policy and the pipeline's tariff.⁷ The Commission explained that it applies a two-part test in determining whether out-of-period adjustments are warranted. The Commission stated as follows:

[U]se of an adjustment to correct a past error that resulted in an under-recovery (or over-recovery) of [fuel loss and use (FL&U)] is consistent with Commission precedent. It is also consistent with the very nature of fuel tracking mechanisms, which always require some adjustments for prior periods. The issue here is whether the tariff language, taken as a whole, provides notice that an adjustment for periods before the current 12-month amortization period might be allowed. In other words, whether the annualized adjustment language is an absolute bar to any other adjustment for prior periods, however reasonable. Although the Commission may have in the past more narrowly circumscribed a pipeline's right to recover prior period FL&U costs on various grounds, most recently, the Commission has applied a two-part test. Pipelines can recover FL&U costs if the underlying tariff can be read to permit FL&U recovery, and if the pipeline establishes that the losses are the type of losses for which recovery was contemplated and demonstrates with reasonable accuracy the amount of the adjustment it seeks to recover. So long as the Commission's findings are reasonable

⁶ See also, *Dominion Transmission, Inc.*, 116 FERC ¶ 61,023 (2006) (applying the instant two-part test and finding that the out-of-period adjustments were permissible under the pipeline's Transportation Cost Rate Adjustment)

⁷ *TransColorado* at P 9-10.

under such an approach, there is no violation of the filed rate doctrine or the rule against retroactive rate making because the shippers are on notice that the pipeline is entitled to recover these costs.⁸

17. In *TransColorado*, the Commission also cited MRT,⁹ observing as follows:

In spite of MRT's tariff language that defined a 12-month recovery period for the FL&U, the Commission determined that there was no bar against prior period recovery in the tariff. Instead, we concluded that MRT had sufficiently notified its customers of such recovery by including general language that the pipeline will adjust for actual usage. . . . In light of such a provision, the Commission found that the fuel adjustment was intended to track fuel use and that neither MRT nor its customers "expected to gain or lose based on the operation of the fuel tracker."¹⁰

18. The Commission finds that Kern River's tariff permits the type of prior-period adjustments proposed by Kern River and does not expressly bar such adjustments. The Commission also finds that the instant tariff provides sufficient notice of such potential adjustments and, thus, Kern River's recovery of such amounts does not constitute retroactive ratemaking as alleged by the commenters.

19. Kern River's tariff contemplates an on-going 2-month adjustment period; however, the tariff does not bar adjustments from periods beyond this two month period. Section 12.3 of the GT&C¹¹ explicitly states that the true-up adjustment is based on total

⁸ *TransColorado* at P 11 (footnotes omitted).

⁹ *Mississippi River Transmission Corp.*, 96 FERC ¶61,185 (2001) (*MRT*).

¹⁰ *TransColorado Gas Transmission Co.*, 112 FERC ¶ 61,135 at P 12 (2005) (footnotes omitted).

¹¹ Section 12.3 of Kern River's tariff states:

For rolled-in rate service, the compressor fuel factors will be determined monthly as follows: for each compressor station, the historical fuel usage at that site will be adjusted for known and expected operational changes to determine projected fuel usage attributable to rolled-in rate service for the month in which the factor is to be effective. The sum of the projected fuel usage and any required true-up adjustment will be divided by projected receipt quantities attributable to rolled-in rate service at that compressor that month. (The true-up adjustment for each compressor is the difference

(continued)

fuel used, which places customers on notice that Kern River's tariff allows it to account for actual fuel usage.¹² Section 12.7 of the GT&C states the same with regard to L&U. Thus, the fuel adjustment and true-up mechanism are intended to track the actual fuel used to provide transportation for its shippers and neither Kern River nor its customers are expected to gain or lose based on the operation of the fuel tracker.

20. The second prong of the *TransColorado* test requires the pipeline to establish that any losses are the type contemplated for recovery and are demonstrated with reasonable accuracy. Kern River states that the losses it is seeking to recover are related to actual fuel used and L&U incurred and that the losses are the type contemplated by section 12 of its GT&C. The Commission finds that Kern River has established in its exhibits¹³ that its losses are the type for which recovery was contemplated, and that it has demonstrated the amount of the adjustments it seeks to recover with reasonable accuracy. Further, according to the Commission's regulations, a filing for such losses need not be accompanied by sworn affidavits as alleged by Nevada Power.¹⁴

21. Commenters also argue that the proposed prior-period adjustments are a result of Kern River's gross negligence.¹⁵ We find that this is not a situation where a pipeline's

between total fuel used by rolled-in rate shippers at that compressor and net fuel reimbursed by rolled-in rate Shippers at that compressor two months earlier.)

¹² *Mississippi River Transmission Corp.*, 96 FERC ¶61,185 (2001) (finding that general language that the pipeline will adjust for actual usage provides adequate notice to permit prior-period adjustments).

¹³ *See*, Exhibits A and B of Kern River's December 21, 2005 filing and Attachment 1 to Kern River's May 8, 2006 filing of Comments following Technical Conference. These Exhibits reflect amounts related to data transfer errors, certain allocation and reporting errors, gas imbalance calculations, and certain measurement adjustments which impact the cumulative balances for compressor fuel and lost and unaccounted for gas.

¹⁴ *See*, 18 CFR § 385.2005 (2006).

¹⁵ "Gross negligence is a willful act or omission in reckless disregard of a legal duty and of the consequences to another party." *Northern Natural Gas Co.*, 110 FERC ¶ 61,253 at P 39 (2005), *citing*, Henry Campbell Black, *Black's Law Dictionary* 5th Edition (1979).

imprudent acts caused that pipeline to incur a cost it would not otherwise have incurred. Kern River's errors allowed shippers to give it less gas from 1999 through 2004 than they should have for the amount of transportation they received, and correcting that error in 2006 simply requires the shippers to give Kern River the same overall quantities that they would have been required to give if the errors had not been made. There is no evidence here to show that any negligence on the part of Kern River caused the undercollections, or that Kern River deliberately created the undercollections.¹⁶ Accordingly, the Commission finds that based upon these circumstances, Kern River was not grossly negligent in maintaining its system. Further, there is no evidence that Kern River waited an inordinate amount of time after discovering its error to seek recovery of these costs.¹⁷

22. BP Energy argues that granting the prior-period adjustments would create a windfall for Kern River. The Commission disagrees with this assertion and finds that granting the prior-period adjustments will permit Kern River to recover gas it actually used in transporting gas for its shippers as was intended by the tariff. In fact, if gas actually burned or lost in the transportation of the shippers' gas was not recovered by the pipeline, the shippers would be receiving a service (the transportation of their gas) for which they had not fully paid.

23. SCGC contends that the Commission should establish appropriate time frames for making prior-period adjustments and should follow the NAESB standards to limit the recovery of losses from a prior period to six months.¹⁸ The NAESB standards suggest a time period of 6 months from the date of the production month, in NAESB 2.3.14, or 6

¹⁶ Further, these data transfer problems, allocation and reporting errors, gas imbalance calculations, and measurement adjustments may occur on any pipeline regardless of its management. Moreover, Kern River asserts that the errors were discovered during an internal audit which is an indication of Kern River's attempt to accurately manage its system. See December 21, 2005 Transmittal Letter at 3. In any event, the Commission cannot find that these are the types of errors which are the result of gross negligence in system management or would constitute anything more than simple mistakes. See *e.g. Northern Natural Gas Co.*, 110 FERC ¶ 61,253 at P 39 (2005).

¹⁷ In *Transco*, the Commission found prior-period adjustments acceptable, unless the pipeline: (1) had been grossly negligent in the management of its system and thereby caused the fuel use differential; (2) deliberately created the undercollections; or (3) had waited an inordinate amount of time after discovery of the errors to seek recovery. See *Transcontinental Gas Pipe Line Corp.*, 95 FERC ¶ 61,299 (2001) (Transco).

¹⁸ Citing, NAESB Standards 2.3.14 and 2.3.26.

months from the date of the initial month end allocation, in NAESB 2.3.26, or 6 months from the initial transportation invoice, or 7 months from the date of the initial sales invoice, in NAESB 3.3.15, as time periods by which adjustments should be accomplished. However, all of these standards explicitly state that “Parties’ other statutory or contractual rights shall not otherwise be diminished by this standard.” Because the Commission finds in the instant case that consistent with our policies, Kern River’s tariff permits it to collect the instant past period costs, the Commission will not adopt the methodology requested by SCGC.

24. Several commenters argue that there is a significant differential between the price of gas at today’s rates and the price of gas at the time of the alleged imbalances and argue that Kern River should only be allowed to recover the value of gas at the prevailing prices at the time of the claimed losses. Section 12.2 of the GT&C provides that “[t]ransportation rates set forth on Sheet Nos. 5, 5-A, 6 and 7 are exclusive of fuel used and lost and unaccounted-for gas, which all Shippers will cause to be furnished in-kind each Day by applying a fuel reimbursement factor to Receipt Point nominations, as provided in NAESB 1.3.16.” Because shippers have been given notice in Kern River’s tariff (section 12 of the GT&C and the Forms of Service Agreements) that fuel and L&U are to be reimbursed in-kind, we find that shippers must provide the adjusted amount to Kern River on an in-kind basis and arguments by commenters that only the value of the gas should be taken into account are without merit. The tariff provides the collection method regardless of the market value of the gas which may be higher or lower than when the fuel was used.

25. Moreover, although some commenters argue that recovery of the prior-period amounts would cause generational inequities among shippers, the Commission finds such arguments to be without merit, because shippers must take Kern River’s system as they find it. The payment of these amounts will be on an in-kind basis which will allow the accounts to be trued-up based on the fuel used to provide transportation.

26. Rolled-In Customers also claim that Kern River has not proposed a specific methodology for recovering the prior-period adjustment fuel amounts. However, Kern River proposed a recovery plan in its original filing and reply comments.

27. To reduce the impact on shippers, Kern River proposes to recover the undercollection of compressor fuel over an extended period of up to 24 months by increasing the monthly compressor fuel reimbursement factors in proportion to the amounts owed by each group of shippers. Kern River explains that it has no storage on its system and operates at a very high load factor. If it is operationally feasible, Kern

River states that it is willing to recover the gas that it is owed during the spring and fall seasons. In addition, Kern River states that it will not need to collect additional gas from its customers with respect to the prior-period adjustments related to system-wide L&U.¹⁹

28. The Commission finds that Kern River's recovery plan is acceptable and, as discussed in the body of this order, the Commission accepts Kern River's proposed prior-period adjustments to its fuel and L&U balances.

The Commission orders:

Kern River's proposed prior-period adjustments to the gas compressor fuel and L&U balances and proposal to recover the adjustments are hereby accepted as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

¹⁹ Kern River submits that the proposed adjustments to L&U will decrease the gain previously reported in the 2004 fuel report by 309,790 Dth. Kern River's gas balance as of March 31, 2006 shows that the balance in the L&U account after taking the prior-period adjustments into consideration continues to be a gain. Kern River contends that the gain will be reduced or eliminated in the normal course of operations as Kern River experiences losses or gains on its system. Further, Kern River states that the L&U balance for the High Desert Lateral, after considering the prior-period adjustments, is very small. Thus, Kern River proposes to resolve this balance during the normal course of operations. *See*, Kern River's May 17, 2006 Reply Comments at page 17.