

128 FERC ¶ 61,024
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Kern River Gas Transmission Company

Docket No. CP08-429-001

ORDER GRANTING REHEARING

(Issued July 14, 2009)

1. On June 4, 2009, the Commission issued a certificate to Kern River Gas Transmission Company (Kern River) pursuant to section 7(c) of the Natural Gas Act (NGA) authorizing it to construct, modify, and operate the facilities necessary to increase the certificated maximum allowable operating pressure (MAOP) on its pipeline from Lincoln County, Wyoming to Kern County, California in order to expand the firm capacity of the pipeline by 145,000 dekatherms per day (Dth/d) (2010 Expansion).¹ The June 4 Order also granted Kern River's request for a predetermination that rolling the costs and fuel associated with the 2010 Expansion into those of its 2003 Expansion² for transportation rate and fuel reimbursement purposes in its next rate case is appropriate, absent a change in circumstances, and approved Kern River's proposal to charge the 2003 Expansion service rates as the initial rates for the 2010 Expansion service.

2. On June 8, 2009, Kern River filed a request for rehearing of the June 4 Order's requirement that Kern River also charge the 2010 Expansion shippers any lower, "step-

¹ *Kern River Transmission Co.*, 127 FERC ¶ 61,223 (2009) (June 4 Order).

² *Kern River Transmission Co.*, 100 FERC ¶ 61,056 (2002).

down” rates afforded to the 2003 Expansion shippers.³ The Commission will grant Kern River’s request for rehearing as discussed below.⁴

I. Background

3. The Kern River system was originally constructed to provide up to 700,000 Mcf/d of year-round firm transportation service from Wyoming receipt points to California delivery points and was placed into service in February 1992.⁵ The original system design included three mainline compressor stations with 50,400 ISO-rated horsepower and a MAOP of 1,200 pounds per square inch gauge (psig).

4. Kern River’s system has undergone several expansions. On April 6, 2001, the Commission authorized Kern River to construct and operate compression and metering facilities required to provide up to 135,000 Dth/d of limited-term, incremental transportation capacity from Wyoming to California (the California Action Project).⁶ On July 26, 2001, the Commission authorized Kern River to construct and operate additional compression and metering facilities to expand its Wyoming-to-California capacity by an additional 10,500 Dth/d (revised 2002 Expansion Project).⁷

5. In addition, in 2002, the Commission authorized Kern River to construct and operate facilities needed to expand its transportation capacity by an additional 885,626 Dth/d in order to provide up to 906,626 Dth/d of long-term incrementally-priced firm

³ June 4 Order, 127 FERC ¶ 61,223 at P. 43.

⁴ On July 2, 2009, Howard Hughes Properties, Inc. and the Howard Hughes Corporation (collectively, Hughes Properties) also filed a request for rehearing of the June 4 Order. The Commission will address Hughes Properties’ request for rehearing in a separate order.

⁵ *Kern River Gas Transmission Co.*, 50 FERC ¶ 61,019 (1990).

⁶ *Kern River Gas Transmission Co.*, 95 FERC ¶ 61,022 (2001). Of the capacity that became temporarily available due to the California Action Project, 114,000 Dth/d was subsequently incorporated into Kern River’s 2002 Expansion proposal to expand its Wyoming-to-California capacity by 124,500 Dth/d.

⁷ *Kern River Gas Transmission Co.*, 96 FERC ¶ 61,137 (2001).

transportation service (the 2003 Expansion).⁸ The 2003 Expansion's additional compression and pipeline loops more than doubled Kern River's existing summer design day capacity to 1,731,126 Dth/d.

6. On April 30, 2004, Kern River filed a general rate case under Section 4 of the NGA in Docket No. RP04-274-000. The proposed rates were accepted and suspended subject to refund, conditions, and hearing.⁹ The Commission's approval of final rates in Docket No. RP04-274-000 is still pending.¹⁰

7. On June 20, 2008, Kern River filed its application for the 2010 Expansion to meet increasing residential and commercial market demand in Utah, Nevada and California, as well as to provide a reliable supply of additional natural gas to existing and new power generation facilities. The 2010 Expansion authorized by the June 4 Order will increase Kern River's summer design day capacity by 145,000 Dth/day to 1,876,126 Dth/d. The June 4 Order authorized Kern River to install a new 20,500 horsepower compressor and related appurtenances at the Muddy Creek compressor station in Lincoln County, Wyoming, and to restage five compressors at the Muddy Creek compressor station and two compressors at the Painter compressor station in Uinta County, Wyoming. The additional compression at the Muddy Creek compressor station will increase Kern River's operating pressures to allow more gas to flow through the existing Kern River pipeline system. Specifically, the June 4 Order authorized Kern River to increase the certificated MAOP of its pipeline facilities from 1,200 psig to 1,333 psig, and the MAOP of its meter stations and compressor stations from 1,250 psig to 1,350 psig.

8. As a result of several open seasons in 2007 and 2008, the 2010 Expansion is fully subscribed. Kern River executed eleven long-term firm transportation agreements for 145,000 Dth/d under Rate Schedule KRF-1, of which nine were for 10-year terms and two were for 15-year terms. Under these agreements, the 2010 Expansion service will be

⁸ *Kern River Gas Transmission Co.*, 100 FERC ¶ 61,056 (2002). The additional capacity includes the remaining 21,000 Dth/d of California Expansion project capacity which was added to the 2003 expansion.

⁹ *Kern River Gas Transmission Co.*, 107 FERC ¶ 61,215 (2004).

¹⁰ See *Kern River Gas Transmission Co.*, Opinion No. 486, 117 FERC ¶ 61,077 (2006), *order on reh'g*, Opinion No. 486-A, 123 FERC ¶ 61,056 (2008), *order on reh'g*, Opinion No. 486-B, 126 FERC ¶ 61,034 (2009).

provided at the firm incremental rate for the 2003 Expansion service under Rate Schedule KRF-1.¹¹

9. However, as Kern River indicated in its application, although the 2010 Expansion costs would be rolled in with Kern River's incrementally priced 2003 Expansion service in the future, the 2010 Expansion shippers agreed in their precedent agreements that they would not be entitled to receive any lower, "step down" rates applicable to the 2003 Expansion shippers.¹² As stated in Article 8.4 of the 2010 expansion shippers' precedent agreements, which provision survives commencement of expansion service and becomes a part of the service agreements:

If the rate for 2003 Expansion shippers under Rate Schedule KRF-1 for Firm Incremental Rate Service 'steps-down' during the primary term of Shipper's TSA, Shipper will not be entitled to receive the 'step down' rate that would be applicable to 2003 Expansion shippers during the term of the new service.

10. In our June 4 Order, the Commission approved as initial rates for the 2010 Expansion service Kern River's existing firm incremental transportation rates under Rate Schedule KRF-1 applicable to the 2003 Expansion shippers.¹³ The Commission also

¹¹ Specifically, the 10-year service agreement provides that service will be provided at a rate that is "equal to the maximum recourse rate applicable to firm incremental rate service related to the 2003 Expansion Project," while the 15-year service agreement provides that service will be provided at a rate that is "equal to the maximum 15-year rate applicable to firm incremental rate service related to the 2003 Expansion Project." Kern River's application at Exhibit I.

¹² Kern River's current rates reflect a levelized cost of service and are designed such that approximately 70 percent of Kern River's initial transmission plant costs will be recovered over the initial terms of its existing customer's contracts. *See* Opinion No. 486 at P. 15. After the 10- or 15-year initial terms of their contracts expire, Kern River's existing customers, including its 2003 Expansion shippers, will generally pay lower, or "stepped down" Period 2 rates. *See* Opinion No. 486, 117 FERC ¶ 61,077 at P 37.

¹³ *See* Kern River's Application at Exhibit P. These rates are the 2003 Expansion shipper motion rates accepted by the Commission in Docket No. RP04-274-003 (*see* unpublished director letter order issued on October 27, 2004). These rates are subject to the outcome of the pending rate case in Docket No. RP04-274-000, *et al.* *See Kern River Gas Transmission Co.*, Opinion No. 486, 117 FERC ¶ 61,077. Thus, in the June 4 Order,
(continued...)

found that a predetermination in favor of rolled-in rate treatment for the 2010 Expansion costs is appropriate, noting that Exhibit N of Kern River's application reflects that the estimated total annual revenues of \$34.3 million from the 2010 Expansion service at the 2003 Expansion rates will exceed the \$10.4 million total annual costs of the project.¹⁴

11. However, regarding the future "step-down" of rates, the Commission stated that

since Kern River is proposing that the 2010 Expansion shippers pay the same rates as the 2003 Expansion shippers and that the 2010 Expansion costs be rolled into the 2003 Expansion rates in a future rate case, the Commission finds that the 2010 Expansion shippers should also pay any lower, 'step-down' rates afforded to 2003 Expansion shippers.¹⁵

II. Request for Rehearing

12. Kern River requests rehearing and revision of the requirements of Paragraph 43 of the June 4 Order that the 2010 Expansion shippers pay any lower, step-down rates afforded the 2003 Expansion shippers to the extent that Kern River would be required to provide the 2010 Expansion service at the 2003 Expansion service step-down rate at the same time that the 2003 step-down rate will become effective for the 2003 Expansion service, i.e., as soon as May 1, 2013. Kern River asserts that under the 2010 Expansion service agreements, the 2010 Expansion shippers agreed to pay the 2003 Expansion recourse rate without step-down during the primary 10- or 15-year terms of their service agreements, and that the 2010 Expansion shippers will have the opportunity to obtain service at the 2003 Expansion step-down rates after the expiration of the 2010 shippers' primary contract terms, or in the years 2020 and 2025. Kern River seeks modification of

the Commission held that the proposed 2010 Expansion rates are also subject to the outcome of the rate proceeding.

¹⁴ The Commission also granted Kern River's request for a predetermination that rolling the fuel attributed to the 2010 Expansion into the 2003 Expansion fuel reimbursement rates is appropriate.

¹⁵ June 4 Order, 127 FERC ¶ 61,223 at P 43. The Commission thus required Kern River to file actual revised tariff sheets incorporating the initial reservation and usage rates to be assessed the 2010 Expansion shippers, as well as any step-down rates to be assessed 2003/2010 Expansion shippers, thirty days prior to the date the rates go into effect.

Paragraph 43 to provide that the step-down rates will not apply to service for the 2010 Expansion shippers until the conclusion of their respective 10-year or 15-year contract terms.

13. Kern River asserts that the June 4 Order's modification of Article 8.4 of the precedent agreements to make the 2003 Expansion step-down rate applicable to 2010 service as early as 2013, only 2 ½ years after their service agreements take effect, fundamentally changes the economic foundation upon which Kern River decided to proceed with the expansion. Kern River states that modifying the parties' agreements will reduce project revenue over the term of the underlying service agreements by approximately \$112 million, which likely will lead to Kern River's abandonment of the project.

14. Several of the 2010 Expansion shippers -- Nexen Marketing U.S.A. Inc., Occidental Energy Marketing, Inc., and Southern California Gas Company -- filed letters in support of Kern River's request for rehearing.

III. Discussion

15. The Commission will grant Kern River's request for rehearing. Traditionally, in setting initial rates for services to be provided by new facilities in certificate proceedings, the Commission has authorized natural gas pipelines to charge either a proposed new incremental rate based on the costs of providing the new service, or an existing cost-based rate which Commission has already approved as just and reasonable for a similar service provided by the pipeline. In this case, Kern River did not propose a separate, incremental rate based on the estimated costs of the 2010 expansion. Instead, Kern River chose the latter avenue of charging an existing just and reasonable rate as a proxy rate for the 2010 Expansion service, i.e., the existing rates on file for its 2003 Expansion service. In its application, Kern River stated that it was proposing that the 2010 Expansion shippers "pay the rates applicable to 2003 Expansion shippers." Our June 4 Order granted that request and, recognizing that the rates applicable to the 2003 Expansion shippers were due to "step-down" in the near term, required that the rates assessed the 2010 Expansion shippers "step-down" at the same time. However, on rehearing, we are persuaded that the near-term "step down" in rates applicable to the 2003 Expansion shippers is contract-specific and applicable only to the 2003 Expansion shippers, as determined in the Commission's Opinion No. 486, *et al.*¹⁶ Therefore, we will grant

¹⁶ Kern River's unique levelized rate design, as approved in Opinion No. 486, *et al.* and applicable to certain shippers, provides for certain costs to be amortized over specific time periods.

Kern River's request that it be authorized to charge as an initial rate for the 2010 Expansion service the "pre-step-down" rates currently applicable to the 2003 Expansion shippers.¹⁷

The Commission orders:

Kern River's request for rehearing of the Commission's June 4, 2009 Order in this proceeding is granted, as discussed herein.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

¹⁷ As noted in our June 4 Order, these rates are subject to the outcome of Kern River's pending rate proceeding. Similarly, the issue of how Kern River's tariff should be modified to reflect shipper eligibility for lower step-down rates is pending in that rate case. We also note that the initial rates approved here, including the underlying rate design, may be subject to change in subsequent section 4 or 5 rate proceedings.