

135 FERC ¶ 61,179
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Kern River Gas Transmission Company

Docket No. RP11-2031-000

ORDER REJECTING TARIFF RECORDS

(Issued May 26, 2011)

1. On April 26, 2011, Kern River Gas Transmission Company (Kern River) filed tariff records¹ to clarify the process for Kern River to reserve capacity, and for Ten Year Rolled-In Rate shippers (Affected Shippers)² to retain capacity when their current contracts (2011 Expiring Agreements) expire on September 30, 2011. For the reasons discussed below, the Commission rejects the tariff records listed in footnote No. 1.

I. Background

2. Kern River and its shippers, including the Affected Shippers, have been involved in a general rate proceeding in Docket No. RP04-274-000 since April 2004. Kern River proposed in that rate case to continue to design its rates based on the levelized rate design methodology approved in its original optional expedited certificate proceeding, as modified in subsequent proceedings. While the rates approved in that certificate proceeding included separate, levelized rates for three periods, Kern River's tariff only included rates for Period One, the term

¹ Sheet No. 292, GT&C Available Capacity, 1.0.0; Sheet No. 293, GT&C Available Capacity, 1.0.0; Sheet No. 293A, GT&C Available Capacity, 0.0.0; Sheet No. 293B, GT&C Available Capacity, 0.0.0; Sheet No. 293C, GT&C Available Capacity, 0.0.0, to Gas Tariff, FERC NGA Gas Tariff.

² The Affected Shippers with ten year rolled-in rates include BP Energy Company (BP) with capacity under Contract No. 1000, and Nevada Power Co. d/b/a NV Energy (NVE) with capacity under Contract Nos. 7650 and 7665.

of its firm shippers' initial contracts, and Kern River did not propose in this rate case to add Period Two or Three rates to its tariff. The Period One Rates are designed to recover 70 percent of Kern River's invested capital, an amount approximately equal to the portion of its invested capital funded through debt. This fact allows Kern River to recover more invested capital during Period One than it would under ordinary straight-line depreciation for the depreciable life of its system.

3. In Opinion No. 486,³ the Commission found that Kern River's proposal to continue its levelized methodology did not result in just and reasonable rates unless the pipeline included tariff sheets reflecting the Period Two step down rates, in addition to its proposed Period One rates. Because Kern River will have an excess recovery of its depreciation expense as of the end of Period One, the Commission held that it could only find the Period One rates to be just and reasonable, if Kern River's tariff also provides for the return of that excess recovery in its Period Two rates.

4. In Opinion No. 486-C, the Commission reaffirmed its holdings in earlier orders that Kern River must include in its tariff levelized rates for Period Two. However, the Commission also established a hearing to determine how levelized Period Two rates should be calculated and what conditions the shipper must satisfy in order to be eligible for the levelized Period Two rates.⁴ The Commission found that these issues included the issue of whether, and how, the duration of shipper contracts for service during Period Two should be coordinated with the length of the Period Two rate levelization period. The Commission found that the record was inadequate to resolve these issues and that the participants in this proceeding had not had an opportunity to present evidence relevant to resolving the Period Two contract duration issue or other issues concerning what conditions shippers must satisfy in order to be eligible for the levelized Period Two rates or how such levelized rates should be calculated.⁵

5. In response to Opinion No. 486-C, Kern River submitted *pro forma* tariff sheets that included Period Two rates levelized over ten years and a new section

³ Opinion No. 486, 117 FERC ¶ 61,077, at P 37 (2006), reh'g, Opinion No. 486-B, 126 FERC ¶ 61,034 (2009).

⁴ Opinion No. 486-C, 129 FERC ¶ 61,240, at P 247 (2009).

⁵ *Id.* P 261- 263.

30 of the General Terms and Conditions (GT&C) of Kern River's tariff.⁶ Section 30 would require each eligible shipper for Period Two rates to provide written notice to Kern River of the shipper's intention to enter into a transportation service agreement for Period Two service no later than 12 months prior to the expiration of the shipper's Period One service agreement.⁷ As part of an agreement on procedural schedule for Period Two hearing, Kern River agreed to accept notice of intention to contract for Period Two service from BP and NVE (currently the only 10-year Original System shippers) six months in advance of the commencement of their Period Two service (i.e. no later than April 1, 2011).

6. Kern River's counsel Mr. Thompson explained the significance of the April 1, 2011, deadline in his statement to the Administrative Law Judge on December 8, 2010, in the general rate case proceeding. Mr. Thompson explained that April 1, 2011, is the deadline to provide notice of intent for 10-year rolled-in shippers to utilize Period Two service or acquire Period Two service. If a customer in good faith tells Kern River by the deadline that it intends to take Period Two service, then the ensuing six months are for the process of developing a contract and getting a contract signed by the time Period Two starts on October 1, 2011. Mr. Thompson also explained that if the customer does not sign a contract, then the Period Two service won't be provided.

7. In March and April 2011, there was correspondence between Kern River and BP as well as correspondence between Kern River and NVE with regard to parties' intentions to contract for Period Two service. Of importance was a letter sent by BP to Kern River on April 1, 2011, indicating its non-binding notice of intent to contract for 51,750 MMBtu of Period Two service. Likewise, NVE sent a letter to Kern River on March 30, 2011, indicating its non-binding notice of intent to contract for 48,283 MMBtu of Period Two service. Kern River responded to both of these letters indicating that the non-binding notices did not meet their requirements to contract for such service.

8. An Initial Decision regarding Period Two rates was issued on April 14, 2011.⁸ Parties filed briefs on exception on May 16, 2011.

⁶ See Kern River's February 1, 2010, Period Two rate compliance filing in the general rate proceeding in Docket No. RP04-274-022.

⁷ See *pro forma* Sheet No. 230 filed on February 1, 2010 in Docket No. RP04-274-022.

⁸ See *Kern River Gas Transmission Company*, 135 FERC ¶ 63,003 (2011) (Initial Decision).

9. Kern River states the Affected Shippers have been unwilling to commit to binding Period Two contracts at this time. Kern River states Affected Shippers assert that Kern River should reserve capacity for their use even though no binding Period Two contracts have been executed. Kern River claims that the instant filing establishes a process that will balance the Affected Shippers' interests with the Commission's mandate that expiring or terminating capacity be made available to the market. Kern River's current tariff does not address the unique timing issues regarding the exercise of Right Of First Refusal (ROFR) rights under the Period One 10 year contracts expiring September 30, 2011.

II. Instant Filing

10. Kern River proposes a new section 27.7 to the GT&C of its tariff that establishes interim procedures prior to the September 30, 2011 expiration of the 2011 Expiring Agreements that will apply only to the Affected Shippers. Section 27.7 provides that an Affected Shipper may retain all or a portion of its capacity for use in Period Two either by (1) providing a binding notice to execute a Period Two agreement or (2) by exercising a ROFR for some or all of the remaining capacity, in accordance with section 27.5 of the GT&C of its tariff. As set forth in section 27.7, Affected Shippers that wish to retain capacity at the lower rates that would apply in Period Two must submit a binding written notice to Kern River prior to June 1, 2011. The binding notice must specify (1) the Demand Maximum Daily Quantity (DMDQ) (if any) for which the Affected Shipper agrees to execute a Period Two agreement, (2) the term of such service (either ten or fifteen years), and (3) the DMDQ (if any) for capacity for which it wishes to retain a right to participate in the ROFR process that does not apply to Period Two capacity rights.

11. In addition, section 27.7 sets forth the steps Kern River will follow after it receives a notice from an Affected Shipper to contract for Period Two service in the interim. Finally, section 27.7 sets forth the result of the Affected Shipper's failure to provide notice, including the shipper's forfeiture of any and all rights to Period Two service during Period Two and the impact on its ROFR for capacity that is not subject to its right to elect the lower capacity available under a Period Two contract.

12. Kern River proposes to revise section 27.6 of the GT&C of its tariff to acknowledge that Affected Shippers may be eligible for a step-down rate that is lower than the maximum recourse rate for Rate Schedule KRF-1.

III. Public Notice

13. Public notice of the filing was issued on April 27, 2011. Interventions and protests were due as provided in section 154.210 of the Commission's regulations (18 C.F.R. § 154.210 (2011)). Pursuant to Rule 214 (18 C.F.R. § 385.214 (2011)),

all timely filed motions to intervene and any unopposed motion to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. Protests were filed by the Rolled-In Customer Group (RCG),⁹ BP Energy Company (BP), NVE, and Southern California Gas Company (SoCalGas) as discussed further below. An answer to protests was filed by Kern River.

IV. Comments

14. RCG states that Kern River appears to be coercing BP and NVE into contracts for Period Two service prior to the Commission issuing an order on the rates that will apply for that service. NVE argues that Kern River is forcing two shippers that seek to recover the excess depreciation they paid to Kern River to accept Kern River's preferred, litigated position with respect to Period Two terms and conditions in order for those shippers to obtain the benefit of lower Period Two rates that will offset those excess payments.

15. Kern River responds that neither its tariff nor the shippers' contracts provide the shippers with any right to their capacity outside of the ROFR process. Kern River states that its failure to make the capacity available to the market reasonably in advance of the expiration of the contracts would be inconsistent with Commission policy. Kern River further states that the only provision under which the Affected Shippers can retain their capacity pursuant to Kern River's tariff is under the ROFR provisions of the tariff. These provisions would require any agreements to match the highest bid submitted by a competing shipper in order to retain their capacity, which could possibly be the maximum recourse rate on Kern River's system. Kern River explains that the Affected Shippers do not appear to be claiming their capacity rights under ROFR and that Kern River's tariff does not provide for any different process for Period Two eligible shippers. Kern River asserts that if Affected Shippers choose to wait until the end of their Period One contracts to retain their capacity for Period Two service, it will lead to a gap in service because there will be insufficient time to award the capacity to other shippers.

⁹ The RCG consists of Area Energy LLC, Anadarko E&P Company LP and Anadarko Petroleum Corporation, Chevron USA Inc. (on its own behalf and on behalf of Nevada Cogeneration Associates #1 and #2), Occidental Energy Marketing Inc., Shell Energy North America (US), L.P., Southwest Gas Corporation, and Williams Gas Marketing Inc.

16. BP and RCG argue that the issues bearing on the contracting for Period Two capacity and determining the rate a shipper must pay for that capacity are also at issue in the rate case proceeding in Docket No. RP04-274-023.¹⁰ Briefs on Exception to the Initial Decision are due to be filed on May 16, 2011. NVE argues that the instant filing should be rejected since Kern River attempts to address unnecessarily and prematurely issues that will be determined in the existing section 5 proceeding currently underway in Docket No. RP04-274-023. BP asserts that to address those issues now is unnecessarily duplicative and a waste of the Commission's resources. RCG and BP argue that the proposed tariff language, which requires a binding notice of intent to take Period Two service, is directly contrary to Kern River's expressed statements on record in Docket No. RP04-274-023 that notice stating intent to take Period Two service does not require a party to execute a contract.¹¹ RCG argues that Kern River's proposed tariff language may also affect parties' litigation positions in the Period Two phase of that proceeding.

17. Kern River responds that the Affected Shippers misconstrued Kern River's statements at the December hearing in the rate case proceeding in Docket No. RP04-274-023. Kern River states that its counsel said nothing at the December hearing about capacity or about whether Kern River intended to reserve capacity. Kern River asserts that its counsel's remarks were intended to describe the meaning of the notice requirement of the illustrative tariff section thirty that was part of the subject of the hearing. It asserts that this description did not bind Kern River to a particular process that would govern the expiring contracts at issue here.

18. BP also argues that Kern River has an incentive to dissuade shippers eligible to contract for Period Two capacity from doing so. BP asserts that Kern River has the incentive to sell unsubscribed Period Two eligible capacity for the recourse rate in its tariff, which would be significantly higher than any Period Two step-down rate. BP states that every Dth of avoided Period Two service results in more depreciation that would otherwise be recovered by shippers in Period Two that will be retained by Kern River. NVE states that in the event there is any spare

¹⁰ RCG cites to *Kern River Gas Transmission Company*, Docket No. RP04-274-023, "Post-Hearing Initial Brief of the Rolled-In Customer Group on Period Two," at 19-22 (filed January 14, 2011), "Post Hearing Reply Brief of the Rolled-In Customer Group on Period Two Issues," at 24-27 (filed February 17, 2011).

¹¹ RCG cites to *Kern River Gas Transmission Company*, Docket No. RP04-274-023, Tr. at 190, 1.19 to 191, 1.1 (stating that the notice was not a binding commitment); Tr. at 195, 1.22 to 196, 1.6 (stating that if a customer does not sign a contract, then Period Two service would not be provided).

capacity, Kern River has asserted its right to sell it at the highest recourse rate in its tariff, allowing it to charge a rate up to three times the step-down Period Two rates the shippers expect to pay for the same capacity.

19. Kern River responds that its rates must be designed to return the excess depreciation to its shippers in Period Two. Kern River states, however, they must contract for the capacity in order to recover it. Kern River claims that it has spent a significant amount of time trying to get a firm commitment from these shippers for Period Two capacity. Kern River asserts that its investment of time demonstrates that Kern River's true intent is to retain the shippers it has and to make sure they get the benefit of the Period One rates they paid. Kern River further asserts that the fact that the rates, terms and conditions are not finalized is irrelevant since the rates are going to be within an estimable range.¹²

20. RCG claims that the phrase "maximum applicable rate" in proposed section 27.7(d)(1)(ii) is ambiguous in that it is not clear what applicable rate is being referenced. In addition, RCG argues that Kern River has not provided an explanation for imposing a ten year term in the event the Affected Shippers fail to mutually agree on the length of the subsequent term.¹³ SoCalGas objects to sections 27.7(c)(1)(i) and 27.7(c)(1)(ii) of Kern River's proposed tariff that would require Affected Shippers holding capacity eligible for Period Two rates to agree on a Period Two contract term of fifteen years or otherwise be limited to the default choice of a ten year contract term. It states that this issue is still pending before the Commission on exceptions to the Initial Decision.

21. BP and NVE argue that Kern River's proposed tariff filing is unduly discriminatory since the new language included in the GT&C applies only to the Affected Shippers. BP argues that if Kern River's tariff filing is approved, the Affected Shippers would be required to commit to Period Two service without the benefit of knowing what rates or terms and conditions of such service will apply as those issues are still outstanding in the rate case in Docket No. RP04-274-023. NVE states that on April 1, 2011, it gave notice to Kern River of its intentions to contract for Period Two service in good faith even though it was not required to do so. NVE asserts that Kern River rejected its notice of intent.

¹² Kern River notes that on its website it has posted rates calculated based on the Initial Decision in the rate case proceeding in Docket No. RP04-274 for the shippers' information.

¹³ RCG cites to section 27.7(c)(1)(ii) of Kern River's proposed tariff.

22. Finally, RCG argues that it is unclear how (1) Kern River's proposal that a shipper could elect to exercise a ROFR would work and (2) how the bidding process for the capacity being offered would work. NVE argues that Kern River has failed to comply with the Commission's filing requirements by not including the specific section of a statute, subpart of the regulations, order of the Commission, provision of the company's tariff, or other appropriate authority.

V. Discussion

23. The Commission finds that Kern River has failed to show that its proposed tariff provisions are just and reasonable. Those provisions would require Affected Shippers to submit, by June 1, 2011, a binding and non-conditional expression of intent that it will execute a service agreement for Period Two service with a term of either 10 or 15 years or forfeit its right to take Period Two service under the step-down Period Two rates required by the Commission. The protesting shippers are correct that Kern River's proposal would prejudge the outcome of the Period Two hearing before the Commission has an opportunity to review the ALJ's Initial Decision.

24. As Kern River recognizes, the procedures for extending the Period One contracts to a subsequent phase, in this case Period Two, were not addressed either in the Period One contracts or in Kern River's currently effective, generally applicable tariff. The Commission established the hearing concerning Kern River's Period Two rates "for the primary purpose of addressing the issue of whether, and how, the duration of shipper contracts for service during Period Two should be coordinated with the length of the Period Two rate levelization period."¹⁴ However, Kern River's instant proposal would require the Affected Shippers to make binding commitments as to the duration of the contracts they will enter into before the Commission has resolved that issue based on the record developed at the Period Two hearing and the parties' briefs on exceptions to the ALJ's initial decision.

25. In establishing the Period Two hearing, the Commission recognized that there are various options for resolving the contract duration issue, including (1) requiring shippers to enter into contracts for the entire length of Period Two, if they desire levelized rates for Period Two, (2) offering the shippers one or more options permitting them to enter into contracts of some specified minimum duration but shorter than Kern River's remaining depreciable life, while nevertheless levelizing Kern River's Period Two rates over the entire remaining depreciable life, (3) offering optional contract lengths that are shorter than Kern

¹⁴ Opinion No. 486-D, 133 FERC ¶ 61,162, at P 200 (2010).

River's remaining depreciable life as in the previous option, but requiring the rates in those contracts to reflect a Period Two cost of service levelized over the term of the contracts, rather than Kern River's remaining depreciable life, and (4) not requiring any minimum contract duration. The Commission stated that the parties were free at the hearing to support or oppose any of these options or to argue for some other option concerning contract duration and the length of the levelization period not listed in Opinion No. 486-C.

26. The Affected Shippers have each indicated in their correspondence with Kern River an interest in executing service agreements for Period Two for the full contractual entitlements under their existing Period One Contracts, albeit without making a binding commitment to execute such contracts. Based on all the current circumstances, the Commission finds that Kern River's proposal to require Affected Shippers at this time to make an additional binding contractual commitment to execute service agreements with either ten or fifteen year terms is unjust and unreasonable, because it would prejudge the very contract duration issue currently pending before the Commission on exceptions to the ALJ's initial decision.

27. In that regard, the Commission further finds that the right of first refusal procedures in section 27.2(b) of the GT&C of Kern River's currently effective tariff does provide Kern River with the right to post capacity under expiring or terminating agreements with a term of one year or longer in order to obtain bids from third parties during a bid period of no less than three days and no greater than six months. In accordance with section 27.2(b), Kern River may post the capacity held by Affected Shippers for third party bids up to six months prior to the September 30, 2011 expiration date. To the extent that some of the expiring contracts and capacity are subject to other provisions of Kern River's existing tariff, such as Rate Schedule MO-1, then those notice and bidding provisions would likewise control.¹⁵ The Commission finds that posting of the relevant capacity for third party bids would provide Kern River with the opportunity to entertain bids, gauge interest in the capacity, and ensure an open and transparent bidding process.

28. Any such open season would be subject to any right of the Affected Shippers to enter into Period Two contracts based on the criteria approved by the Commission after it acts on the Initial Decision and therefore Kern River would not be in a position to offer binding contracts to the highest third party bidder until after the Affected Shippers have determined not to contract for Period Two

¹⁵ See note 13 of Kern River's May 16, 2011 answer that describes the details of this specific tariff published at Sheet No. 723 of its tariff.

service. But whenever a pipeline seeks third party bids in a right of first refusal process, there is a possibility that the existing shippers will choose to retain that capacity.¹⁶ Therefore, the present situation is not substantially different from the ordinary situation when capacity subject to a right of first refusal is marketed. It is Kern River's decision whether to begin an open season at this time, or to wait and take the risk that the Affected Shippers will not exercise their Period Two rights with any attendant delay in selling the expiring capacity to other shippers under Kern River's standard section 27.2 ROFR procedures. The instant tariff records would improperly shift those risks from Kern River to the Affected Shippers.

The Commission orders:

The tariff records listed in footnote No. 1 are rejected for the reasons discussed herein.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

¹⁶ In this case, protecting the ability of the existing shippers to retain their capacity under reasonable terms and conditions is particularly important, because those shippers have paid Period One rates which have allowed Kern River to obtain an excess recovery of its depreciation expense as of the end of Period One. For that reason, the Commission held that it could only find the Period One rates to be just and reasonable, if Kern River's tariff also provides for the return of that excess recovery in its Period Two rates.