

133 FERC ¶ 61,199
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 Nos. RP04-274-000
RP10-1406-000
RP11-1499-000

ORDER GRANTING MOTION FOR CLARIFICATION

(Issued December 6, 2010)

1. This order addresses three related filings by Kern River Gas Transmission Company (Kern River) that address a single issue that has arisen in the ongoing litigation in its Docket No. RP04-274-000 rate case over its Period Two rates.¹ The issue is whether Kern River may recover in its Period Two rates certain compressor costs that are stated as a regulatory asset in its Period One compliance filing dated January 29, 2010. The three related filings include: (1) a motion for clarification filed September 28, 2010 in Docket No. RP04-274-023; (2) a proposed periodic rate adjustment surcharge filed September 30, 2010 in Docket No. RP10-1406-000;² and (3) a filing in Docket No. RP11-1499-000 to conditionally correct its prior January 29, 2010 compliance filing in Docket No. RP04-274-021.³ On review, the Commission grants Kern River's motion for clarification. This moots the need to rule on the proposed periodic rate adjustment

¹ See *Kern River Gas Transmission Company*, 133 FERC ¶ 61,162, at P 1-5, P 102-107, and P 141 (2010) (Opinion No. 486-D) for a description of Kern River's levelized rate structure with the separate levelized rates for the terms of the shippers' initial contracts (Period One), and for its remaining depreciable life (Period Two).

² The Commission accepted and suspended this proposed surcharge, subject to refund, on October 29, 2010. See *Kern River Gas Transmission Company*, 133 FERC ¶ 61,105 (2010) (Suspension Order).

³ This filing was noticed on November 9, 2010. Because the filing is dismissed the proposed tariff sheets are not listed in detail here.

surcharge filed in RP10-1406-000, and the conditional correction to Kern River's January 29, 2010 Period One compliance filing. Therefore those latter two filings are dismissed. In addition, requests for rehearing of the Suspension Order were filed on November 29, 2010 by the Rolled-In Customer Group (RCG), Southern California Generation Coalition (SCGC) filing jointly, and Nevada Power (NVC). These filings assert that the Commission should have summarily rejected Kern River's proposed periodic rate adjustment surcharge filed in Docket No. RP10-1406-000. The arguments advanced in these requests for rehearing are moot given the Commission's action here and therefore they are denied.

Background

2. Kern River and its opposing Shipper Parties have filed numerous pleadings about the three Kern River filings at issue here,⁴ which are summarized and discussed below. By way of background, the issues presented here have their genesis in Kern River's April 30, 2004 general rate case filing in Docket No. RP04-274-000 pursuant to section 4 of the Natural Gas Act. In that filing Kern River proposed to remove the depreciation expenses for its Solar Mars compressors from its levelized rate methodology. The depreciation charges related to the compressors would be recovered under a separate rate based on a revised straight line depreciation methodology of 12.53 percent. Opinion No. 486 rejected Kern River's proposal in two regards. First, it required Kern River to continue to include the compressor costs in its levelized rate methodology.⁵ After an extensive analysis of the record, Opinion No. 486 also required Kern River to adopt a 9.92 percent depreciation rate for the compressors at issue and again stated that the revised depreciation rate must be included in Kern River's levelized rate methodology.⁶ On rehearing, these determinations were affirmed by Opinion No. 486-A,⁷ which also clarified that deferred depreciation of the compressor costs could be treated as a

⁴ The answering or responding Shipper Parties include BP Energy Company (BP Energy), Calpine Energy Services Company, Morgan Stanley Capital Group, Inc., NVP, RGC, Southern California Gas Company and San Diego Gas & Electric Company, and SCGC. In the case of all three filings, Kern River filed an answer to the protests or the answer to its motion.

⁵ See *Kern River Gas Transmission Company*, 117 FERC ¶ 61,077, at P 55-57 (2006) (Opinion No. 486).

⁶ *Id.* P 464-476.

⁷ *Kern River Gas Transmission Company*, 123 FERC ¶ 61,056, at P 366-369, 376-378 (2008) (Opinion No. 486-A).

regulatory asset.⁸ There was no discussion of these matters in the subsequent orders regarding Kern River's various compliance filings and the parties' rehearing requests through the end of 2009.

3. On January 29, 2010, Kern River made a revised compliance filing to Opinion No. 486-C⁹ concerning its Period One rates. The Commission accepted that filing on November 18, 2010 in Opinion No. 486-D.¹⁰ Kern River also made a separate February 1, 2010 compliance filing setting forth the Period Two rates required by Opinion No. 486-C,¹¹ which filing is now at hearing. Both filings included the compressor costs at issue here as a regulatory asset in Kern River's rate base. Thus the balance of that regulatory asset at the end of Period One was also included in the rate base to be recovered through the Period Two rates. As discussed in Opinion Nos. 486-C and 486-D, Kern River must use a levelized rate methodology for both its Period One and Period Two.¹² Under that methodology Kern River will over-recover some costs and under-recover others in Period One. Thus, as is explicitly stated in Opinion No. 486-A, if the costs of the Solar Mars compressors are over-recovered in Period One, the result is a regulatory liability. If those costs are under-recovered, the result is a regulatory asset.¹³ The significance of this is that regulatory liabilities serve to reduce Kern River's Period Two rates as it has over-recovered its costs in Period One. A regulatory asset increases Kern River's Period Two rates as it has under-recovered its costs in Period One.

The Filings

4. The three Kern River filings at issue here address whether Kern River may recover in Period Two the regulatory asset for the Solar Mars compressors included in Kern River's January 29, 2010 Period One and February 1, 2010 Period Two compliance filings. The regulatory asset represents the amount of deferred depreciation associated with the compressors which Kern River claims will not be recovered during Period One. The three Kern River filings at issue and the Shipper Parties' responses arose in

⁸ *Id.* P 369-375.

⁹ See *Kern River Gas Transmission Company*, 129 FERC ¶ 61,240 (2009) (Opinion No. 486-C).

¹⁰ Opinion No. 486-D, 133 FERC ¶ 61,162, Ordering Paragraph (B).

¹¹ Opinion No. 486-C, 129 FERC ¶ 61,240, at P 263-264.

¹² *Id.* P 245; Opinion No. 486-D, 133 FERC ¶ 61,162 at P 4, 12, 112-115, 171-173.

¹³ Opinion No. 486-A, 123 FERC ¶ 61,056 at P 368.

conjunction with the Period Two hearing. The Shipper Parties and the Trial Staff argue that Opinion No. 486-A held that Kern River was at risk for any under-recoveries of the compressor costs that Kern River did not recover in Period One. Specifically, the Shipper Parties and Trial Staff rely on the highlighted sentence in the following paragraph in Opinion No. 486-A (P 368), describing generally the treatment of Kern River's book depreciation:¹⁴

As noted in the introduction to this section, it is necessary to establish book (straight-line) depreciation rates for Kern River's assets, including compressor engines and general plant. These are the depreciation rates to which Kern River is entitled for its assets. Kern River is required to keep track of the actual amount of costs it recovers for these plant items and to compare that amount to the amount that it would have collected under its book depreciation rates. It may over or under collect the amount of book depreciation to which it is entitled. If it overcollects its book depreciation, then it must credit that amount against its Period Two rates. *If it undercollects its book depreciation, however, it may not recover for undercollections as it has assumed the risk of undercollecting its depreciation amounts.*¹⁵

5. The second argument by the Shipper Parties and Trial Staff is that as Kern River will not recover 70 percent of the compressor costs in Period One, its proposed recovery of the compressor regulatory asset in Period Two is inconsistent with the regulatory bargain underpinning its leveled rate methodology.¹⁶ The Shipper Parties also assert that the regulatory asset is improperly based on the amount, or estimate, of the compressor replacements that Kern River made, or would make outside the test period for the Period One rates accepted by Opinion No. 486-D.¹⁷

6. The Kern River filings at issue respond to those arguments of the Shipper Parties regarding its Period Two rates in three different ways. Kern River's motion for

¹⁴ See Answer of Rolled-In Customer Group in Opposition to Motion for Clarification of Kern River Gas Transmission Company at 1-2, 8.

¹⁵ Opinion No. 486-A, 123 FERC ¶ 61,056 at P 366-368 (footnotes omitted).

¹⁶ Answer of Rolled-In Customer Group in Opposition to Motion for Clarification of Kern River Gas Transmission Company at 9-10.

¹⁷ See Answer of BP Energy Company to Kern River Gas Transmission Company's Motion for Clarification at 7-9, 11-12.

clarification dated September 18, 2010 seeks a Commission ruling that the compressor based regulatory asset may be recovered through Kern River's Period Two rates. The proposed periodic surcharge filed on September 30, 2010 would recover the entire compressor-based regulatory asset during the remainder of the Period One contracts. The conditional revised Period One compliance filing submitted on November 4, 2010 would revise Kern River's Period One rolled-in rates to assure the minimum necessary recovery of the compressor costs during Period One.¹⁸ Thus, while the three filings reflect different legal mechanisms, Kern River advances the same assertions in all three filings. These include that Kern River's regulatory asset for compressors is \$37 million at the beginning of Period Two, that under its levelized rate methodology it must have a reasonable opportunity to recover any regulatory asset that carries over to Period Two, that the Shipper Parties are attempting to prevent it from doing so despite the acceptance of the compressor-based regulatory asset by the Commission in Opinion Nos. 486-B and 486-C,¹⁹ and therefore Kern River needs immediate rate certainty as a matter of equity and to avoid unnecessary litigation. Kern River urges the Commission to accept one of the filings to assure that Kern River has a reasonable opportunity to recover the compressor costs it has included in its proposed Period Two rates as a regulatory asset.

7. The Shipper Parties filed responses to the request for clarification. These are more generic arguments that occur in their responses to all three of Kern River's filings and focus on the same central points. These include that Kern River is in essence filing an untimely rehearing request directed to the relevant language from Opinion No. 486-A,²⁰ that the quoted language from Paragraph 368 of Opinion No. 486-A supports their position that recovery of the regulatory asset in question is barred,²¹ that Kern River created this situation by changing the depreciation rates for its compressors in the first place,²² that Kern River is attempting to delay the resolution of the Period One rates by requesting Commission action before it rules on the January 29, 2010 compliance

¹⁸ In the case of the latter two filings, Kern River stated it would withdraw both of those filings if the Commission granted its motion for clarification. *Cf.* September 10, 2010 filing in Docket No. RP10-1499-000 at 5.

¹⁹ *See* Motion for Clarification of Kern River Gas Transmission Company at 2-4, 6, 8-9.

²⁰ RCG Answer at 2-3.

²¹ *Id.* at 1-2, 7-8.

²² *Id.* at 2-3.

filing,²³ and that Kern River is trying to resolve an issue now which should be decided as part of the Period Two hearing.²⁴

8. The Shipper Parties also made arguments against the legality of the proposed periodic surcharge filed in Docket No. RP10-1406-000. Those arguments were summarized in detail in the Suspension Order,²⁵ as was Kern River's answer,²⁶ and need not be repeated here. It is also not necessary to rule on the merits of the proposed periodic surcharge given the action here. However, the Commission will briefly address Kern River's filing in Docket No. RP11-1499-000 to modify its Period One compliance filing in Docket No. RP04-274-021. As previously noted, that filing was noticed on November 8, 2010 with interventions due November 18, 2010. Pursuant to Rule 214, 18 C.F.R. § 385.214 (2010), all timely filed motions to intervene and any motions 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 this proceeding or place additional burdens on existing parties. There were four protests²⁷ and nine interventions.²⁸ The main points of the protests include that this is a new rate proposal that does not comply with Opinion No. 486-C, that the economics are inconsistent with the interim refunds previously distributed to Kern River's shippers, that the filing is an effort to recover certain post-test period costs that are inconsistent with the 2004 test year adopted by Opinion No. 486-B,²⁹ that those costs are in fact only estimates (not actual costs), and that if Kern River desires to recover costs incurred outside the 2004 test period, it must file a new section 4 rate case. The protests also assert that the Docket No. RP11-1499-000 filing is a retroactive rate increase and violates the policy against piecemeal rate filings.

²³ *Id.* at 5-6; BP Energy Answer at 2, 4-5.

²⁴ BP Energy Answer at 6-7.

²⁵ Suspension Order, 133 FERC ¶ 61,105 at P 6-8.

²⁶ *Id.* P 9.

²⁷ The protesting parties are BP Energy, Calpine, Nevada Power, and RCG.

²⁸ Aera Energy LLC, Anadarko Petroleum Corporation, Chevron U.S.A. Inc., Occidental Energy Marketing, Inc., Questar Gas Company, RRI Energy Services, Inc., Shell Energy North America (US), L.P., Southwest Gas Corporation, and Williams Gas Marketing, Inc.

²⁹ *Citing Kern River Gas Transmission*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 54-56 (2009).

Discussion

9. The Commission grants Kern River's motion for clarification. As approved in Kern River's optional expedited certificate proceeding and described in detail in prior orders in this proceeding,³⁰ Kern River recovers its invested capital through levelized rates, with separate levelized rates calculated for different periods. The Period One levelized rates are intended to permit Kern River to recover approximately 70 percent of its original invested capital, which is the amount financed by debt. The Period Two rates are designed to permit Kern River to recover the remainder of its invested capital. As described in the orders in the optional expedited certificate proceeding,³¹ together the Periods One and Two rates would permit Kern River to recover 100 percent of its invested capital.

10. When the Commission stated in P 368 of Opinion No. 486-A that, if Kern River undercollects its book depreciation, it may not recover the undercollection in Period Two, it cited its discussion in Opinion No. 486 addressing Trial Staff's concern that Kern River might not use the funds collected during Period One to pay off its debt.³² In that part of Opinion No. 486, the Commission stated that, regardless of whether Kern River actually paid off its debt, Kern River's Period Two rates would be designed as if Kern River had paid off the debt.³³ In other words, the annual allowance for depreciation included in the Period One rates would be subtracted from Kern River's rate base each year, regardless of whether Kern River had collected that amount and used it to pay off the debt. As a result, at the end of Period One, the invested capital in Kern River's starting rate base would be reduced by about 70 percent, with only about 30 percent of the original invested capital to be included in the rate base at the start of Period Two.

11. However, it does not follow from this fact that Kern River may not include any regulatory asset associated with its compressor costs in its starting rate base for Period Two. In subsequent paragraphs of Opinion No. 486-A (P 369 through 375), the Commission discussed the regulatory treatment of the compressor engines in detail. The

³⁰ See, e.g., Opinion No. 486-A, FERC ¶ 61,056 at P 20.

³¹ See, e.g., *Kern River Transmission Co.*, 58 FERC ¶ 61,073, at 61,243 (1992), and *Kern River Transmission Co.*, 60 FERC ¶ 61,123, at 61,437 (1992).

³² Opinion No. 486, 117 FERC ¶ 61,077 at P 49 and 50.

³³ *Id.* P 41-43.

Commission denied RCG's assertion that Kern River could not record the compressor costs as a regulatory asset, nor include that asset in its rate base, stating:

The Commission denies RCG's rehearing requests. The Commission affirms that compressor engines and general plant will be treated the same as all other plant under Kern River's levelized methodology. That means that deferred depreciation for these plant assets will be treated as a regulatory asset or a regulatory liability and that the regulatory asset or regulatory liability will be included in Kern River's rate base (as an increase if it is a regulatory asset and as a decrease if it is a regulatory liability), as determined by Kern River's levelized model.³⁴

The Commission then explained in detail in the following paragraphs how Kern River's levelized rate methodology results in either a regulatory asset or a regulatory liability. That analysis was necessary only if the Commission intended that Kern River would either amortize any regulatory liability or recover any regulatory asset in Period Two.³⁵

12. Thus, Kern River may keep track of the difference between the annual allowance for depreciation of its compressors included in its levelized rates and the straight-line depreciation of those compressors recorded in its books. If at the start of Period Two, the cumulative allowance for depreciation of compressor included in its rates is projected to be less than the straight-line depreciation on its books, Kern River may treat the difference as a regulatory asset and add it to the starting Period Two rate base for purposes of calculating the levelized Period Two rates.

13. The quoted language in Paragraph 368 of Opinion No. 486-A does not require a different result. The language simply states that, as with all deferred regulatory assets, Kern River is at risk whether it will actually recover those assets over the total period to which its levelized rate methodology applies. At worst the quoted language is ambiguous as it does not state the time frame to which that risk applies. The extensive discussion that follows establishes that the compression costs at issue were to be treated as a regulatory asset or liability. To hold that the language in Paragraph 368 denies recovery of the compressor costs in Period Two is inconsistent with the subsequent finding that Kern River may properly include the compressor costs as regulatory asset in its rate base. Thus the Shipper Parties' arguments would deprive Kern River of an opportunity to recover the very costs the Commission stated in Opinion No. 486-A could be included in Kern River's rate base under its levelized rate methodology.

³⁴ *Id.* at P 371.

³⁵ *Id.* P 369-381.

14. The Commission is not addressing here whether the amount of the regulatory asset Kern River proposes to add to its starting Period Two rate base is correct. This is a matter that can be explored at hearing due to the technical nature of the issue. However, the Commission emphasizes that Kern River's Period Two rates must be based on the 2004 cost of service used to design its Period One rates unless Opinion No. 486-D specifically stated otherwise. The Commission stated it "continues to find that the starting point for calculating the Period Two rates in this proceeding must be the cost of service we have already determined for Period One based upon the 2004 test year data used in this section 4 rate case."³⁶ Moreover, as correctly stated in Calpine's protest,³⁷ if Kern River wishes to recover costs that were not included in the 2004 test period for its Period One rates, it must file a new rate case. Opinion No. 486-D states:

If Kern River believes that the cost-of-service determined in this section 4 rate case based on 2004 test period data is now stale and should be updated, then it is free to file a new general section 4 rate case at any time to update the cost of service underlying the rates of all its shippers for all its services. Likewise, if any shipper believes that the cost-of-service developed in this rate case should be updated it may file a complaint under NGA section 5 against all of Kern River's rates.³⁸

The same paragraph in Opinion No. 486-D makes clear that the Commission generally does not permit a pipeline to file a limited section 4 proceeding to change the rates for some groups of customers, but not others.³⁹ Thus, while the Commission is not addressing the particulars of this issue here, it holds that Kern River may not include in its regulatory assets new compressor costs that it has incurred after the 2004 test period. If Kern River desires to include such new costs, not incurred as of year-end 2004, in either its Period One or Period Two rates, it may do so. However, as with any other new cost Kern River may desire to include in its rates, Kern River must file a new general section four rate case covering all of its cost of service factors, including the revenues obtained in a new test period.

³⁶ Opinion No. 496-D, 133 FERC ¶ 61,162 at P 193.

³⁷ Motion to Intervene, Protest and Request for Summary Rejection of Calpine Energy Services, L.P. at 9-10.

³⁸ Opinion No. 496-D, 133 FERC ¶ 61,162 at P 193, n.229.

³⁹ *Id.* P 193. *See also ANR Pipeline Co.*, 110 FERC ¶ 61,069, at P 18 (2005).

15. Finally, regarding the procedural arguments, a motion for clarification may be filed at any time. Unlike a request for rehearing, whether to respond is a matter for the Commission's sole discretion. The Commission is exercising that discretion here to

remove an unnecessary issue from the Period Two hearing.⁴⁰ The Commission therefore concludes that Kern River is correct that the Commission affirmed in Opinion No. 486-A⁴¹ that the compressor costs at issue might result in a regulatory asset that could be recovered through the Period Two rates of its levelized rate methodology. Given this conclusion, the surcharge filed on September 30, 2010 in Docket No. RP10-1406-000 and the November 4, 2010 conditional correction to the Kern River's January 29, 2010 filing in Docket No. RP11-1499-000 are moot at this point. Therefore the filings in those two dockets are dismissed.

The Commission orders:

- (A) Kern River's motion for clarification filed September 18, 2010 is granted.
- (B) The surcharge filed in Docket No. RP10-1406-000 is dismissed.
- (C) Kern River's November 4, 2010 proposed amendment to its January 29, 2010 compliance filing filed in Docket No. RP11-1499-000 is dismissed.
- (D) The requests for rehearing filed November 29, 2010 in Docket No. RP10-1406-000 are denied.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

⁴⁰ The decision here also disposes of two additional filings by Kern River the Commission believes were unneeded and accomplished little more than imposing additional burdens on the Commission and the Shipper Parties.

⁴¹ *Id.* P 42, 364-365, 366-369.