

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell, Joseph T. Kelliher,  
and Suedeen G. Kelly.

Kern River Gas Transmission Company

Docket No. RP04-274-000

ORDER ACCEPTING AND SUSPENDING TARIFF  
SHEETS SUBJECT TO REFUND, AND ESTABLISHING  
HEARING PROCEDURES

(Issued May 28, 2004)

1. On April 30, 2004, Kern River Gas Transmission Company (Kern River) filed, under section 4 of the Natural Gas Act (NGA), a general rate case. Kern River filed tariff sheets<sup>1</sup> to reflect an increase of approximately \$40.1 million in its jurisdictional cost of service, to a total of approximately \$347.4 million. Kern River requests effective dates of June 1, 2004, and January 1, 2005, as indicated in Appendix A.<sup>2</sup> Further, Kern River requests waiver of the requirement to submit Schedule H-3(2) since Kern River has yet to prepare its 2003 federal income tax return which would reconcile its book depreciable plant, tax depreciable plant and accumulated provision for deferred income taxes. Finally, Kern River requests that this proceeding be placed on a Fast Track procedural schedule to resolve Kern River's proposed rate change as quickly as possible.

2. The Commission conditionally accepts and suspends the proposed tariff sheets listed in Appendix A for five months, to be effective November 1, 2004, and June 1, 2005, as indicated, or an earlier date set by subsequent Commission order, subject to refund, and the outcome of a hearing. Further, the Commission denies waiver of section 154.312(m)(2) of the Commission's regulations

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<sup>1</sup> See Appendix A.

<sup>2</sup> Kern River states that the June 1, 2004, effective date reflects rates calculated based on 366 days for leap year 2004. However, Kern River states that the rates proposed to become effective January 1, 2005, were calculated based on 365 days per year.

pertaining to the submittal of Schedule H-3(2) and requires Kern River to file an estimate within 15 days of the date an order issues in this proceeding. Finally, the Commission will deny Kern River's request for Fast Track procedural scheduling for the reasons discussed herein. This order is in the public interest since the parties will have an opportunity to determine just and reasonable rates through the hearing process.

### **Background**

3. Kern River's last section 4 rate case resulted in a settlement which was approved by the Commission on February 9, 2000 (the Settlement).<sup>3</sup> Article VI of the Settlement required Kern River to file a general rate application no later than five years from the May 1, 1999 effective date<sup>4</sup> of the settlement.

### **Notice, Interventions, and Protests**

4. Notice of Kern River's filing was issued on May 5, 2004. Interventions and protests were due May 12, 2004, as provided in § 154.210 of the Commission's regulations. Pursuant to Rule 214 (18 C.F.R. § 385.214), 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. Protests were filed by Rolled-In Customer Group<sup>5</sup>, High Desert Power Trust, Calpine Energy Services, L.P., Reliant Energy Services, Inc., Southern Nevada Water Authority, BP Energy Company, and the Public Utilities Commission of Nevada (collectively Protesters). Kern River filed an answer to issues raised by Protesters.

5. Rule 213 (a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2003), prohibits the filing of an answer to a protest unless permitted by the decisional authority. Accordingly, Kern River's answer is rejected.

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<sup>3</sup> 90 FERC ¶ 61,124 (2000), reh'g denied, 91 FERC ¶ 61,103 (2000).

<sup>4</sup> 87 FERC ¶ 61,128 (1999).

<sup>5</sup> Rolled-In Customer Group includes Aera Energy LLC, Anadarko E&P Company LP, Anadarko Petroleum Corporation, Chevron USA Inc., Nevada Cogeneration Associates # 1 and #2, Coral Energy Resources, L.P., Occidental Energy Marketing, Inc., Sempra Energy Trading Corp., Southwest Gas Corp., and Shell Oil Company.

6. Protesters raise many issues regarding Kern River's rate filing. They claim that the rate increase is unsupported and based on unsubstantiated assertions. Specifically, they maintain that return on equity, depreciation rates for transmission and compressor engines, inflation factor, rate base, negative salvage amounts, blended IT fuel rate, accumulated deferred income tax, market-oriented revenue credits, gas sales revenue from Park and Loan service, High Desert monthly incremental facility charge, rate design, and throughput adjustments may be inappropriate. Protesters argue that Kern River's proposed cost allocation needs to be examined to determine its justness and reasonableness.

7. The Protesters either request that the Commission reject certain aspects of Kern River's filing or, in the alternative, accept and suspend the filing for the full five months, subject to refund and hearing. The Protesters also request that all rates be established based on only those facilities that are in service by the end of the test period. Finally, Protesters state that they reserve their right to file additional comments at a later date.

## **Discussion**

### **Cost of Service and Rates**

#### **Proposal**

8. In this rate case, Kern River proposes approximately a \$40.1 million increase in its jurisdictional cost of service, to approximately a \$347.4 million overall cost of service. The cost of service is based on a base period ending January 31, 2004, as adjusted for known and measurable changes with a test period ending October 31, 2004. The overall cost of service consists of \$34.1 million in total Operation and Maintenance expenses, plus depreciation, depletion and amortization of gas and general plant in service, income and other taxes, and an overall after-tax return of 9.59 percent. The proposed return reflects an overall cost of debt of 6.62 percent annually and a rate of return on equity of 15.1 percent. Kern River proposes a rate base of \$1,803.8 million. Kern River proposes a decrease in projected throughput from 630,415 MDth to 572,174 MDth based on actual quantities transported. Kern River proposes to establish a separate subclass of transmission plant consisting of compressor engines and to establish an annual depreciation accrual rate of 9.92 percent for such engines. Kern River proposes to increase the annual depreciation accrual rates for transmission plant other than compressors for book accounting purposes only from 2.0 percent to 3.39 percent and to implement a negative salvage rate of 0.21 percent. As a result, Kern River has revised its new daily base tariff rates, including recourse rates, that were derived from the cost of service and billing determinants set forth in the instant filing. Finally, Kern River has removed the Gas Research Institute surcharges listed in its tariff since they are no longer applicable.

### **Comments**

9. Protesters request that rate issues such as return on equity, depreciation rates for transmission and compressor engines, inflation factor, rate base, negative salvage amounts, blended IT fuel rate, accumulated deferred income tax, market-oriented revenue credits, gas sales revenue from Park and Loan service, rate design, and throughput adjustments may be inappropriate, and therefore, should be set for hearing. Reliant further requests the Commission establish a section 5 proceeding and direct its staff to determine whether Kern River's rates should be reduced below pre-filed levels.

10. High Desert Power Trust (High Desert)<sup>6</sup> requests that the Commission direct Kern River to file revisions to High Desert's monthly incremental facility charge and upon filing of such re-determination, suspend the rates for a minimal period subject to refund to be effective June 1, 2004. High Desert argues that Kern River has not reflected any change in its currently effective incremental facility charge and that such re-determination is required pursuant to its currently effective contract with Kern River at such time as it files its next general section 4 rate case. Finally, High Desert contends that the currently effective monthly incremental facility charge of \$391,432 is approximately 400 percent higher than actual costs needed to operate and support the High Desert lateral.

### **Commission Ruling**

11. The Commission finds that all issues raised by Kern River's filing, including but not limited to those concerning rate derivation and cost-of-service, such as Kern River's proposed cost of service, cost allocation, billing determinants, fuel tracker rates, inflation factor, High Desert incremental facility charge, and other rate issues should be explored at a hearing established by this order. Based upon a review of the filing, the Commission finds that the rates proposed herein reflect increases from test period adjustments which are estimates. Further, the rates reflect a substantial increase in depreciation and a reduction in rate design volumes. All of these are factual issues which require further examination in a hearing. As a result, the Commission finds that the rate changes reflected in the proposed tariff sheets have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, the Commission will accept the revised tariff sheets listed on Pages 1 and 2 of Appendix A, for filing and suspend their effectiveness for five

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<sup>6</sup> High Desert Power Trust is a special-purpose, wholly-owned, indirect subsidiary of Constellation Energy Group, Inc. which owns an 830 MW generating facility located in Victorville, California.

months, and permit them to become effective, November 1, 2004, subject to refund and the conditions set forth in this order.

12. The Commission's policy regarding rate suspensions is that rate filings generally should be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable, or that it may be inconsistent with other statutory standards.<sup>7</sup> It is recognized, however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results.<sup>8</sup> Such circumstances do not exist here. Accordingly, the Commission will exercise its discretion to suspend the accepted tariff sheets listed in Appendix A for the maximum period and permit the rates to take effect on November 1, 2004, and June 1, 2005, as indicated, subject to refund and the ordering paragraphs below.

13. Section 154.303(c)(2) of the Commission's regulations provides that at the end of the test period, the pipeline must remove from its rates costs associated with any facility that is not in service or for which certificate authority is required but has not been granted. Accordingly, Kern River must adhere to this regulation.

### **Rate Related Tariff Changes**

#### **Compressor Fuel Factor Proposal**

14. Kern River has incorporated sections 12.5 and 12.12(3) to the General Terms and Conditions (GT&C) of its tariff proposing to establish monthly gas and electric compressor fuel factors for both interruptible and authorized overrun service based on a blended rate. The fuel rate is calculated on the basis of 48 percent of the currently effective factor for Rolled-In system service and 52 percent of the currently effective factor applicable to 2003 Expansion service.

#### **Comments**

15. Protesters argue that the blended IT fuel rate results in a reduction below maximum rates resulting in an advantage to Kern River selling IT service over released Expansion capacity. Protesters contend that shippers would choose Kern

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<sup>7</sup> Great Lakes Gas Transmission Co., 12 FERC ¶ 61,293 (1980) (five-month suspension).

<sup>8</sup> Valley Gas Transmission, Inc., 12 FERC ¶ 61,197 (1980) (one-day suspension).

River's IT service over released Expansion capacity due to the lower fuel rate charged.

### **Commission Ruling**

16. The Commission has determined that sections 12.5 and 12.12(3) of Kern River's GT&C pertaining to the establishment of both gas and electric fuel factors constitutes a rate issue. Therefore, the Commission will set this issue for hearing along with the other rate issues discussed above.

### **Removal of Tariff Provisions**

17. Kern River proposes to delete its currently effective annual revenue sharing threshold provision as a result of its expiration under Kern River's rate case settlement proceeding in Docket No. RP99-274-000, due to expire upon the effectiveness of the instant rate case proceeding.

18. Kern River proposes to delete section 24 of its GT&C and the related Amendment in its tariff pertaining to Extended Term Rate provisions. Kern River states that extended term rates were made available to original system shippers in conjunction with the September 2001 refinancing of Kern River's existing debt. These 10-year and 15-year extended term rates are now listed on Kern River's rate sheets in its tariff. Since no additional shippers are eligible for extended term rates, Kern River proposes to delete these provisions establishing term rates from its tariff.

19. Kern River proposes a minor tariff change reflected in Rate Schedules KRF-1 and KRI-1 pertaining to the subheading titled Discounted Recourse Rates.

### **Commission Ruling**

20. The Commission has determined that section 18 of Kern River's GT&C, pertaining to annual revenue sharing threshold, states that this provision shall continue for the period the Settlement rates in Docket No. RP99-274-000 are in effect. As stated above, the Commission is suspending the rate related tariff changes proposed herein for five months, which results in the termination of the Settlement rates in Docket No. RP99-274-000 on November 1, 2004. Therefore, the Settlement's annual revenue sharing threshold provision in section 18 of Kern River's tariff also terminates on November 1, 2004. However, parties may raise the issue of the annual revenue sharing threshold mechanism as part of the hearing process.

21. The Commission will accept the termination of the Extended Term Rate provisions and related Amendment for good cause shown. Section 24.2 of Kern River's GT&C states that to be eligible to pay extended term rates, a firm shipper

with an existing service agreement must sign an amendment to that agreement on or before March 31, 2001 to extend the primary term of that agreement. As a result, no additional shippers are eligible for extended term rates. Further, the extended term rates that were made available to original system shippers for a term of 10 years and 15 years are now listed on Kern River's rate sheets in its tariff. Therefore, the Commission will accept the termination of these provisions effective at the end of the five month suspension period commencing November 1, 2004.

22. The Commission will accept the minor tariff change reflected on Sheet Nos. 17, 18, and 59 proposed herein pertaining to a change in the subheading Discounted Recourse Rates to be effective June 1, 2004.

### **Park and Loan Revenue Sharing Proposal**

23. Kern River states that section 28.2 of its currently effective GT&C requires Kern River to share with its firm shippers on a 50-50 basis any revenues it receives from selling gas that was confiscated from a shipper receiving Park and Loan service when that shipper fails to withdraw its parked gas on a timely basis. This 50-50 sharing of revenues is subject to the annual revenue sharing threshold provision in Kern River's tariff, which Kern River has now proposed to delete for the reason discussed above. As a result, Kern River proposes to modify section 28.2 of its GT&C by deleting references made to the annual revenue threshold provisions while maintaining its existing 50-50 revenue sharing method.

### **Comments**

24. Rolled-In Customer Group argue that confiscation of gas a customer leaves on the system constitutes a penalty, and as such, all revenues associated with sales, net of costs, must be credited to the pipeline's customers.<sup>9</sup> Therefore, Rolled-In Customer Group requests that Kern River's proposal to retain 50% of revenues associated with sales of gas that is left on its system should be summarily rejected.

### **Commission Ruling**

25. The Commission has determined that the Park and Loan revenue sharing provision in section 28.2 of Kern River's GT&C was accepted by the Commission as part of Kern River's previous rate case settlement which preceded Order No. 637.<sup>10</sup> Pursuant to the principles established by Order No. 637,<sup>11</sup> the Commission

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<sup>9</sup> See Dominion Cove Point LNG, L.P., 104 FERC ¶ 61,218 (2003).

<sup>10</sup> Regulation of Short-Term Natural Gas Transportation Services and  
(continued)

views any confiscation of gas for failure to take specified action as a form of penalty. As a result, Commission policy as established in Order No. 637 requires the revenues derived from the penalty should be credited to non-offending firm and interruptible shippers. Therefore, the Commission will require Kern River to revise section 28.2 of its tariff. Any excess gas is to be credited in accordance with section 10.11 of Kern River's GT&C which provides for 100% crediting to non-offending firm and interruptible shippers. The effectiveness of these changes will take place upon the termination of the current settlement rates.

### **Waiver Request**

26. Kern River requests waiver of the requirement to submit Schedule H-3(2) with the instant filing. Kern River states that it was unable to prepare a meaningful reconciliation of its book depreciable plant and tax depreciable plant and accumulated provision for deferred income taxes since Kern River has not yet prepared its 2003 federal income tax return. Kern River states that it does not intend to file its 2003 federal income tax return until September 2004 when it is required to do so. Kern River claims that preparation of Schedule H-3(2) using 2002 tax return information would not be meaningful since the 2002 return did not reflect the investment in Kern River's 2003 Expansion or the related bonus depreciation expenses and their effects on accumulated deferred income taxes. Kern River states that it is willing to submit the schedule when the necessary information to do so becomes available.

### **Commission Ruling**

27. The Commission has determined that the parties are disadvantaged by the delay in filing Schedule H-3(2). Therefore, the Commission will deny waiver of section 154.312(m)(2) of its regulations pertaining to the submittal of Schedule H-3(2) and require Kern River to file an estimate, within 15 days of the date of this order, justifying its claim of taxes. Kern River can use last year's return as a basis for an estimate and update its numbers as the actuals come in. Finally, Kern

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Regulations of Interstate Natural Gas Transportation Services, FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,091 (February 9, 2000); order on rehearing, Order No. 637-A, FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,099 (May 19, 2000); order on rehearing, Order No. 637-B, 92 FERC ¶ 61,062 (July 26, 2000); aff'd in part and remanded in part, Interstate Natural Gas Association of America v. FERC, 285 F.3d 18 (D.C. Cir. April 5, 2002).

<sup>11</sup> 18 C.F.R. § 284.12(c)(2)(v)(2001).

River will be required to file in this docket and submit Schedule H-3(2) to all parties to this proceeding, based on actuals, at such time Kern River is required to file its 2003 federal tax return by September 2004.

### **Fast Track Treatment Request**

28. Kern River requests that the Commission initiate a Fast Track (Track II) procedural schedule for the instant proceeding in order to resolve its proposed rate change as quickly as possible. This schedule would provide until approximately February 2005 for the parties to reach a settlement or prepare for a hearing. Kern River states that the issues herein are limited and the small group of customers is familiar with the principal components of Kern River's proposed rate increase through their participation in negotiations to reach a pre-filing settlement. Kern River asserts that extensive information pertaining to costs, revenues, as well as financial and market data were presented to the parties during negotiations. Kern River claims that such knowledge should readily enable the parties to resolve this case within the time contemplated by the Track II schedule.

### **Commission Ruling**

29. The Commission will deny Kern River's requests for a Track II schedule. The Commission trial staff has not been privy to the cost and rate information presented in this case prior to the submittal of the instant rate case as some parties may have been as suggested by Kern River. We find there are many rate issues for which the Commission needs adequate time to review such as the full depreciation study presented by Kern River. Secondly, the speed of negotiations and the impending rate increases are subjectively based upon Kern River's own speed at handling a date requested. Therefore, the Commission believes that a Track II schedule is not supported and only places Kern River at an advantage here. Nevertheless, parties are encouraged to negotiate a settlement in good faith throughout the course of this proceeding.

### **The Commission orders:**

(A) The tariff sheets listed on Page 1 of Appendix A are accepted and suspended, to be effective November 1, 2004, subject to refund, conditions discussed herein, the outcome of the hearing established in this order, and pursuant to Ordering Paragraph (C).

(B) The tariff sheets listed on Page 2 of Appendix A are accepted and suspended, to be effective June 1, 2005, subject to refund, the outcome of the hearing established in this order, and pursuant to Ordering Paragraph (C).

(C) Upon its motion to place suspended rates into effect, Kern River must remove the costs associated with any facility not placed into service before the effective date.

(D) Kern River is directed to revise section 28.2 of Kern River's GT&C to reflect the revenue sharing provision as a confiscation of gas and therefore constituting a type of penalty. Kern River is also directed to revise section 28.2 to reflect that any revenues derived from the penalty will be credited to non-offending firm and interruptible shippers in accordance with section 10.11 of Kern River's GT&C.

(E) Waiver of section 154.312(m)(2) of the Commission's regulations pertaining to the submittal of Schedule H-3(2) is denied. Kern River is directed to file an estimate, within 15 days of the date of this order, justifying its claim of taxes. Kern River is also directed to file in this docket and submit Schedule H-3(2) to all parties to this proceeding, based on actuals, at such time Kern River is required to file its 2003 federal tax return by September 2004.

(F) The minor tariff change reflected on tariff sheets listed in Appendix B are accepted effective June 1, 2004.

(G) Pursuant to the authority of the NGA, particularly sections 4, 5, 8 and 15 thereof, with the exception of the issues reserved herein, a public hearing will be held in Docket No. RP04-274-000 concerning the lawfulness of Kern River's proposed rates.

(H) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose pursuant to 18 C.F.R. § 375.304, must convene a prehearing conference in this proceeding to be held within ten (10) days after issuance of this order, in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington D.C. 20426. The prehearing conference shall be held for the purpose of establishing a procedural schedule. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Commission's rules of practice and procedure.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.

**Second Revised Volume No. 1**  
**Tariff Sheets Accepted**  
**Effective November 1, 2004**

Thirteenth Revised Sheet No. 5  
Ninth Revised Sheet No. 5-A  
Eleventh Revised Sheet No. 6  
Second Revised Sheet No. 7  
First Revised Sheet No. 8  
Seventh Revised Sheet No. 71  
Fourth Revised Sheet No. 76  
Fourth Revised Sheet No. 110  
Third Revised Sheet No. 110-A  
First Revised Sheet No. 110-A.1  
Third Revised Sheet No. 110-B  
Fourth Revised Sheet No. 171  
First Revised Sheet No. 186  
First Revised Sheet No. 214  
First Revised Sheet No. 423

**Second Revised Volume No. 1**  
**Tariff Sheets Accepted**  
**Effective June 1, 2005**

Fourteenth Revised Sheet No. 5  
Tenth Revised Sheet No. 5-A  
Twelfth Revised Sheet No. 6  
Third Revised Sheet No. 7  
Second Revised Sheet No. 8

**Appendix B**

**Second Revised Volume No. 1  
Tariff Sheets Accepted  
Effective June 1, 2004**

Third Revised Sheet No. 17  
Fourth Revised Sheet No. 18  
Third Revised Sheet No. 59