

1 **Q.** Please state your name and business address.

2 **A.** My name is Bruce E. Warner. I am employed by Kern River Gas Transmission
3 Company (“Kern River” or “Company”) as Director, Rates and Government
4 Affairs. My business address is 2755 East Cottonwood Parkway, Suite 300, Salt
5 Lake City, Utah 84121.

6 **Q.** Please summarize your educational and employment history.

7 **A.** I received a B.S. degree in accounting from Brigham Young University in 1975
8 and a M.B.A. from the University of Utah in 1981. I am a licensed certified
9 public accountant in Utah. I am a member of the Utah Association of CPAs and
10 the American Institute of Certified Public Accountants. I was employed as an
11 auditor with an international CPA firm for three years early in my career. For
12 over 26 years, I have been involved in the natural gas pipeline business, serving in
13 a number of accounting and regulatory management positions since 1981.
14 Among my past responsibilities, I have managed and submitted testimony in

1 several general rate cases presented to the Federal Energy Regulatory
2 Commission (“FERC”) for Kern River and Northwest Pipeline Corporation.

3 **Q.** Please describe your current responsibilities.

4 **A.** In my current position, I am responsible for and direct Kern River’s rate,
5 certificate and tariff-related filings before the FERC. I also direct governmental
6 relations activities with various state and Federal agencies. I contribute to the
7 Company’s strategic and annual plans by developing regulatory strategies and
8 necessary rate studies. I monitor and direct responses to the regulatory
9 proceedings of other companies as their proceedings may affect Kern River’s
10 business.

11 **Q.** What is the purpose of your direct testimony?

12 **A.** My testimony has several purposes, relating primarily to the design of Kern
13 River’s interruptible and firm transportation rates and levelization of the cost of
14 service. I describe the various principles applicable to developing rates for Kern
15 River’s services. I recommend the appropriate treatment of market-oriented
16 revenues in developing the final cost of service used for rate design. I sponsor
17 the rate design billing determinants utilized in the rate calculations.

18 My testimony supports the following statements and schedules included in
19 Kern River’s rate change filing:

20 Statement J – Revenue Reconciliation

21 Statement J-1 – Summary of Billing Determinants

22 Schedule J-2 – Derivation of Rates

23

1 **Q.** Please describe Statement J.

2 **A.** Statement J compares the revenues computed in Schedule J-2 to the cost of
3 service derived in Statement A. It also presents the reservation and usage cost of
4 service and the overall adjustment to the usage and reservation costs related to the
5 classification of a portion of the fixed costs to commodity rates. This adjustment
6 was made to convert the rate design from the straight fixed-variable (SFV)
7 method to an enhanced fixed-variable (EFV) methodology. I discuss this
8 adjustment in more detail below.

9 **Q.** Please describe Schedule J-1.

10 **A.** This schedule presents the derivation of the billing determinants used in rate
11 design. The data is also presented by customer group.

12 **Q.** Please provide an overview of the relationship between Kern River's rate design
13 quantities and revenues.

14 **A.** The direct testimony of Ms. Lynn Dahlberg supports the G statements and
15 schedules of Kern River's filing, particularly Schedule G-2, where the projected
16 revenues are derived. As a part of that testimony, Kern River's current contract
17 quantities, projected firm commodity volumes and projected interruptible
18 revenues are discussed.

19 I discuss the rate design treatment of Ms. Dahlberg's reservation
20 quantities, throughput quantities and interruptible transportation revenues in this
21 testimony. The rate design adjustments to the Statement G-2 contract quantities
22 and commodity quantities are set forth in Statement G-3. In limited instances,
23 which I describe herein, the amounts used for rate design vary from the amounts
24 used to calculate projected revenues.

1 **Q.** Please describe Schedule J-2.

2 **A.** This schedule contains multiple parts and presents the major details of Kern
3 River's rate design. The schedule also presents the results of Kern River's
4 levelized cost of service calculations.

5 **Q.** Please describe the rate models used to develop Kern River's cost of service.

6 **A.** The outputs of the models are shown on various pages of Schedule J-2. The
7 following is a summary:

- 8 • Kern River has two models (10-Year and 15-Year) that derive the levelized
9 costs of service for the Original System over the remaining terms of the
10 shipper contracts.
- 11 • Kern River employed two models (10-Year and 15-Year) that calculate the
12 levelized costs of service for the 2002 Expansion over the remaining terms of
13 the shipper contracts.
- 14 • Kern River utilized two models (10-Year and 15-Year) to calculate the
15 levelized, incremental costs of service for the 2003 Expansion Project over the
16 remaining terms of the shipper contracts.
- 17 • Kern River calculated a traditional cost of service for general items and
18 compressor engines separately from the levelization process. The results of
19 those calculations are shown on Statements A-2 and A-3. The rate base
20 investment in these support assets tends to remain relatively constant over
21 time. These short-lived assets (e.g., computers, vehicles, software,
22 communications equipment, compressor engines) are added and replaced on a
23 frequent basis. The resulting costs of service are allocated among the various
24 Kern River services as indicated in Statements A-2 and A-3.

1 • Kern River used a levelized model to calculate the cost of service of the Big
2 Horn Lateral project.

3 • Kern River used a traditional, declining rate base model to calculate the
4 recourse rate cost of service for the High Desert Lateral project.

5 **Q.** What principles guided Kern River's preparation of the rate design and cost of
6 service in this general rate filing?

7 **A.** Kern River recognizes that it has an obligation in this filing to present a case to
8 support its rates that fully complies with the Commission's regulations. Those
9 regulations in general require Kern River to file representative costs and billing
10 determinants to support the proposed rate change. The regulations require the
11 pipeline to normalize costs and billing determinants through test period
12 adjustments to synchronize and update costs and billing units. This procedure
13 also involves eliminating out-of-period items and annualizing new items that, if
14 not adjusted, would otherwise distort the rates. Plant investment balances are
15 projected to those amounts expected to be in service at the end of the test period.
16 The purpose of these procedures is to place reasonable rates into effect, generally
17 subject to refund, pending resolution of the case through settlement or litigation.

18 **Q.** Is the above-described procedure a complete description of the process used to set
19 final just and reasonable rates?

20 **A.** No.

21 **Q.** What other events and factors are typically considered in formulating final rates in
22 a general rate case?

23 **A.** Although allowing variances for certain items, the Commission has recognized
24 that the use of actual costs and billing determinants for the twelve months ended

1 on the last day of the test period generally provides the most reliable basis for
2 establishing new rates. In certain cases, such as payroll expense, rate base
3 balances or reservation quantities, end of test period costs or quantities are
4 traditionally adopted. In evaluating the proper costs and billing determinants,
5 non-representative items are eliminated in a similar manner to the pipeline's
6 evaluation of the base period experience. This procedure has evolved because the
7 Commission generally prefers to use the most recent information available to
8 establish rates.

9 **Q.** In light of the foregoing, what events will occur that will be important to
10 establishing the final rates in this proceeding?

11 **A.** Once the test period is concluded, Kern River will develop updated information
12 regarding its actual cost and revenue experience for the twelve months ended
13 October 31, 2004. This will include updated O&M and A&G expenses, an
14 updated base payroll run, updated gas plant investment amounts, updated test
15 period experience for market-oriented revenues and throughput quantities, end of
16 test period reservation quantities, and so forth.

17 Assuming the rate case proceeds that far, Kern River will fully discuss the
18 updated information in its rebuttal testimony to support the proposed final rates.
19 While such actual information cannot be known at this time, the updates
20 ultimately will greatly assist in resolving issues that might otherwise revolve
21 around the use of estimates contained in this filing. This is particularly true in this
22 proceeding, since by the end of the test period Kern River will have more than 12
23 months of actual experience since the 2003 Expansion was completed. The
24 history available at that time will eliminate the need for a number of annualizing

1 adjustments that have been made in evaluating the base and test period data
2 available at the time this filing was prepared. However, some limited adjustments
3 to the actual data may also be required to develop just and reasonable rates.

4 **Q.** Please describe Kern River's proposed rate design in more detail.

5 **A.** For Kern River's Rolled-In System, the proposed revised rates are derived from
6 the updated costs of service sponsored by Mr. Martin Hansen. The rates reflect
7 the rate principles approved in Kern River's initial system certificate (Docket
8 Nos. CP89-2047 and -2048, et al.), as modified by the Extended Term Rate
9 Settlement (Docket No. RP00-298), the rolled-in rate design for the 2002
10 Expansion under the methodology adopted in Docket No. CP01-31, and Kern
11 River's prior rate settlements (Docket Nos. RP92-226 and RP99-274).

12 The proposed revised rates for 2003 Expansion service are derived on an
13 incremental cost basis, consistent with the Commission's 1999 policy statement
14 regarding pricing of pipeline expansions and its orders authorizing construction of
15 the 2003 Expansion project. The 2003 Expansion rates otherwise are developed
16 generally under the same principles used to derive the Rolled-In System rates.

17 All of the firm transportation rates reflect the firm rate design from the
18 Docket No. RP99-274 Rate Settlement, which included a commodity (usage) rate
19 designed to collect a negotiated level of fixed costs. Those rates are referred to
20 herein as EFV rates. To make the commodity rates for the Rolled-In System and
21 2003 Expansion services uniform, all of the firm transportation rates proposed
22 herein reflect a \$.06 per Dth commodity charge.

23 The other principal rate design features of Kern River's proposed, revised
24 rates include:

1 (a) A 95% load factor for the Original System shippers' billing
2 determinants, as approved in Kern River's original optional certificate, for
3 designing firm reservation and commodity billing determinants;

4 (b) A 100% load factor for 2003 and 2002 Expansion shippers' reservation
5 billing determinants and historical experience for derivation of commodity
6 billing determinants for such shippers;

7 (c) A 100% load factor interruptible transportation rate;

8 (d) A levelized rate design that recovers 70% of Kern River's capital
9 investments over the terms of the firm shippers' contracts;

10 (e) An approximate 70% debt/30% equity starting capital structure (the
11 original Kern River certificate and subsequent rate computations have
12 embodied a changing capital structure in each year through the
13 levelization processes or the Ozark methodology, as further explained
14 below); and

15 (f) A postage stamp rate form.

16 **Q.** What steps has Kern River taken to ensure the calculation of appropriate rates for
17 each service?

18 **A.** Kern River followed appropriate cost charging and allocation procedures to
19 ensure there are no inappropriate cross-subsidies among Kern River's services.
20 Kern River focused particularly on ensuring that the costs of service underlying
21 its incrementally-priced and rolled-in services are based as much as possible on a
22 direct charge basis. Mr. Swensen explains Kern River's time and cost accounting
23 system that facilitates this approach.

1 **Q.** Are there certain cost allocations between shipper groups used in the derivation of
2 Kern River's rates?

3 **A.** Yes. Some of Kern River's costs are allocated, prior to designing rates, among the
4 10-year and 15-year shipper groups, due to the Extended Term ("ET") program
5 principles and the 10-year and 15-year contract options provided to 2002
6 Expansion and 2003 Expansion project shippers. In addition, Kern River
7 allocated certain costs among its various rolled-in and incremental services under
8 conventional cost of service calculation methodologies. The details of these
9 allocations are discussed in the testimony of Mr. Martin Hansen.

10 **Q.** Why are the lengths of the contracts and the ET program factors in the allocation
11 of costs among shipper groups?

12 **A.** In Kern River's May 24, 2000, ET program filing in Docket No. RP00-298, Kern
13 River stated:

14 In designing the extended term-rates, cost of service and rate base
15 components will be allocated first to each rate option based on the
16 percentage of contract demand electing to pay the 10-year ET
17 rates, the 15-year ET rates, and the existing rates. . . . Then, the
18 levelized rates for the 10-Year and 15-Year ET rate options will be
19 calculated by levelizing the cost-of-service over the extended
20 contract terms. (footnote omitted)

21 Kern River explained that this method of allocating certain costs among shipper
22 groups, based on contract demand quantities, produces the same rate results as if
23 the entire system were to convert to either a 10-year or a 15-year ET rate option.
24 The method derives rates that are not dependent on the magnitude of the service
25 elections for each particular service.

26 **Q.** What is the proposed design of rates for Kern River's separately priced lateral
27 services?

1 **A.** The High Desert Lateral rates are also incremental rates, which are derived using
2 a traditional, declining rate base methodology, calculated over the term of the
3 anchor shipper's contract. This approach ensures that costs are properly allocated
4 to the High Desert service and the calculation of appropriate rates for other
5 shippers utilizing the lateral (such as interruptible customers). The rate design is a
6 recourse rate calculation, but the actual rates charged to the anchor shipper for the
7 project are levelized, negotiated rates.

8 The Big Horn Lateral project cost of service, related to the facilities
9 agreement between Kern River and the principal shipper, reflects a levelized cost
10 of service and a 60% equity/40% debt capital structure.

11 **Q.** What is the treatment of the costs of Kern River's 2002 Expansion project?

12 **A.** In the certificate order for Kern River's 2002 Expansion (96 FERC ¶ 61,137
13 (2001)), the Commission determined that Kern River should be allowed to roll-in
14 the costs of the project because the result would be a lower rate for Original
15 System shippers. However, to ensure that the benefit to Original System shippers
16 would not be completely offset by incremental fuel costs associated with the new
17 facilities, the Commission directed Kern River to submit work papers showing the
18 net benefit of the expansion project to Original System shippers after fuel costs
19 are considered. Kern River was directed to submit a "net benefits" test each time
20 it files to adjust its electric compressor fuel surcharge and when it files annual gas
21 compressor fuel reimbursement reports. To the extent that the increase in total
22 gas and electric fuel costs for the Original System shippers exceeds the excess
23 revenues provided by the 2002 Expansion shippers (incremental revenues minus
24 the incremental cost of service), as established in Kern River's April 24, 2002

1 compliance filing approved by the Commission by letter order dated May 21,
2 2002, the excess fuel and electric costs must be allocated to the 2002 Expansion
3 shippers. The “net benefits” test affects only the fuel and electric compressor
4 charges. Accordingly, Kern River in this rate change filing continues to roll in the
5 2002 Expansion costs with the costs of the Original System.

6 **Q.** What are the roll-in calculations that are employed in the derivation of the Rolled-
7 In System base transportation rates?

8 **A.** Kern River utilizes the same methodology as employed in the 2002 Expansion
9 certificate filing and the April 24, 2002 compliance filing for that project. Under
10 that methodology, all Original System and 2002 Expansion shippers are given the
11 same, per unit rate reduction as a part of the roll-in calculations. This
12 methodology is used because the 2002 Expansion Shippers’ contracts and the
13 Original System shippers’ contracts terminate on different dates. The levelization
14 calculations are performed separately for each group of shippers. See Schedule I-
15 1 (a) and Schedule J-2 for the costs of service and the roll-in calculations. See
16 Schedule J-2 for the derivation of the per unit rate reduction benefit.

17 **Q.** Please further explain Statements J-1 and J-2 of Kern River’s filing.

18 **A.** As noted above, Statement J-1 details the rate design billing determinants that are
19 used to calculate the transportation rates. The firm reservation and commodity
20 billing determinants for Original System services have been reduced to a quantity
21 equivalent to the 95% load factor amount, as specified in Kern River’s original,
22 optional certificate. The reservation billing determinants for the 2002 Expansion
23 and the 2003 Expansion services are the 100 percent load factor equivalent
24 quantities. The 2003 Expansion determinants thus include the 90,000 Dth per day

1 of firm capacity recently turned back to Kern River by Mirant Americas Energy
2 Marketing, L.P. ("Mirant") after its bankruptcy filing. This reflects Kern River's
3 proposal to bear the risk of that unsubscribed capacity, as explained in Mr.
4 Smith's testimony.

5 The commodity billing determinants for the 2002 and 2003 Expansions
6 are Kern River's projection of throughput quantities for the twelve months ended
7 October 31, 2004. The commodity quantity projections incorporate actual
8 experience for the base period for the 2002 Expansion capacity and projections
9 based in major part on actual experience for the 2003 Expansion capacity (two out
10 of the twelve months are estimated amounts). The commodity quantity
11 projections for the 2003 Expansion capacity assume that the 90,000 Dth per day
12 of capacity formerly dedicated to Mirant is utilized at the 2003 Expansion
13 shippers' expected average load factor during the test period.

14 The reservation billing determinants have also been adjusted for two
15 discounted contracts. A 10-year, 2003 Expansion contract for 10,000 Dth per day
16 with Questar has been discount-adjusted to the full rate equivalent. A short-term
17 contract for 4,000 Dth per day with Pinnacle West that terminates on November
18 30, 2004 was assumed to be recontracted. While Kern River does not yet know
19 the ultimate disposition of this capacity, the proposed billing determinants for this
20 agreement are also the full rate equivalent. Mr. Smith discusses the risk that the
21 Pinnacle West contract capacity will not be recontracted on a long-term basis.
22 That risk is not reflected in the rate design through a further adjustment that
23 would reduce the billing determinants.

1 Schedule J-2 presents the rate design for Kern River's transportation
2 services. Kern River has several different services and employs more than one
3 rate design. Each of these rate designs is shown in Schedule J-2. In particular, the
4 levelization worksheets contained in that schedule are important to understanding
5 the design of Kern River's rates since those worksheets present the results of the
6 levelized cost of service calculations.

7 **Q.** What costs are included in Kern River's rates?

8 **A.** They are the functionalized, classified and allocated costs of service reflected in
9 Statement I. The costs of service are supported in the direct testimony of Mr.
10 Martin Hansen, with input on certain items from Dr. Charles Olson, Mr. Darrell
11 Swensen, Mr. Edward Feinstein and Mr. Jeffrey Valentine.

12 **Q.** Did Kern River design its firm service rates to recover its entire cost of service?

13 **A.** No. The costs that the firm transportation rates are designed to recover are net of
14 the costs attributable to the Mirant capacity and costs allocated to market-oriented
15 (interruptible) transportation services. Ms. Lynn Dahlberg explains in her
16 testimony how Kern River derived its proposed allocation of \$6.1 million per year
17 to such market-oriented services. Since reservation and commodity quantities
18 associated with the former Mirant capacity are separately built into the rate design
19 (to place Kern River at risk of recovery of costs associated with the Mirant
20 capacity), the cost allocation to market-oriented services does not include any
21 potential interruptible transportation revenues associated with that capacity.

22 The cost allocation includes a \$.4 million adjustment to reflect Kern
23 River's proposal to charge fuel to interruptible transportation shippers as set forth
24 in Ms. Dahlberg's testimony and in the tariff sheets submitted with Kern River's

1 filing. This adjustment to reduce the revenue credit for market-oriented services
2 will need to be computed again after test period actual data become available.
3 This will be necessary in order to state properly the revenue credit in the final rate
4 design in this proceeding, since the new fuel collection procedure is not expected
5 to become effective until November 1, 2004. Therefore, the required fuel
6 adjustment will not be reflected in the actual market-oriented revenues for the
7 base or test periods.

8 The as-adjusted, market-oriented revenues that Kern River expects to
9 receive are detailed on Schedule G-2, which Ms. Dahlberg sponsors.

10 **Q.** Please explain the revenue credit or, in other words, the allocation to market-
11 oriented services, in more detail.

12 **A.** The allocation of costs to market-oriented services reflects the current annual
13 revenues that Kern River expects to generate from such services, in light of recent
14 actual experience and the known and measurable conditions expected to prevail
15 through the end of the test period for this filing, October 31, 2004. The projection
16 does not require a calculation to derive discount-adjusted quantities associated
17 with interruptible transportation, since Kern River expects all interruptible
18 revenues to flow at below the proposed maximum rate. The projection, however,
19 includes only those market-oriented revenues expected to be collected on a daily
20 basis in excess of the 90,000 Dth per day of capacity formerly under contract to
21 Mirant. Exclusion of the market-oriented revenues derived from the turned-back
22 Mirant capacity is appropriate because Kern River is assuming the risk of cost
23 recovery associated with the capacity by including the 90,000 Dth per day
24 formerly associated with the Mirant contract in the calculation of firm reservation

quantities and designing commodity billing determinants at the same load factor as used for other firm 2003 Expansion shippers. This treatment of the Mirant capacity in rate design is intended to make Kern River responsible for mitigating the loss of the Mirant contract. In Schedule G-2, Kern River has reflected the revenues it projects it will obtain from using the Mirant capacity to provide interruptible transportation service. A comparison of the Schedule G-2 projected revenues for the former Mirant capacity of \$6,788,438, against the rate design calculation of revenues from the Mirant capacity of \$17,298,810 for reservation charges and \$1,644,208 for commodity charges, quantifies Kern River's forecasted loss on the Mirant capacity of over \$12.1 million per year.

Q. Please explain the 95% load factor adjustments used in deriving the Rolled-In System rates.

A. Under Kern River's optional certificate for construction of its Original System (50 FERC ¶ 61,069), Kern River was required to design its firm reservation and commodity rates using a 95% load factor, even if contracted quantities were below that level. This rule was established to place Kern River reasonably at risk for unsubscribed capacity. In both the Docket No. RP92-226 and Docket No. RP99-274 rate settlements, the rate design level for reservation billing determinants was set at a negotiated, 96% load factor. In Docket No. RP99-274, this rate design was agreed upon when Kern River had reservation billing determinants under contract in excess of the 96% load factor. This agreement recognized Kern River's ongoing risks related to remaining fully contracted and the requirement in the optional certificate not to reallocate costs related to lost contracts among its Original System shippers. Shippers strongly desired this

1 principle to be maintained and Kern River reaffirmed this commitment to its
2 shippers in the ET rate settlement. For these reasons, Kern River proposes to
3 preserve the 95% load factor for billing determinants within the underlying design
4 of the Rolled-In System firm rates.

5 **Q.** How is the maximum rate for interruptible (“IT”) and authorized overrun
6 (“AOS”) services derived?

7 **A.** The proposed maximum rate for IT and AOS transportation service is the 100%
8 load factor equivalent of the highest maximum firm recourse rate on the system,
9 that is, the recourse rate for 10-Year, 2003 Expansion service, including the \$.06
10 per Dth commodity charge. This rate design for IT service benefits all firm
11 shippers by creating a level playing field for the maximum rate and by providing
12 Kern River an appropriate opportunity to maximize market-oriented revenues,
13 while remaining consistent with the requirement that the rate must be cost-based.
14 In addition, this approach is consistent with Kern River’s historic use of the
15 highest, 100% load factor rate on the system for authorized overrun and IT
16 service. The Commission approved this approach in the ET rate settlement, when
17 three firm transportation rates were established (92 FERC ¶ 61,061 (2000)).

18 **Q.** How has Kern River calculated the recourse rates proposed herein?

19 **A.** The recourse rates for the Rolled-In System shippers and for the 2003 Expansion
20 shippers are the same as the 10-Year reservation rates for the Rolled-In System
21 and the 2003 Expansion, respectively. The rates were calculated through the
22 levelization computations shown in Schedule J-2 and the workpapers. As such,
23 the rates are cost-based. Of course, any shipper paying a recourse reservation rate
24 would also be responsible to pay the \$.06 per Dth commodity charge.

1 **Q.** Why has Kern River presented on its proposed tariff sheets separate cost-based
2 recourse rates for the Rolled-In System and the 2003 Expansion?

3 **A.** To acquire available capacity, shippers must agree to pay the maximum lawful
4 rate applicable to the service, unless Kern River agrees to a discounted rate, or
5 Kern River and the shipper mutually agree on a negotiated rate. If a shipper
6 requests a negotiated rate, both the pipeline and the shipper need to know the
7 cost-based ceiling rate, or recourse rate, that would apply to the service if the rate
8 negotiations are unsuccessful. In addition, under FERC policy, any shipper that
9 releases its capacity to another shipper in the capacity release market may not
10 collect more than the maximum lawful price for the released capacity. It is
11 necessary and appropriate to clearly establish recourse rates which apply to such
12 transactions and which provide the maximum rate flexibility to shippers. In both
13 instances, of course, the ceiling rates must be consistent with the cost-based
14 standard applicable to such transactions. Two separate recourse rates are
15 necessary on the Kern River system due to Kern River having both the Rolled-In
16 System and the incremental 2003 Expansion services.

17 **Q.** Please explain Kern River's use of a single, composite cost of debt in calculating
18 its costs of service.

19 **A.** Mr. Darrell Swensen presents the calculation of the composite (weighted average)
20 cost of Kern River's outstanding long-term debt in Statement F-3, as further
21 supported in the workpapers. Use of the composite cost of debt is appropriate
22 because of the interrelated nature of the financings of the ET program and the
23 2003 Expansion. The debt was issued in both cases under the same debt
24 covenants and the consolidated cash flows of Kern River were relied upon by

1 both series of debt holders, since the 2003 Expansion was a known, projected
2 event at the time of the ET financing. The credit quality of the Rolled-In System
3 shippers and related cash flows of Kern River were major factors resulting in the
4 favorable credit rating and interest rate obtained for the 2003 Expansion shippers.
5 The settlement in Docket No. RP99-274 stands for the sound principle that
6 existing shippers should benefit from any lower interest rate in a subsequent
7 financing that they helped make possible. Kern River believes this approach is
8 equitable and that it is reasonable to continue it.

9 **Q.** Does Kern River propose rates that vary by distance of haul?

10 **A.** No. From its inception of service in 1992, Kern River has employed a postage
11 stamp rate design and it continues to propose and favor postage stamp rates. Kern
12 River's system was initially designed to operate and continues to operate
13 primarily for the purpose of transporting shippers' gas on a firm basis from supply
14 sources in southwestern Wyoming to markets in California at or near the end of
15 the system. While it is true that smaller markets have developed in Utah and
16 Nevada since construction of the Original System, almost all of the firm shippers
17 have retained firm rights to transport their full MDQ to markets in California.
18 Shippers in fact use those rights. Even those few shippers that do not have
19 primary delivery points in California can serve California markets on a secondary
20 firm basis. Therefore, Kern River believes postage stamp rates continue to be
21 appropriate because they best reflect the nature of the service provided and the
22 costs of Kern River's predominant service.

23 **Q.** Kern River's reservation rates are computed on a daily basis. How many days
24 were used to compute rates in the filing?

1 **A.** The computations reflect a 365-day year. However, Kern River has developed a
2 work paper that computes the rates on a 366-day basis for use during the balance
3 of calendar year 2004. Kern River's filing includes two sets of rate sheets, one set
4 proposed to be effective on June 1, 2004, with rates calculated on the basis of a
5 366-day year, and the other set proposed to be effective on January 1, 2005, with
6 rates calculated on the basis of a 365-day year.

7 **Q.** Please describe Kern River's rate levelization methodology and the related
8 levelized schedules contained in Kern River's filing.

9 **A.** The genesis of Kern River's levelized cost of service methodology and related
10 rate design can be traced to the Commission's 1990 Order Issuing Certificates for
11 the original Kern River system. This basic structure continues today, as
12 subsequently affirmed in Kern River's ET rate settlement in Docket No. RP00-
13 298 (92 FERC ¶ 61,061 (2000), reh'g denied, 94 FERC ¶ 61,115 (2001)), and in
14 the 2003 Expansion certificate preliminary determination (98 FERC ¶ 61,205
15 (2002)). The most important features of Kern River's rate design are: (1)
16 levelized recovery of 70 percent of the initial investment in the applicable
17 facilities over the firm shippers' contract terms; (2) a 95 percent load factor for
18 reservation and commodity billing determinants for the Original System; (3) a
19 three percent annual inflation factor applied to O&M and A&G costs; (4) a
20 generally increasing depreciation profile over the years of the levelization period,
21 using depreciation as the cost of service element which is modified to achieve the
22 levelized cost of service; (5) use of the Ozark method (Ozark Gas Transmission
23 Sys. v. FERC, 897 F.2d 548 (D.C.Cir. 1990)) to derive common equity; and (6)

1 use of an average rate base each year, computed from beginning and end of year
2 rate base component balances.

3 **Q.** Please describe the “Ozark method” referred to above.

4 **A.** Under the Ozark methodology, the common equity used in the model varies each
5 year from its starting point of about 30 percent of total capitalization. Rate base,
6 as adjusted by accumulated deferred income taxes, is calculated first. Once rate
7 base is determined, the total long-term debt balance is deducted from rate base to
8 derive common stockholder’s equity. This methodology, therefore, has the effect
9 of reducing common stockholder’s equity by the accumulated deferred income tax
10 balance outstanding in each period. As the debt balance declines, the equity-to-
11 debt ratio increases over time.

12 **Q.** Do Kern River’s levelization computations include straight-line depreciation
13 figures with adjustments for regulatory assets or liabilities?

14 **A.** No. Kern River’s rate base models include accumulated regulatory depreciation,
15 rather than accumulated straight-line depreciation adjusted by a depreciation-
16 related regulatory asset or liability.

17 **Q.** In this regard, how are regulatory assets related to past levelized depreciation for
18 compressor engines and general plant presented?

19 **A.** Statements A and B and the related schedules sponsored by Mr. Hansen include
20 regulatory assets for those undepreciated components of plant which are no longer
21 included in the derivation of the levelized costs of service. In other words, the as-
22 adjusted book accumulated depreciation reserves, along with the regulatory
23 assets, are based on the projected balances as of October 31, 2004. In addition,
24 the costs of service indicate the amortization amounts related to the regulatory

1 assets that are needed to amortize and eliminate the regulatory assets over the
2 remaining lives of the shipper contracts, as further discussed by Mr. Feinstein and
3 Mr. Hansen.

4 **Q.** Please further explain the levelized cost of service methodology in terms of its
5 effect on Kern River's filed rates.

6 **A.** First, it is important to recognize that these rates are based on an estimate of
7 future costs over the remainder of the shippers' contracts. Those costs are
8 levelized to produce level rates. The resulting rates are lower in the initial years
9 of the shippers' contracts than would be the case with a traditional, declining rate
10 base model. Shippers are given the full benefits of the rate base decline within the
11 rate calculations. In addition, shippers are given the full benefit of the "interest
12 free" capital supplied by income tax deductions for accelerated depreciation
13 within the computation of accumulated deferred income taxes. Within the
14 models, depreciation expenses generally increase as interest expense decreases,
15 such that the two cost factors together remain relatively constant over time.

16 **Q.** What time period has Kern River used in its levelization calculations?

17 **A.** Kern River levelized its cost of service from the projected effective date of its
18 new rates (November 1, 2004) through the end of the firm shippers' existing
19 contracts. To accommodate a partial year at the end of the levelization period,
20 Kern River used a pro-rationing and iterative calculation process to compute the
21 appropriate rates. That process is necessary due to Kern River's use of average
22 rate base balances in the levelization computations.

23 **Q.** How did Kern River derive the appropriate starting balances for the levelized
24 calculations?

1 **A.** To derive the appropriate starting balances for the levelized calculations, the
2 starting points for O&M expense, A&G expense, ad valorem and other taxes, and
3 investment balances in gross plant, regulatory assets and accumulated
4 depreciation were taken from Kern River's books, as adjusted by the known and
5 measurable adjustments described in Mr. Hansen's testimony and the related
6 schedules. For accumulated depreciation, Kern River summed the past regulatory
7 depreciation used in its rate models approved in connection with its rate
8 settlements or certificates. To these amounts, Kern River added the net cost of
9 property retired. (Those retirement amounts exclude retirement costs associated
10 with investments that Kern River proposes to exclude from the levelization
11 calculations, i. e., general plant and compressor engines.) Debt balances were
12 obtained from principal amounts projected to be outstanding on November 1,
13 2004, excluding debt principal amounts related to debt-financed interest rate
14 swaps and financing fees. Those swap and financing fee principal amounts do not
15 pertain to amounts in rate base and, therefore, should be excluded from the
16 financing of rate base. In addition, the outstanding debt used in the levelization
17 calculations has been reduced to reflect amounts properly associated with general
18 plant and compressor engines, since the costs of service for those categories of
19 plant have been calculated separately. The accumulated deferred income tax
20 balances were computed by Mr. Valentine, as described in his direct testimony.

21 **Q.** What are the iterative processes associated with Kern River's levelization
22 computations?

23 **A.** The cost of service is levelized using a Visual Basic® for applications program
24 within Microsoft Excel® models. The calculations are made through an iteration

1 process whereby the model steps through each year of the levelization process to
2 calculate a trial cost of service. The trial cost of service is then compared to the
3 following year's cost of service. The model changes the depreciation for the
4 subsequent year until the cost of service difference for both years is within a
5 tolerance range. The second year's cost of service is compared to the third year's
6 figure in a similar manner, which is then adjusted in a similar manner. This
7 process continues in succession through a series of program loops until the costs
8 of service for all years are level.

9 **Q.** Have Kern River's levelization computations changed over the years?

10 **A.** The basic theory, formulas and methodology of the levelization computations
11 have remained the same. However, there have been some refinements to adapt to
12 changes over the years. In this regard, Kern River now incorporates additional
13 details within the levelization calculations that were not necessary in the earlier
14 years of the levelization methodology.

15 **Q.** Please explain.

16 **A.** For example, Kern River has added a comprehensive accumulated deferred
17 income tax calculation to comply with the regulations that require that temporary,
18 income tax related timing differences that pertain to all aspects of jurisdictional
19 cost of service and revenues must be included in cost of service calculations.
20 Kern River has also revised the approach for recovery of certain short-lived
21 assets, i.e., compression turbines and general plant, to exclude them from the
22 levelization calculations consistent with the recommendations of Mr. Edward
23 Feinstein presented in his direct testimony. Kern River has further refined its
24 approach to recovery of interim and terminal net negative salvage as described by

1 Mr. Feinstein. The models have been modified to improve their flexibility and
2 functionality, such as levelizing over varying periods and stub periods. Finally,
3 Kern River has included iterative calculations in the levelization models to adjust
4 the billing determinants for discounted firm contracts.

5 **Q.** Does this conclude your prepared direct testimony?

6 **A.** Yes.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Kern River Gas Transmission Company) Docket No. RP04-___-000

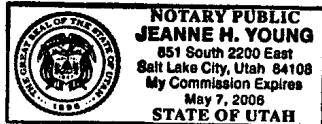
STATE OF UTAH)
 : ss
COUNTY OF SALT LAKE)

AFFIDAVIT OF BRUCE E. WARNER

Bruce E. Warner, being first duly sworn, on oath states that he is the witness whose testimony appears on the preceding pages entitled "Prepared Direct Testimony of Bruce E. Warner"; that, if asked the same questions that appear in the text of said direct testimony, he would give the answers that are herein set forth; and that affiant adopts the aforesaid testimony as his sworn, direct testimony in this proceeding.

Bruce E. Warner
Bruce E. Warner

SUBSCRIBED AND SWORN TO before me, a Notary Public in and for the State of Utah, this 21st day of April, 2004.



Jeanne H. Young
Notary Public