1. On March 25, 2013, Kern River Transmission Company (Kern River) filed a request for clarification or, in the alternative, rehearing of Opinion No. 486-F in the captioned proceeding. As discussed below, the Commission grants in part, and denies in part, Kern River’s request.

Background

2. Kern River’s rehearing request relates solely to the rulings in Opinion Nos. 486-E and 486-F concerning the recovery of its compressor costs. Therefore, we summarize the prior history of this proceeding solely as relevant to that issue. Briefly, in January of 1990, the Commission issued a certificate to Kern River to permit it to construct its Original System under the optional expedited certificate regulations adopted in Order No. 436. The Commission approved initial rates based on, among other things, a levelized cost of service and a 25-year depreciation life. The levelized cost of service included a levelized recovery of all plant costs, including the cost of compressor engines and general plant. The Commission also authorized Kern River to charge separate levelized rates for three different periods: (1) the 15-year term of the firm shippers’
initial contracts (Period One); (2) the 10-year period from the expiration of those contracts to the end of Kern River’s assumed 25-year depreciable life (Period Two); and (3) the period thereafter (Period Three). The levelized rates for Period One (Period One Rates) were designed to recover approximately 70 percent of Kern River’s original investment, an amount about equal to the portion of its invested capital funded through debt.\(^4\) The Period Two rates would recover the remaining 30 percent of Kern River’s invested capital. While the rates approved in the Original Certificate proceeding included separate, levelized rates for three periods, Kern River’s tariff only included rates for Period One, the term of its firm shippers’ initial contracts.

3. On April 30, 2004, Kern River filed a general rate case. Kern River proposed to continue to design its rates based on the levelized rate design methodology approved in its Original Certificate Order, as modified in subsequent proceedings,\(^5\) with one exception. Kern River proposed to remove compressor engines and general plant from its levelized rates and collect depreciation costs for these plant items through traditional cost-of-service rates with straight-line depreciation, because these items have a significantly shorter depreciable life than the rest of Kern River’s plant.\(^6\) Kern River did not propose in this rate case to add Period Two or Three rates to its tariff.

4. The Commission has issued seven opinions in this section 4 rate case.\(^7\) In Opinion Nos. 486 and 486-A, the Commission approved Kern River’s proposed continuation of its levelized Period One rates. However, the Commission rejected Kern River’s proposal to remove the costs of compressor engines and general plant from the levelized cost of service. The Commission explained that the costs of the compressor engines and general plant were included in the levelized rate methodology approved in Kern River’s optional expedited certificate proceeding. That levelized rate methodology is part of the risk sharing agreement among Kern River, its shippers and lenders underlying Kern River’s

\(^4\) Original Certificate Order, 50 FERC at 61,144.

\(^5\) See Kern River Gas Transmission Co., Opinion No. 486, 117 FERC ¶ 61,077 at PP 4-17 (providing a detailed history of recent regulatory proceedings regarding Kern River’s system).

\(^6\) Id. P 134.

optional expedited certificate. The Commission stated it would not change the allocation risk underlying the optional certificate, absent some overarching policy reason or agreement of all the parties to a change, neither of which was present here. In Opinion No. 486-A, the Commission stated that, if the levelized rate methodology requires Kern River to defer recovery of its investment in compressor engines and general plant, it may treat such deferred recoveries as a regulatory asset. Such a regulatory asset may be included in its rate base, which allows it to earn a return on any deferred cost recovery.

5. Opinion Nos. 486 and 486-A also directed Kern River to include in its tariff the expected Period Two rates that would take effect when the existing contracts expired. The Commission held that this was necessary in order to assure that the shippers would obtain the benefit of the lower Period Two rates if they continue service beyond the terms of their existing contracts.

6. In Opinion No. 486-B, after determining the appropriate return on equity to be included in Kern River’s rates, the Commission ordered Kern River to make a revised compliance filing setting forth both Period One and Period Two rates consistent with the rulings in Opinion Nos. 486, 486-A, and 486-B. In Opinion No. 486-C, the Commission accepted the revised Period One rates filed by Kern River, subject to certain conditions unrelated to the treatment of compressor costs. However, the Commission rejected the Period Two rates filed by Kern River, because they were premised on the use of a traditional rate design for Period Two. The Commission found that the parties’ original risk sharing agreement required levelized rates for Period Two. Therefore, Opinion No. 486-C required Kern River to file pro forma tariff sheets setting forth its proposed levelized Period Two rates, and the Commission established a hearing on how levelized Period Two rates should be calculated.

7. While the hearing established by Opinion No. 486-C was in progress, Kern River filed a motion for clarification concerning its ability to carry over from Period One to Period Two any compressor-based regulatory asset not recovered during Period One. In December 2010, the Commission issued an order stating that, if at the start of Period Two

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8 Opinion No. 486, 117 FERC ¶ 61,077 at PP 56-57, order on reh'g, Opinion No. 486-A, 123 FERC ¶ 61,056 at PP 356-359.

9 Id. PP 359, 373.

10 Opinion No. 486, 117 FERC ¶ 61,077 at P 37.


12 Id. P 247.
the cumulative allowance for depreciation of compressors included in its rates is 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. However, the Commission stated that Kern River could not include in its regulatory assets any new compressor costs that it had incurred after the 2004 test period applicable in this rate case.

8. In Opinion Nos. 486-E and 486-F, the Commission reviewed the Administrative Law Judge’s initial decision concerning Kern River’s Period Two rates. The Commission held that, in calculating its Period Two rates, Kern River had improperly included in its rate base new costs it projected it would incur to replace compressors after the end of the 2004 test period. The Commission found that the Period Two rates in this rate case must be developed based on the same 2004 test period data used in developing the Period One rates, except where circumstances unique to the transition from Period One to Period Two justifies an adjustment. The Commission found that nothing about the post-test period compressor replacement costs justified an adjustment to the Period Two rate base. The Commission also found that Kern River had not shown that the levelized rate methodology approved in the optional expedited certificate proceeding permitted the inclusion in rate base of post-test period compressor replacements.

9. The Commission concluded that in this rate case Kern River may treat as a regulatory asset the amount by which (1) the straight line depreciation of compressors in existence at the end of the 2004 test period recorded in Kern River’s books exceeded (2) the regulatory depreciation recovered in rates of those same compressors, and the Commission permitted Kern River to add that regulatory asset to its rate base for the purpose of calculating Period Two rates. However, the Commission held that if Kern River wishes to include in rate base compressor costs incurred after the end of the 2004 test period, it must do so through a new section 4 rate filing.

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14 Opinion No. 486-E, 136 FERC ¶ 61,045 at P 142.

15 Id. P 146.

16 Id. P 144. Opinion No. 486-F, 142 FERC at P 156.
Request for Clarification and/or Rehearing

10. Kern River requests clarification or rehearing of Opinion No. 486-F, with respect to one issue. Kern River states that in its request for rehearing of Opinion No. 486-E, it asked the Commission to clarify that it did not intend to bar Kern River from seeking recovery in a future rate case of regulatory asset/liability amounts related to differences between actual book depreciation on its gross plant in service (including assets purchased post-2004) and the approved levelized (regulatory) depreciation. Kern River states that Opinion No. 486-F failed to address this request. Therefore, Kern River seeks clarification and/or rehearing solely on the issue of the treatment of regulatory asset or liability amount related to gross plant in service, particularly assets purchased after the October 2004 test period in the instant proceeding and before the next rate case.

11. Kern River acknowledges that the Commission ruled in Opinion No. 486-F that Kern River is not entitled to adjust its rates to include post-test period compressor and general plant replacement costs, absent a new rate case filing. However, Kern River asserts that it requested the Commission to clarify that Paragraph 143 of Opinion No. 486-E does not bar Kern River from seeking recovery in a future rate case of certain regulatory asset/liability amounts. That paragraph states:

The Commission therefore affirms that if Kern River desires to include replacement costs incurred after the close of the 2004 test period in its levelized rate methodology, it must file a new rate case, or a series of rate cases. The accounting protocol for filing a new rate case to recover these compressor costs is illustrated by the accounting sheets in the 45 Day Update documenting the compressor rate base, including the replacement dates, the book and regulatory cost involved through the October 31, 2004 end of the test period. Kern River appears to have calculated separately the regulatory asset that existed on the date of the analysis for all the compressors that had already been included in its rate base at the end of the test period and that were proposed to be amortized through its Period One rates. Thus in any new rate case Kern River would perform the same analysis based on the verified book costs of any compressor replacement costs incurred after 2004. It would then adjust its levelized rate methodology to reflect the portion of those

17 Kern River Request at p. 2 (citing Request of Kern River Gas Transmission Company For Clarification and/or Rehearing of Opinion No. 486-E, dated August 22, 2011, at pp. 25-34).

18 Id. at pp. 59-64.
additional costs that remained in its rate base at the end of the test period used to support any future section 4 rate case. The regulatory depreciation for the assets acquired after 2004 would be included in rates of any new section 4 rate filing on a going forward basis, as would any regulatory asset accrued from the use of that regulatory depreciation on a going forward basis from the end of the new test period. Therefore one of Kern River’s considerations in deciding whether to file a new section 4 rate case is that it will not be permitted to recover in its prospective rates the regulatory depreciation for past periods for any additional compressors it acquired between the end of the 2004 test period and the date that it filed a new rate case, for example January 1, 2012. Moreover, since there might otherwise be a difference between the two under Kern River’s levelized rate methodology that would otherwise generate a regulatory asset, Kern River may not include that difference in the rates it files for a new section 4 rate case. 19 (Emphasis added by Kern River.)

12. Kern River asserts that the emphasized language refers to a difference that would “otherwise generate a regulatory asset”, which it understands as a difference between book depreciation and regulatory depreciation which would create a regulatory asset or liability. Kern River asserts that this language implies that some portion of such differences relating to replacements of compressor and or general plant assets after the end of the test period of this case may be at issue in a future rate proceeding contrary to the Commission’s prior rulings in this case.

13. Kern River argues that its accounting methodology relating to replacement of compressors and general plant has not changed since the inception of its service in 1992. Kern River avers that its practice follows the Commission’s directive to record book depreciation to Account 108. 20 Kern River asserts that if it replaces an asset it cannot record book depreciation on the retired asset because it has been removed from plant. Therefore, Kern River asserts that it has no other choice but to record the book depreciation on its new compressor. Kern River asserts that the Commission requires that Kern River record a regulatory asset/liability for all differences between book

19 Opinion No. 486-E, 136 FERC at P 143 (emphasis added by Kern River).

20 Kern River Clarification Request at p. 6 (citing Opinion No. 486, 117 FERC ¶ 61,077, at P 47 (2006) (“Further, Kern River records annual book depreciation as an addition to Account No. 108 (Accumulated Depreciation Expense), and a regulatory asset or liability is booked for the difference between the annual regulatory depreciation expense it recovers in rates and the book depreciation expense it records in Account No. 108.”)).
depreciation and regulatory depreciation\textsuperscript{21} and alleges that the Commission has not directed Kern River to do anything differently in any of its orders in this rate case. In addition, Kern River notes that the levelized regulatory depreciation amount contained in the current rate cannot be changed until a future rate case.

14. Therefore, Kern River requests that the Commission clarify that the emphasized language provides no basis to question the Commission’s prior rulings approving Kern River’s regulatory asset/liability accounting and rate treatment for deferred depreciation, as applied to compressor and general plant replacements between general rate changes.

15. Kern River states that in a future rate case just as it did in the instant rate case, Kern River would look to its then-existing regulatory asset/liability balance as of the end of the test period to determine what to include in its rate base. Kern River asserts that the Commission did not intend to prohibit Kern River from reflecting in its rate base any portion of its post-2004 compressor or general plant investment at the time a future rate change becomes effective because such a restriction would contravene the Commission’s findings upholding Kern River’s levelized rates.\textsuperscript{22}

16. Kern River states that because it must file a new rate case to recover replacement compressor and general plant costs incurred after the 2004 test period, it will perform the same analysis of costs incurred after 2004, as it did in the 45 Day Update, consistent with Paragraph 143 of Opinion No. 486-E. Moreover, Kern River states that in Opinion No. 486-A, the Commission stated that Kern River had “properly reflected” its regulatory asset/liability balance in its rate base in the 2004 rate case in utilizing its levelized rate model.\textsuperscript{23} Kern River states that its recovery, through its regulatory asset/liability balance, of all deferred depreciation for all plant, including compressor and general plant replacements between rate changes is clearly documented in the evidentiary record of its 2004 rate proceeding, including its compliance filing dated January 29, 2010, as accepted in Opinion No. 486-D.\textsuperscript{24} However, Kern River states that as set forth above, the last two sentences of Paragraph 143 may be inconsistent with Kern River’s long-standing practice and with the orders of the Commission in this case.

\textsuperscript{21} Id. (citing Opinion No. 486, 117 FERC at PP 40, 47).

\textsuperscript{22} Kern River Request for Rehearing at p. 7.

\textsuperscript{23} Kern River Clarification Request at p. 8 (citing Opinion No. 486-A, 123 FERC ¶ 61,056 at P 374).

\textsuperscript{24} Kern River Clarification Request at p. 9 (citing Opinion No. 486-D, 133 FERC ¶ 61,162 at P 100).
17. Accordingly, Kern River states that it intends to continue to follow the instructions the Commission has repeatedly provided regarding the establishment of a regulatory asset/liability for deferred depreciation with the understanding that any portion of its regulatory asset/liability balance as of the test period of its next rate case that relates to compressor and general plant replacements will be properly reflected in Kern River’s rates. Therefore, Kern River states that should the Commission decline to grant the requested clarification of Paragraph 143, the Commission should grant rehearing of Opinion No. 486-F and vacate or modify the last two sentences of Paragraph 143 to remove the seeming inconsistency of that language with the Commission’s orders approving Kern River’s accounting for and rate treatment of deferred depreciation associated with compressor and general plant replacements between general rate changes.

Discussion

18. Kern River’s clarification/rehearing request asks us to decide now an issue that will not be ripe for decision until it files its next rate case. As discussed below, we clarify that the opinions issued in this proceeding have not addressed the merits of the issue Kern River now raises. Therefore, when and if the issue is presented in a future section 4 rate case filed by Kern River, the Commission will decide the issue at that time, based on the record developed by the parties in that future case.

19. The issue raised by Kern River is best understood in the context of the following simplified example. Assume Kern River replaces a compressor at a cost of $10 million in 2013 and has a 10-year depreciation period. A 10-year depreciation period would result in a $1,000,000 per year depreciation expense calculated on a straight-line basis. Kern River files a new section 4 rate case in 2018, when the compressor is half way through its depreciable life. Therefore, Kern River has recorded on its books $5 million in straight line accumulated depreciation, leaving a $5 million undepreciated compressor investment on its books. Kern River argues that, in these circumstances, it should be allowed to treat the $5 million in depreciation expenses that accumulated between 2013 and 2018 and that was not reflected in its rates in effect during that period as a regulatory asset. This would permit it to include in the 2018 rate case the entire $10 million investment in the replacement compressor in its rate base, composed of the $5 million undepreciated portion of the investment plus the $5 million in depreciation expenses not recovered through existing rates and booked as a regulatory asset.  

25 Under traditional, non-levelized rates, Kern River could only include in its rate base the $5 million undepreciated portion of its investment in the replacement compressor. In traditional rate cases, rate base is not adjusted for the accumulated differences between actual depreciation expenses and the depreciation expenses recovered from existing rates.
20. The Commission has consistently held in its various opinions in this rate case that Kern River must continue the levelized rate methodology underlying its optional expedited certificate, absent some overarching policy reason or agreement of all the parties to a change.\footnote{For example, Opinion No. 486, 117 FERC ¶ 61,077 at P 39 (“we hold that in Kern River’s instant rate case, it may and should continue the levelized rate model agreed to in its certificate proceeding and subsequent proceedings”); at P 42 (“In the Commission’s view, the depreciation recovery under levelized rates is, by necessity, a long term proposition. . . . it is inherent in any such plan that the levelized rate will remain in effect for the entire agreed upon period.”); at P 44 (“Therefore, the Commission finds that the levelization methodology must remain in place for shippers to realize the benefits bargained for as a part of the refinancing settlement.”).} Therefore, the issue of whether Kern River may treat depreciation accumulating on replacement compressors or other plant investments made between rate cases as a regulatory asset to be included in its rate base in its next rate case turns on whether the levelized rate methodology approved in the optional expedited certificate contemplates such regulatory asset treatment.

21. Kern River asserts that it has treated all plant investments made between rate cases in this manner since the inception of its service in 1992, including in the Period One rates approved in this rate case. If Kern River is correct, then we would agree that a continuation of that practice in its next rate case would be reasonable, absent some overarching policy reason for a change in the levelized rate methodology or agreement of the parties. However, in neither this rate case nor any earlier Kern River rate case, have the parties litigated this issue in a manner that required the Commission decide on the merits whether Kern River’s levelized rate methodology permits it to treat depreciation expenses accumulated on plant investments made between rate cases as a regulatory asset (i.e., the $5 million in accumulated depreciation expenses in the example above). Therefore, the Commission finds that this issue is best left to be decided in a future rate case, where all parties will have an opportunity to present evidence and argument on the issue of whether the levelized rate methodology approved in Kern River’s optional expedited certificate proceeding permits depreciation expenses that accumulated on plant investments made between rate cases to be treated as a regulatory asset.

22. In asserting that it has consistently treated plant investments made between rate cases in the manner illustrated by the above example, Kern River does not cite to narrative testimony by any of its witnesses in this or previous rate cases which would bring to our attention that its rate base has been calculated in this manner. Rather, Kern River cites only to the workpapers accompanying its December 15, 2004 filing updating its test period data 45 days after the end of the test period (45-day Update Filing)\footnote{That filing was required by 18 C.F.R. § 154.311 (2013).} and its
January 29, 2010 Period One Compliance Filing as showing that the Period One rates the Commission approved in Opinion Nos. 486-C and 486-D reflect regulatory asset treatment of the depreciation expense of new plant investments accumulating before this rate case. Specifically, Kern River asserts those workpapers show that it treated the depreciation expenses of compressor and general plant replacements made after its last rate case, which accumulated during the period before it filed this rate case, as a regulatory asset, and Kern River asserts that it included that regulatory asset in the rate base underlying the Period One rates. Kern River asserts that the support for this assertion is found in the referenced work papers at pages 4 and 7 and in the 45-day Update work papers found under Tab A.

23. The Commission’s examination of these pages does not demonstrate that Kern River treated depreciation expenses accumulated on new plant or compressors added after the last rate case in the manner it states. Nor can the Commission determine whether the referenced pages identify the cost of any new plant to be placed in rates as the original (undepreciated) cost of the plant or whether the asset is proposed to be included in the rates as a depreciated asset. The workpapers cited by Kern River merely reflect accumulated book depreciation to total plant in Kern River’s Period One rates which includes unidentified compressor plant costs. The workpapers do not reflect the addition of individually identified compressors to replace compressors on Kern River’s system, the original cost of such compressors, the date such compressors were placed into service, the amount of depreciation incurred by the new compressors prior to the test period of the rate case and the amount Kern River proposed to add to the rate base of the new rate case to accommodate its costs associated with such new compressors.

24. The 45-Day Update Filing does provide a listing of individual compressors and the date they were placed into service. However, this update is unclear concerning the difference between its treatment of book and regulatory assets for levelized depreciation. For example, the Commission cannot determine from this source whether Kern River added an adjustment to regulatory costs (assets) to reflect the difference between the levelized regulatory depreciation and book depreciation for compressors added before the end of the test period in the instant proceeding. Moreover, despite Kern River’s description of its information as clearly supporting its request, the Commission is simply unable to reconcile the information from the 45-Day Update Filing with the information contained on pages 4 and 7 of the January 29, 2010 Compliance Filing.

25. In any event, the parties’ contentions in this rate case have focused on whether Kern River may adjust its plant and regulatory asset balances to reflect the post-test period installation of compressors, not the determination of those balances as of the end of the test period. No party protested Kern River’s calculation, in the Period One compliance filing, of the regulatory asset in existence at the end of the test period in this rate case. Nor did any party raise any issue concerning whether Kern River had improperly included in that regulatory asset depreciation which had accumulated on plant
investments since its last rate case. Therefore, the Commission did not address the merits of that issue in Opinion Nos. 486-C and 486-D, and our acceptance of Kern River’s Period One compliance should not be relied on as precedent that in its next rate case Kern River may treat as a regulatory asset any depreciation which accumulates on any post-2004 plant replacement investments.

26. By the same token, however, we find the language in P 143 of Opinion No. 486-E which suggested that Kern River may not treat such depreciation expense as a regulatory asset in its next rate case was unnecessary to our decision. That language stated:

The regulatory depreciation for the assets acquired after 2004 would be included in rates of any new section 4 rate filing on a going forward basis, as would any regulatory asset accrued from the use of that regulatory depreciation on a going forward basis from the end of the new test period. Therefore one of Kern River’s considerations in deciding whether to file a new section 4 rate case is that it will not be permitted to recover in its prospective rates the regulatory depreciation for past periods for any additional compressors it acquired between the end of the 2004 test period and the date that it filed a new rate case, for example January 1, 2012. Moreover, since there might otherwise be a difference between the two under Kern River’s levelized rate methodology that would otherwise generate a regulatory asset, Kern River may not include that difference in the rates it files for a new section 4 rate case.

27. Because Opinion No. 486-E only addressed the issue of whether Kern River may include post-2004 test period compressor replacements in its Period Two rates in this rate case, there was no need in that opinion to address what within-the-test period compressor costs may be included in Kern River’s rates in its next rate case. We therefore withdraw the above quoted language.

28. In summary, we leave to the next rate case the issue of whether Kern River’s levelized rate methodology permits it to treat depreciation expenses that accumulate on plant investments made between rate cases as a regulatory asset which may be included in rate base in its next rate case. This will give all interested parties an opportunity to present evidence and views on that issue in the next rate case. This clarification brings this rate case to a close. Accordingly, Kern River’s request for clarification or rehearing is granted to the extent that we clarify that Opinion No. 486-E does not decide this issue. However, Kern River’s request for clarification and rehearing is denied to the extent that we reject its request to decide this issue now in its favor and hold that the subject depreciation expenses may be reflected in its rates in its next rate case.
The Commission orders:

The Commission grants in part, and denies in part, Kern River’s request for clarification and rehearing, as discussed above.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,
Deputy Secretary.