ORAL ARGUMENT HAS NOT BEEN SCHEDULED

In the United States Court of Appeals for the District of Columbia Circuit

Nos. 13-1138 and 13-1303 (consolidated)

AERA ENERGY, LLC, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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Washington, D.C. 20426

October 29, 2014

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are identified in the briefs of Petitioners.

B. Rulings Under Review

1. *Kern River Gas Transmission Co*., Opinion No. 486, 117 FERC ¶ 61,077 (2006), JA 173;

2. *Kern River Gas Transmission Co*., Opinion No. 486-A, 123 FERC ¶ 61,056 (2008), JA 441;

3. *Kern River Gas Transmission Co*., Opinion No. 486-B, 126 FERC ¶ 61,034 (2009), JA 592;

4. *Kern River Gas Transmission Co*., Opinion No. 486-C, 129 FERC ¶ 61,240 (2009), JA 698;

5. *Kern River Gas Transmission Co*., Opinion No. 486-D, 133 FERC ¶ 61,162 (2010), JA 840;

6. *Kern River Gas Transmission Co*., Opinion No. 486-E, 136 FERC ¶ 61,045 (2011), JA 2676;

7. *Kern River Gas Transmission Co*., Opinion No. 486-F, 142 FERC ¶ 61,132 (2013), JA 3676; and

8. *Kern River Gas Transmission Co*., 133 FERC ¶ 61,199 (2010).

C. Related Cases

This case has not been before this Court or any other court. There are no related cases.

/s/ *Lona T. Perry*
Lona T. Perry
Deputy Solicitor

October 29, 2014

TABLE OF CONTENTS

PAGE

STATEMENT OF THE ISSUES 1

STATUTES AND REGULATIONS 3

STATEMENT OF FACTS 3

I. KERN RIVER'S LEVELIZED RATE DESIGN 3

II. KERN RIVER'S RATE PROCEEDINGS 7

A. Proceedings On Period One Rates 7

1. The Hearing On Period One Rates 7

2. Commission Orders Following the Period One Rate Hearing 8

B. Proceedings On Period Two Rates 12

1. Commission Orders Preceding The Period Two Rate Hearing 12

2. The Hearing On Period Two Rates 14

3. Commission Orders Following The Period Two Rate Hearing 16

SUMMARY OF ARGUMENT 20

ARGUMENT 23

I. STANDARD OF REVIEW 23

TABLE OF CONTENTS

PAGE

II. KERN RIVER'S PERIOD ONE RATE ARGUMENTS ARE WITHOUT MERIT 25

A. The Commission Reasonably Made Period One Rates Prospective From The Date Of Opinion No. 486-C 25

1. The Commission Reasonably Made Period One Rates Effective As Of The Date The Commission Approved Kern River's Compliance Filing Conditioned On One Mathematical Change 25

2. *Electrical District* Does Not Compel Awaiting the Very Last Computation 28

3. The Commission's Interpretation Comports With The Statutory Purpose of Protecting Customers 33

B. The Commission Reasonably Affirmed The Administrative Law Judge's Refusal To Adjust Already-Finalized Period One Rates In The Period Two Rate Hearing 36

1. Kern River Sought To Adjust Already-Finalized Period One Rates In The Period Two Rate Proceeding 36

2. The Administrative Law Judge, As Affirmed By The Commission, Rejected Kern River's Proposal Because Period One Rates Had Already Been Finalized in Opinion No. 486-D 38

3. Kern River Has Not Challenged The Finding That Period One Rates Were Final As Of Opinion No. 486-D 40

4. The Commission's Statement That It Would Consider Unique Transitional Circumstances Applied Only To Issues Affecting Period Two Rates 42

TABLE OF CONTENTS

PAGE

III. CUSTOMERS' PERIOD TWO RATE ARGUMENTS ARE WITHOUT MERIT 45

A. The Commission Reasonably Set Kern River's Return On Equity At The Median 45

B. Customers' Arguments Regarding Re-Contracting Are Without Merit 51

C. Customers' Arguments Regarding Investor Perception of Composite Equity Are Without Merit 57

D. The Commission's Finding Is Not Contrary To Precedent 59

CONCLUSION 63

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

Ass'n of Oil Pipe Lines v. FERC,
83 F.3d 1424 (D.C. Cir. 1996).. 24

**Borek Motor Sales, Inc. v. NLRB*,
425 F.2d 677 (7th Cir. 1970) 40

**Boroughs of Ellwood City v. FERC*,
731 F.2d 959 (D.C. Cir. 1984).. 40

Bowman Transp., Inc. v. Arkansas-Best Motor Freight Sys.,
419 U.S. 281 (1974).. 40

Burlington Truck Lines, Inc. v. United States,
371 U.S. 156 (1962).. 23

Canadian Ass'n of Petroleum Producers v. FERC,
254 F.3d 289 (D.C. Cir. 2001).. 42

Cities of Campbell v. FERC,
770 F.2d 1180 (D.C. Cir. 1985).. 42

City of Anaheim v. FERC,
558 F.3d 521 (D.C. Cir. 2009).. 30

Consol. Edison Co. of N.Y. v. FERC,
347 F.3d 964 (D.C. Cir. 2003).. 41

**Credit Card Serv. Corp. v. FTC*,
495 F.2d 1004 (D.C. Cir. 1974).. 39

***Cases chiefly relied upon are marked with an asterisk.**

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

Dickson v. Sec'y of Def.,
68 F.3d 1396 (D.C. Cir. 1995).. 40

Electrical Dist. No. 1 v. FERC,
774 F.2d 490 (D.C. Cir. 1985).................................. 26-28, 30-31, 35-36

ExxonMobil Oil Corp. v. FERC,
487 F.3d 945 (D.C. Cir. 2007)..23-24

FCC v. Schreiber,
381 U.S. 279 (1965)... 41

Florida Mun. Power Agency v. FERC,
315 F.3d 362 (D.C. Cir. 2003).. 24

FPL Energy Me. Hydro LLC v. FERC,
287 F.3d 1151 (D.C. Cir. 2002).. 24

Lyons v. Barrett,
851 F.2d 406 (D.C. Cir. 1988).. 42

Me. Pub. Utils. Comm'n v. FERC,
520 F.3d 464 (D.C. Cir. 2008).. 24, 42

Mich. Consol. Gas Co. v. FERC,
883 F.2d 117 (D.C. Cir. 1989).. 42

Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1,
554 U.S. 527 (2008)... 23

Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.,
463 U.S. 29 (1983)... 23

NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n,
558 U.S. 165 (2010)... 24

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

NSTAR Elec. & Gas Corp. v. FERC,
481 F.3d 794 (D.C. Cir. 2007).. 31, 62

Pac. Gas Transmission Co. v. FERC,
998 F.2d 1303 (5th Cir. 1993) 4, 61

Petal Gas Storage, L.L.C. v. FERC,
496 F.3d 695 (D.C. Cir. 2007)... 24

Permian Basin Area Rate Cases,
390 U.S. 747 (1968)... 23

Pub. Serv. Co. of N.H. v. FERC,
600 F.2d 944 (D.C. Cir. 1979)... 30

Pub. Serv. Comm'n of N.Y. v. FERC,
813 F.2d 448 (D.C. Cir. 1987)... 24

Pub. Serv. Comm'n of N.Y. v. FERC,
866 F.2d 487 (D.C. Cir. 1989)... 5

Pub. Utils. Comm'n of Cal. v. FERC,
254 F.3d 250 (D.C. Cir. 2001).. 31, 32

Sithe/Independence Power Partners v. FERC,
165 F.3d 944 (D.C. Cir. 1999)... 23

Sw. Gas Corp. v. FERC,
145 F.3d 365 (D.C. Cir. 1998)... 10

TransCanada Pipelines Ltd. v. FERC,
24 F.3d 305 (D.C. Cir. 1994)... 7

**Transwestern Pipeline Co. v. FERC*,
897 F.2d 570 (D.C. Cir. 1990).. 12, 29-30, 33

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

Vermont Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.,
435 U.S. 519 (1978) 41

**W. Deptford Energy, LLC v. FERC*,
766 F.3d 10 (D.C. Cir. 2014) 31-32

Western Resources, Inc. v. FERC,
9 F.3d 1568 (D.C. Cir. 1993) 24

Williston Basin Interstate Pipeline Co. v. FERC,
165 F.3d 54 (D.C. Cir. 1999) 5

Xcel Energy Serv. Inc. v. FERC,
510 F.3d 314 (D.C. Cir. 2007) 41

ADMINISTRATIVE CASES:

Alabama-Tennessee Natural Gas Co.,
38 FERC ¶ 61,251 (1987) 59-60

Discovery Gas Transmission LLC,
78 FERC ¶ 61,194 (1997) 60

Enbridge Pipeline (KPC),
109 FERC ¶ 61,042 (2004) 60

High Island Offshore Sys., LLC,
113 FERC ¶ 61,280 (2008) 28

KansOK Partnership,
71 FERC ¶ 61,340 (1995) 59

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES: **PAGE**

Kern River Gas Transmission Co.,
50 FERC ¶ 61,069, *on reh'g*,
51 FERC ¶ 61,195 (1990) 4

Kern River Gas Transmission Co.,
60 FERC ¶ 61,123 (1992) 45

Kern River Gas Transmission Co.,
96 FERC ¶ 61,137 (2001) 36

Kern River Gas Transmission Co.,
107 FERC ¶ 61,215, *on reh'g*,
109 FERC ¶ 61,060 (2004) 8

Kern River Gas Transmission Co.,
114 FERC ¶ 63,031 (2006) 8

Kern River Gas Transmission Co.,
119 FERC ¶ 61,106 (2007) 32

Kern River Gas Transmission Co.,
135 FERC ¶ 63,003 (2011) 14-15, 38-39, 46

Kern River Gas Transmission Co.,
136 FERC ¶ 61,141 (2011) 44

Kern River Gas Transmission Co.,
Opinion No. 486,
117 FERC ¶ 61,077 (2006) 1, 3, 5, 7-9, 12-13
16, 25, 27, 29
34, 39, 43

Kern River Gas Transmission Co.,
Opinion No. 486-A,
123 FERC ¶ 61,056 (2008) 1, 3, 5, 6, 9, 11-13,
25, 27, 34, 36, 60

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES: **PAGE**

Kern River Gas Transmission Co.,
Opinion No. 486-B,
126 FERC ¶ 61,034 (2009) 1, 3, 9, 12, 17, 27, 45-48, 52

Kern River Gas Transmission Co.,
Opinion No. 486-C,
129 FERC ¶ 61,240 (2009) 1-3, 6-13, 17, 21 25-29, 32-39 48, 51, 53

Kern River Gas Transmission Co.,
Opinion No. 486-D,
133 FERC ¶ 61,162 (2010) 1-3, 11-13, 15-16, 25-30, 32-46, 53, 56, 59-62

Kern River Gas Transmission Co.,
Opinion No. 486-E,
136 FERC ¶ 61,045 (2011) 2-3, 6, 11, 15-20, 39, 44, 51, 53-58, 62

Kern River Gas Transmission Co.,
Opinion No. 486-F,
142 FERC ¶ 61,132 (2013) 2-3, 5, 11, 14, 16-20, 37, 39, 44, 47-62

La. Intrastate Gas Corp.,
50 FERC ¶ 61,011 (1990) 59

Ocean State Power II,
69 FERC ¶ 61,146 (1994) 32

Tarpon Transmission Co.,
41 FERC ¶ 61,044 (1987) 59

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES: **PAGE**

Transcontinental Gas Pipe Line Corp.,
71 FERC ¶ 61,305 (1995) 59

Transcontinental Gas Pipe Line Corp.,
Opinion No 414-A,
84 FERC ¶ 61,084 (1998) 50

Transcontinental Gas Pipe Line Corp.,
Opinion No. 414-B,
85 FERC ¶ 61,323 (1998) 47

Transcontinental Gas Pipe Line Corp.,
90 FERC ¶ 61,279 (2000) 46-47

Williams Natural Gas Co.,
77 FERC ¶ 61,277 (1996) 60

Williston Basin Interstate Pipeline Co.,
59 FERC ¶ 61,202 (1992), *order on remand*,
68 FERC ¶ 61,357, *reh'g denied*,
69 FERC ¶ 61,360 (1994) 28-29, 33, 34

STATUTES:

Natural Gas Act

Section 4, 15 U.S.C. § 717c 7, 8, 43-44, 61

Section 5, 15 U.S.C. § 717d 9, 11-12, 20, 26-29, 33-34, 39-40

Section 7(c), 15 U.S.C. § 717f(c) 4, 60

Section 19, 15 U.S.C. § 717r 24, 33, 41

GLOSSARY

Commission or FERC	Federal Energy Regulatory Commission
Customers	Petitioners Aera Energy, LLC, Anadarko E&P Onshore LLC, Chevron U.S.A., Inc., Occidental Energy Marketing, Inc., Shell Energy North America (US), L.P., and WPX Energy Marketing, LLC
Kern River	Petitioner Kern River Gas Transmission Company
Period One Initial Decision	*Kern River Gas Transmission Co*., 114 FERC ¶ 63,031 (2006), JA 14
Period Two Initial Decision	*Kern River Gas Transmission Co*., 135 FERC ¶ 63,003 (2011), JA 2289

In the United States Court of Appeals for the District of Columbia Circuit

Nos. 13-1138 and 13-1033 (consolidated)

AERA ENERGY, LLC, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

The orders of the Federal Energy Regulatory Commission (FERC or the Commission) challenged in this appeal address numerous issues concerning the rates of the Kern River Gas Transmission Company (Kern River), for long-distance natural gas transportation service, over two separate rate periods (Periods One and Two). Period One rates were the subject of a 2005 hearing before an Administrative Law Judge and a 2006 Initial Decision, and five subsequent Commission orders: Opinion Nos. 486, 486-A, 486-B, 486-C and 486-D. Period

Two rates were the subject of a 2010 hearing before an Administrative Law Judge and a 2011 Initial Decision, and three subsequent Commission orders: Opinion Nos. 486-E, 486-F and 486-G.

Petitioner Kern River raises two issues regarding Period One rates:

(1) Whether the Commission properly made lower Period One rates effective as of the date of Opinion No. 486-C, when the Commission accepted Kern River's Period One compliance filing conditioned on changing one number, rather than postponing (for eleven months) the effective date of the reduced rate until the last rate calculation with the new number had been performed and accepted in Opinion No. 486-D; and

(2) Whether the Commission properly affirmed the Administrative Law Judge's refusal in the Period Two hearing to adjust Period One rates that had already been finalized in Opinion No. 486-D.

Petitioner customers of Kern River (Customers)[1] raise one issue regarding Period Two rates:

(3) Whether the Commission was compelled to reduce Kern River's return on equity in Period Two based upon the change in Kern River's capital structure from 70 percent debt/30 percent equity in Period One to 100 percent equity, when

[1] Customers include petitioners Aera Energy, LLC, Anadarko E&P Onshore LLC, Chevron U.S.A., Inc., Occidental Energy Marketing, Inc., Shell Energy North America (US), L.P., and WPX Energy Marketing, LLC.

the Commission found that the decreased financial risk from the change in capital structure did not offset Kern River's increased business risk in Period Two from the expiration of Period One contracts.

STATUTES AND REGULATIONS

The relevant statutes and regulations are contained in the Addendum to this brief.

STATEMENT OF FACTS

I. KERN RIVER'S LEVELIZED RATE DESIGN

This appeal concerns a ratemaking proceeding for the Kern River pipeline, on review of the following orders: *Kern River Gas Transmission Co*., Opinion No. 486, Order on Initial Decision, 117 FERC ¶ 61,077 (2006), *order on reh'g*, Opinion No. 486-A, 123 FERC ¶ 61,056 (2008), *order on reh'g*, Opinion No. 486-B, 126 FERC ¶ 61,034 (2009), *order on reh'g*, Opinion No. 486-C, 129 FERC ¶ 61,240 (2009), *order on reh'g*, Opinion No. 486-D, 133 FERC ¶ 61,162 (2010); and *Kern River Gas Transmission Co*., Opinion No. 486-E, Order on Initial Decision, 136 FERC ¶ 61,045 (2011); *order on reh'g*, Opinion No. 486-F, 142 FERC ¶ 61,132 (2013). *See also* Attachment A hereto (presenting a table of relevant dates and holdings of the Opinion No. 486 series).

Kern River transports natural gas supplies from the Rocky Mountain area primarily to California. Opinion No. 486 PP 6-7, JA 179. The Commission

authorized Kern River to construct its facilities in 1990, under the Commission's optional expedited certificate procedures. *Id.* P 8, JA 179. To obtain authorization to construct a new pipeline, a natural gas company first must obtain a certificate of public convenience and necessity from the Commission pursuant to section 7(c) of the Natural Gas Act, 15 U.S.C. § 717f(c). Under the Commission's regulations in effect when Kern River applied for its certificate, a pipeline could obtain a standard section 7 certificate, which required that the applicant meet rigorous standards, including demonstrating demand for the total capacity of its proposed facilities and adequate gas supply. Alternatively, under the Commission's optional expedited certificate procedures, applicants did not have to demonstrate markets or gas supplies, but applicants had to assume the economic risks of the project. *See Pac. Gas Transmission Co. v. FERC*, 998 F.2d 1303, 1306 n.1 (5th Cir. 1993) (describing the optional certificate procedures).

In granting Kern River's optional certificate, the Commission permitted Kern River to use a levelized cost of service method. Opinion No. 486 P 10, JA 180 (citing *Kern River Gas Transmission Co*., 50 FERC ¶ 61,069, *on reh'g*, 51 FERC ¶ 61,195 (1990)). This levelized rate method is central to the issues involved in this appeal.

The Commission employs a test period approach in ratemaking, whereby the pipeline supports its proposed rates with data that reflect its actual experience over

the most recent twelve months. *See, e.g., Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 56 (D.C. Cir. 1999). Under a traditional rate design, the pipeline's return is based on its rate base at the end of the test period, without taking into account the subsequent decline in the rate base as the pipeline recovers depreciation. Opinion No. 486-A P 25, JA 453. Under the traditional method, the pipeline receives higher rates during its early years and lower rates in later years. *See Pub. Serv. Comm'n of N.Y. v. FERC*, 866 F.2d 487, 492-93 (D.C. Cir. 1989).

Levelizing the pipeline's cost of service over its life provides lower rates at the beginning of service than traditional ratemaking, but those rates gradually become higher than traditionally-designed rates as the rate base declines. Opinion No. 486-A P 25, JA 453. Lower initial rates help a new pipeline market its capacity and compete with other established pipelines in the area charging low rates, and therefore pipelines like Kern River often offer levelized rates when seeking customers for a new pipeline project. Opinion No. 486-F P 67, JA 3702; Opinion No. 486 P 40, JA 193-94.

Kern River's rates were levelized over three different periods, but only Periods One and Two are at issue in this appeal:

(1) Period One: the term of firm shippers' initial contracts, during which Kern River recovers the 70 percent of its invested capital financed by debt;

(2) Period Two: from the expiration of firm shippers' initial contracts to the end

of Kern River's depreciable life, during which Kern River recovers the 30 percent equity-financed portion of its rate base; and

(3) Period Three: the period thereafter, during which Kern River recovers a reasonable management fee.

See Opinion No. 486-A P 26, JA 454; Opinion No. 486 PP 19, 46, JA 185, 195; Opinion No. 486-E PP 147, 152, JA 2742, 2744.

Because Kern River recovered the debt-financed 70 percent of its capital in Period One, Kern River recovered less of its costs than under traditional rates during the early years of Period One, but by the end of Period One the levelized rates recovered more costs than traditional rates. Opinion No. 486-A P 26, JA 454. *See also* Opinion No. 486-C P 3, JA 702 (Period One rates allowed Kern River to recover more invested capital during Period One than under ordinary straight-line depreciation). The excess recovery at the end of Period One was an essential feature of Kern River's levelized rate methodology, as it allowed Kern River to repay its construction loans during the terms of its shippers' initial contracts. Opinion No. 486-A P 26, JA 454. Kern River was required to return the Period One excess recovery to shippers through step-down rates in Period Two. *Id.*

Following various expansions, there are six groups of shippers paying different levelized rates, with Period One contract expiration dates ranging from 2011 to 2018. *See* Opinion No. 486-E P 4 n.10, JA 2678-79. Specifically relevant

here are the four groups of so-called "rolled-in system" shippers, which include the shippers on the original Kern River system and the shippers on expansion facilities added in 2002, the costs of which were "rolled-in"[2] to the costs of the original system. The contract durations of the four groups of rolled-in system shippers are as follows: original system shippers with 10-year contracts expiring in 2011; original system shippers with 15-year contracts expiring in 2016; shippers on 2002 expansion facilities with 10-year contracts expiring in 2012; and shippers on 2002 expansion facilities with 15-year contracts expiring in 2017. Opinion No. 486-C P 5 n.15, JA 703.

II. KERN RIVER'S RATE PROCEEDINGS

A. Proceedings On Period One Rates

1. The Hearing On Period One Rates.

The rate proceedings at issue in this appeal began with Kern River's April 30, 2004 proposal under section 4 of the Natural Gas Act, 15 U.S.C. § 717c, to increase its Period One rates. Opinion No. 486 PP 18, 20, JA 184, 185. Kern River addressed only Period One rates in its filing because, at that time, all

[2] Generally, under rolled-in pricing the costs of new facilities are added to the pipeline's total rate base and recaptured by increasing the general rate charged to all customers in proportion to the pipeline capacity they use. In contrast, under incremental pricing, the costs of new facilities are assigned to particular customers and recaptured by increasing those customers' rates. *TransCanada Pipelines Ltd. v. FERC*, 24 F.3d 305, 307 n.1 (D.C. Cir. 1994).

shippers subject to levelized rates were still paying Period One rates. *Id*. P 20, JA 185. The Commission conditionally accepted Kern River's filing, subject to refund and to the outcome of a hearing before an Administrative Law Judge. *Kern River Gas Transmission Co*., 107 FERC ¶ 61,215, *on reh'g*, 109 FERC ¶ 61,060 (2004).

The hearing before the Administrative Law Judge on Period One rates began on August 17, 2005. *Kern River Gas Transmission Co*., 114 FERC ¶ 63,031 (2006) (Period One Initial Decision), JA 14. In the 2006 Period One Initial Decision, the Administrative Law Judge addressed numerous cost of service and rate design issues, including Kern River's proposal to continue its levelized rate methodology. Opinion No. 486-C P 6, JA 704. The Administrative Law Judge found that Kern River had carried its burden under Natural Gas Act section 4, 15 U.S.C. § 717c, to prove that its levelized cost of service methodology would produce just and reasonable rates (subject to certain limited changes). Opinion No. 486 P 27, JA 188 (citing Period One Initial Decision P 253, JA 103).

2. Commission Orders Following The Period One Rate Hearing

In Opinion No. 486, the Commission affirmed the Administrative Law Judge's finding that Kern River's rates should continue to be designed based on the levelized rate methodology. Opinion No. 486 P 37, JA 192. However, Opinion No. 486 required Kern River to include in its tariff the Period Two rates that would

take effect upon expiration of the Period One contracts. *Id.* In Opinion No. 486-A, the Commission reopened the record to permit all parties to submit additional evidence regarding Kern River's Period One return on equity. Opinion No. 486-C PP 9-10, JA 705. Based on that evidence, the Commission held in Opinion No. 486-B that Kern River's return on equity should be 11.55 percent, the median return on equity of a range of reasonableness of 8.8 percent to 13 percent. Opinion No. 486-B PP 1, 131, JA 594, 650. Opinion No. 486-B required Kern River to submit a compliance filing revising its rates consistent with the Commission's merits findings in Opinion Nos. 486, 486-A and 486-B. Opinion No. 486-C P 12, JA 706.

The rates required by those opinions for all customer classes, other than the 10-year shippers on the 2002 expansion facilities, were lower than the rates in effect before Kern River made its 2004 rate increase filing. *See* Opinion No. 486-C P 193, JA 770. Kern River accordingly asserted that section 5 of the Natural Gas Act, 15 U.S.C. § 717d, required that rate decrease to be prospective only. *See* April 15, 2009 Reply Comments of Kern River Gas Transmission Company in Support of March 2 Compliance Filing, R. 919 at 4, JA 384.

In Opinion No. 486-C, the Commission accepted Kern River's compliance filings with regard to its Period One rates, subject to the condition that Kern River

change the reservation billing determinants[3] used to allocate costs to 15-year rolled-in system shippers. Opinion No. 486-C PP 167-68, JA 763. Specifically, Kern River used 15-year shippers' actual reservation billing determinants of 639,570 dekatherms in designing the Period One rates, but allocated costs to 15-year shippers based on reservation billing determinants of 624,416 dekatherms, which excluded billing determinants related to seasonal contracts. *Id*. P 171, JA 764. Opinion No. 486-C required Kern River to allocate costs to the 15-year shippers using the same 639,570 dekatherms figure that it used to design the Period One rates. *Id*. The Commission directed Kern River to file revised tariff sheets to comply with this determination. The Commission further determined that the decrease in the Period One rates below the pre-existing level would be effective prospectively as of the date of issuance of Opinion No. 486-C, December 17, 2009.[4] *Id*. P 14, JA 706.

On rehearing, Kern River argued that the Commission erred in declaring the Period One rates effective as of the issuance of Opinion No. 486-C. Opinion No.

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[3] A "billing determinant" is a measure of customer demand or entitlement to a pipeline's services. *Sw. Gas Corp. v. FERC*, 145 F.3d 365, 368 (D.C. Cir. 1998).

[4] This effective date concerned only prospective Period One rates, not rates for the so-called "locked-in period" (i.e. the period from November 1, 2004, when Kern River began collecting the rates it proposed in this proceeding, subject to refund, to the date the prospective rates become effective). *See* Opinion No. 486-C PP 192-93, JA 770 (discussing calculation of refunds for the locked-in period).

486-D P 16, JA 849-50. Because the Commission accepted the Period One rates subject to changing the billing determinants used to allocate costs, Kern River contended that the prospective Period One rates were indeterminable as of the date of Opinion No. 486-C, and therefore the Commission did not "fix" the rates as required by section 5 of the Natural Gas Act, 15 U.S.C. § 717d. *Id.*

Opinion No. 486-D denied rehearing regarding Period One rates, and accepted Kern River's January 29, 2010 filing setting out Period One rates in compliance with Opinion No. 486-C. Opinion No. 486-D PP 14, 92, JA 849, 882. Opinion No. 486-D thus finally resolved all issues concerning Period One rates. Opinion No. 486-E P 8, JA 2680-81; Opinion No. 486-F P 8, JA 3680.

Particularly relevant here, Kern River's January 29, 2010 compliance filing, approved in Opinion No. 486-D, included a per unit rate reduction for original system shippers' prospective Period One rates set at $0.0345 per dekatherm. *See* January 29, 2010 Period One Compliance Filing, R. 1283, at Schedule J-2, page 6, JA 1523. This rate reduction relates to the expansion facilities Kern River added in 2002. Kern River was permitted to roll the costs of that expansion into the overall rate base because it would lower rates to the original shippers. *See* Opinion No. 486-A P 330, JA 565. The per unit rate reduction reflects this rate benefit. *Id.*

Opinion No. 486-D also denied rehearing on the effective date for prospective Period One rates. Opinion No. 486-D PP 19-31, JA 851-55. Prior to

accepting Kern River's Period One rate filing in Opinion No. 486-C, the Commission had already issued three orders making merits rulings on Kern River's proposed Period One rates in Opinions 486, 486-A and 486-B. *Id*. P 24, JA 852. Opinion No. 486-B directed Kern River to submit a compliance filing revising its Period One rates consistent with those orders. *Id*. The Commission properly made those rates effective as of the date of Opinion 486-C, its first order accepting Kern River's compliance filings concerning Period One rates. *Id*.

Opinion No. 486-C required Kern River to make one change to the Period One rates -- to use different reservation billing determinants for allocating costs to 15-year shippers. Opinion No. 486-D P 25, JA 853. This was a mechanical change which involved substituting one number (639,570 dekatherms) for another (624,416 dekatherms) and permitted Kern River no discretion. *Id*. This change was consistent with this Court's caselaw that rates need not be confined to specific numbers but may include a rate formula or rule. *Id*. P 28, JA 854 (citing *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570 (D.C. Cir. 1990)).

B. Proceedings on Period Two Rates

1. Commission Orders Preceding The Period Two Rate Hearing

In Opinion No. 486, the Commission acted under section 5 of the Natural Gas Act, 15 U.S.C. § 717d, to require that Kern River include in its tariff the Period Two rates that will take effect when firm shippers' Period One contracts

expire. Opinion No. 486 P 37, JA 192; Opinion No. 486-A P 61, JA 469. As discussed in Section I, *supra*, at the end of Period One, Kern River will have an excess recovery of its depreciation expense. Opinion No. 486-A P 61, JA 469. Accordingly, the Commission could only find Period One rates to be just and reasonable if Kern River's tariff also provided for the return of that excess recovery in its Period Two rates. *Id*.

Opinion No. 486 further held that the Period Two rates were to be based on the same cost of service as Period One rates. Opinion No. 486 P 54, JA 200; Opinion No. 486-A P 62, JA 469-70; Opinion No. 486-D P 192, JA 925.

In a March 2, 2009 compliance filing, Kern River proposed to use a traditional rate design for its Period Two rates, rather than continue the levelized rate method used in Period One. Opinion No. 486-C P 227, JA 780. In Opinion No. 486-C, the Commission rejected Kern River's proposed Period Two tariff filing because it was not based upon a levelized rate method, and set for hearing how those levelized rates should be calculated. *Id*. PP 148, 263, JA 756, 796.

Opinion No. 486-D clarified the Period Two rate issues set for hearing. Opinion No. 486-D P 192, JA 925. The Commission reiterated that the starting point for calculating Period Two rates is the cost of service determined for Period One based upon the 2004 test year data. *Id*. P 193, JA 926. "In general, this

should lead to the use of the same cost of service for Period Two rates as for the Period one rates." *Id*. P 202, JA 929.

"The only exception to this general approach to developing Kern River's Period Two rates is where there are circumstances unique to the transition from Period One rates to Period Two rates that justify an adjustment to the cost of service underlying the Period One rates." *Id*. P 194, JA 926. Among the unique circumstances that could be addressed anew in the Period Two rate hearing was the change in Kern River's capital structure from 70 percent debt/30 percent equity in Period One to 100 percent equity in Period Two. *Id*. P 196, JA 927. Due to this change in capital structure, the Commission permitted the parties to address in the Period Two hearing whether Kern River's return on equity for Period Two should be adjusted from the median 11.55 percent return on equity underlying its Period One rates. *Id*.

2. The Hearing On Period Two Rates

The hearing before the Administrative Law Judge on Period Two rates commenced on December 8, 2010. With regard to Kern River's Period Two return on equity, Kern River proposed to increase its return on equity to 13 percent, the top of the range of reasonableness, and shippers advocated a reduction to 8.8 percent, the bottom of the range. Opinion No. 486-F P 221, JA 3768. In *Kern River Gas Transmission Co*., 135 FERC ¶ 63,003 (2011) (Period Two Initial

Decision), the Administrative Law Judge concluded that neither Kern River nor shippers justified departing from the median 11.55 percent return on equity. Period Two Initial Decision PP 1020-26, JA 2525-27.

During the Period Two rate hearing, Kern River also sought to adjust the $0.0345 per dekatherm rate reduction to original shipper Period One rates set in Kern River's January 29, 2010 Period One compliance filing and approved in Opinion No. 486-D. November 29, 2010 Kern River Gas Transmission Company's Disputed Issues List, Issue H, R. 1374 at 8-10, JA 1653-55. Because the rate reduction was based upon revenue generated by 2002 expansion shippers, Kern River contended that it should be adjusted to reflect that 2002 expansion shippers will produce less revenue when paying lower Period Two rates. *Id.*

Customers responded that Kern River was attempting to increase Period One rates that had already been approved in Opinion No. 486-D. December 1, 2010 Rolled-In Customers' Joint Pre-Hearing Brief, R. 1384 at 21-22, JA 1685-86 (citing Opinion No. 486-D P 100, JA 885). In the Period Two Initial Decision, the Administrative Law Judge held that "Issue H involved whether Period One rates should be adjusted to account for reduction in the 2002 Expansion roll-in credit due to Period Two step-down rates. The undersigned finds this issue is not part of this proceeding. Period One rates were finalized by Opinion No. 486-D." Period Two Initial Decision P 346, JA 2381.

3. Commission Orders Following The Period Two Rate Hearing

On exceptions to the Period Two Initial Decision, Kern River argued that the Administrative Law Judge erred in rejecting its proposed adjustments to Period One rates. *See* May 16, 2011 Brief on Exceptions, R. 1803 at 31-32, JA 2632-33; August 22, 2011 Request of Kern River Gas Transmission Company for Clarification and/or Rehearing of Opinion No. 486-E, R. 1857 at 50-52, JA 3657-59. Customers again asserted that Kern River's arguments properly were rejected because "the Commission has already approved final Period One rates, without condition, based on the 2004 test period." June 6, 2011 Brief Opposing Exceptions, R. 1810 at 29-30, JA 2670-71.

In Opinion Nos. 486-E and 486-F, the Commission affirmed the Period Two Initial Decision on all matters, except for one issue not relevant to this appeal, and denied rehearing. Opinion No. 486-E PP 1, 25, JA 2677, 2687; Opinion No. 486-F P 25, JA 3685. Opinion Nos. 486-E and 486-F further reiterated that Period One rates had been finally resolved in Opinion No. 486-D. "In Opinion No. 486 and the subsequent four orders in the Opinion No. 486 series, the Commission has finally resolved all issues concerning Kern River's Period One rates . . . ." Opinion No. 486-E P 8, JA 2680-81. *See also* Opinion No. 486-F P 8, JA 3680.

Opinion Nos. 486-E and 486-F also affirmed maintaining Kern River's return on equity for Period Two at the median value of 11.55 percent. Opinion No.

486-E P 192, JA 2765; Opinion No. 486-F P 263, JA 3781. The Commission has a strong presumption that most regulated pipelines fall within a broad range of average risk absent highly unusual circumstances. Opinion No. 486-E P 201, JA 2771. The Commission requires a very persuasive case in support of any adjustment precisely because of the difficulty of quantifying why a given firm's relative risk should be deemed significantly above or below that of the firms included in the proxy group. Opinion No. 486-C P 102, JA 741; Opinion No. 486-B P 140, JA 653. In Opinion Nos. 486-B and 486-C, the Commission set Kern River's return on equity at 11.55 percent because there was no persuasive evidence of unusual circumstances in 2004 that would support departing from the median value. Opinion No. 486-E P 201, JA 2771 (citing Opinion No. 486-B PP 146-48, JA 657-58, and Opinion No. 486-C PP 97, 115-16, JA 738, 746-47).

The starting point for calculating the Period Two rates is the Period One cost of service based on 2004 test year data. Opinion No. 486-E P 200, JA 2770. Thus, any changes to the median 11.55 percent rate of return for purposes of Period Two rates would require compelling evidence that an investor in 2004 -- based on information available in 2004 regarding Kern River's circumstances between 2011 and 2018 (the time frame during which Period Two contracts would become effective) -- would perceive Kern River to be a pipeline of greater or lower than average risk. *Id.* P 201, JA 2771. The Commission concluded that neither Kern

River nor the Customers presented compelling evidence justifying adjusting the 11.55 percent median return on equity either up or down. Opinion No. 486-F P 263, JA 3781; Opinion No. 486-E P 204, JA 2773.

Investors consider information relevant to both financial and business risks. Opinion No. 486-F P 255, JA 3778. Customers argued that Kern River's return on equity should be reduced because its financial risk would greatly diminish in Period Two, when Kern River would transition from the Period One 70 percent debt/30 percent equity capital structure to a 100 percent equity capital structure. Opinion No. 486-E P 196, JA 2768. The Commission found that investors would recognize that Kern River's capital structure would gradually evolve to a 100 percent equity structure beginning in 2011, and that this would gradually reduce its financial risk as its debt was retired.[5] *Id.* P 204, JA 2773; Opinion No. 486-F P 255, JA 3778. This decline in financial risk was sufficiently gradual, however, with 88 percent of the Period One contracts still in effect in 2015, that investors would likely conclude that Kern River's risk would be little different in the early

[5] Kern River's levelized methodology results in a gradual transition to an increasingly 100 percent equity structure over the period from 2011 to 2018. *Id.* P 156, JA 2747. As each Period One contract expires, the shippers to that contract have paid at that point for 70 percent of the rate base apportioned to their contracts and have amortized the debt attributable to financing that portion of Kern River's rate base. *Id.* Thus, as each Period One contract expires, Kern River enters a proportionate part of its 100 percent equity phase because debt related to that particular portion of its rate base has been retired. *Id.*

years of Period Two than during Period One, which tended to support a median return on equity for Period Two. Opinion No. 486-E P 205, JA 2773-74.

The Commission further found insufficient evidence that this change in capital structure would be enough, in the view of a 2004 investor, to offset the contracting risk presented by the expiring Period One contracts. *Id*. P 204, JA 2773; Opinion No. 486-F P 257, JA 3779. Investors in 2004 would have appreciated the risk to Kern River that the expiring Period One contracts may not be replaced due to pipeline competition. Opinion No. 486-F PP 249-50, JA 3776-77; Opinion No. 486-E P 202, JA 2772. In 2004, Kern River's capacity had strong underlying value due to the absence of other "take away" pipeline capacity in the Rocky Mountain producing area, which depressed the price of Rocky Mountain gas in comparison to destination markets. Opinion No. 486-E P 204, JA 2773. The fact that Kern River had relatively high basis differentials[6] in 2004 due to this lack of competition would create an incentive for entry by competing firms. *Id*. This re-contracting risk was the primary reason the Commission did not adjust the return on equity downward, as Customers requested, to the low end of the range of reasonableness. Opinion No. 486-F P 250, JA 3776. The Commission also concluded that reducing Kern River's return to the lower end of the median would

[6] The basis differential is the difference in the price paid to producers for gas and the price at which the gas is sold in the destination market. Opinion No. 486-E P 178, JA 2759.

penalize Kern River for the efficiency with which it has managed and expanded its system. Opinion No. 486-E P 206, JA 2774.

Thus, the 2004 record did not support a finding that investors would perceive the risks associated with re-contracting as so high that a premium return would be required for Period Two, as Kern River argued. Opinion No. 486-F P 250, JA 3776 (citing Opinion No. 486-E PP 202-03, JA 2772-73). At the same time, investors would not view the risks as so low that a reduced return was warranted, as Customers argued, because there was sufficient risk of unexpected market developments during the seven-year period before Period One contracts begin expiring that could affect Kern River's ability to replace those contracts. *Id.*

SUMMARY OF ARGUMENT

The orders challenged in this appeal resolved numerous issues regarding Kern River's Period One and Period Two rates. Kern River challenges the Commission's determination to make lower Period One rates effective in Opinion No. 486-C, the first Commission order approving Kern River's Period One compliance filing. Because Opinion No. 486-C required Kern River to change one billing determinant figure used to allocate costs among shippers, Kern River asserts that this Court's precedent requires the conclusion that Opinion No. 486-C did not "fix" Period One rates for purposes of section 5 of the Natural Gas Act, 15 U.S.C. § 717d. Rather, Kern River contends that the Period One rates were fixed

eleven months later in Opinion No. 486-D, which accepted Kern River's final calculation of its Period One rates without condition.

The Commission appropriately made the lower Period One rates effective in Opinion No. 486-C. This Court's precedent does not require that a numerical rate be finally stated before a rate may be "fixed" under the Natural Gas Act. To the contrary, this Court has recognized the validity under the statute of formula rates that may incorporate unknowable future costs into the rate. Here, Opinion No. 486-C approved Kern River's compliance filing, but for requiring the substitution of one number. This decision permitted Kern River no discretion with regard to recalculating its rates, and provided sufficient rate certainty to satisfy this Court's precedent as an order fixing rates under the statute.

Kern River also challenges the determination in the Period Two Initial Decision, affirmed by the Commission, rejecting Kern River's efforts to adjust already-finalized Period One rates in the Period Two rate hearing. As Kern River itself repeatedly asserts, the Commission finalized the Period One rates in Opinion No. 486-D. Accordingly, the Administrative Law Judge reasonably declined, in the subsequent Period Two rate proceeding, to adjust the already-finalized Period One rates. Kern River argues that the Commission permitted consideration of transitional issues between Period One and Period Two in the Period Two rate hearing, but the Commission only permitted consideration of transitional issues

that affect the appropriate cost of service for Period Two. The Commission did not allow reopening of the finalized Period One rates in the Period Two rate hearing.

Customers challenge the Commission's decision to keep Kern River's return on equity at the median of the range of reasonable returns for purposes of Period Two rates. Because with each Period Two contract, Kern River transitioned from a 70 percent debt/30 percent equity capital structure to a 100 percent equity capital structure, Customers assert that Kern River's financial risks necessarily declined, which in their view compelled the Commission to lower Kern River's return on equity in Period Two.

The Commission has a strong presumption that most regulated pipelines fall within a broad range of average risk absent highly unusual circumstances. Here, that presumption was not overcome. Primarily, the Commission found insufficient evidence that the change in capital structure would be enough, in the view of investors in 2004, to offset Kern River's increased re-contracting risk in Period Two from the expiring Period One contracts. Further, while investors in the 2004 test year would recognize that the change in capital structure would reduce Kern River's financial risk, the change would occur gradually over the course of Period Two as Period One contracts expire (from 2011 to 2018), so investors would view Kern River's overall financial risk during Period Two as a composite of the new and old equity structures. The Commission also found that reducing Kern River's

return on equity below the median would penalize Kern River for the efficiency with which it has managed and expanded its system.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See*, *e.g.*, *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). A court must satisfy itself that the agency has "articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

The Commission's decisions regarding rate issues are entitled to broad deference because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *see also Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 532 (2008) ("The statutory requirement that rates be 'just and reasonable' is obviously incapable of precise judicial definition, and we afford great deference to the Commission in its rate decisions."); *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 951 (D.C. Cir. 2007) ("In reviewing FERC's orders, we are 'particularly

deferential to the Commission's expertise' with respect to ratemaking issues.") (quoting *Ass'n of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996)). "Ordinarily, this court is 'without authority to set aside any rate selected by the Commission which is within a zone of reasonableness.'" *Western Resources, Inc. v. FERC*, 9 F.3d 1568 (D.C. Cir. 1993) (quoting *Pub. Serv. Comm'n of N.Y. v. FERC*, 813 F.2d 448, 451 (D.C. Cir. 1987)).

The Commission's factual findings are conclusive if supported by substantial evidence. NGA § 19(b), 15 U.S.C. § 717r(b). The substantial evidence standard "'requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.'" *Florida Mun. Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003) (quoting *FPL Energy Me. Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002)). "When the record would support more than one outcome," the court upholds the Commission's order because the relevant question "is not whether record evidence supports [the petitioner's desired outcome], but whether it supports FERC's." *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464, 470 (D.C. Cir. 2008) (alteration in original, citation omitted), *rev'd on other grounds sub nom., NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n*, 558 U.S. 165 (2010). *See Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 703 (D.C. Cir. 2007) (Commission is not required to choose the best solution, only a reasonable one); *ExxonMobil*, 487 F.3d at 955 (FERC need not adopt the best

possible policy as long as agency acts within the scope of its discretion and reasonably explains its actions).

II. KERN RIVER'S PERIOD ONE RATE ARGUMENTS ARE WITHOUT MERIT.

A. The Commission Reasonably Made Period One Rates Prospective From The Date Of Opinion No. 486-C.

1. The Commission Reasonably Made Period One Rates Effective As Of The Date The Commission Approved Kern River's Compliance Filing Conditioned On One Mathematical Change.

In Opinion No. 486-C -- following a hearing, Initial Decision, and three merits orders (Opinion Nos. 486, 486-A and 486-B) -- the Commission accepted Kern River's compliance filings with regard to its Period One rates, subject to one numerical change. Opinion No. 486-C P 2, JA 701. (Attachment A, appended to the end of this brief, is a chart of the relevant dates and holdings of the Opinion No. 486 series). Opinion No. 486-C required that Kern River use a different figure for the reservation billing determinants used to allocate costs to 15-year rolled-in system shippers. Opinion No. 486-C PP 167-170, JA 763-64; Opinion No. 486-D P 25, JA 853. Specifically, Kern River used reservation billing determinants of 624,416 dekatherms to allocate costs to 15-year shippers (which excluded billing determinants associated with seasonal contracts), instead of the actual reservation billing determinants of 639,570 dekatherms Kern River used to design its rates

(which included the seasonal contract billing determinants).[7] Opinion No. 486-C P 168, JA 763; Opinion No. 486-D PP 78-82, JA 873-76. The Commission directed Kern River to use the actual reservation billing determinants of 639,570 dekatherms for allocating costs to 15-year shippers. Opinion No. 486-C P 171, JA 764. This was a mechanical change that involved substituting one number for another and permitted Kern River no discretion. Opinion No. 486-D P 25, JA 853.

Kern River contends that, because the Commission required that this mathematical change be made in a further compliance filing, the Commission could not have "fixed" the prospective Period One rates in Opinion No. 486-C within the meaning of section 5(a) of the Natural Gas Act, 15 U.S.C. § 717d(a). Kern River Br. 19-32 (relying upon *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490 (D.C. Cir. 1985)). *See* section 5(a) of the Natural Gas Act, 15 U.S.C. § 717d(a) (providing that, if the Commission finds an existing rate to be unjust or unreasonable, "the Commission shall determine the just and reasonable rate . . . to

[7] In Opinion No. 486-C the Commission mistakenly believed that Kern River first committed this error in its March 2, 2009 compliance filing, *see* Kern River Br. 24-25, when Kern River had in fact used the erroneous figure in its initial rate filing and earlier compliance filings. Opinion No. 486-D P 78, JA 873-74. It was nevertheless error for Kern River not to use the same billing determinants for all aspects of its rate design, including cost allocation. *Id*. P 82, JA 876. Using the lower number of billing determinants for the 15-year shippers is unjust and unreasonable because it results in lower costs being allocated to the 15-year shippers to the detriment of the 10-year shippers. *See id*. P 81, JA 875-76. Kern River has not appealed this finding.

be thereafter observed and in force, and shall fix the same by order"). Rather, Kern River asserts that the prospective Period One rates were only "fixed" as of Opinion No. 486-D, when the Commission accepted Kern River's Period One rate compliance filing without condition. *See* Kern River Br. 19, 22-23, 32.

The Commission reasonably rejected this contention. Prior to accepting Kern River's Period One rate filing in Opinion No. 486-C, Kern River's proposed Period One rates had been subject to a full hearing before an Administrative Law Judge, a post-hearing Initial Decision, and three Commission orders making merits rulings on Kern River's proposed Period One rates in Opinions 486, 486-A and 486-B. Opinion No. 486-D P 24, JA 852-53. Opinion No. 486-B directed Kern River to submit compliance filings revising its Period One rates consistent with Opinion Nos. 486, 486-A and 486-B. *Id.* On March 2, March 27, and September 22, 2009, Kern River submitted the required compliance filings, and the Commission accepted those filings, subject to the one change required in Opinion No. 486-C. *Id.* Accordingly, Opinion No. 486-C was the Commission's first order accepting Kern River's compliance filings concerning its Period One rates. *Id.*

2. *Electrical District* Does Not Compel Awaiting the Very Last Computation.

Contrary to Kern River's assertions, Kern River Br. 25-26, *Electrical District* does not compel the conclusion that Period One rates were not "fixed" until Opinion No. 486-D, when the Commission approved the last rate

calculations. *See* Opinion No. 486-D PP 26-29, JA 853-54. *Electrical District* concerned whether a rate increase was effective as of the date of a Commission order "setting forth no more than the basic principles pursuant to which the new rates are to be calculated," or as of the date of the order accepting the compliance filing where "the numerical rate is specified." Opinion No. 486-D PP 21, 26, JA 851, 853; *Electrical Dist.*, 774 F.2d at 492-93. Faced with this choice, and reading the statute "in light of [its] primary purpose of protecting the utility's customers," the Court found that the order specifying rate principles did not provide the "necessary predictability" required by the filed rate doctrine, and therefore the rate increase was "fixed" in the Commission order accepting the subsequent compliance filing. *Electrical Dist.*, 774 F.2d at 492-93.

Following *Electrical District*, the Commission's general practice in determining the effective date of rate changes ordered pursuant to section 5 of the Natural Gas Act has been either to calculate the new just and reasonable rate itself, or to order the pipeline to calculate the rate in a compliance filing. Opinion No. 486-D P 22, JA 852. If the Commission requires a pipeline to make a compliance filing, the Commission makes the section 5 rate change effective on the date that the Commission issues an order accepting the pipeline's initial compliance filing, thereby "fixing" the new just and reasonable rate. *Id.* (citing *High Island Offshore Sys., LLC*, 113 FERC ¶ 61,280 P 26 (2008); *Williston Basin Interstate Pipeline*

Co., 59 FERC ¶ 61,202 at 61,716-17 (1992), *order on remand*, 68 FERC ¶ 61,357, *reh'g denied*, 69 FERC ¶ 61,360 at 62,362-63 & n.16 (1994)). The Commission sets the effective date as of its acceptance of the first compliance filing, even if acceptance of the initial compliance filing is subject to the pipeline making a second compliance filing to correct errors. *Id.* (citing *Williston*, 59 FERC at 61,717 (accepting a section 5 compliance filing effective on the date of the order accepting the filing, subject to Williston making a further compliance filing to remove an unauthorized rate design change)).

Consistent with that practice, the Commission made the prospective Period One rates effective as of the date of Opinion No. 486-C, its first order accepting Kern River's Period One compliance filings. Opinion No. 486-D P 24, JA 852. Thus, here, the Commission is not attempting to make the Period One rates effective even earlier, as of the date of Opinion No. 486 (the order on Initial Decision), but as of the date over three years later when the Commission first accepted the pipeline's compliance filings in Opinion No. 486-C. Opinion No. 486-D P 31, JA 855.

The filed rate doctrine "allows purchasers of gas to know in advance the consequences of the purchasing decisions they make." *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570, 578 (D.C. Cir 1990), discussed in Opinion No. 486-D P 28, JA 854. Under the filed rate doctrine, the Commission may not fix a new

rate to be applied retroactively, as this Court found in *City of Anaheim v. FERC*, 558 F.3d 521, 523 (D.C. Cir. 2009) (cited Kern River Br. 28-29) (overturning Commission orders making new rates effective retroactively to a prior order that found the old rates unjust and unreasonable, but stated that the Commission would fix new rates in the future).

In Kern River's view, under *Electrical District*, the filed rate doctrine requires that Kern River's numerical rate be "finally established definitely, or determined with certainty" before the rate can be deemed "fixed" under the statute. *See* Kern River Br. 23. In *Transwestern*, however, this Court found "[o]ur decisions on the necessary notice have not been altogether clear." 897 F.2d at 577. On the one hand, *Electrical District* "adopted a bright-line insistence that a numerical rate be specified." *Id.* (citing *Electrical Dist.*, 774 F.2d at 492-93). On the other hand, in *Pub. Serv. Co. of N.H. v. FERC*, 600 F.2d 944 (D.C. Cir. 1979), the Court was "untroubled by a rate system under which a customer *could not* know the exact charge for service in a given period until after the end of the period." *Transwestern*, 897 F.2d at 578. *Transwestern* reconciled these cases by finding that "[t]he Commission need not confine rates to specific, absolute numbers but may approve a tariff containing a rate 'formula' or rate 'rule' (as *Public Service Co. of New Hampshire* assumed)." *Id.* *See* Opinion No. 486-D P 28, JA 854 (quoting *Transwestern*). "[I]t may not, however, simply announce

some formula and later reveal that the formula was to govern from the date of announcement (as it had done in *Electrical District*)." *Transwestern*, 897 F.2d at 578. The Court recognized that "this view of *Electrical District* fails to implement its objective of drawing lines as to what notice is inadequate," but the Court found that "where the Commission explicitly adopts a formula and indicates when it will take effect, courts may not (without invading the Commission's province) say that such a formula may never qualify as a 'rate' within the meaning of § 4 and § 5 of the Natural Gas Act." *Id.*

Thus, as this Court recently recognized in *W. Deptford Energy, LLC v. FERC*, 766 F.3d 10, 22 (D.C. Cir. 2014), notice to ratepayers of the formula that will be applied, rather than a specific rate number, satisfies the filed rate doctrine. Such rate formulas result in situations where the customer may not know the exact numerical charge. *See Transwestern*, 897 F.2d at 578 (discussing a "cost of service" tariff that tracks actual fuel costs with deferred billing); *Pub. Utils. Comm'n of Cal. v. FERC*, 254 F.3d 250, 254 (D.C. Cir. 2001) (approving formula rate that incorporates costs of future reliability contracts with non-jurisdictional entities); *NSTAR Elec. & Gas Corp. v. FERC*, 481 F.3d 794, 801 (D.C. Cir. 2007) (discussing "the acceptability of tariffs with a rate formula, under which rates may constantly change (as long as they do so consistently with the formula) without

prior notice to the Commission or the public, and thus are not precisely knowable at the time of sale").

"The Commission's acceptance of formula rates is premised on the rate design's 'fixed, predictable nature,'" which "prevents a utility from utilizing excessive discretion in determining the ultimate amounts charged to customers." *Pub. Utils. Comm'n*, 254 F.3d at 254 (quoting *Ocean State Power II,* 69 FERC ¶ 61,146, at 61,552 (1994)). *See also W. Deptford*, 766 F.3d at 22 ("the objectivity of formulae ensures evenhandedness, predictability and stability in rates"). Here, the Commission did not set out general "guidelines," Kern River Br. 29; rather, Opinion No. 486-C left Kern River no discretion with regard to changing the billing determinant figure used to allocate costs to 15-year shippers. Opinion No. 486-D P 28, JA 854.

Substituting the 639,570 dekatherms figure for 624,416 dekatherms did require re-running Kern River's rate models. *See* Kern River Br. 26-27, 29. That does not mean, however, that Kern River's shippers could not determine the rate themselves. *See id*. at 29. The Commission previously had ordered Kern River to provide shippers the computer models it used to calculate its levelized rates, and therefore the customers could determine for themselves the specific numerical rate that would result from Opinion No. 486-C. *See Kern River Gas Transmission Co*., 119 FERC ¶ 61,106 P 9 (2007), R. 821, JA 378-79.

Consequently, Opinion No. 486-C -- in approving Kern River's compliance filing but for the 15-year shipper cost allocation billing determinants -- provided far more rate certainty in "fixing" Kern River's Period One rates than do many of the rate formulas approved by this Court as "fixing" rates under the statute. Consistent with *Transwestern* and this Court's decisions approving rate formulas or rules, the Commission's decision in Opinion No. 486-C was well within its authority under section 5 of the Natural Gas Act to fix rates to be effective prospectively from the date of that order. Opinion No. 486-D P 28, JA 854.

3. The Commission's Interpretation Comports With The Statutory Purpose of Protecting Customers.

This statutory interpretation also is consistent with section 19(c) of the Natural Gas Act, 15 U.S.C. § 717r(c), which provides that the filing of an application for rehearing "shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order." *Williston Basin Interstate Pipeline Co*., 69 FERC ¶ 61,360 at 62,363 (1994) (discussed in Opinion No. 486-D PP 29-30, JA 854-55). Under section 19, the Commission can require a jurisdictional pipeline to implement a rate change ordered under section 5 of the Natural Gas Act following the initial Commission order requiring the rate change, regardless of subsequent rehearing requests which may result in a later order further addressing the issues in the case. *Id.* Indeed, "to require the effective date of a section 5 action to be deferred until the very last word has been spoken in

response to arguments made by the company would seriously weaken, if not destroy, the Commission's power to act under section 5." Opinion No. 486-D P 29, JA 855 (quoting *Williston Basin*, 69 FERC ¶ 61,360 at 62,363).

Kern River protests that it is blameless in causing the delay in resolving the Period One rates because the Commission did not recognize Kern River's error regarding the billing determinants until Opinion No. 486-C. Kern River Br. 30. As the Commission found, however, when Kern River in compliance with Opinion Nos. 486 and 486-A used actual test period billing determinants to calculate per unit rates, it should also have used those billing determinants to allocate costs between the 10-year and 15-year original system shippers. Opinion No. 486-D P 68, JA 870. The Commission's requirement in Opinion Nos. 486 and 486-A to use actual test period reservation billing determinants to design the original system rates "naturally carried with it a requirement to use the same billing determinants for allocation purposes." *Id*. P 80, JA 875. "[A]bsent some unique situation which Kern River has not alleged, any mismatch between the volumes used to allocate costs and calculate per unit rates would lead to unjust and unreasonable results." *Id*.

In any event, whether or not a pipeline is culpable in causing delay, the fact remains that delay of a rate decrease, such as that involved here, harms the pipeline's customers. Opinion No. 486-D P 27, JA 853. As the Commission

found, the Court in *Electrical District* relied upon "the Federal Power Act's primary purpose of protecting the utility's customers" in postponing the effective date of a rate increase until the amount of that increase was specified. Opinion No. 486-D PP 23, 27, JA 852, 853 (citing *Electrical Dist.*, 774 F.2d at 493-94). Here, in contrast, setting the effective date of the prospective Period One rates at the date of issuance of Opinion No. 486-C, December 17, 2009, rather than, as Kern River asserts, the date of Opinion No. 486-D, November 18, 2010, benefits customers, because the prospective Period One rates ordered in Opinion No. 486-C are lower than the rates for the "locked in period."[8] Opinion No. 486-D P 27, JA 853. As evidence of this shipper benefit, Kern River was obliged to pay refunds in the amount of $16.7 million as a consequence of charging the "locked in" period rates rather than the prospective Period One rates for the period beginning with the issuance of Opinion No. 486-C on December 17, 2009 through October 31, 2010. *See* December 17, 2010 Kern River Gas Transmission Company Refund Report, Docket No. RP04-274, R. 1833, JA 2782. By protecting shippers, the Commission's decision in Opinion No. 486-C is consistent with the rationale

[8] The "locked in" period began with Kern River's Period One rate filing on November 1, 2004, and ended with the December 17, 2009 effective date of prospective Period One rates. Opinion No. 486-C P 2 n.4, JA 701. *See id.* PP 192-93, JA 770 (calculation of refunds for locked-in period).

underlying *Electrical District*, which is protecting customers. Opinion No. 486-D P 27, JA 853-54.

B. The Commission Reasonably Affirmed The Administrative Law Judge's Refusal To Adjust Already-Finalized Period One Rates In The Period Two Rate Hearing.

1. Kern River Sought To Adjust Already-Finalized Period One Rates In The Period Two Rate Proceeding.

When Kern River added expansion facilities in 2002, the Commission permitted the costs for those facilities to be rolled into the original system costs. Because the expansion provided a greater proportional increase in billing determinants than in overall costs, rolling in the costs of expansion reduced the rates for shippers on Kern River's original system. Opinion No. 486-A P 330, JA 565 (citing *Kern River Gas Transmission Co*., 96 FERC ¶ 61,137 (2001)). To reflect this rate benefit, Kern River calculates a rate reduction on an equal per unit (i.e. per dekatherm) basis for all original system shippers. Opinion No. 486-A PP 330, 337, JA 565-66, 568.

In its January 29, 2010 Period One Compliance Filing, Kern River set this per unit rate reduction for the prospective Period One rates at $0.0345 per dekatherm. *See* January 29, 2010 Period One Compliance Filing, R. 1283, at Schedule J-2, page 6, JA 1523. As Kern River itself repeatedly asserts, the prospective Period One rates were fixed in Opinion No. 486-D, which accepted

Kern River's January 29, 2010 Period One Compliance Filing. *See* Kern River Br. 19, 22-23, 32.

Nevertheless, in the proceedings on Period Two rates, Kern River sought to adjust the $0.0345 per dekatherm Period One rate reduction. In its filing listing disputed issues (i.e. issues other parties do not believe are properly within the scope of the proceeding), Kern River included the issue of whether the prospective Period One per unit rate reduction fixed in Opinion No. 486-D should be adjusted. November 29, 2010 Kern River Gas Transmission Company's Disputed Issues List, Issue H, R. 1374 at 8-10, JA 1653-55. Because the rate reduction is based upon revenues generated by 2002 expansion shippers, Kern River contended that the Period One rate reduction should be adjusted to reflect lower revenues when 2002 expansion shippers begin to pay lower Period Two rates.[9] At hearing, Kern River introduced evidence regarding the adjustment. *See* Kern River Br. 36 (citing Prepared Opening Testimony of Timothy Kissner, Exhibit KR-P2-3, R. 1410 at 10-

[9] It appears that only one 2002 expansion shipper stepped down to Period Two rates while any original shippers were still paying Period One rates. Only one 2002 expansion shipper, WPX Energy Marketing LLC, had a 10-year Period One contract that expired on 2012, and a replacement Period Two contract. Opinion No. 486-F P 351 & n.380, JA 3810. At that time, original shippers with 15-year contracts were still paying Period One rates until 2016. Fifteen year 2002 expansion shipper contracts do not expire until 2017, at which point all original shippers will already be paying Period Two rates. *See* Opinion No. 486-C P 130 n.186, JA 752 (setting out when Period Two rates are available to each shipper group.)

12, JA 1697-99, and Exhibit KR-P2-4, R. 1411 at 9, JA 1710; and Prepared Rebuttal Testimony of Mary Kay Miller, Exhibit KR-P2-26, R. 1432 at 21-23, JA 1901-1903).

Customers opposed the proposed adjustment to the Period One rates, calling it "an effort by Kern River to increase Period One rates that have already been approved" in Opinion No. 486-D. *See* December 1, 2010 Rolled-In Customers' Joint Pre-Hearing Brief, R. 1384 at 21, JA 1685 (citing Opinion No. 486-D P 100, JA 885).

2. The Administrative Law Judge, As Affirmed By The Commission, Rejected Kern River's Proposal Because Period One Rates Had Already Been Finalized in Opinion No. 486-D.

In his 2011 Period Two Initial Decision, the Administrative Law Judge held that "Issue H involved whether Period One rates should be adjusted to account for reduction in the 2002 Expansion roll-in credit due to Period Two step-down rates. The undersigned finds this issue is not part of this proceeding. Period One rates were finalized by Opinion No. 486-D." Period Two Initial Decision P 346, JA 2381.

Kern River asserts that "the Administrative Law Judge found, without explanation, that Disputed Issue H was not part of the proceeding." Kern River Br. 36. This disregards the Administrative Law Judge's clear statement that Kern River's proposed Period One rate adjustment was not part of the proceeding

because "Period One rates were finalized by Opinion No. 486-D." Period Two Initial Decision P 346, JA 2381. Kern River faults the Commission for not addressing the precise issue of the adjustment in Opinion Nos. 486-E and 486-F, Kern River Br. 35-37, but the Commission affirmed the Period Two Initial Decision on all issues except one not relevant here, Opinion No. 486-E P 1, 25, JA 2677, 2687, and denied rehearing. Opinion No. 486-F P 25, JA 3685. As Kern River acknowledges, Opinion Nos. 486-E and 486-F expressly held that Period One rates were finalized in Opinion No. 486-D. Kern River Br. 37 (citing Opinion Nos. 486-E P 8, JA 2680 ("In Opinion No. 486 and the subsequent four orders in the Opinion No. 486 series, the Commission has finally resolved all issues concerning Kern River's Period One rates . . . ."); 486-F P 8, JA 3680 (same)).[10]

The Commission did not reiterate the Administrative Law Judge's specific holding on Kern River's adjustment issue in Opinion Nos. 486-E and 486-F, but it need not do so. Where the Commission adopts an Administrative Law Judge's initial decision, it need not repeat the Administrative Law Judge's findings and reasoning. *See, e.g., Credit Card Serv. Corp. v. FTC*, 495 F.2d 1004, 1009-10

[10] The Commission further reiterated that the 2010 hearing was only for the purpose of determining Period Two rates. "The purpose of the hearing established by Opinion No. 486-C was to develop a record for the purpose of establishing just and reasonable Period Two rates." Opinion No 486-E P 27, JA 2688. *See also* Opinion No. 486-E P 28, JA 2689 (hearing was initiated under Natural Gas Act section 5, to establish just and reasonable rates for Period Two service).

(D.C. Cir. 1974). "The Commission is not required to recapitulate the reasoning of the [Administrative Law Judge] if it is satisfied that the initial decision and the reasoning underlying it are sound. We have not been left to guess at the Commission's findings or reasons; they are to be found in the [Administrative Law Judge's] decision." *Boroughs of Ellwood City v. FERC*, 731 F.2d 959, 967-68 (D.C. Cir. 1984) (citing *Borek Motor Sales, Inc. v. NLRB,* 425 F.2d 677, 681 (7th Cir. 1970) (agency's statement that it adopted examiner's findings, conclusions and recommendations except as modified adequately preserves reasoning for review under the Administrative Procedure Act)). An agency's decision will be upheld even if it is not ideally clear as long as the "'agency's path may be reasonably be discerned.'" *Dickson v. Sec'y of Def.,* 68 F.3d 1396, 1404 (D.C. Cir.1995) (quoting *Bowman Transp., Inc. v. Arkansas-Best Motor Freight Sys.,* 419 U.S. 281, 286 (1974)).

3. Kern River Has Not Challenged The Finding That Period One Rates Were Final As Of Opinion No. 486-D.

Neither on rehearing before the Commission, nor in its opening brief before this Court, has Kern River challenged the Administrative Law Judge's and the Commission's finding that Period One rates were final as of Opinion No. 486-D. To the contrary, Kern River repeatedly argues on brief that Period One rates were final and "fixed" for purposes of section 5 of the Natural Gas Act, as of Opinion No. 486-D. *See* Kern River Br. 19, 22-23, 32.

As Kern River failed to challenge the finding that Period One rates were final as of Opinion No. 486-D on rehearing before the Commission or in its opening brief before this Court, the argument is "twice waived." *Xcel Energy Servs. Inc. v. FERC*, 510 F.3d 314, 318 (D.C. Cir. 2007) (by failing to raise an argument on rehearing before the Commission or in the opening brief on appeal the argument is "twice waived."); *Consol. Edison Co. of N.Y. v. FERC,* 347 F.3d 964, 970 (D.C. Cir. 2003) (same). *See* NGA § 19(b), 15 U.S.C. § 717r(b) ("[n]o objection to the Order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure to do so.").

As Period One rates were final as of Opinion No. 486-D, the Administrative Law Judge and the Commission were well within their discretion in refusing -- during the hearing on Period Two rates -- to reopen the Period One rate evidentiary record to adjudicate Kern River's new claim. The Commission's authority to reject untimely arguments and filings is well-settled. "Absent constitutional constraints or extremely compelling circumstances the 'administrative agencies should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties.'" *Vermont Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 543 (1978) (quoting *FCC v. Schreiber*, 381 U.S. 279, 290 (1965)). This Court

accords the Commission "broad discretion in fashioning hearing procedures." *Mich. Consol. Gas Co. v. FERC,* 883 F.2d 117, 125 (D.C.Cir.1989) (quoting *Lyons v. Barrett,* 851 F.2d 406, 410 (D.C.Cir.1988)).

In particular, reopening an evidentiary hearing is a matter of agency discretion, and is reserved for extraordinary circumstances. *Cities of Campbell v. FERC*, 770 F.2d 1180, 1191 (D.C. Cir. 1985). This Court has affirmed the Commission's authority to reject untimely requests to reopen proceedings or to make untimely filings. *See, e.g., Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 294-95 (D.C. Cir. 2001) (rejecting claim that the Commission unlawfully refused to reopen proceedings when party could have timely raised the issue before the record closed); *Mich. Consol. Gas*, 883 F.2d at 125 ("When a party is on reasonable notice as to the dates and times for hearings and for filings in an administrative proceeding, we are hard pressed to hold that the administering agency acted arbitrarily or capriciously in denying admission of materials untimely filed."); *Me. Pub. Utils. Comm'n*, 520 F.3d at 476 (affirming rejection of evidence filed three months after order approving settlement).

4. The Commission's Statement That It Would Consider Unique Transitional Circumstances Applied Only To Issues Affecting Period Two Rates.

Kern River argues that it was permitted to raise this Period One rate issue in the Period Two hearing based upon the Commission's statement in Opinion No.

486-D that it would consider "circumstances unique to the transition from Period One to Period Two rates that justify an adjustment to the cost of service underlying the Period One rates." Kern River Br. 35-36, 43 (citing Opinion No. 486-D P 194, JA 926). Kern River omits the rest of the statement in Opinion No. 486-D that shows that this exception applies only to calculating the proper cost of service for Period Two rates. *See* Opinion No. 486-D PP 193-94, JA 926.

In Opinion No. 486, the Commission held that Period Two rates were to be based on the same cost of service as Period One rates. *Id*. P 192, JA 925 (citing Opinion No. 486 P 54, JA 200). Accordingly, the starting point in calculating Period Two rates is the cost of service underlying the Period One rates, based upon the 2004 test year data. *Id*. P 193, JA 926. In the full statement referenced by Kern River, the Commission specified that "[t]he only exception *to this general approach to developing Kern River's Period Two rates* is where there are circumstances unique to the transition from Period One rates to Period Two rates that justify an adjustment to the cost of service underlying the Period One rates." *Id*. P 194, JA 926 (emphasis added). *See also id*. P 202, JA 929 ("In summary, the Period Two rates in this proceeding should be developed based upon the same 2004 test year data used in developing the Period One rates in this section 4 rate case. In general, this should lead to the use of the same cost of service for the Period Two rates as for the Period One rates, except where circumstances unique

to the transition from Period One to Period Two rates justify projecting different costs or volumes than used in developing the Period One rates.")

Thus, the Commission established in Opinion No. 486-D that the transitional issues that would justify altering the 2004 test year cost of service were issues related to developing Period Two rates, not issues that would require reopening Period One rates. The Commission made plain that the 2010 hearing was only for the purpose of determining Period Two rates. *See* Opinion No. 486-E PP 27-28, JA 2688-89.

Indeed, as Kern River acknowledges, Kern River Br. 43-44, the Commission granted Kern River's request to adjust original shipper Period Two rates to reflect the decrease in revenues when the 15-year 2002 expansion shippers step down to Period Two rates. *See* Opinion No. 486-F P 341, JA 3806-07 (citing *Kern River Gas Transmission Co*., 136 FERC ¶ 61,141 PP 35-44 (2011)). Specifically, the Commission permitted Kern River to "include in its tariff a mechanism under which it may file for approval an appropriate adjustment to the Period Two rates of the Original System shippers within a reasonable time after each group of 2002 Expansion Project shippers have made their contract duration election." *Id*. P 342, JA 3807. The Commission found that the mechanism could take the form of a future limited proceeding under section 4 of the Natural Gas Act. *Id*.

III. CUSTOMERS' PERIOD TWO RATE ARGUMENTS ARE WITHOUT MERIT.

A. The Commission Reasonably Set Kern River's Return On Equity At The Median.

In the 1992 order issued in Kern River's certificate proceeding, *Kern River Gas Transmission Co.*, 60 FERC ¶ 61,123 at 61,437 (1992), the Commission approved a 100 percent equity capital structure for Kern River during Period Two. Opinion No. 486-D P 195, JA 927. Therefore, for purposes of setting Period Two rates, the Commission permitted an adjustment to the Period One cost of service to use a 100 percent equity structure. *Id.* The Commission further allowed the parties at the hearing on Period Two rates to address whether Kern River's return on equity for Period Two should be adjusted from the median 11.55 percent return on equity underlying its Period One rates as a result of the change in equity capital structure from the Period One capital structure of 70 percent debt/30 percent equity. *Id.* P 196, JA 927. As Period Two rates must be designed based on the 2004 test period data, any adjustment above or below the median similarly must be based on 2004 test period data. *Id.* P 197, JA 927-28. The Commission did not permit the parties to challenge the proxy group or the range of reasonableness of 8.8 to 13 percent adopted in Opinion No. 486-B. Opinion No. 486-E P 191, JA 2765; Opinion No. 486-D P 197, JA 927-28.

At the Period Two rate hearing, Kern River argued that its return on equity should be increased to the top of the range of reasonableness, while Customers argued that it should be reduced to the bottom of the range. Period Two Initial Decision P 1016, JA 2524. The Administrative Law Judge concluded that neither Kern River nor Customers justified a departure from the median, and the Commission reasonably affirmed that determination. Opinion No. 486-E PP 192, 206, JA 2765-66, 2774.

The Commission has a strong presumption that most regulated pipelines fall within a broad range of average risk absent highly unusual circumstances. *Id.* P 201, JA 2771. The tools available to the Commission for determining the return on equity for a particular pipeline are blunt, making it difficult to reflect subtle differences in risk among pipelines by making carefully calibrated adjustments within the zone of reasonableness. *Transcontinental Gas Pipe Line Corp.*, 90 FERC ¶ 61,279 at 61,936 (2000). The Commission requires a very persuasive case in support of any adjustment precisely because of the difficulty of quantifying why a given firm's relative risk should be deemed significantly above or below that of the firms included in the proxy group. Opinion No. 486-C P 102, JA 741; Opinion No. 486-B P 140, JA 653-54. Thus, unless a party makes a very persuasive case in support of the need for an adjustment and the level of the adjustment proposed, the Commission will set the pipeline's return at the median of the range of reasonable

returns. Opinion No. 486-E P 201, JA 2771-72; Opinion No. 486-B PP 138, 140, JA 652-53, 653-54 (citing *Transcontinental*, 90 FERC at 61,936).

The starting point for calculating the Period Two rates is the Period One cost of service based on 2004 test year data. Opinion No. 486-E P 200, JA 2770. Accordingly, any deviation from the median return on equity for Period Two must be based upon risks that informed investors in 2004 would have perceived concerning Kern River's risks during the 2011 to 2018 time period (the range of expiration dates for Period One contracts). *Id*. P 201, JA 2771; Opinion No. 486-F P 254, JA 3778. "'The cost of common equity to a regulated enterprise depends upon what the market expects not upon precisely what is going to happen.'" Opinion No. 486-B P 120, JA 644 (quoting *Transcontinental Gas Pipe Line Corp*., Opinion No. 414-B, 85 FERC ¶ 61,323 at 62,268 (1998)).

Investors consider information relevant to both financial and business risks. Opinion No. 486-F P 255, JA 3778. The Commission rejected Kern River's arguments that it should have returns at the top of the range of reasonableness, concluding that an informed investor would have knowledge in 2004 of Kern River's consistently strong throughput level, its superior credit rating, and history of successful expansions. Opinion No. 486-E P 202, JA 2772. Kern River has not appealed this finding.

On the other hand, the Commission also found that in 2004 investors would be unlikely to view Kern River's equity as so low risk in the relevant period that Kern River's return should be placed at the lowest possible point in the range of reasonable returns. *Id*. P 204, JA 2773. Customers urged the Commission to reduce Kern River's return on equity in Period Two based upon the fact that Kern River would transition from the Period One 70 percent debt/30 percent equity capital structure to a 100 percent equity capital structure, thereby reducing its financial risks. *Id*. P 196, JA 2768. The Commission recognized that, in 2004, investors would appreciate that Kern River's capital structure would gradually evolve to a 100 percent equity structure beginning in 2011 through 2018, and that this would gradually reduce its financial risk as its debt was retired.[11] *Id*. PP 204-05, JA 2773-74; Opinion No. 486-F P 255, JA 3778. This decline in financial risk was sufficiently gradual, however, with 88 percent of Period One contracts in effect through 2015, that investors likely would conclude that Kern River's risk would be little different during the initial years of Period Two rates than Period

[11] Kern River's levelized methodology results in a gradual transition to an increasingly 100 percent equity structure over the period from 2011 to 2018. *Id*. P 156, JA 2747. As each Period One contract expires, the shippers to that contract have paid for 70 percent of the rate base apportioned to their contracts and have amortized the debt attributable to financing that portion of Kern River's rate base. *Id*. At that point, Kern River enters a proportionate part of its 100 percent equity phase because debt related to that particular portion of its rate base has been retired. *Id*.

One, which tended to support a median return on equity for Period Two. Opinion No. 486-E P 205, JA 2773-74; Opinion No. 486-F P 260, JA 3780.

The Commission further found insufficient evidence that this change in capital structure would be enough, in the view of a 2004 investor, to offset the contracting risk presented by the expiring Period One contracts. Opinion No. 486-E P 204, JA 2773; Opinion No. 486-F P 257, JA 3779. Investors in 2004 would have appreciated the risk to Kern River that expiring Period One contracts may not be replaced due to pipeline competition. Opinion No. 486-F PP 249-50, JA 3776-77. In 2004, Kern River's capacity had strong underlying value because there was a lack of other pipeline capacity to take gas away from the Rocky Mountain production area, depressing the price of Rocky Mountain gas and allowing shippers to obtain Rocky Mountain supplies at prices significantly below the value in destination markets (i.e. Kern River's basis differential was high). Opinion No. 486-E P 204, JA 2773. The fact that Kern River had relatively high basis differentials in 2004 due to this lack of competition would create an incentive for entry by competing firms. *Id.* An informed investor therefore would discern that Kern River faced some risk of increased pipeline competition due to Kern River's wide basis differentials. *Id.* P 202, JA 2772.

Thus, while the risks of re-contracting did not demand a premium return as Kern River argued, there was sufficient risk of unexpected market developments

during the seven-year period before the first set of Period One contracts expired (in 2011), that a reduction in Kern River's return on equity was not justified. Opinion No. 486-F P 250, JA 3776-77. Kern River's risk in re-contracting was the primary reason that the Commission did not require Kern River's return on equity to be adjusted downward from the median for purposes of determining Period Two rates. *Id*.

The Commission further concluded that reducing Kern River's return to the lower end of the median would penalize Kern River for the efficiency with which it has managed and expanded its system. Opinion No. 486-E P 206, JA 2774. As the Commission found, the record strongly suggested that Kern River has engaged in sound business planning through carefully staged expansions, offering its shippers attractive long-term contracts, and using a levelized rate that enhances its competitive position compared to its older competitors. Opinion No. 486-C P 116, JA 747. The Commission has recognized that evaluations of risk tend to award higher returns to less efficient pipelines, giving them less incentive to improve, and lower returns to more efficient pipelines, failing to recognize their success. *Id.* (citing *Transcontinental Gas Pipe Line Corp*., Opinion No. 414-A, 84 FERC ¶ 61,084 at 61,427 (1998) (where pipeline's positive market position was largely the result of its relatively low rates in its market area and its lengthy contract terms,

the Commission declined to lower the pipeline's rate of return below the middle of the range of returns developed by the proxy group)).

Accordingly, while the Commission continues to examine a pipeline's relative risk, the Commission will not lower a pipeline's return on equity if its lower risk is the result of its own efficiency. *Id.* Rather, the Commission focuses on risks faced by the pipeline that are attributable to circumstances outside the control of the pipeline's management, such as the competitive environment. *Id.* Here, where "Kern River's relative strength reflects its prudent expansion and low rates," Kern River "should not be penalized for its accomplishments by having its [return on equity] lowered below the median of the proxy group." *Id.*

Thus, the Commission carefully assessed the information investors would have had available to them in 2004, relative to both Kern River's financial and business risk in the 2011-2018 time frame. Opinion No. 486-F P 263, JA 3781. On balance, the Commission concluded that there was no compelling evidence that a 2004 investor would have perceived Kern River to be a pipeline of greater or lower than average risk during the relevant period. *Id.* No adjustment to the median return of 11.55 percent was warranted. *Id.*

B. Customers' Arguments Regarding Re-Contracting Are Without Merit.

Customers' primary response to the Commission's findings is based on the Commission's determination in Period One that Kern River's business risk was

lower than, or equal to, the proxy group companies. Customer Br. 16-20, 26-27. Customers assert that the only change in circumstances from Period One to Period Two is the change in Kern River's capital structure, which in their view compels the conclusion that Kern River has diminished risk in Period Two, and therefore its return on equity must be adjusted downward. *Id.*

Customers fail to appreciate that, while the 2004 test period record did not change, the relevant inquiry did. For purposes of the Period One return on equity, the issue was whether Kern River was more or less risky than the proxy group during the test period. Opinion No. 486-C P 114, JA 746. The Commission found the proxy group business risk comparable during Period One, when Kern River was fully contracted, as the proxy group pipelines also had significant forward contract cover. Opinion No. 486-C P 108, JA 743; Opening Testimony of Paul R. Carpenter, Exhibit No. KR-P2-18, R. 1424 at 10-11, JA 1807-08. The contract risk Kern River faced for purposes of the Period One analysis concerned Kern River's risk of contract default based on the credit profile of its shippers and the fact that Kern River served fewer local distribution companies and more independent gas-fired generating plants with less stable demand than other pipelines. *See* Customer Br. 17 (quoting Opinion No. 486-B P 146, JA 657).

In contrast, the Period Two analysis concerns what an investor in 2004 would have perceived regarding Kern River's risks in 2011 through 2018, when

the Period One contracts expire. Opinion No. 486-E P 201, JA 2771; Opinion No. 486-F P 254, JA 3778. During the test period, no shipper had agreed to contract for capacity in Period Two. Opinion No. 486-D P 198, JA 928. Consequently, with regard to the 2011-2018 period, the Commission reasonably found that investors in 2004 would have considered the risk that pipeline competition, drawn by Kern River's high basis differentials in 2004, would present a risk for replacing the expiring Period One contracts. Opinion No. 486-E P 204, JA 2773; Opinion No. 486-F P 260, JA 3780.

Accordingly, the Commission was not, as Customers maintain, compelled to lower Kern River's return on equity simply because Kern River evolved to a 100 percent equity capital structure over the duration of Period Two. Rather, the Commission found insufficient evidence to conclude that the change in capital structure would be enough, in the view of a 2004 investor, to offset the contracting risk of replacing the expiring contracts. Opinion No. 486-E P 204, JA 2773. *See also* Opinion No. 486-F P 257, JA 3779 ("the existence of the 100 percent equity capital structure cannot be construed to completely off-set the potential business risks that Kern River might face").

The Commission's findings are not inconsistent with its "rejection of re-contracting risk as a basis for decreasing rate design volumes" in Period Two. Customer Br. 28. Kern River argued that its Period Two rates should be based

upon lower volumes than Period One because its re-contracting risk made it less likely it would maintain its Period One 100 percent capacity throughput. *Id*. The Commission rejected this argument because the billing determinants used to design Kern River's rates are based on the 2004 test period, during which Kern River was fully contracted. Opinion No. 486-E PP 166-67, JA 2750-51. The fact that Kern River had contracts expiring in a future period did not distinguish Kern River from any other pipeline with future contract expirations that must nevertheless adhere to test period principles, basing billing determinants on actual throughput during the test period. *Id*. P 166, JA 2750-51 (quoted Customer Br. 28-29); Opinion No. 486-F P 188, JA 3756 (quoted Customer Br. 29).

This finding has no bearing on the return on equity inquiry at issue here, which concerns not 2004 test period billing determinants, but rather 2004 investor perceptions of risk in the 2011-2018 time frame. Indeed, the Commission expressly recognized that "if there is an increased risk associated with contract expirations, **this goes to the equity cost of capital**, not throughput determinations addressing the use of a 100 percent load factor." Opinion No. 486-E P 167, JA 2751 (emphasis added).

The Commission's discussion of Kern River's post-test period throughput also has no relevance here. *See* Customer Br. 29 (citing Opinion No. 486-E P 171, JA 2754). The Commission considered this evidence only to determine whether it

supported deviating from the test period method in setting Kern River's Period Two billing determinants. Opinion No. 486-E PP 168, 172, JA 2751-52, 2754. The Commission occasionally permits use of post-test period data if it demonstrates that projections based on test period data will be seriously in error. Opinion No. 486-F P 187, JA 3755. *See also* Opinion No. 486-E P 172, JA 2754 ("As these arguments are based on information far outside the 2004 test period, they are relevant only if Kern River presents compelling testimony that the Commission should adopt what is in essence a new test period to determine its Period Two load factor."). The Commission concluded that the post-test period evidence did not justify a deviation. Opinion No. 486-E P 189, JA 2764 ("the Commission concludes that Kern River's arguments regarding current market conditions (2005-2010) have not justified a departure from the 2004 test period billing determinants"); Opinion No. 486-F P 203, JA 3762. Such post-test period data is not relevant to the return on equity inquiry, which concerns only investor perception of risk in 2004. *See, e.g.,* Opinion No. 486-E P 200, JA 2771 (rejecting Kern River arguments concerning the appropriate return on equity for Period Two that were based on events and data occurring outside of the test period).

Customers point to the Commission's finding that "the risk that shippers will not renew expiring contracts is not a circumstance unique to the transition from Period One to Period Two and does not justify consideration of post-test period

market changes. The Period One shipper's option not to renew its contract at the end of Period One is no different from any other situation in which a shippers' contract expires." Customer Br. 25 (quoting Opinion No. 486-F P 245, JA 3775). This statement does not aid Customers. It relates to the same transitional issue discussed previously in Argument Section II(B)(4) *supra*: Kern River's Period Two rates were required to be designed based on the Period One 2004 test period cost of service, except where "there are circumstances unique to the transition from Period One to Period Two rates that justify an adjustment to the cost of service underlying the Period One rates." Opinion No. 486-D P 194, JA 926. Kern River argued that the risk that Period One shippers would not re-contract for Period Two was a transitional issue that would justify deviating from the test year cost of service with regard to the return on equity. Opinion No. 486-F PP 244-45, JA 3775-76. The Commission found that the risk that shippers will not re-contract was not an issue unique to the Period One-Period Two transition and thus did not "justify consideration of post-test period market changes." Opinion No. 486-F P 245, JA 3775-76. That holding in no way constituted a finding that Kern River's re-contracting risk did not exist in the 2011-2018 time frame, or that Kern River's risks in that time frame were comparable to the re-contracting risk of the other members of the proxy group.

At bottom, as the Commission found, Customers' arguments emphasize Kern River's 100 percent equity capital structure to the exclusion of any other considerations. Opinion No. 486-F P 259, JA 3779-80. Acceptance of Customers' arguments would ignore the role of business risk in assessing the appropriate return on equity. *Id.*

C. Customers' Arguments Regarding Investor Perception of Composite Equity Are Without Merit.

Customers challenge the Commission's findings based on investor perception of a "composite equity" and the gradual transition to Period Two rates as inconsistent with Kern River's levelized rate design, which expressly contemplates a 100 percent equity capital structure for each shipper transitioning to Period Two rates. Customer Br. 21-23. Customers also assert that these findings are inconsistent with the Commission's rejection of other parties' arguments for using a weighted cost of capital in Period Two. Customer Br. 22-24 (quoting Opinion No. 486-E PP 151-53, JA 2744-45). There is no inconsistency.

The Commission's point with regard to the gradual transition was that an investor in 2004, in assessing Kern River's risks throughout the relevant 2011-2018 time period, would not perceive Kern River's risks premised upon a 100 percent equity capital structure for all shippers when the transition to that rate structure occurs gradually over that period, and indeed 88 percent of the Period One rates would remain in effect through 2015. Opinion No. 486-E P 205, JA

2773-74. In other words, the Commission rejected the contention that "the 2004 investor would be considering investment in a pipeline that would have exclusively Period Two contracts and a Period Two all-equity capital structure." Opinion No. 486-F P 236, JA 3773.

In referring to a "composite equity," *id.*, *see* Customer Br. 22, the Commission was not referring to the capital structure underlying each shipper's Period Two rates, which is 100 percent equity. Opinion No. 486-F PP 254-59, JA 3778-80. *See* Customer Br. 21-23 (arguing that Period Two rates must be designed with a 100 percent equity capital structure). Rather, the Commission was referring to the fact that, until the end of the relevant time period, all shippers will not have transitioned to Period Two rates and a 100 percent equity capital structure, and therefore an investor would not perceive Kern River's overall risk during the relevant period based upon a 100 percent equity structure. Opinion No. 486-F PP 254-59, JA 3778-80.

With regard to the weighted cost of capital, other parties to the proceeding argued that Kern River's 100 percent equity capital structure should be delayed until all the Period One contracts have expired and all Period One debt has been paid; until that time, the Commission should apply the weighted cost of capital at the end of the 2004 test period (*i.e.* 70 percent debt/30 percent equity) to Period Two rates. Opinion No. 486-E P 149, JA 2743. The Commission rejected that

argument, finding that, as each shipper transitions to a Period Two contract, that shipper has fully amortized its share of Kern River's debt, and therefore that shipper's Period Two rate properly is based upon a 100 percent equity structure. *Id*. P 152, JA 2744. That is precisely the basis for the Commission's finding that Kern River's transition to a full 100 percent equity capital structure will be gradual. *Id*. P 205, JA 2773-74.

D. The Commission's Finding Is Not Contrary To Precedent.

Customers also contend that Commission precedent compels the conclusion that Kern River's return on equity must be adjusted downward in Period Two, given Kern River's "thick" and "anomalous" 100 percent equity structure. Customer Br. 30-34. As noted at Customer Br. 31-32, the Commission recognized that an equity-rich capital structure increases costs to ratepayers, because a pipeline's cost of equity is higher than its cost of debt. Opinion No. 486-D P 161 & n.201, JA 912 (citing *Transcontinental Gas Pipe Line Corp*., 71 FERC ¶ 61,305 (1995), which is cited in Customer Br. 32-33). Accordingly, the Commission ordinarily does not approve the use of a 100 percent equity capital structure. Opinion No. 486-D P 161 n.202, JA 912-13 (citing cases listed at Customer Br. 31, imposing hypothetical capital structures in lieu of atypical equity ratios: *KansOK Partnership*, 71 FERC ¶ 61,340 (1995); *La. Intrastate Gas Corp*., 50 FERC ¶ 61,011 (1990); *Tarpon Transmission Co*., 41 FERC ¶ 61,044 (1987); *Alabama-*

Tennessee Natural Gas Co., 38 FERC ¶ 61,251 (1987)). *See also* Opinion No. 486-A P 146, JA 499.

In this case, however, Kern River is not using traditional cost-of-service ratemaking and the principles concerning the use of a hypothetical capital structure in traditional cost-of-service ratemaking do not apply. Opinion No. 486-A P 146, JA 499. Here, the Commission approved the recovery of the debt-financed portion of the rate base over the terms of the shippers' contracts through the use of levelized rates, and the deferral of recovery of the equity-financed portion of the rate base until Period Two. *Id*. *See also* Opinion No. 486-D P 161, JA 912-13.

Customers expressly "do not take issue with that finding [declining to impose a hypothetical rate structure] in this appeal." Customer Br. 32. Nevertheless, Customers maintain that the Commission should have reduced Kern River's return on equity to the low end of the zone of reasonableness, citing *Williams Natural Gas Co*., 77 FERC ¶ 61,277 (1996) (reducing a return on equity downward where equity was high), and *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042 (2004), and *Discovery Gas Transmission LLC*, 78 FERC ¶ 61,194 (1997) (both adjusting returns on equity upward where debt was high).

Again, these cases concern traditional ratemaking in the context of rates proposed by pipelines certificated under the traditional requirements of section 7 of the Natural Gas Act. Opinion No. 486-F P 262 & n.308, JA 3780. These cases are

not persuasive in evaluating Kern River's rates approved under the Commission's optional certificate regulations. *Id.* The Commission's optional expedited certificate regulations provide pipelines a streamlined procedure for obtaining a certificate of public necessity and convenience for a project if the pipeline assumes the full economic risk of the project. Opinion No. 486-D P 121, JA 893. *See Pac. Gas*, 998 F.2d at 1306 & n.1 (explaining the optional certificate procedure in a decision addressing amendments to Kern River's certificate). Accordingly, a central issue the Commission must decide before approving an optional expedited certificate is the appropriate allocation of risk between the pipeline and its customers. Opinion No. 486-D P 122, JA 894.

The Commission considered the issue of how a pipeline may satisfy the assumption of risk requirement in related optional expedited certificate proceedings, including Kern River's. *Id.* P 123, JA 894. In those proceedings, the Commission permitted the parties to negotiate a sharing of risk so long as the customers were willing, arms-length participants in the negotiations. *Id.* P 124, JA 895. Although future rate proceedings may occur under either section 4 or 5 of the Natural Gas Act to reflect changes in costs, it was the Commission's intent that the negotiated rate design would not be subject to change in such proceedings because that rate design reflects the assignment of risk agreed to by the parties to construct the project. *Id.* PP 124, 132, JA 896, 899.

Thus, while the return of equity appears high because there is no debt included in determining the Period Two rates, the original bargain between Kern River and its shippers explicitly contemplated the use of a 100 percent equity structure as the Period One contracts expired, and the 100 percent equity capital structure was an integral part of the overall rate design. Opinion No. 486-E P 206, JA 2774; Opinion No. 486-D P 161, JA 912-13. Kern River's capital structure is therefore unique as the product of the particular risk-sharing bargain with its shippers, and not comparable to the issues regarding capital structure in the cases relied upon by Customers. Opinion No. 486-F P 262, JA 3780-81. *See NSTAR*, 481 F.3d at 799 (Court gives substantial deference to the Commission's interpretation of its own precedents). The cases cited by Customers show nothing more than that the Commission has previously adjusted the return on equity in appropriate circumstances. Opinion No. 486-F P 262 n.308, JA 3780. Customers "adduced no additional facts relevant to Kern River's circumstances which would bear upon the determination of return on equity in this proceeding." *Id.*

CONCLUSION

For the foregoing reasons, the Commission respectfully requests that the petitions for review be denied and that the orders on appeal be upheld in all respects.

Respectfully submitted,

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October 29, 2014

ATTACHMENT A: THE OPINION NO. 486 ORDERS

PERIOD ONE RATES	PERIOD TWO RATES
October 2006	**Opinion 486**
• Affirms Initial Decision on Kern River's NGA § 4 rate filing, seeking to increase its Period One rates, on most issues, including use of levelized rates	• Under NGA § 5, requires Kern River to include Period Two rates in its tariff • Period Two rates are to be based on 2004 test period cost of service for Period One
April 2008	**Opinion 486-A**
• Denies rehearing of Opinion No. 486, except for reopening record for a hearing on the return on equity	• Denies rehearing on issues above
January 2009	**Opinion 486-B**
• Sets Period One return on equity at 11.55 %, the median of the range of reasonableness from 8.8 % to 13 % • Requires a compliance filing	• Reiterates order that Kern River file levelized Period Two rates
December 2009	**Opinion 486-C**
• Denies rehearing of Op. No. 486-B • Accepts Period One compliance filing, subject to using 639,570 dth rather than 624,416 dth as billing determinants for allocating costs to 15-year shippers • Makes prospective Period One rates effective as of the date of issuance	• Rejects compliance filing proposing traditional Period Two rates • Sets for hearing calculation of levelized Period Two rates • Permits parties to address at hearing whether return on equity should be below the median because of Period Two 100 % equity capital structure
November 2010	**Opinion 486-D**
• Denies rehearing of Opinion No. 486-C on Period One rates • Accepts January 29, 2010 compliance filing establishing Period One rates, including a $0.0345 per dth rate reduction for original shippers	• Levelized Period Two rates are based on Period One 2004 test year cost of service • The only exception is for circumstances unique to the transition from Period One to Period Two that justify altering the cost of service for Period Two
July 2011	**Opinion 486-E**

	• Affirms Initial Decision:
	  o rejecting Kern River's proposed adjustment to Period One $0.0345 per dth rate reduction
	  o finding that Period Two return on equity should remain at the median of 11.55 %

February 2013	**Opinion 486-F**
	• Denies rehearing of Opinion No. 486-E on relevant issues

Aera Energy, LLC v. FERC,
Nos. 13-1138 and 13-1303 (consolidated)

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C) and this Court's order of April 22, 2014, setting a word limit for Respondent's brief of 18,000 words, I hereby certify that this brief contains 15,597 words, including the chart appended to this brief as Attachment A, but not including the tables of contents and authorities, the glossary, the certificate of counsel and this certificate.

/s/ *Lona T. Perry*
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October 29, 2014

ADDENDUM
Statutes

TABLE OF CONTENTS

PAGE

Natural Gas Act

Section 4, 15 U.S.C. § 717c A1

Section 5(a), 15 U.S.C. § 717d(a) A3

Section 7(c), 15 U.S.C. § 717f(c) A5

Section 19(b)&(c), 15 U.S.C. §§ 717r(b)&(c) A6

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

USCA Case #13-1138 Document #1519525 Filed: 10/29/2014 Page 81 of 91

(6) the need to encourage remote siting.

(c) Advisory report

The State agency may furnish an advisory report on State and local safety considerations to the Commission with respect to an application no later than 30 days after the application was filed with the Commission. Before issuing an order authorizing an applicant to site, construct, expand, or operate an LNG terminal, the Commission shall review and respond specifically to the issues raised by the State agency described in subsection (b) of this section in the advisory report. This subsection shall apply to any application filed after August 8, 2005. A State agency has 30 days after August 8, 2005 to file an advisory report related to any applications pending at the Commission as of August 8, 2005.

(d) Inspections

The State commission of the State in which an LNG terminal is located may, after the terminal is operational, conduct safety inspections in conformance with Federal regulations and guidelines with respect to the LNG terminal upon written notice to the Commission. The State commission may notify the Commission of any alleged safety violations. The Commission shall transmit information regarding such allegations to the appropriate Federal agency, which shall take appropriate action and notify the State commission.

(e) Emergency Response Plan

(1) In any order authorizing an LNG terminal the Commission shall require the LNG terminal operator to develop an Emergency Response Plan. The Emergency Response Plan shall be prepared in consultation with the United States Coast Guard and State and local agencies and be approved by the Commission prior to any final approval to begin construction. The Plan shall include a cost-sharing plan.

(2) A cost-sharing plan developed under paragraph (1) shall include a description of any direct cost reimbursements that the applicant agrees to provide to any State and local agencies with responsibility for security and safety—

(A) at the LNG terminal; and

(B) in proximity to vessels that serve the facility.

(June 21, 1938, ch. 556, §3A, as added Pub. L. 109–58, title III, §311(d), Aug. 8, 2005, 119 Stat. 687.)

REFERENCES IN TEXT

The National Environmental Policy Act of 1969, referred to in subsec. (a), is Pub. L. 91–190, Jan. 1, 1970, 83 Stat. 852, as amended, which is classified generally to chapter 55 (§4321 et seq.) of Title 42, The Public Health and Welfare. For complete classification of this Act to the Code, see Short Title note set out under section 4321 of Title 42 and Tables.

§ 717c. Rates and charges

(a) Just and reasonable rates and charges

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) Undue preferences and unreasonable rates and charges prohibited

No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Filing of rates and charges with Commission; public inspection of schedules

Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Changes in rates and charges; notice to Commission

Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Authority of Commission to hold hearings concerning new schedule of rates

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such

USCA Case #13-1138 Document #1519525 Filed: 10/29/2014 Page 82 of 91

suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Storage services

(1) In exercising its authority under this chapter or the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 et seq.), the Commission may authorize a natural gas company (or any person that will be a natural gas company on completion of any proposed construction) to provide storage and storage-related services at market-based rates for new storage capacity related to a specific facility placed in service after August 8, 2005, notwithstanding the fact that the company is unable to demonstrate that the company lacks market power, if the Commission determines that—

(A) market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services; and

(B) customers are adequately protected.

(2) The Commission shall ensure that reasonable terms and conditions are in place to protect consumers.

(3) If the Commission authorizes a natural gas company to charge market-based rates under this subsection, the Commission shall review periodically whether the market-based rate is just, reasonable, and not unduly discriminatory or preferential.

(June 21, 1938, ch. 556, § 4, 52 Stat. 822; Pub. L. 87–454, May 21, 1962, 76 Stat. 72; Pub. L. 109–58, title III, § 312, Aug. 8, 2005, 119 Stat. 688.)

REFERENCES IN TEXT

The Natural Gas Policy Act of 1978, referred to in subsec. (f)(1), is Pub. L. 95–621, Nov. 9, 1978, 92 Stat. 3350, as amended, which is classified generally to chapter 60 (§ 3301 et seq.) of this title. For complete classification of this Act to the Code, see Short Title note set out under section 3301 of this title and Tables.

AMENDMENTS

2005—Subsec. (f). Pub. L. 109–58 added subsec. (f).

1962—Subsec. (e). Pub. L. 87–454 inserted ''or gas distributing company'' after ''State commission'', and struck out proviso which denied authority to the Commission to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only.

ADVANCE RECOVERY OF EXPENSES INCURRED BY NATURAL GAS COMPANIES FOR NATURAL GAS RESEARCH, DEVELOPMENT, AND DEMONSTRATION PROJECTS

Pub. L. 102–104, title III, Aug. 17, 1991, 105 Stat. 531, authorized Federal Energy Regulatory Commission, pursuant to this section, to allow recovery, in advance, of expenses by natural-gas companies for research, development and demonstration activities by Gas Research Institute for projects on use of natural gas in motor vehicles and on use of natural gas to control emissions from combustion of other fuels, subject to Commission finding that benefits, including environmental benefits, to both existing and future ratepayers resulting from such activities exceed all direct costs to both existing and future ratepayers, prior to repeal by Pub. L. 102–486, title IV, § 408(c), Oct. 24, 1992, 106 Stat. 2882.

§ 717c–1. Prohibition on market manipulation

It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 78j(b) of this title) in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers. Nothing in this section shall be construed to create a private right of action.

(June 21, 1938, ch. 556, § 4A, as added Pub. L. 109–58, title III, § 315, Aug. 8, 2005, 119 Stat. 691.)

§ 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Decreases in rates

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

USCA Case #13-1138 Document #1519525 Filed: 10/29/2014 Page 83 of 91

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(A) market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services; and

(B) customers are adequately protected.

(2) The Commission shall ensure that reasonable terms and conditions are in place to protect consumers.

(3) If the Commission authorizes a natural gas company to charge market-based rates under this subsection, the Commission shall review periodically whether the market-based rate is just, reasonable, and not unduly discriminatory or preferential.

(June 21, 1938, ch. 556, § 4, 52 Stat. 822; Pub. L. 87–454, May 21, 1962, 76 Stat. 72; Pub. L. 109–58, title III, § 312, Aug. 8, 2005, 119 Stat. 688.)

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USCA Case #13-1138 Document #1519525 Filed: 10/29/2014 Page 84 of 91

with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) Costs of production and transportation

The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

(June 21, 1938, ch. 556, § 5, 52 Stat. 823.)

§ 717e. Ascertainment of cost of property

(a) Cost of property

The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Inventory of property; statements of costs

Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

(June 21, 1938, ch. 556, § 6, 52 Stat. 824.)

§ 717f. Construction, extension, or abandonment of facilities

(a) Extension or improvement of facilities on order of court; notice and hearing

Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) Abandonment of facilities or services; approval of Commission

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) Certificate of public convenience and necessity

(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however*, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however*, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

(d) Application for certificate of public convenience and necessity

Application for certificates shall be made in writing to the Commission, be verified under

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

USCA Case #13-1138 Document #1519525 Filed: 10/29/2014 Page 85 of 91

with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) Costs of production and transportation

The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

(June 21, 1938, ch. 556, § 5, 52 Stat. 823.)

§ 717e. Ascertainment of cost of property

(a) Cost of property

The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Inventory of property; statements of costs

Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

(June 21, 1938, ch. 556, § 6, 52 Stat. 824.)

§ 717f. Construction, extension, or abandonment of facilities

(a) Extension or improvement of facilities on order of court; notice and hearing

Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) Abandonment of facilities or services; approval of Commission

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) Certificate of public convenience and necessity

(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however*, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however*, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

(d) Application for certificate of public convenience and necessity

Application for certificates shall be made in writing to the Commission, be verified under

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each of the States affected or to be affected by such matter. Any such board shall be vested with the same power and be subject to the same duties and liabilities as in the case of a member of the Commission when designated by the Commission to hold any hearings. The action of such board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The Board shall be appointed by the Commission from persons nominated by the State commission of each State affected, or by the Governor of such State if there is no State commission. Each State affected shall be entitled to the same number of representatives on the board unless the nominating power of such State waives such right. The Commission shall have discretion to reject the nominee from any State, but shall thereupon invite a new nomination from that State. The members of a board shall receive such allowances for expenses as the Commission shall provide. The Commission may, when in its discretion sufficient reason exists therefor, revoke any reference to such a board.

(b) Conference with State commissions regarding rate structure, costs, etc.

The Commission may confer with any State commission regarding rate structures, costs, accounts, charges, practices, classifications, and regulations of natural-gas companies; and the Commission is authorized, under such rules and regulations as it shall prescribe, to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

(c) Information and reports available to State commissions

The Commission shall make available to the several State commissions such information and reports as may be of assistance in State regulation of natural-gas companies. Whenever the Commission can do so without prejudice to the efficient and proper conduct of its affairs, it may, upon request from a State commission, make available to such State commission as witnesses any of its trained rate, valuation, or other experts, subject to reimbursement of the compensation and traveling expenses of such witnesses. All sums collected hereunder shall be credited to the appropriation from which the amounts were expended in carrying out the provisions of this subsection.

(June 21, 1938, ch. 556, § 17, 52 Stat. 830.)

§ 717q. Appointment of officers and employees

The Commission is authorized to appoint and fix the compensation of such officers, attorneys, examiners, and experts as may be necessary for carrying out its functions under this chapter; and the Commission may, subject to civil-service laws, appoint such other officers and employees as are necessary for carrying out such functions and fix their salaries in accordance with chapter 51 and subchapter III of chapter 53 of title 5.

(June 21, 1938, ch. 556, § 18, 52 Stat. 831; Oct. 28, 1949, ch. 782, title XI, § 1106(a), 63 Stat. 972.)

CODIFICATION

Provisions that authorized the Commission to appoint and fix the compensation of such officers, attorneys, examiners, and experts as may be necessary for carrying out its functions under this chapter ''without regard to the provisions of other laws applicable to the employment and compensation of officers and employees of the United States'' are omitted as obsolete and superseded.

As to the compensation of such personnel, sections 1202 and 1204 of the Classification Act of 1949, 63 Stat. 972, 973, repealed the Classification Act of 1923 and all other laws or parts of laws inconsistent with the 1949 Act. The Classification Act of 1949 was repealed by Pub. L. 89–554, Sept. 6, 1966, § 8(a), 80 Stat. 632, and reenacted as chapter 51 and subchapter III of chapter 53 of Title 5, Government Organization and Employees. Section 5102 of Title 5 contains the applicability provisions of the 1949 Act, and section 5103 of Title 5 authorizes the Office of Personnel Management to determine the applicability to specific positions and employees.

Such appointments are now subject to the civil service laws unless specifically excepted by those laws or by laws enacted subsequent to Executive Order 8743, Apr. 23, 1941, issued by the President pursuant to the Act of Nov. 26, 1940, ch. 919, title I, § 1, 54 Stat. 1211, which covered most excepted positions into the classified (competitive) civil service. The Order is set out as a note under section 3301 of Title 5.

''Chapter 51 and subchapter III of chapter 53 of title 5'' substituted in text for ''the Classification Act of 1949, as amended'' on authority of Pub. L. 89–554, § 7(b), Sept. 6, 1966, 80 Stat. 631, the first section of which enacted Title 5.

AMENDMENTS

1949—Act Oct. 28, 1949, substituted ''Classification Act of 1949'' for ''Classification Act of 1923''.

REPEALS

Act Oct. 28, 1949, ch. 782, cited as a credit to this section, was repealed (subject to a savings clause) by Pub. L. 89–554, Sept. 6, 1966, § 8, 80 Stat. 632, 655.

§ 717r. Rehearing and review

(a) Application for rehearing; time

Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

USCA Case #13-1138 Document #1519525 Filed: 10/29/2014 Page 87 of 91

(b) Review of Commission order

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which is supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

(c) Stay of Commission order

The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(d) Judicial review

(1) In general

The United States Court of Appeals for the circuit in which a facility subject to section 717b of this title or section 717f of this title is proposed to be constructed, expanded, or operated shall have original and exclusive jurisdiction over any civil action for the review of an order or action of a Federal agency (other than the Commission) or State administrative agency acting pursuant to Federal law to issue, condition, or deny any permit, license, concurrence, or approval (hereinafter collectively referred to as ''permit'') required under Federal law, other than the Coastal Zone Management Act of 1972 (16 U.S.C. 1451 et seq.).

(2) Agency delay

The United States Court of Appeals for the District of Columbia shall have original and exclusive jurisdiction over any civil action for the review of an alleged failure to act by a Federal agency (other than the Commission) or State administrative agency acting pursuant to Federal law to issue, condition, or deny any permit required under Federal law, other than the Coastal Zone Management Act of 1972 (16 U.S.C. 1451 et seq.), for a facility subject to section 717b of this title or section 717f of this title. The failure of an agency to take action on a permit required under Federal law, other than the Coastal Zone Management Act of 1972, in accordance with the Commission schedule established pursuant to section 717n(c) of this title shall be considered inconsistent with Federal law for the purposes of paragraph (3).

(3) Court action

If the Court finds that such order or action is inconsistent with the Federal law governing such permit and would prevent the construction, expansion, or operation of the facility subject to section 717b of this title or section 717f of this title, the Court shall remand the proceeding to the agency to take appropriate action consistent with the order of the Court. If the Court remands the order or action to the Federal or State agency, the Court shall set a reasonable schedule and deadline for the agency to act on remand.

(4) Commission action

For any action described in this subsection, the Commission shall file with the Court the consolidated record of such order or action to which the appeal hereunder relates.

(5) Expedited review

The Court shall set any action brought under this subsection for expedited consideration.

(June 21, 1938, ch. 556, § 19, 52 Stat. 831; June 25, 1948, ch. 646, § 32(a), 62 Stat. 991; May 24, 1949, ch. 139, § 127, 63 Stat. 107; Pub. L. 85–791, § 19, Aug. 28, 1958, 72 Stat. 947; Pub. L. 109–58, title III, § 313(b), Aug. 8, 2005, 119 Stat. 689.)

REFERENCES IN TEXT

The Coastal Zone Management Act of 1972, referred to in subsec. (d)(1), (2), is title III of Pub. L. 89–454, as added by Pub. L. 92–583, Oct. 27, 1972, 86 Stat. 1280, as amended, which is classified generally to chapter 33 (§ 1451 et seq.) of Title 16, Conservation. For complete classification of this Act to the Code, see Short Title note set out under section 1451 of Title 16 and Tables.

CODIFICATION

In subsec. (b), ''section 1254 of title 28'' substituted for ''sections 239 and 240 of the Judicial Code, as amend-

Aera Energy LLC, et al. v. FERC **Docket No. RP04-274**
D.C. Cir. No. 13-1138

CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 29th day of October 2014, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system or via U.S. Mail, as indicated below:

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