

Patricia French
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PATRICIA M. FRENCH
Vice President & Assistant General Counsel

2755 E. COTTONWOOD PARKWAY
Suite 300
P.O. BOX 71400 (84171-0400)
SALT LAKE CITY, UT 84121
PHONE: 801-937-6068
FAX: 801-937-6155

June 23, 2009

VIA OVERNIGHT COURIER

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Ms. Mary Nichols, Chairman
Mr. James Goldstene, Executive Officer
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814-2828

Re: Kern River Gas Transmission Company Comments on the CARB's Initial Staff Report for
Administrative Fee Regulations to Fund AB 32

Dear Chairman Nichols and Executive Officer Goldstene:

Kern River Gas Transmission Company (Kern River) appreciates this opportunity to provide its comments to the Air Resources Board of the State of California (CARB) on the Initial Staff Report proposing the AB 32 Administrative Fee Regulation. Kern River is grateful to your staff for working with Kern River to understand our concerns over fee recovery in light of our unique characteristics and status as an interstate pipeline. In particular, your staff took appropriate measures to understand the implications of federal jurisdiction, federal rate recovery and pre-emption with regard to Kern River. Kern River is pleased to advise the Board that we have reached a resolution of our concerns by accepting a requirement from CARB staff that ensures our cooperation in CARB's reporting needs, as set forth in substance in Exhibit A.¹

About Kern River

Kern River is a Texas general partnership based in Salt Lake City, Utah, an interstate natural gas company within the meaning of the Natural Gas Act and regulated by the Federal Energy Regulatory Commission. The Kern River system transports natural gas utilizing nearly 1,680

¹ CARB staff addressed Kern River's concerns with an appropriate seriousness of purpose, took the time to meet with Kern River in-person at the CARB offices in Sacramento, patiently asked reasonable but tough questions of both Kern River and the Federal Energy Regulatory Commission (FERC) staff with regard to Kern River's opportunity for recovery of the fee from its customers and ultimately exchanged with us information that permitted a redline of the May 8 regulations to be developed cooperatively by both Kern River and CARB staff.

miles of pipeline, from the production fields of southwestern Wyoming to delivery points in Utah and Nevada and on to Bakersfield, California. Kern River's pipeline currently has a design capacity of more than 1.7 billion cubic feet per day. As a federally-regulated open-access interstate natural gas transporter, Kern River utilizes its interstate natural gas transmission system to provide transportation services to customers throughout the Western United States. Kern River does not own the natural gas it transports.

Kern River's Concerns with the CARB Staff Initial Report and Fee Regulations

1. The plain language of the statute does not support the initial draft of the fee regulations

The Global Warming Solutions Act, AB 32, explicitly provides for the establishment of "a schedule of fees to be paid *by the sources of greenhouse gas emissions*" (emphasis supplied) by the Board.² Interstate natural gas transportation companies are not significant emissions "sources" within the meaning of AB 32. In balancing the need to impose the fees upstream whenever possible to minimize the number of entities subject to the fee and reduce the complexity and the administrative burden of the regulation, the Board should be mindful that placing the costs associated with implementing California's emissions-reduction program retroactively and too far upstream from the source, as is the case for interstate natural gas pipelines, defeats the basic purpose of the legislative mandate. In the case of interstate pipelines, however, plain language is not the only objection: the imposition of the state program fees on interstate pipelines is complicated further by the factors discussed herein.

2. The construct of Kern River's contracts do not ensure Kern River any reasonable opportunity to recover the fee from AB 32-defined end-users

All of Kern River's contracts are *regulated* transportation-only service contracts governed exclusively by the rules and regulations of the FERC. Kern River provides a "transport service," meaning that Kern River does not own or sell the natural gas that flows through the pipeline. "Shippers" on Kern River's system (not Kern River) generally hold contracts with end-users for the commodity. Kern River has no contracts for natural gas supply service: Kern River's shippers may or may not be an end-user of natural gas. Often Kern River's shippers are more likely to be a marketer or supplier. Accordingly, Kern River's regulated transportation contracts generally do not even reach to the end-user upon whom CARB's AB 32 fee must be placed. With no contract to link Kern River to the end-user, there is no contract upon which to place the fee once assessed. As the next section discusses, because the contracts are heavily regulated and Kern River's rates may only recover for costs associated with *transportation service*, it is likely that recovery of AB 32 program fees would be significantly challenged by shippers if Kern River sought to recover the same in rates.

² Moreover, the legislation requires that the source be "significant," in the Board's estimation, in order "to enable [it] to effectively reduce greenhouse gas emission and monitor compliance" with California's stringent emissions reduction goals. The requirement that "sources" pay the "fees" is an issue of fairness: those who cause significant emissions should support the programs to curb them.

3. Federal regulatory mechanisms currently do not permit Kern River to recover the fee from shippers and/or end-users, and it is questionable whether recover would ever be allowed

As a federally-regulated pipeline, Kern River may collect CARB-related fees only following special tariff and rate approval from FERC. No such mechanism (for a current or retroactive exaction of fees) exists in Kern River's federal tariff. Kern River transports natural gas in interstate commerce for its customers; it does not own it. Kern River is a transportation service provider. Therefore, the policy concept that CARB staff pursued (e.g. that the fee would be "passed through" by increasing the price for either natural gas or interstate transportation service) is not necessarily advanced even in the best of circumstances. Kern River's pipeline transportation rates are subject to the exclusive jurisdiction of federal rate regulation, requiring the consent of FERC to recover any new regulatory cost. Kern River's regulated contracts with its shippers require the consent of FERC for any term or condition that differs from tariff requirements or deviates from its *pro forma* service agreement. While the Initial Staff Report concept of upstream regulation contemplates that AB 32 program fees will reach end-users immediately and on a constant basis, interstate pipeline rate proceedings at FERC occur only on a periodic basis. Thus, even if a rate tracking mechanism were proposed to and approved by FERC,³ there would likely be long periods during which Kern River would be forced to bear and pay all or a substantial portion of the AB 32 program fees: those costs would not be borne by emitters of greenhouse gases, reflected in the price of natural gas or recovered in the price of interstate natural gas transportation.

Because of these inherent difficulties and intense federal regulation, imposing AB 32 program fees on federally-regulated interstate pipelines is unlikely to ensure either the emitter-level responsibility or the stability or ease of revenue collection that CARB seeks.⁴ Federally-regulated interstate pipelines subject to collecting the fee cannot collect the fee from customers (who are not necessarily end-users) without federal approval. Kern River's ability to obtain such approval would be unlikely and untimely at best.

4. Attaching the fee to Kern River is an impermissible intrusion into and burden upon interstate commerce

Kern River appreciates the difficulty placed upon the CARB and its staff with the challenges of AB 32's enormous and ambitious public health initiative. During this process, Kern River has worked hard to understand both the complexity and the administrative burden placed upon CARB in promulgating the fee implementation regulations. However, the identification of interstate natural gas pipelines as a fee collection entity, as Kern River explained to CARB staff, creates many more problems than it solves.

³ (1) There is no known FERC-approved tracking mechanism in use for state-level emissions program fees and (2) no tracking mechanism approved for Kern River is automatic but rather requires regulatory filings to institute a change in the cost recovery level, permitting comment, hearing and investigation.

⁴ In addition, as in any regulatory environment, Kern River may not be authorized to recover the full fee. Pipeline rate proceedings typically are heavily contested. Kern River's rate structure may not readily permit the inclusion of additional fees and costs at this time.

In May, Kern River approached its review of the Initial Report with the general premise that California and CARB may have a legitimate basis, given the enabling legislation, for the fee regulation. Where California's public health laws, rules and regulations – a function of its police powers – do not unduly interfere with interstate commerce,⁵ such may be valid so long as state laws, rules and regulations do not also conflict with federal regulations on the subject.⁶ Where Congress has demonstrated its intent to regulate an entire field – action known as federal pre-emption–, then California's laws, rules and regulations that purport to regulate that field (in whole or in part) are in jeopardy.

The conclusion that Kern River came to, in addition to the concerns stated herein, is that *in fact* Congress intended to wholly and exclusively regulate the activity of interstate natural gas pipeline transportation, and that CARB staff's proposal to impose a fee on that activity (for any purpose) would be proven invalid. In addition, Kern River was troubled that the fee regulation proposed relying on heavily-regulated interstate transportation contracts to be a conduit for fee recovery, when the power of Congress to regulate interstate commerce also clearly extends to all contracts of private companies that substantially relate to interstate commerce, particularly where Congress has pre-empted the field by making any contract for that service a *federally-regulated contract*. Accordingly, Kern River could not escape that its federally-regulated contracts governing the transportation of natural gas from Rocky Mountain production fields of Wyoming, through Utah and Nevada and on to Southern California markets are contracts in interstate commerce. The activity upon which CARB staff initially established its nexus for regulatory imposition of the fee (the transportation of natural gas across state lines) was within the scope of the Commerce Clause. It was Kern River's position that because of the burden on commerce, the initially proposed regulation – if promulgated – would violate the Commerce Clause of the U.S. Constitution.

Kern River Supports CARB Staff's Proposed Revisions to the Initial Staff Report and Proposed Regulations

Kern River worked diligently with CARB staff to address the problems posed by interstate pipelines as a collection point for the fee, and worked out a resolution whereby Kern River would continue to assist (as requested initially and thereafter periodically by CARB staff) to verify end-users (as defined by AB 32 and CARB's regulations) within the state of California, to the extent it has such information. The changes to the proposed regulations, as agreed to in principle and substance by CARB staff, are set forth in Exhibit A.

⁵ Commerce begins with the physical transport of the good and ends when the good reaches its destination. The continuum of passage from one state to another state is a transaction of and in interstate commerce.

⁶ By asserting that such laws must not unduly interfere, we mean such laws may interfere, *but no more than is necessary in the proper exercise of California's police power*. The original draft of staff's proposed regulations unduly interfered with the federal regulatory scheme, as set forth herein.

Conclusion

Kern River sincerely appreciates the opportunity to comment on the Initial Staff Report and Fee Implementation Regulations and asks the Board to adopt Kern River's and staff's proposed amendment to the fee regulations as set forth in Exhibit A. Please do not hesitate to contact me with any questions you may have concerning Kern River's comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'P. French', with a long horizontal flourish extending to the right.

Patricia M. French

cc: Edie Chang, Chief, Program Planning and Management Branch, Office of Climate Change
Jon Constantino, CARB
Bruce Tuter, CARB
Jeannie Blakeslee, CARB

EXHIBIT A

Appendix A

**Proposed Regulation for the
AB 32 Cost of Implementation Fee
and Proposed Amendments to the Mandatory
Reporting of Greenhouse Gas Emissions
Regulations**

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95201. Applicability.

(a) This article applies to the following entities. The terms used below are defined in section 95202.

(1) *Natural Gas Utilities, Users, and Pipeline Owners and Operators that distribute or use natural gas in California.*

(A) All public utility gas corporations operating in California. Fees shall be paid for each therm of natural gas delivered to any end user in California.

(B) All owners or operators that are end-users of natural gas received directly from interstate pipelines and are not included in any other category of section 95201 (a). Fees shall be paid by such end-users for each therm of natural gas directly distributed by interstate pipelines.

(C) All owners or operators of interstate pipelines, not included in section 95201 subsection (a)(1)(A), that distribute natural gas directly to end users in California as identified in subsection 95201(a)(1)(B) shall be required to report natural gas delivered to end-users in accordance with subsection 95204(c)(4) to assist in the determination of the end-users paying the fee under subsection 95201(a)(1)(B). These entities interstate pipelines are included for the purposes of reporting only. Each entity shall report those end users to which they supply natural gas in California

(DB) All owners or operators of interstate and intrastate pipelines, not included in subsection (a)(1)(A), that distribute natural gas directly to end users in California. Fees shall be paid for each therm of natural gas directly distributed by interstate or intrastate pipelines.

(EG) All California owners or operators that consume natural gas produced on-site and that are subject to Mandatory Reporting Regulation. Fees shall be paid for each therm of natural gas consumed of the natural gas produced on-site.

(FD) All California owners or operators that consume associated gas that is produced on-site and that are subject to the Mandatory Reporting Regulation. Fees shall be paid on the

amount of emissions resulting from the combustion of these fuels.

95204. Reporting and Recordkeeping Requirements.

(a) *Reporting Format.*

All reports required by this article must be submitted to ARB by using the California Air Resources Board's Greenhouse Gas Reporting Tool, as specified in title 17, California Code of Regulations section 95104(e), and is available on ARB's internet website at www.arb.ca.gov.

(b) All entities subject to this article must report the following:

(1) Report Information:

- (A) Report Year
- (B) Facility Information
 - (i) Facility name
 - (ii) Physical address
 - (iii) Mailing address
 - (iv) Description of facility geographic location

(2) Operator Information:

- (A) Operator name
- (B) Email address
- (C) Telephone number

(3) Operator Statement of Truth, Accuracy and Completeness.

Operator signature and date stating: *This report has been prepared in accordance with subchapter 105, article 1, sections 95100 to 95133, title 17, California Code of Regulations. The statements and information contained in this emissions data report are true, accurate and complete.*

(b) *Timeline for Reporting.*

- (1) Reports for the 2008 calendar year must be submitted to ARB by January 2, 2010, or by the operative date of this article, whichever is later.
- (2) Reports for the 2009 and subsequent calendar years must be submitted to ARB by June 30 of each year. For those entities subject to ARB's Mandatory Reporting Regulation, changes made to reported data as a result of the verification process must be concluded by December 1 of each year.

(c) *Natural Gas Utilities, Users and Pipeline Owners and Operators.*

- (1) All public utility gas corporations operating in California must annually report the aggregate quantity of therms of natural gas delivered at the meter to end users.
- (2) All owners or operators of interstate and intrastate pipelines that distribute natural gas directly to end users must annually report the aggregate quantity of therms of natural gas directly distributed, at the metered to the end users.
- (3) All owners or operators that are end-users of natural gas received directly from interstate pipelines must annually report the therms of natural gas directly distributed, at the meter from the interstate pipeline(s).
- (4) All owners or operators of interstate pipelines that distribute natural gas directly to end users must annually report end users to which the interstate pipeline directly distributes natural gas. This information shall include the following contact information for the end user, if available to the interstate pipeline:: name, contact address, and contact phone number.
- (35) All California owners or operators that consume natural gas produced on-site and are subject to the Mandatory Reporting Regulation must report the quantity of therms of natural gas consumed annually of natural gas produced on-site in addition to all information required under the Mandatory Reporting Regulation.
- (46) All California owners or operators that consume associated gas produced on-site and that are subject to the Mandatory Reporting Regulation must report all information required by the Mandatory Reporting Regulation, including the quantities of emissions resulting from the combustion of these fuels.

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