UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Chevron Pipe Line Company Docket No. AC04-30-001

ORDER DENYING REHEARING

(Issued March 8, 2005)

1. On April 13, 2004, the Chief Accountant issued an order, pursuant to delegated authority which: (a) allowed Chevron Pipe Line Company (CPL) to expense $24.5 million of abandonment costs; (b) allowed CPL to expense $22.2 million associated with the unamortized portion of the "push down premium" paid for assets acquired in a merger; and (c) denied CPL's request to expense a $4.5 million depreciation catch-up adjustment. On May 11, 2004, CPL filed a request for rehearing of the April 13 Order to the extent it denied CPL's request to expense the $4.5 million depreciation catch-up adjustment. In this order, the Commission denies CPL's request for rehearing, as discussed below. This order benefits the public because it maintains consistency in accounting practices with other regulated oil pipelines.

Background

CPL's Proposal

2. In a letter dated March 15, 2004, CPL requested Commission approval to credit Account 31, Accrued Depreciation, and charge Account 665, Unusual or Infrequent Items (Debit) in the amount of $4.5 million, representing a one-time adjustment of depreciation for the period 1995 - 2003. CPL asserted that it has certain assets that, while they may be in common carrier service, are not subject to the Commission's jurisdiction because they are used exclusively for intrastate service. According to CPL, certain of these assets were retired in 1995 and the costs associated with those retirements were charged to Account 31. However, CPL maintained that its depreciation rates were not modified to reflect the effects of these retirements. CPL further stated that it was modifying its depreciation rates for non FERC-jurisdictional assets to resolve this issue on a going-forward basis, and that a catch-up adjustment was needed to correct the accounts for not modifying its depreciation rates on a timely basis (*i.e.*, in 1995). Consequently,

CPL stated that it is seeking permission from the Commission to record the catch-up adjustment in Account 645. CPL asserted that it was proper to charge the adjustment to Account 645 since it constitutes an infrequent occurrence as defined in Instruction l-6(a).

The Chief Accountant's Ruling

3. On April 13, 2004, the Chief Accountant denied CPL's request to expense the depreciation catch-up adjustment. The Chief Accountant ruled that the discovery in 2003 resulted from better insight and improved judgment which is considered a change in accounting estimate as defined in Accounting Principles Board (APB) Opinion No. 20. [1] As such, the Chief Accountant stated that changes in accounting estimates are to be handled prospectively and CPL should revise its depreciation rates for non-jurisdictional assets accordingly.

CPL's Rehearing Request

4. CPL argues that the Chief Accountant incorrectly denied its request to expense the $4.5 million depreciation catch-up adjustment under the assumption that it was a change in accounting estimates resulting from better insight and improved judgment. CPL claims the $4.5 million charge results from the discovery and correction of an error for the erroneous lack of amortization from 1995 through 2003. CPL states it will adjust its depreciation rates for non-jurisdictional assets to prevent this error from reccurring. However, CPL states adjusting depreciation rates on a prospective basis does not resolve the proper FERC accounting treatment for the costs associated with the prior periods.

Discussion

5. The Commission's Uniform System of Accounts prescribed for Oil pipeline Carriers contains the following definition of depreciation:

> *Depreciation* means the loss in service value not restored by current maintenance and incurred in connection with the consumption or prospective retirement of property in the course of service from causes against which the carrier is not protected by insurance, and the effect of which can be forecast with a reasonable approach to accuracy.[2]

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[1] APB Opinion No. 20, paragraph 20: "A change in accounting estimate results from new information or subsequent development and accordingly from better insight and improved judgment."

[2] *See* 18 CFR, Part 352, Definition 15 (2004).

6. In general, some of the causes to be given consideration in determining the appropriate depreciation are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, or changes in demand. Carriers are required to implement depreciation practices that will distribute the book cost less estimated salvage value by the straight-line method in equal annual charges to operating expenses during the service life of the property using composite rates of depreciation. Additionally, the service lives are to be supported by engineering or other studies. [3]

7. CPL uses the group method of depreciation.[4] Under the group method, a number of similar or related assets are included in a group to which a single composite depreciation rate is applied. The assets within the group typically have various useful lives and therefore the single composite rate reflects an average useful life for the assets within the group. The development and use of composite depreciation rates recognize that some assets within the group will outlive the average useful life of the group while other assets within the group will be retired from service earlier than the average life. Accordingly, gains and losses upon retirement are not recognized. Over time however, all assets within the group are depreciated over the average useful life of the group.

8. CPL essentially argues that use of the group method of depreciation required that it increase its depreciation rate immediately upon the retirement of certain assets in common carrier service in 1995, and their failure to do so was an error now requiring a retrospective adjustment to depreciation expense in the amount of $4.5 million.

9. We disagree. As discussed above, determining appropriate depreciation rates involve the use of estimates for a variety of factors affecting the change in economic usefulness of depreciable assets. Contrary to CPL's argument, use of the group method of depreciation does not require changing depreciation rates immediately upon the retirement of an asset. While we agree that premature retirements of plant are factors that should be considered in determining whether a change in depreciation rate is warranted, it is only one factor. Other factors or causes must also be considered, including those that could operate in an opposite fashion to mitigate or eliminate the need for a change in the rate. In addition, management generally has significant latitude in determining when to implement a change in depreciation rates. This makes it particularly difficult to reach a conclusion that the absence of a change in deprecation rates in 1995 constitutes an

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[3] *See* 18 CFR Part 352, General Instruction 1-8.

[4] *See* memorandum prepared by PriceWaterhouseCoopers, CPL's outside auditors, attached to CPL's rehearing request.

accounting error by CPL. Were we to conclude otherwise, the management of virtually every entity could claim it made errors in past periods related to its depreciation estimates.

10. We consider CPL to have exercised its judgment in each of the years 1995 through 2003 by not changing its depreciation rates in those years. CPL cannot now argue that it should have changed its depreciation rates in 1995 and claim its failure to do so as error.[5] CPL should instead consider all of the factors affecting the economic useful lives of its assets and, if an adjustment to its depreciation rate is appropriate, it should be implemented prospectively.

The Commission orders:

CPL's request for rehearing is denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

[5] Our decision here might be different if the failure to adjust the depreciation rate was the result of a glaring mistake and of such magnitude that the results of operations would be misleading without correction. However, CPL admits that the amounts are immaterial.