

130 FERC ¶ 61,194  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Marc Spitzer, Philip D. Moeller,  
and John R. Norris.

Florida Gas Transmission Company LLC

Docket Nos. CP09-17-001  
AC08-161-002  
AD10-3-000

Accrual of Allowance for Funds Used During  
Construction

ORDER GRANTING REHEARING

(Issued March 18, 2010)

1. On December 21, 2009, Florida Gas Transmission Company LLC (Florida Gas) filed a request for rehearing of the order issued in *Florida Gas Transmission Co. LLC* (November 19 order).<sup>1</sup>
2. We will grant Florida Gas's request for rehearing, as discussed below, revising our policy regarding the timing of the accrual of Allowance for Funds Used During Construction (AFUDC) for natural gas construction projects.

**I. Background**

3. In the November 19 Order the Commission issued Florida Gas a certificate of public convenience and necessity to construct and operate its Phase VIII Expansion Project, which includes the construction and operation of approximately 483.2 miles of pipeline facilities, the addition of 213,600 horsepower (hp) of compression at eight existing and one new compressor station, the acquisition of 22.7 miles of existing pipeline facilities from Florida Power and Light (FPL), the construction and upgrade of metering and regulating stations, and the construction of associated auxiliary facilities. The Phase VIII Expansion Project is designed to increase the firm transportation capacity of Florida Gas's system in Florida by 820,000 million Btu (MMBtu) per day. Florida Gas intends to commence service in two phases timed to meet its customers' requirements, with Phase 1 to go into service by July 1, 2010, and Phase 2 to go into service by April 1, 2011.

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<sup>1</sup> 129 FERC ¶ 61,150 (2009).

4. The November 19 Order also addressed Florida Gas's August 14, 2008 request in Docket No. AC08-161-000 for permission to start the accrual of AFUDC for its Phase VIII Expansion Project coincident with its filing of its request to use the Commission's pre-filing<sup>2</sup> process in March 2008. Florida Gas renewed this request in its October 31, 2008 certificate application for the Phase VIII Expansion. We denied this request, finding that the information provided by Florida Gas did not support its request to accrue AFUDC on costs incurred prior to the filing of its certificate application. Furthermore, we found:

Although Florida Gas states that it incurred various costs prior to filing its certificate application, Florida Gas did not provide sufficient detail to demonstrate that the costs incurred before it filed the certificate application on October 31, 2008, were in fact construction costs, rather than costs related to preliminary survey and investigation type activities.<sup>3</sup>

5. We also found that "AFUDC should not be accrued on expenditures for materials and supplies, including progress and other payments incurred for the manufacture of pipe, purchased prior to the initiation of construction."<sup>4</sup> Furthermore, we continued that participation in the pre-filing process does not in and of itself serve as evidence sufficient to justify the accrual of AFUDC on costs during that time period and that AFUDC could only be accrued on construction costs incurred on a continuous, planned, progressive basis.<sup>5</sup>

## **II. Florida Gas's Rehearing Request**

6. On December 21, 2009, Florida Gas filed a timely request for rehearing of the November 19 Order. Florida Gas seeks a limited rehearing of the November 19 Order on two grounds: (1) that our rejection of its proposed inclusion of AFUDC accrued prior to its filing of the certificate application, and our requirement that Florida Gas reverse the AFUDC accrued prior to that date, was arbitrary and capricious in violation of section 706 of the Administrative Procedures Act (APA); and (2) that our decision to require Florida Gas to reverse the AFUDC prior to its filing of the certificate application

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<sup>2</sup> *Regulations Implementing Energy Policy Act of 2005; Pre-Filing Procedures for Review of LNG Terminals and Other Natural Gas Facilities*, Order No. 665, FERC Stats. & Regs., Regulations Preambles 2001 – 2005 ¶ 31,195 (2005).

<sup>3</sup> November 19 Order at P 55.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at P 56.

unreasonably denies Florida Gas the opportunity to recover the costs of providing service.

7. Florida Gas states that the Commission relied on Accounting Release No. 5 (Revised) (AR-5), Capitalization of Interest During Construction, in denying its request to begin the accrual of AFUDC coincident with our approval of Florida Gas's request to initiate the pre-filing process.<sup>6</sup> Florida Gas argues that it provided the Commission with enough information for the Commission to grant its request to begin the accrual of AFUDC prior to the filing of its certificate application. Florida Gas states that consistent with customary practice in certificate proceedings, it noted its total AFUDC costs (including AFUDC accrued during pre-filing) in its certificate application. Florida Gas states it further delineated its estimated AFUDC costs by month to support its original estimate that its AFUDC costs related to expenses incurred prior to the filing of the certificate application would be approximately \$6.8 million. (Florida Gas now states that its actual AFUDC costs accrued during pre-filing was approximately \$3.3 million.) Florida Gas argues that allowing recovery of these costs would have a negligible impact on rate payers, estimating that the AFUDC on pre-application expenditures represent an initial incremental recourse rate impact of \$0.002, and declining thereafter. Furthermore, Florida Gas argues, the vast majority of the shippers on the Phase VIII Expansion Project have long-term agreements with negotiated rates.

8. Florida Gas states that as a direct result of the Commission's pre-filing process, which the Commission encourages applicants to use, it was required to incur costs to do the following prior to the time it filed its certificate application: (1) develop a detailed description of the project, including detailed maps for 580 miles of pipeline and 200,000 hp of compression at nine compressor stations; (2) identify and contact over 4,000 stakeholders, perform agency consultation, and project engineering and route planning; (3) engage environmental and engineering contracts; and (4) develop a public participation plan. Florida Gas argues that prior to the inception of the Commission's pre-filing process, most of these activities would have taken place after the certificate

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<sup>6</sup> Accounting Release No. 5 (Revised) (AR-5), Capitalization of Interest During Construction, states in pertinent part, "Interest during construction may be capitalized starting from the date that construction costs are continuously incurred on a planned progressive basis. Interest should not be accrued for the period of time prior to... (2) the date of the application to the Commission for a certificate to construct facilities by a natural gas company. Interest accruals may be allowed by the Commission for the period prior to the above dates if so justified by the company." *Accounting Release No. 5 (Revised), Capitalization of Interest During Construction*, FERC Stats. & Regs. ¶ 40,005 (1968).

application had been filed, and the costs would have clearly qualified for capitalization of interest.

9. Florida Gas also argues that significant investment prior to the filing of a certificate application is necessary in order to meet customer in-service requirements and deal with long lead times for materials and mill space. Florida Gas argues that these investments towards construction costs were continuously incurred on a planned progressive basis prior to the filing of its certificate application. Among other things, Florida Gas states that it was required to make partial prepayments to its compressor unit manufacturers and significant investments in steel. If it had not made these expenditures prior to filing its certificate application, Florida Gas argues that it would have been unable to meet its April 1, 2011 in-service date.

10. Florida Gas states that as of the initiation of its pre-filing, the Phase VIII Expansion project had already been determined to be feasible, had been approved by the necessary Boards of Directors, and costs were being continuously incurred on a planned progressive basis. Therefore, Florida Gas argues, accrual of AFUDC beginning on that date is justified based on the Commission's criteria in AR-5 and supported by Statement of Financial Accounting Standards No. 34, Capitalization of Interest (FAS 34).<sup>7</sup>

11. Florida Gas argues that the Commission's refusal to allow AFUDC on costs incurred prior to the certificate filing was a reversal of Commission policy and was not reasoned decision-making. Furthermore, Florida Gas contends the Commission's decision to deny AFUDC on pre-application costs in this case, without notice or the opportunity to address what it contends is a change in policy, was arbitrary and capricious.

12. Finally, Florida Gas also argues that our decision not to allow it to recover AFUDC for its costs incurred prior to the filing of its certificate application unreasonably denies Florida Gas the ability to recover the costs of providing service.

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<sup>7</sup> Also referred to as Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 835-20, Capitalization of Interest.

### III. Technical Conference

13. In this and several recent and pending cases,<sup>8</sup> the Commission has been presented with proposals to accrue AFUDC on expenditures made prior to the time that an application is filed for authorization to construct and operate natural gas pipeline facilities. In those cases the applicants suggest that the Commission should allow the accrual of AFUDC on expenditures made prior to the filing of a certification application, particularly on those costs incurred during the pre-filing period. Therefore, on December 15, 2009, the Commission convened a technical conference seeking input and comments on the continuing propriety of the Commission's current policy of limiting the accrual of AFUDC, absent specific justification, to expenditures incurred after the filing of an application.<sup>9</sup> The Commission received extensive comments from numerous natural gas pipelines through pre- and post-technical conference filings and conference presentations and discussions.

14. In the technical conference proceeding, commenters argue that since AR-5 was issued, the natural gas industry and the process for obtaining Commission authorization to construct and operate pipeline facilities have gone through many changes;<sup>10</sup> and therefore, AR-5 is no longer consistent or compatible with the current regulatory or business landscape. Commenters assert that the principle behind AFUDC is that regulated entities are entitled to the opportunity to earn a return on the cost of prudently incurred expenditures, including the opportunity to recover the cost of funds used during construction. Commenters argue that Commission rulings denying early accrual of AFUDC: 1) elevate form over substance by drawing a line between costs incurred before and after a pipeline files a formal application for a construction certificate; 2) creates a

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<sup>8</sup> *Fayetteville Express Pipeline LLC*, 129 FERC ¶ 61,235 (2009); *Pacific Connector Gas Pipeline, LP*, 129 FERC ¶ 61,234 (2009); *Southern Natural Gas Co.*, 128 FERC ¶ 61,198 (2009); *Texas Eastern Transmission, LP*, 129 FERC ¶ 61,151 (2009); *Midcontinent Express Pipeline LLC*, 128 FERC ¶ 61,253 (2009); *Ruby Pipeline, LLC*, 128 FERC ¶ 61,224 (2009); *Gulfstream Natural Gas System, L.L.C.*, Docket No. CP10-4-000; *Wyoming Interstate Company, Ltd.*, Docket No. CP09-449-000.

<sup>9</sup> *Notice of Technical Conference on Commission Policy on Commencement of Accrual of Allowance for Funds Used During Construction*, 74 Fed. Reg. 65,117 (December 2, 2009). Pre-technical conference comments were due December 11, 2009. Post-technical conference comments were due December 29, 2009.

<sup>10</sup> Commenters explain that these changes include extensive preparation of an environmental assessment or environmental impact statement to fulfill the requirements of the National Environmental Policy Act and the Commission's pre-filing program.

disincentive for pipelines to participate in the pre-filing process; and 3) may affect the incentive to invest in building new pipelines.

15. Most commenters recommend that the Commission adopt criteria similar to those established in FAS 34 to determine when natural gas pipelines should be permitted to commence accrual of AFUDC.<sup>11</sup> Additionally, some commenters suggest that the Commission establish a presumption that all costs incurred after the initiation of the pre-filing process should accrue AFUDC without review. Further, commenters propose that pipelines should accrue AFUDC on costs incurred prior to the initiation of pre-filing, provided that the pipeline can affirmatively demonstrate that those costs were prudent and necessary to the construction of the project.

16. Most commenters advocate that the Commission need not adopt a new “bright-line” standard for determining when a pipeline may commence the accrual of AFUDC. Rather, they state the Commission should permit pipelines to accrue AFUDC on all costs prudent and necessary to the construction of the project regardless of when those costs are incurred. As stated, commenters recommend that the Commission rely on the guidance provided in FAS 34 for determining when AFUDC accruals may commence. However, if a “bright-line” test is needed by the Commission, commenters propose establishing a “safe harbor” date that is at least 180 days prior to the date on which a pipeline files a request to initiate the pre-filing process.

17. One commenter, however, asserts that changing the Commission’s policy on AFUDC accrual could have wide-ranging impacts on shippers as well as pipelines, which have not been fully quantified. Therefore, the commenter recommends that pipelines provide greater transparency when proposing the recovery of AFUDC-related costs and provide complete and detailed information that supports the calculation and reporting of AFUDC costs.

#### **IV. Discussion**

18. As discussed below, based on the comments received in the technical conference and in Florida Gas’ request for rehearing, we will grant Florida Gas request for rehearing and authorize it to include its requested level of pre-certificate filing AFUDC in its initial rates.

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<sup>11</sup> FAS 34 provides that the capitalization period shall begin when three conditions are present: (1) expenditures for the asset have been made, (2) activities that are necessary to get the asset ready for its intended use are in progress, and (3) interest cost is being incurred. *See* FAS 34, paragraph 17; *see also* reference in FASB ASC Subtopic 835-20, Capitalization of Interest.

19. In establishing cost-based rates, the Commission has traditionally included only costs relating to utility plant that is “used and useful” in providing utility service. However, the Commission recognizes that jurisdictional companies incur costs related to funds invested in construction projects prior to the time that facilities are placed in or ready for service, and accordingly, has permitted jurisdictional companies to reflect these financing costs by accruing AFUDC. When utility plant is placed in service, the cost of the facilities, along with the accrued AFUDC, is capitalized and included in utility plant and rate base. The company then recovers the construction costs, which include the accrued AFUDC, through approved depreciation rates over the useful life of the utility plant.

20. Gas Plant Instruction 3(17) of the Commission’s regulations<sup>12</sup> prescribes the formula for determining the maximum amount of AFUDC that may be capitalized as a component of construction costs. AFUDC represents the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate of return on other funds. The Commission has restricted the maximum amount of AFUDC that a natural gas pipeline is allowed to capitalize to a rate not to exceed the overall rate of return underlying its recourse rates.<sup>13</sup>

21. The Commission has historically relied on the guidance issued by the Commission’s Chief Accountant in AR-5 to address when a company may begin to accrue AFUDC. Under this guidance, a company may begin accruing AFUDC on construction costs when such costs are continuously incurred on a planned progressive basis, but AR-5 also provides that interest should not be accrued for the period of time prior to the date that a pipeline files a certificate application with the Commission, unless the company otherwise justifies such an accrual. Our ruling in the November 19 Order denying accrual of AFUDC on costs incurred prior to the filing of Florida Gas’ certificate application was based on this guidance.

22. However, as Florida Gas and comments filed in conjunction with the technical conference point out, the natural gas industry has undergone significant changes since the issuance of AR-5 in 1968. We find that these changes require the Commission to reconsider its longstanding policy of limiting AFUDC accruals generally to those costs incurred after a certificate application is filed with the Commission. Of particular note, in 2001, the Commission’s Office of Energy Projects instituted an optional pre-filing

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<sup>12</sup> 18 C.F.R. Part 201 (2009).

<sup>13</sup> See *Gulfstream Natural Gas System, L.L.C.*, 91 FERC ¶ 61,119 (2000); *Buccaneer Gas Pipeline Co., L.L.C.*, 91 FERC ¶ 61,117 (2000).

process and encouraged entities seeking authorization to construct new facilities to prepare and submit to the Commission conceptual design and engineering features of the proposed project, as well as extensive information about potential environmental, security and safety impacts prior to the filing of an actual certificate application.<sup>14</sup> Today, many natural gas pipeline companies use the pre-filing process with much success before seeking a construction certificate. Additionally, as a result of the Energy Policy Act of 2005,<sup>15</sup> it is mandatory for all applicants seeking to construct new LNG facilities to use the pre-filing process.<sup>16</sup> Natural gas pipelines that participate in the pre-filing process typically engage in activities that require them to incur significant project-related expenditures prior to the filing of a certificate application. These activities may include, but are not limited to, landowner meetings, route planning, performing environmental impact and other studies, and incurring costs to comply with a myriad of state and federal requirements. In today's market environment, pipeline companies often also find it necessary to make expenditures to acquire right-of-ways, secure pipe mill space, line pipe, and other equipment in advance of actually filing their certificate applications, in order to meet proposed in-service dates.

23. Since many natural gas pipelines take advantage of the pre-filing process and incur significant construction project-related costs during this time, they may be at risk of not being able to capture all the cost of financing their construction projects if they cannot accrue AFUDC on expenditures made prior to the filing of a certificate application. In the 1960s, and for many years thereafter, costs incurred prior to the filing of a certificate application were generally immaterial and preliminary in nature. Accordingly, the guidance provided in AR-5 was appropriate at the time it was issued. However, in light of the current landscape in the natural gas industry, the certificate application date is no longer an appropriate milestone for determining when construction project-related expenditures begin, and thus for when to begin accruing AFUDC. Therefore, the

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<sup>14</sup> See Office of Energy Projects Gas Outreach Team, *Ideas for Better Stakeholder Involvement in the Interstate Natural Gas Pipeline Planning Pre-Filing Process*, December 2001, available at <http://www.ferc.gov/legal/maj-ord-reg/land-docs/stakeholder.pdf>.

<sup>15</sup> Pub. L. No. 109-58, 119 Stat. 594 (2005).

<sup>16</sup> *Regulations Implementing Energy Policy Act of 2005; Pre-Filing Procedures for Review of LNG Terminals and Other Natural Gas Facilities*, Order No. 665, 70 Fed. Reg. 60,426 (October 18, 2005), FERC Stats. & Regs., Regulations Preambles 2001-2005 ¶ 31,195 (2005). See also section 157.21 of the Commission's regulations. 18 C.F.R. § 157.21 (2009) (Pre-filing procedures and review process for LNG terminal facilities and other natural gas facilities).

Commission will revise its policy for when natural gas pipelines may begin accruing AFUDC based on the criteria set forth below.

24. In revising its policy on the accrual of AFUDC by natural gas pipelines, the Commission finds that it is important that the policy be in harmony with the recent developments in the natural gas industry. In addition, the policy should allow AFUDC capitalization on all prudent construction costs and serve to promote infrastructure development by allowing for recovery of all monies invested in the construction of interstate facilities. Moreover, the policy should be directly correlated to the occurrence of construction project-related expenditures incurred to prepare the construction project for its intended use and not tied to a bright line date or particular milestone. Finally, in order to protect shippers, compliance with the revised policy on AFUDC accrual should be transparent and subject to review by the Commission.

25. Based on the above objectives, the Commission will revise its policy and allow natural gas pipelines to begin accruing AFUDC on construction projects when the following two conditions are met: (1) capital expenditures for the project have been incurred and (2) activities that are necessary to get the construction project ready for its intended use are in progress. The term “activities” is to be construed broadly. It includes all the actions required to prepare the construction project for its intended use. Also, it includes activities prior to physical construction, such as the development of plans or the process of obtaining permits from governmental authorities. Moreover, “activities” include costs pursuant to Gas Plant Instruction No. 3.<sup>17</sup>

26. The term “activities” does not include preliminary survey and investigation activities. Activities occurring prior to the revised policy conditions being met would be considered preliminary in nature for the purpose of determining feasibility of projects under contemplation and would be included in Account 183.2, Other Preliminary Survey and Investigation Charges. These preliminary activities would not be subject to AFUDC accruals until such a time as the revised policy conditions are met and the amounts included in Account 183.2 are transferred to Account 107, Construction Work in Progress.

27. The Commission will continue to apply the existing standard for determining when AFUDC accruals must cease. Pipelines may continue to accrue AFUDC for as long as the two conditions in the revised policy continue to be met. However, the accrual of AFUDC must cease once the facility has been tested and is ready for or placed in service. Also, if a natural gas pipeline suspends substantially all activities related to the construction of pipeline facilities, AFUDC accruals must cease unless the company can justify the interruption as being reasonable under the circumstances.

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<sup>17</sup> 18 C.F.R. Part 201 (2009).

28. Although the Commission finds that it is unnecessary to establish a bright line for when natural gas pipelines may begin to accrue AFUDC, we find that the date that the Commission approves the request to initiate the pre-filing process is a strong indicator of the initiation of construction project-related activities. Therefore, for the purposes of implementing this revised policy, construction project-related costs incurred subsequent to the pre-filing date will be eligible for AFUDC accrual, save a showing to the contrary, provided that capital expenditures have been incurred and activities are underway to get the asset ready for its intended purpose. However, the pre-filing date in and of itself is not to be construed as the date that a natural gas pipeline may begin to accrue AFUDC without applying the revised policy conditions. Furthermore, to accrue AFUDC prior or subsequent to the initiation of pre-filing, we reiterate that natural gas companies must be prepared to demonstrate that capital expenditures are being incurred and activities necessary to get the construction project ready for its intended use are in progress. Therefore, the Commission will require applicants seeking a certificate of public convenience and necessity for authorization to construct pipeline facilities to make a representation in their filing that AFUDC accruals included in the cost of the facilities are calculated in accordance with the Commission's rules and regulations and pursuant to and consistent with the following conditions: (1) capital expenditures for the project have been incurred and (2) activities that are necessary to get the construction project ready for its intended use are in progress. The Commission finds that this revised policy will serve to promote infrastructure development and will allow natural gas companies the opportunity to earn a return on all prudent expenditures made during project construction.

29. Consistent with the Commission's existing records retention requirements,<sup>18</sup> pipelines must retain records supporting the commencement of AFUDC accruals, and such AFUDC accruals will be subject to scrutiny through Commission audit or rate review, just as any other cost would.

### **Commission Determination**

30. We believe that this order adequately addresses the issues raised by Florida Gas in its request for rehearing. Based on the discussion above and our revised AFUDC policy the Commission grants rehearing of the November 19 Order and will allow Florida Gas to include its proposed AFUDC in its initial rates, subject to Florida Gas filing a representation that its originally proposed AFUDC accruals comply with the requirements set forth above. Furthermore, if Florida Gas determines that its proposed AFUDC accruals should be revised in light of the revised policy conditions, it must revise all cost-of-service items dependent upon Gas Plant in Service such as Income

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<sup>18</sup> 18 C.F.R. Part 225 (2009).

Taxes, Depreciation Expense, Return, and Interest Expense, and file its revised rates and work papers in sufficient time for the Commission to act on the revised rates prior to filing the tariff sheets to implement those rates.

31. Lastly, the Commission directs the Chief Accountant to revise AR-5, consistent with the revised policy directives herein.

The Commission orders:

(A) Florida Gas's request for rehearing is granted.

(B) Florida Gas shall file a representation that its proposed AFUDC accruals for the project comply with the revised policy conditions. In the alternative, if Florida Gas determines that its proposed AFUDC accruals should be revised in light of the revised policy conditions, it shall revise all cost-of-service items dependent upon Gas Plant in Service such as Income Taxes, Depreciation Expense, Return, and Interest Expense, and file its revised rates and work papers in sufficient time for the Commission to act on the revised rates prior to filing the tariff sheets to implement those rates.

(C) Florida Gas and its representations made with respect to AFUDC accruals are subject to audit to determine whether it is in compliance with the revised policy and related Commission rules and regulations.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.