

154 FERC ¶ 61,186
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

Kern River Gas Transmission Company

Docket No. AC12-53-000

ORDER DENYING REQUEST TO COMPOUND ALLOWANCE FOR FUNDS USED
DURING CONSTRUCTION ON A MONTHLY BASIS RATHER THAN
SEMIANNUALLY

(Issued March 10, 2016)

1. In this order, we deny a request by Kern River Gas Transmission Company (Kern River) to depart from the Commission's longstanding methodology for calculating a natural gas company's allowance for funds used during construction (AFUDC) when it calculates the AFUDC for its Apex Expansion project (Apex Project) and other current and prospective projects so that the allowance calculated for these projects could be compounded monthly rather than semiannually. We will require Kern River to calculate AFUDC in accordance with the Commission's precedent in FPC Order Nos. 561 and 561-A¹ and the instructions in 18 C.F.R. Part 201.

¹ See *Amendments to Uniform System of Accounts for Public Utilities and Licensees and For Natural Gas Companies to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, Order No. 561, 57 FPC 608, 612 (1977) (FPC Order No. 561), *reh'g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶ 61,050 (1978) (FPC Order No. 561-A). FPC Order No. 561 provides that the cost of construction shall include the net cost, for the period of construction, of borrowed funds and a reasonable rate on other funds when so used, not to exceed allowances computed using a rate determined in accordance with the formula contained in Gas Plant Instruction No. 3(17), Allowance for Funds Used During Construction. See 18 C.F.R. Part 201 (2015). We refer these orders as "FPC orders" to avoid confusion with Order Nos. 561 and 561-A that were later issued by the Federal Energy Regulatory Commission and that concern different matters.

I. Background

2. Kern River is a general partnership formed under the laws of the State of Texas that operates an interstate natural gas pipeline extending from Wyoming, through Utah and Nevada, to California. Kern River is a “natural gas company” under the Natural Gas Act (NGA)² engaged in the interstate transportation of natural gas. On November 2, 2009, Kern River filed an application with the Commission in Docket No. CP10-14-000 for a certificate of public convenience and necessity to construct and operate its Apex Project. Kern River proposed that the project would include an approximately 28-mile 36-inch diameter pipeline, three new compressor units, restaging of three boost compressors and replacement of another, and a new compressor station. Kern River represented that the Apex Project would add an additional 78,000 units of horsepower (as rated by the International Organization for Standardization) to its existing pipeline system. Kern River estimated the total cost of the Apex Project to be \$373.4 million, including approximately \$22 million of AFUDC. Kern River commenced service on the Apex Project facilities on October 1, 2011.³ The Commission granted the requested authorizations, subject to conditions.⁴

3. Kern River executed a precedent agreement and a long-term, firm transportation service agreement with Nevada Power Company d/b/a NV Energy (NV Energy) for the full capacity of the Apex Project facilities, a total of 266,000 dekatherms per day of forward-haul firm transportation service.⁵ The agreements state that the initial term of the transportation service agreement commenced on the in-service date of the Apex Project facilities, and extends for 20 years. Kern River charges shippers taking service over the Apex Project facilities incremental transportation and fuel reimbursement rates.⁶ According to Kern River, the cost of service of the Apex Project is only recovered from shippers on the facilities.

² 15 U.S.C. § 717 (2012).

³ See Kern River Transmission Company, Notice of Placement in Service of Apex Expansion Facilities, Docket No. CP10-14-000 filed October 5, 2011.

⁴ *Kern River Gas Transmission Co.*, 132 FERC ¶ 61,226 (2010).

⁵ The Commission accepted the agreements in a letter order issued in Docket No. No. RP09-457-000, *Kern River Gas Transmission Co.*, 127 FERC ¶ 61,203 (2009).

⁶ Third Revised Sheet No. 5-B to Kern River's FERC Gas Tariff, Third Revised Volume No. 1.

4. On March 29, 2012, as supplemented on September 6, 2012, Kern River filed a request for Commission approval to calculate the AFUDC on its Apex Project and on other current and prospective projects based on a monthly compounding, rather than compounding on a semi-annual basis.

II. Notice of Filing and Interventions

5. Notice of Kern River's filing was published in the *Federal Register*, 77 Fed. Reg. 24,483 (2012), with interventions and protests due on or before May 17, 2012. The Public Utility Commission of Nevada (Nevada Commission) filed a notice of intervention and comments and NV Energy filed a timely motion to intervene and a protest. Kern River filed an answer to the protests of NV Energy and Nevada Commission on May 21, 2012. NV Energy filed an answer to Kern River's answer on June 5, 2012. On August 17, 2012, the Director, Division of Audits, Office of Enforcement issued a letter under delegated authority directing Kern River to provide additional information. On September 6, 2012 Kern River submitted its response to the August 17, 2012 letter.

III. Discussion

A. Procedural Matters

6. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2015), Nevada Commission's notice of intervention and NV Energy's timely, unopposed motion to intervene serve to make them parties to this proceeding.

7. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2015), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept Kern River's May 12, 2012 answer or NV Energy's June 5, 2012 answer and, therefore, will reject them.

B. Kern River's Proposed Accounting Treatment for AFUDC

1. Kern River's Proposal

8. Kern River seeks authorization to compound AFUDC on a monthly basis on its Apex Project and on current and prospective construction projects, effective January 1, 2012. Kern River concedes that FPC Order No. 561 prohibits compounding AFUDC on a basis more frequent than semiannual because the Commission determined that cash outlays for interest and dividends are not normally made on a monthly basis.⁷ However,

⁷ Kern River's March 29, 2012 Accounting Request at 2.

Kern River contends that this prohibition should not apply to it because it has arranged to pay interest and principal on its debt and dividends on a monthly basis. Kern River explains that it pays interest and principal for the Apex Project on a monthly basis in accordance with the terms of its debt indentures. Kern River also explains that dividends are paid on a monthly basis equal to its distributable cash (as determined by certain debt covenants), unless there is a major construction project or other major planned expenditure that may require the dividend funds be retained to pay for those expenditures.⁸ Kern River pledges that, if it were to cease paying dividends or interest on a monthly basis for a reason other than funding construction projects and maintaining a minimum cash balance, it will cease compounding AFUDC monthly and would compound semiannually.

9. Kern River asserts that, if it is allowed to adjust the amount of AFUDC to capitalize its costs by compounding AFUDC on a monthly basis, rather than semiannually, this would more accurately reflect its true cost of funds used to construct the Apex Project. Kern River represents that monthly compounding of AFUDC would result in an increase in the cost of the Apex Project of \$390,049 as compared to AFUDC costs calculated based on semiannual compounding.⁹

10. Kern River states that it currently compounds AFUDC on a semiannual basis in accordance with Commission policy and FPC Order No. 561 using a reduced rate method to convert its annual AFUDC rate into an equivalent monthly rate. Kern River explains that, in the determination of its requested annual AFUDC rate based on monthly compounding, it will modify the reduced rate method to derive an equivalent monthly rate. Kern River asserts that this method is consistent with the method endorsed by Commission Staff in the *Trans-Elect* proceeding.¹⁰

⁸ Kern River contends that the suspension of monthly dividend distributions resulting from payments to fund construction projects or other expenditures should continue to be treated as if a monthly distribution had been made because the company could continue to make the dividend distributions and then receive a contribution from its parent to fund the construction project and other activities.

⁹ Kern River's March 29, 2012 Accounting Request, Exhibit 1, reflected \$743,461 as the incremental additional AFUDC to be capitalized based on monthly, rather than semiannual, compounding. Kern River subsequently corrected this amount in its supplemental filing, Response to August 17, 2012 Data Request, submitted on September 6, 2012, to reflect an incremental impact of \$390,049 additional AFUDC using monthly, rather than semiannual, compounding.

¹⁰ Kern River's March 29, 2012 Accounting Request at n.2 (citing *Trans-Elect NTD Path 15, LLC*, Docket Nos. ER05-17-000 and 002 (Oct. 24, 2005)). Note that, in (*continued ...*)

2. Protests

11. NV Energy contends that Kern River's proposal to compound AFUDC monthly rather than semiannually as provided in FPC Order No. 561 is inconsistent with long-established Commission policy. NV Energy states that the Commission has consistently upheld the semiannual compounding limit. Moreover, NV Energy asserts that the Commission specifically denied commenters requests for rehearing of the AFUDC compounding policy in FPC Order No. 561-A, where the Commission reasoned that although compounding semiannually may, in some instances, tend to understate the cost of capital used for construction, the policy nonetheless "provides for a rate for AFUDC which is in the zone of reasonableness, based upon uniform standards which can be effectively implemented and administered."¹¹ NV Energy argues, even assuming Kern River makes monthly interest payments and dividend distributions, the Commission's AFUDC compounding policy is not tied to the timing of interest and dividend payments by pipelines.

12. NV Energy argues that Kern River's proposal to compound AFUDC monthly even when it has suspended monthly distributions leads to non-uniformity and will not be easily implemented or administered. NV Energy asserts that allowing a pipeline to switch between monthly and semiannual compounding at its discretion, as Kern River requests, based on internal decisions regarding distributions, would require constant vigilance by the Commission to ensure that the pipeline was properly accounting for AFUDC at any particular moment. NV Energy states that approving Kern River's proposal would subject the computation of its AFUDC to manipulation at the pipeline's whim.

13. NV Energy states that Kern River alleges its proposal is consistent with the AFUDC method endorsed by the Commission's Trial Staff in *Trans-Elect NTD Path 15, LLC*. NV Energy points out that, in the *Trans-Elect* proceeding, notwithstanding the position taken by any party in that proceeding, the Commission declined to authorize the monthly compounding of AFUDC, and instead required the use of semiannual compounding in the calculation of AFUDC.

14. Nevada Commission states that it generally agrees with NV Energy's positions and it likewise opposes Kern River's attempt to compound AFUDC on a monthly basis.

Trans-Elect NTD Path, LLC, 117 FERC ¶ 61,214, at PP 57-61 (2006), the Commission reversed the Initial Decision (113 FERC ¶ 63,039, at P 75 (2005)) and reaffirmed FPC Order No. 561 that requires AFUDC rates to be compounded no more frequently than semiannually.

¹¹ NV Energy Comments at 5 (quoting FPC Order No. 561-A).

Further, Nevada Commission states that the Commission has recently affirmed its continuing applicability of the semiannual compounding frequency limit in a recent denial of a request for monthly compounding.¹² Nevada Commission asserts that the compounding request was denied because it resulted in a higher amount of interest than allowed for construction expenditures that accrue AFUDC. Nevada Commission notes that, as shown in Exhibit 2 of Kern River's accounting request, the proposed monthly compounding rate exceeds the semiannual compounding rate. Nevada Commission also states that Kern River provides no legal authority for its request to compound AFUDC on a monthly basis. Additionally, Nevada Commission states that Kern River cites the Initial Brief of the Commission Trial Staff in the *Trans-Elect* proceeding in which the Commission ultimately expressly rejected the proposal for monthly compounding of AFUDC.¹³

C. Commission Determination

15. The Federal Power Commission amended its gas plant accounting requirements contained in the Uniform System of Accounts Prescribed for Natural Gas Companies (USofA) and established a formula for determining the maximum rate for capitalization of AFUDC in FPC Order No. 561. This policy remains unchanged. The stated objective of FPC Order No. 561 was to establish a method that gives recognition to the interrelationship between capital used for rate case purposes and the capital components of AFUDC in a manner that would permit a utility to achieve a rate of return on its total utility operations, including its construction program, at approximately the rate which would be allowed in a rate case.¹⁴ Specifically, FPC Order No. 561 provides that the AFUDC rate is determined annually using a formula that includes actual long-term debt, preferred stock, and common stock balances as of the end of the prior year, and respective cost rates.¹⁵ The AFUDC formula also includes estimates for average construction work in progress and short-term debt balances, and short-term debt rates. FPC Order No. 561 also requires natural gas companies to compare the AFUDC rate using estimates to actual experience and adjust capitalized AFUDC, if a significant deviation (25 basis points) between AFUDC rates computed based on estimated and

¹² Nevada Commission Comments at 3 (citing *Midwest Indep. Transmission Sys. Operator, Inc.*, 138 FERC ¶ 61,021 (2012)).

¹³ *Id.* (citing *Trans-Elect NTD Path 15, LLC*, 117 FERC ¶ 61,214 (2006)).

¹⁴ FPC Order No. 561, 57 FPC at 608.

¹⁵ The cost rate for long-term debt and preferred stock is the weighted average costs determined under 18 C.F.R. Part 154 (D) and the cost rate for common stock is the rated granted in the last rate proceeding.

actual realized inputs should occur. Additionally, FPC Order No. 561 requires that compounding of AFUDC occur no more frequently than semiannually.¹⁶ In FPC Order No. 561, the Commission reasoned that monthly compounding of AFUDC may result in excessive amounts of AFUDC capitalized since cash outlays for interest and dividends are not normally made on a monthly basis.

16. In FPC Order No. 561-A, the Commission responded to requests for rehearing in support of monthly compounding of AFUDC on the basis that cash outlays for interest and dividends are often made more frequently than semiannual. Despite these arguments, the Commission denied the respondents' request for rehearing. The Commission noted that that in some instances semiannual compounding would understate the cost of capital used for construction. Additionally, the Commission noted that there may be relatively minor items of consumer contributed capital which are not considered in either the ratemaking process or through AFUDC and there may well be some instances in which the estimates used result in an AFUDC rate that exceed by up to 25 basis points the rate that would be derived from actual experience. Therefore, the Commission concluded that FPC Order No. 561 should not be modified with respect to these matters because when considered together the proposed modifications tend to offset each other.¹⁷ The Commission concluded that FPC Order No. 561 provides for a rate for AFUDC that is in the zone of reasonableness and provides a uniform standard that can be effectively implemented and administered.¹⁸

17. The Commission has consistently upheld its general directive of FPC Order No. 561 that limits compounding of AFUDC to no more frequently than semiannual. In cases where companies were found to have compounded AFUDC more frequently than semiannual, the Commission directed the companies to adjust their AFUDC semiannually.¹⁹ The Commission has denied more frequent compounding on the basis that (1) the calculated AFUDC rate exceeded the overall rate of return on operating

¹⁶ FPC Order No. 561, 57 FPC at 612.

¹⁷ *Id.*

¹⁸ FPC Order No. 561-A, 59 FPC at 1345.

¹⁹ *Ingleside Energy Center, LLC*, 112 FERC ¶ 61,101, at P 81 (2005); *Iroquois Gas Transmission System, L.P.*, 64 FERC ¶ 62,211, at 64,267 (1993); *Endicott Pipeline Co.*, 55 FERC ¶ 63,028, at 65,154 (1991); *Trunkline LNG Co.*, 29 FERC ¶ 61,195 (1984), *aff'd in part and rev'd in part on other grounds*, Opinion No. 319, 45 FERC ¶ 61,256 (1988); *Carolina Power & Light Co.*, 4 FERC ¶ 61,203, *reh'g denied*, 5 FERC ¶ 61,065 (1978) (where the Commission affirmed the ALJ's decision that semiannual compounding should be permitted consistent with FPC Order No. 561's principles).

assets;²⁰ or (2) the company did not have cash outlays representative of monthly payments of interest and dividends.²¹ In addition, the Commission has denied past requests to retroactively adjust AFUDC on the part that is not offset by the overcollection of AFUDC adjusting entry.²²

18. Kern River interprets FPC Order No. 561 and *Trans-Elect* to imply that the Commission permits monthly compounding of AFUDC when an entity pays dividends and interest on debt monthly. However, Kern River's position is incorrect. In FPC Order No. 561, the Commission stated:

We believe that a monthly compounding of AFUDC as suggested by some respondents may result in excessive amounts capitalized since cash outlays are not normally made on a monthly basis. We shall therefore permit compounding but no more frequently than semiannually.^[23]

In announcing this policy it is clear that the Commission understood that, while not the normal practice, in some instances cash outlays are made on a monthly basis. This did and does not mean, as argued by Kern River, that if a pipeline makes outlays on a monthly basis it is entitled to compute AFUDC compounded on a monthly basis. It must follow the same rule applicable to everyone else and compute AFUDC compounded no more frequently than semiannually. In FPC Order No. 561, the Commission promulgating a rule of general application and was not deciding an individual proceeding based on the specific facts in an isolated case, and where the outcome in future cases would vary in each individual case based on the particular facts presented.

19. The fact that Kern River chose to enter transactions wherein it agreed to pay interest on a monthly basis does not change this requirement and does not dictate a different result. The Commission's methodology was established long before Kern River made these arrangements and Kern River was on notice of how the Commission requires AFUDC to be computed. While this did not prevent Kern River from making interest payments more frequently, it did so with full knowledge of the Commission's policy on AFUDC. We do not find that Kern River's circumstances justify an exception to this rule.

²⁰ See *Gulfstream Natural Gas System, L.L.C.*, 91 FERC ¶ 61,119 (2000); *Buccaneer Gas Pipeline Company, L.L.C.*, 91 FERC ¶ 61,117 (2000).

²¹ See *Trans-Elect NTD Path 15, LLC*, 119 FERC ¶ 61,093, at P 14 (2007).

²² *Trunkline LNG Company*, 29 FERC ¶ 61,195 (1984).

²³ FPC Order No. 561, 57 FPC at 612.

20. Nor is Kern River's position supported by our precedent in *Trans-Elect*. In that proceeding, the Commission reversed the presiding ALJ's finding on this issue and found that AFUDC should be recomputed with compounding no more often than semi-annually.²⁴

21. Additionally, we find that Kern River's proposal for monthly compounding would yield an excessive AFUDC rate. By its nature, Kern River's proposal to compound AFUDC monthly results in higher amounts of AFUDC being capitalized compared to the amount that would be capitalized if AFUDC is compounded on a semiannual basis for current and future projects. For the Apex Project, monthly compounding would yield an additional \$390,049 of capitalized AFUDC. The additional amount capitalized would yield an AFUDC rate in excess of overall rate of return.

22. Kern River also states that, if it ceases to pay interest or dividends on a monthly basis for a reason other than funding construction projects and maintaining a minimum cash balance, it will cease monthly compounding and will calculate AFUDC based on semiannual compounding. As NV Energy mentioned, this proposal is not easily implemented or administered and Kern River's request would add an unnecessary complication to oversight of its actions. Because AFUDC is such an important part of ratemaking, permitting a pipeline to switch on its own terms the method it uses to compound AFUDC would require constant vigilance by the Commission to ensure proper accounting.

23. Finally, in the *Trans-Elect* proceeding cited by Kern River, Trans-Elect did not request monthly compounding of AFUDC in its initial certificate application and the Commission concluded that Trans-Elect "bore the burden of proof as to why this additional incentive is appropriate." Similarly, Kern River did not request monthly compounding of AFUDC in its certificate application for the Apex Expansion facilities and has failed to prove that the additional incentive of monthly compounding of AFUDC is either necessary or appropriate. In the past, the Commission concluded that data filed in a rate case can be "updated to reflect post-filing data if the updated data are shown to be reasonable."²⁵

24. Kern River has not justified a waiver of the requirement of FPC Order No. 561 to compound AFUDC more frequently than semiannually either going forward or retroactively for its Apex Project.

²⁴ *TransElect NTD Path 15, LLC*, 117 FERC ¶ 61,214 at P 61, *reh'g denied*, 119 FERC ¶ 61,093 at PP 13-17.

²⁵ *Williston Basin Interstate Pipeline Co.*, 67 FERC ¶ 61,137, at 61,370 (1994).

25. In the event that Kern River has not computed AFUDC consistent with the findings in this order and our findings in FPC Order No. 561 and the instructions in 18 C.F.R. Part 201 (i.e., if its computation of AFUDC reflects compounding more frequently than semiannually) then Kern River must submit a compliance filing within 60 days of the date of issuance of this order correcting its AFUDC calculation and issuing any refunds, if necessary. In such a compliance filing, Kern River must also provide a full explanation of how it has accounted for AFUDC for the Apex Project and whether any corrections are needed to bring that accounting into conformance with the Commission's policies, as discussed above.

The Commission orders:

(A) Kern River's request to compound AFUDC on a monthly basis is hereby denied, as discussed in the body of this order.

(B) Kern River is hereby directed to submit a compliance filing as needed, as explained in P 25, within 60 days of the date of issuance of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.