

COMM-OPINION-ORDER, 6 FERC ¶61,042, **Incentive Rate of Return for the Alaska Natural Gas Transportation System, Docket No. RM78-12**, (Jan. 17, 1979)

Incentive Rate of Return for the Alaska Natural Gas Transportation System, Docket No. RM78-12

[61,092]

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Incentive Rate of Return for the Alaska Natural Gas Transportation System, Docket No. RM78-12

Order No. 17-A

Order Confirming the Incentive Rate of Return Mechanism and Denying Petition for Reconsideration and Clarification

(Issued January 17, 1979)

Before Commissioners: Charles B. Curtis, Chairman; Don S. Smith, Georgiana Sheldon, Matthew Holden, Jr. and George R. Hall.

[Note: Published in the Federal Register on January 30, 1979 (44 F.R. 5929).]

I. Background

On December 1, 1978, in [Order No. 17](#) (in the above-referenced docket), [5 FERC ¶61,199](#), the Federal Energy Regulatory Commission (Commission) appended certain Incentive Rate of Return (IROR) terms and conditions to the conditional certificates of public convenience and necessity for the Alaska Natural Gas Transportation System (ANGTS). These conditions were developed pursuant to a rulemaking. An original notice (May 8, 1978, [3 FERC ¶61,111](#)) and a revised notice (September 15, 1978, [4 FERC ¶61,315](#)) of proposed rulemaking were issued soliciting comments on the IROR mechanism. The Commission in [Order No. 17](#) solicited further comments and scheduled an oral argument before the Commission on the sole issue of the inclusion of an allowance for funds used during construction (AFUDC) in the Cost Performance Ratio of the IROR mechanism. Written comments were received on December 19, 1978, from three interested parties: (1) the Alaskan Northwest Natural Gas Transportation Company, a Partnership; (2) the Northern Border Pipeline Company, and (3) the Office of Regulatory Analysis, Federal Energy Regulatory Commission. Representatives of these same parties presented oral arguments to the Commission on December 21, 1978. Members of the Commission attending were Don S. Smith (presiding), Charles B. Curtis, Georgiana Sheldon, and Matthew Holden, Jr. This order affirms the terms and conditions in [Order No. 17](#) and provides additional information concerning future proceedings to implement the IROR mechanism.

II. AFUDC in the Cost Performance Ratio

In their comments on the revised notice of September 15, the project sponsors (Alaskan Northwest and Northern Border) stated that the IROR mechanism as proposed in the revised notice was unacceptable to the sponsors and would result in the sponsors seeking Federal financial assistance. The major area of concern to the sponsors was the inclusion of AFUDC in the Cost Performance Ratio and a consequent reduction in the IROR if there are delays in construction. In response to valid criticisms and in order to make AFUDC consistent with other cost components in the Cost Performance Ratio, the Commission in [Order No. 17](#) made four changes to or clarifications of the IROR mechanism. These are:

1. AFUDC will be calculated from a Real Rate of Return on equity and debt, after removing the effects of inflationary expectations, instead of the nominal or current dollar rates.

2. The IROR will not be reduced for delays occurring prior to the granting of a final certificate of public convenience and necessity by the Commission.

3. The Change in Scope procedure, to be the subject of a separate rulemaking, " * * * will absolve the project sponsors of responsibility for delays which are clearly the fault of the government." ¹

4. The rulemaking on Change in Scope will also address the issue of " * * * what other delays and cost increases are truly beyond the project sponsors' control." ²

The net effect of these adjustments to the IROR mechanism is to greatly reduce the penalty for delay. However, because of the importance given to the AFUDC issue by the sponsors, the Commission concluded that submittal of additional written comments and presentation of oral arguments were appropriate before a final ruling on this matter.

III. *Resolution of the AFUDC Issue*

Upon consideration of the written and oral views and comments received on the AFUDC issue, it is this Commission's judgment that AFUDC should remain in the Cost Performance Ratio as provided by the Commission in [Order No. 17](#). In reaching this judgment the Commission is appreciative of the incentive effects discussed by the Commission's Office of Regulatory Analysis (ORA) but

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is at least equally influenced by a factor discussed during the oral argument by both the Office of Regulatory Analysis ³ and Alaskan Northwest, ⁴ sponsor of the Alaskan segment of the ANGTS: namely, the relationship of the Commission's decision to the Canadian IROR mechanism.

The filed capital costs which are to form the basis for the Canadian IROR mechanism are specified in Annex III to the "Agreement between the United States of America and Canada on Principles Applicable to a Northern Natural Gas Pipeline." ⁵ These filed costs, which are to be in the denominator of the Canadian IROR mechanism's Cost Performance Ratio, ⁶ contain an allowance for AFUDC. Similar treatment for the sponsors of the U.S. segments requires inclusion of AFUDC in the IROR Cost Performance Ratio for the U.S. companies.

While deciding that AFUDC should be included in the Cost Performance Ratio, the Commission, as previously stated, ⁷ is sympathetic to the project sponsors' concerns about delays caused by the government. As specified in [Order No. 17](#), it is the Commission's intention that the Change in Scope procedure will hold the project sponsors harmless for delays caused by the government.

In proceeding to resolve the remaining issues, the Commission observes that the consumer of gas delivered by the ANGTS shares with the project sponsors an interest in a regulatory environment that provides a fair distribution of the risks and benefits associated with the ANGTS, because of the potential impact of that environment on consumer costs. Both the project sponsors and gas consumers have a legitimate right to identify which delays and cost increases are the fault of the government and which are the fault of the project sponsors, and to hold each accountable for its actions. Thus, providing a credible, fair regulatory environment is as important to gas consumers as it is to the project sponsors. The Commission's complete IROR mechanism will contribute to such an environment.

IV. *Certification Procedures and Schedules*

The Commission notes the view, expressed by counsel for the Alaskan Northwest Natural Gas Transportation Company, that

[n]o assessment of the [impact on private financing] of the December 1 order [[Order No. 17](#)] is

possible until the related issues which have been carved out for later resolution have been answered.⁸

The Commission shares this view and recognizes its role in resolving the remaining issues. Indeed, the discussion presented herein regarding certification procedures and schedule is an expression of the Commission's intention to expedite resolution of the remaining issues.

The Commission understands that putting the various pieces of the IROR mechanism in place one at a time, by means of [Order No. 17](#), the Change in Scope procedure, and so forth, makes it somewhat difficult for the project sponsors to evaluate the overall impact of the IROR mechanism on the project as an investment proposition. In this regard, the Commission takes note of the sponsors' Joint Petition for Reconsideration and Clarification,⁹ which in effect requests deferral of final Commission action on the matters addressed in [Order No. 17](#) until more of the IROR pieces are in place.¹⁰

Against this request the Commission must balance Northwest Alaskan's concerns about " * * * delay and its Siamese twin, uncertainty." ¹¹ The Commission does not anticipate that its resolution of any of the matters addressed by [Order No. 17](#) (or by this order) will change. Therefore, in the interest of providing some certainty about the matters which the Commission has previously addressed, and in the interest of focusing the efforts of both the Commission and other interested parties on the matters which remain to be resolved, the Commission denies the sponsors' request for reconsideration.

The Commission also understands the project sponsors' concerns that the equity support for expenditures required to develop the project to the point of filing for final certification is difficult to generate if "[t]he equity sponsors must invest their equity to find out if their equity investment is sound." ¹² The Commission is willing to do what it properly can to expedite the certification process or to modify it so as to reduce risk to investors in a manner consistent with the Commission's general mandate to protect the public interest. With regard to the procedure and timetable for determining the various rates of return and the overall IROR schedule, the Commission offers the following elaboration upon its comments on this subject in [Order No. 17](#):

-- Footnotes --

¹. Project company tariff/Operation Phase Rate determination: The Commission expects a report by the end of January 1979 from the Alaskan Delegate on tariff issues in the context of the risk allocation framework during the operation phase. That report should provide sufficient discussion to serve as framework for setting the Operation Phase Rate, as well as for acting on the project sponsors' proposed tariff.

Upon completion of the report, the Commission will order filing of tariff applications by a date certain for each segment of ANGTS. The Commission expects to circulate concurrently to interested parties for comment the tariff filings and the Delegate's report, then to act on the tariff filings according to an expedited schedule to be specified in the Commission's order.

Upon approval of the project company tariff, the Commission will immediately begin a rulemaking for setting the Operation Phase Rate. The Commission will order that the filing from the project sponsors contain enough information about their intended financing plan to allow an evaluation

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of financial risks along with all other operation phase risks.

². Non-Incentive Rate determination: The Alaskan Delegate should also report to the Commission within 30 days of issuance of this order regarding project risks during construction other than those associated with the IROR mechanism. The Commission intends to utilize this report as the basis for a rulemaking to determine the Project Risk Premium.

The Project Risk Premium added to the Operation Phase Rate comprises the Non-Incentive Rate. As the Non-Incentive Rate is used to compute AFUDC during the pre-construction period, establishing this rate should allow the project sponsors to evaluate the potential return on project development expenditures.

³. Change in Scope Procedure/Center Point/IROR Risk Premium/Marginal Rate: the Alaskan Delegate advises that these issues are strongly interrelated, and there is no obvious procedural route other than sequentially resolving them. The Commission restates its request that the Alaskan Delegate work with the project sponsors to develop a schedule and procedure to resolve these matters and to report to the Commission. The Commission will then order a schedule and procedure to provide guidance to the applicants, the Commission staff, and other interested parties.

⁴. Certification Cost and Schedule Estimates: The Commission recognizes that certain key considerations in establishing the Certification Cost and Schedule Estimates have not yet been determined. For the Alaska segment, the principal outstanding issues are the proximity of the gas pipeline to the oil pipeline, the maximum allowable operating pressure, and application of the environmental and other technical stipulations; for Northern Border, the stipulations are the principal problem. The Alaskan Delegate advises that these matters are approaching resolution, as is the question of cost estimate formats for their submission.

The Commission also recognizes that some aspects of the cost estimates will not be known with any degree of precision prior to completion of the sponsors' project development program, some months hence. The Commission expects, however, that the changing reliability of the Certification Cost and Schedule Estimates can best be handled through the Change in Scope procedure and establishment of the Center Points for Northern Border and the Alaska segment. Accordingly, the Commission plans to order filing of the Certification Cost and Schedule Estimates no later than 60 days after resolution of the principal issues enumerated in the previous paragraph.

V. Findings

(1) After reviewing the written comments and oral arguments submitted pursuant to Commission [Order No. 17](#), the Commission finds that modification of the terms and conditions set forth in [Order No. 17](#), which are appended to the conditional certificates of public convenience and necessity for the Alaska Natural Gas Transportation System issued by order on December 16, 1977, [1 FERC ¶61,248 \(Docket No. CP78-123, et al.\)](#), is not warranted.

(2) The Joint Petition for Reconsideration and Clarification, filed December 29, 1978, is hereby denied.

(Department of Energy Organization Act, P.L. 95-91, 91 Stat. 565, E.O. No. 12009, 42 F.R. 46267 (September 15, 1977), Natural Gas Act, [15 U.S.C. §§ 717](#), *et seq.*, Alaska Natural Gas Transportation Act, [15 U.S.C. §719](#) (g)).

¹ [Order No. 17](#), *op. cit.* mimeo p. 6.

² *Ibid.*

³ Oral Argument held December 21, 1978, in [Docket No. RM78-12](#), Tr. 21.

⁴ *Ibid.*, Tr. 40.

⁵ This Agreement was made a part of the Decision and Report to Congress on the Alaska Natural Gas Transportation System; Executive Office of the President, Energy Policy and Planning; transmitted to the Congress under the provisions of the Alaska Natural Gas Transportation Act, September 22, 1977. The Agreement is pp. 47-83 of the *Decision*.

⁶ "Proposed Approach to Incentive Rate of Return for the Northern Pipeline," Canada, National Energy Board; October 5, 1978; p. 2 of Regulations.

⁷ [Order No. 17](#), mimeo p. 6.

⁸ Oral Argument, Tr. 9.

⁹ Joint Petition of Northern Border Pipeline Company and Alaskan Northwest Natural Gas Transportation Company for Reconsideration and Clarification, filed December 29, 1978, in [Docket No. RM78-12](#).

¹⁰ The present petition is being reviewed by the Commission in its discretion, since Section 10 of the Alaska Natural Gas Transportation Act ([15 USC §719](#) (h)) makes no provision for rehearing. Our actions herein should not be construed as indicating that the standards and procedures of judicial review under the Natural Gas Act are in any way applicable to [Order No. 17](#).

¹¹ Oral Argument, Tr. 7.

¹² Oral Argument, Tr. 10.