

130 FERC ¶ 61,193
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Southern Natural Gas Company	Docket Nos. CP09-36-002
Southeast Supply Header, LLC	CP09-40-001
Southern Natural Gas Company	
Accrual of Allowance for Funds used During Construction	AD10-3-000

ORDER ISSUING CLARIFICATION AND GRANTING REHEARING

(Issued March 18, 2010)

1. On August 27, 2009, the Commission authorized Southern Natural Gas Company's (Southern) South System Expansion III Project (SSEIII Project) to increase the capacity of its system by 375,000 Dth per day and also Southern's and Southeast Supply Header, LLC's (SESH) Joint Pipeline Expansion Phase II Project expansion of their jointly-owned segment of the SESH pipeline to accommodate an increase in Southern's capacity in that pipeline segment.¹
2. Southern requests rehearing of the August 27 Order regarding accruing Allowance for Funds Used During Construction (AFUDC) and also requests clarification regarding two separate rate issues. In addition, the Interstate Natural Gas Association (INGAA) filed a late motion to intervene for the limited purpose of seeking rehearing of the AFUDC issue.
3. We will grant the requests for rehearing as discussed below, revising our policy regarding the timing of the accrual of AFUDC for natural gas construction projects. We will also grant Southern's requests for clarification.

¹*Southern Natural Gas Co.*, 128 FERC ¶ 61,198 (2009) (August 27 Order).

I. The August 27 Order

4. The August 27 Order issued certificates both for the SSEIII project and for the expansion of the Joint Pipeline. However, the Commission, relying heavily on *Capitalization of Interest During Construction, Accounting Release No. 5 (Revised)*, (AR-5),² denied Southern's proposal to commence accruing AFUDC as of March 2008 when Southern began the Commission's pre-filing process. Instead, the Commission stated that accrual of AFUDC could not begin until December 15, 2008, the date on which Southern filed its certificate application.

II. INGAA's Late Motion to Intervene

5. On September 28, 2009, INGAA filed a motion to intervene for the limited purpose of seeking rehearing on a discrete issue. INGAA's concern is the availability of AFUDC for pipeline construction costs incurred prior to the filing of an application to build new pipeline facilities under NGA section 7. INGAA states that it represents the interstate natural gas industry operating in the United States, and that the Commission's order in this proceeding and in *Ruby Pipeline, LLC*³ "announced a policy with respect to AFUDC that seemingly will govern the recovery of AFUDC by other INGAA members in the future."⁴

6. INGAA claims that prior to the issuance of these orders, it "was not aware that the Commission viewed pre-filing activities as unrelated to 'construction' costs that the Commission has previously considered eligible for AFUDC treatment."⁵ INGAA states that it can speak for the regulated industry as a whole and that its intervention would not delay any established procedural schedule or otherwise disrupt this proceeding.

7. The Commission notes that INGAA represents jurisdictional natural gas companies and is able in this proceeding to present their common views regarding an

²*Accounting Release No.5 (Revised), Capitalization of Interest During Construction*, Effective Jan. 1, 1968, FERC Stats. & Regs. ¶ 40,005.

³In *Ruby Pipeline, LLC*, 128 FERC ¶ 61,224 (2009), the Commission considered analogous issues regarding AFUDC.

⁴Motion of INGAA at 3.

⁵*Id.*

issue of continued significance for the industry. We will grant INGAA's motion to intervene.⁶

III. Requests for Rehearing

A. AFUDC

8. Southern filed a request to commence the Commission's pre-filing process regarding the SSEIII project on March 14, 2008, and was assigned Docket No. PF08-13-000. Southern states that during the pre-filing process, it filed extensive documents and maps and performed numerous activities, all directed at complying with the Commission's regulations and those procedures necessary to obtain a certificate of public convenience and necessity.

9. On December 15, 2008, at the completion of the pre-filing process, Southern filed an application pursuant to sections 7(c) and 7(e) of the NGA and Part 157 of the Commission's regulations for a certificate of public convenience and necessity authorizing its SSEIII Project. In its certificate application, Southern proposed to commence the accrual of AFUDC for the SSEIII Project beginning in March 2008, when Southern received its pre-filing docket number.

10. Southern asserts that beginning in March 2008, construction expenditures were continuously incurred on a planned and progressive basis. In denying Southern's request to start accruing AFUDC from the date Southern received its pre-filing docket number, the Commission relied upon Accounting Release No. 5 (Revised) (AR-5), which states the following:

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 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. No interest should be accrued during the period of interrupted construction unless the company can justify the interruption as being reasonable under the circumstances.

⁶INGAA's AFUDC arguments closely track Southern's in this case and will be cited herein as necessary and appropriate, given the facts at issue here.

11. The Commission stated that for a company constructing a natural gas pipeline, the receipt of a pre-filing docket number does not justify the accrual of AFUDC prior to the date the certificate application is filed.⁷ The Commission also determined that although Southern asserted that its construction expenditures were continuously incurred on a planned progressive basis starting from the date of pre-filing, Southern “did not provide sufficient detail to demonstrate that the costs incurred were in fact construction costs rather than costs related to preliminary survey and investigation type activities.”⁸

12. Southern requests that the Commission grant rehearing of this issue and permit Southern to begin accruing AFUDC from March 2008.⁹ Southern states that AR-5 is outdated and is no longer consistent with the current regulatory policy, noting that AR-5 became effective on January 1, 1968, and that the regulatory landscape has changed significantly and permanently.

13. Southern states that on January 1, 1970, Congress enacted the National Environmental Policy Act of 1969 (NEPA),¹⁰ which required for the first time that all federal agencies prepare Environmental Impact Statements (EISs) and Environmental Assessments (EAs) in conjunction with every action significantly affecting the quality of the human environment.¹¹ Further, the Commission has implemented the policies and procedures of NEPA and established Part 380 under the Commission's regulations.¹² Under section 380.5, an EA and, in some cases an EIS, is required for “authorization under section 7 of the Natural Gas Act for the construction, replacement, or abandonment of compression, processing, or interconnecting facilities, onshore and offshore pipelines,

⁷128 FERC ¶ 61,198 at P 43.

⁸*Id.* P 44.

⁹INGAA states that, under *Mid-Tex Elec. Co-op., Inc. v. FERC*, 773 F.2d 327, 330-31 (D.C.Cir. 1985), and other authorities, a regulated pipeline is entitled to recover the cost of financing construction of facilities used in transporting jurisdictional gas, including interest on debt and a reasonable return on capital investment, and also including certain costs incurred before facilities go into service (i.e., become “used and useful”). Request of INGAA for Rehearing at 2-3.

¹⁰42 U.S.C. § 4321 *et seq.*

¹¹42 U.S.C. § 4332(2)(C).

¹²18 C.F.R. § 380 *et seq.*

metering facilities, LNG peak-shaving facilities, or other facilities necessary for the sale, exchange, storage, or transportation of natural gas.”¹³

14. Southern notes that in such cases, the applicant bears the burden of submitting an environmental report satisfying the strict requirements of section 380.12 of the Commission’s regulations, and that an applicant’s failure to submit an adequate environmental report normally results in rejection of the application.¹⁴ Southern states that the Commission’s Office of Energy Projects (OEP) hosted a series of public outreach meetings to explore strategies for constructive public participation in the early pre-filing stages of natural gas facility planning.¹⁵

15. In December 2001, the OEP issued a report detailing different pre-filing techniques.¹⁶ The report encouraged pipeline companies to “seek out greater involvement from the various [stakeholder] groups early in the planning so that those who are interested can participate in the decision-making process.”¹⁷ Southern states that the Commission thought that “[e]arlier and more productive involvement [would] lead to better project designs and less contentious applications to FERC.”¹⁸ Southern states that since the release of the OEP Report, the Commission has consistently reiterated its desire that natural gas pipelines utilize the pre-filing process.

16. Southern argues that the Commission’s clear policy of promoting the use of the pre-filing process has effectively converted an otherwise voluntary procedure into an integral part of the certificate application process¹⁹ and thus AR-5 is no longer consistent

¹³18 C.F.R. § 380.12.

¹⁴18 C.F.R. § 380.12(a)(3).

¹⁵*Citing* Letter from Richard R. Hoffmann, Director, Division of Environmental and Engineering Review, Office of Energy Projects, to Rhey Solomon, Assistant Task Force Leader, National Environmental Policy Act Task Force, Council on Environmental Quality (Sept. 23, 2002).

¹⁶Office of Energy Projects Gas Outreach Team: Ideas for Better Stakeholder Involvement In the Interstate Natural Gas Pipeline Planning Pre-Filing Process (December 2001).

¹⁷*Id.* at 1.

¹⁸*Id.*

¹⁹Southern notes that section 311(d) of the Energy Policy Act of 2005 mandated

with the current regulatory landscape.²⁰ Southern states that, unlike when AR-5 was first issued, an applicant seeking to construct or expand a pipeline has a strong incentive to utilize the benefits of the pre-filing process. The pre-filing process requires the applicant to satisfy a laundry list of requirements, including a proposed schedule and a detailed description of the project, including preparation of location maps and plot plans to scale and performing surveys as well as gathering right-of-way data. The applicant may not thereafter file a certificate application until an environmental report has been completed, and in most cases no sooner than 180 days after pre-filing.²¹

17. Today, Southern states, pre-filing expenses are no longer miniscule administrative costs incurred merely to prepare the application but are significant steps to obtaining ultimate Commission approval and completing the NEPA requirement under Section 380. Southern points to the filing and completion, to the satisfaction of the Commission staff, of all of the Resource Reports 1-12 required to be filed as part of the application under section 157.14(a)(6a) of the Commission's regulations. In addition, extensive landowner lists must be compiled and submitted during the pre-filing process to show the applicant can meet the requirements of section 157.6(d) of the Commission's regulations. Extensive engineering, design and civil survey work -- essential first steps in the construction process -- must be performed during the pre-filing process.

18. Accordingly, states Southern, as a result of the Commission's policy, continuous progress toward construction has shifted from post-application or even post-approval work to integral requirements in the pre-filing process. Southern claims that the Commission has erred in not recognizing that its own regulations and requirements have

pre-filing for applicants seeking to construct LNG terminals. FERC Order No. 665, which implements this Congressional mandate, also codified the current voluntary pre-filing procedure. Order No. 665, *Regulations Implementing Energy Policy Act of 2005; Pre-Filing Procedures for Review of LNG Terminals and Other Natural Gas Facilities*, FERC Stats. & Regs. ¶ 31,195 (2005). *See* 18 C.F.R. § 157.2 1(b).

²⁰INGAA reiterates all of Southern's arguments regarding the Commission's encouragement of the use of the pre-filing approach. *See* Request of INGAA for Rehearing, 4-6, and 8-9. INGAA goes on (*id.* at 10-11) to discuss various competitive pressures in the construction processes purportedly faced currently by interstate pipelines in general, issues which, although unsupported by evidence in this record, have been useful in the Commission's broader review of the AFUDC issue on an industry-wide basis. *See Accrual of Allowance for Funds Used During Construction*, Docket No. AD10-3-000, as discussed below.

²¹18 C.F.R. § 157. 21(b)(2)(i).

evolved such that actions today performed by an applicant before and during the pre-filing process are the same as actions previously taken by an applicant after the certificate application filing which have been deemed eligible for AFUDC accrual. Southern argues that it is arbitrary and capricious to reject AFUDC accrual for costs incurred during the pre-filing process simply because the actual certificate application has not been filed when those same costs would be eligible for AFUDC accrual if they had been performed after the certificate was filed. Therefore, Southern argues that the Commission should amend AR-5 to recognize the development of the pre-filing process in the construction of pipelines by generally permitting the accrual of AFUDC at least after the receipt of a pre-filing docket number.

19. Southern states further that, if the Commission declines to amend AR-5, it should still permit Southern to begin accruing AFUDC in March 2008 because AR-5 is not a legally binding source of law. Southern argues that the Commission noted in paragraph 42 of its August 27 Order that the notion that a company constructing a natural gas pipeline should not accrue AFUDC prior to the date the company files is merely “long standing guidance.” Southern states that AR-5 is suggestive rather than authoritative.

20. To the extent AR-5 does govern this matter, Southern states that its accrual of AFUDC prior to filing its certificate application is justified, since AR-5 states that interest accruals may be allowed by the Commission for the period prior to the date of the certificate application if so justified by the company. Southern asserts that, in this case, the accrual of AFUDC prior to the date Southern filed its certificate application is justified.

21. Southern states further that it is unclear what the Commission considers sufficient justification for early accrual, arguing that the only indication publicly available is an “Additional Information Request” issued to Florida Gas Transmission Company, LLC (Florida Gas) in Docket No. AC08-161-000.²² Southern states that it provided similar cost data to the Commission on March 11, 2009,²³ and on April 20, 2009).²⁴

²²*Citing Florida Gas Transmission Co., LLC*, Docket No. AC08- 161-000 (Sept. 16, 2008) (Additional Information Request) (unpublished). In that docket, Florida Gas requested the Commission's permission to start capitalizing interest (debt and equity AFUDC) on its planned Phase VIII Expansion Project with Florida Gas's filing to use the Pre-Filing process. In response to Florida Gas's request, the Commission requested additional information which included extensive questions about the costs incurred by Florida Gas.

²³In response to the Commission staffs February 19, 2009 Accounting Question No. I, Southern submitted its expenditures for the period March 2008 through November

Accordingly, Southern submits that it has adequately justified that the costs incurred after the establishment of the pre-filing proceeding were part of costs continuously incurred on a planned, progressive basis.

22. Indeed, states Southern, had the Commission staff desired more information from Southern other than the actual expenditures showing that such costs were continuously incurred to further the project, it could have submitted to Southern the same request for data as that presented to FGT. For purposes of clarity, however, Southern has attached as Appendix A herein a spreadsheet detailing the costs (by category) it incurred from May 2007 through December 2008.

23. INGAA argues that the Commission puts misplaced reliance on an accounting release issued more than four decades ago, which did not arise out of an adjudication or a rulemaking proceeding, and which offers no explanation of the merits of its terms.²⁵ Further, INGAA reiterates that AR-5 is outdated in view of the evolution of the Commission's pre-filing process, and claims that the Commission failed to provide sufficient guidance as to the detail required to justify AFUDC accrual prior to the certificate application.

IV. Technical Conference

24. In this and several recent and pending cases,²⁶ 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,

2008.

²⁴Southern's April 20, 2009 disclosure was made in response to the Commission staff's April 10, 2009 Accounting Request No. 9.

²⁵INGAA Request for Rehearing at 11-12.

²⁶*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.

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.²⁷ The Commission received extensive comments from numerous natural gas pipelines through pre- and post-technical conference filings and conference presentations and discussions.

25. 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,²⁸ 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 disincentive for pipelines to participate in the pre-filing process; and 3) may affect the incentive to invest in building new pipelines.

26. Most commenters recommend that the Commission adopt criteria similar to those established in Financial Accounting Standard No. 34, Capitalization of Interest Cost, (FAS 34) to determine when natural gas pipelines should be permitted to commence accrual of AFUDC.²⁹ Additionally, some commenters suggest that the Commission

²⁷*Notice of Technical Conference on Commission Policy on Commencement of Accrual of Allowance for Funds Used During Construction*, 74 Fed. Reg. 65117 (December 2, 2009). Pre-technical conference comments were due December 11, 2009. Post-technical conference comments were due December 29, 2009.

²⁸Commenters explain that these changes include extensive preparation of an environmental assessment or environmental impact statement to fulfill the requirements of the NEPA and the Commission's Pre-filing program.

²⁹FAS 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 the Financial Accounting Standards Board's (FASB) Codification Standards (ASC) Section Subtopic 835.20 Capitalization of Interest.

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.

27. 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.

28. 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.

V. Discussion

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

30. 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.

31. Gas Plant Instruction 3(17) of the Commission's regulations³⁰ 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.³¹

32. 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 August 27 Order denying accrual of AFUDC on costs incurred prior to the filing of Southern's certificate application was based on this guidance.

33. However, as Southern 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 instituted an optional pre-filing 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.³² 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 2005,³³ it is mandatory for all

³⁰18 C.F.R. Part 210 (2009).

³¹*See Gulfstream Natural Gas System, LLC.*, 91 FERC ¶ 61,119 (2000); *Buccaneer Gas Pipeline, L.L.C.*, 91 FERC ¶ 61,117 (2000).

³²*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>.

³³Pub. L. No. 109-58, 119 Stat. 594 (2005).

applicants seeking to construct LNG facilities to use the pre-filing process.³⁴ 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 myriad 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.

34. Since many natural gas pipelines take advantage of the pre-filing process and incur significant 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 Commission will revise its policy for when natural gas pipelines may begin accruing AFUDC based on the criteria set forth below.

35. 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 and provide greater transparency, compliance with the revised

³⁴*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. 60426 (October 18, 2005), FERC Stats. & Regs., Regulation Preambles 2001-2005 ¶ 31,195 (2005); *see also* section 157.21 of the Commission's regulations promulgated under the Energy Policy Act of 2005, 18 C.F.R. § 157.21 (2009) (Pre-filing procedures and review process for LNG terminal facilities and other natural gas facilities prior to filing of applications).

policy on AFUDC accrual should be transparent and subject to review by the Commission.

36. 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. 3.³⁵

37. 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.

38. 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, AFUDC must cease once construction is complete and 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.

39. 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

³⁵18 C.F.R. Part 201 (2009).

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.

40. Consistent with the Commission's existing records retention requirements,³⁶ 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 be.

Commission Determination

41. We believe that this order adequately addresses the issues raised by Southern in its request for rehearing. Based on the discussion above and our revised AFUDC policy, the Commission grants rehearing of the August 27 Order and will allow Southern to include its proposed AFUDC in its initial rates, subject to Southern's filing a representation that its originally proposed AFUDC accruals comply with the requirements set forth above. Furthermore, if Southern 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 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.

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

³⁶18 C.F.R. Part 225 (2009).

B. Requests for Clarification**1. Interruptible Transportation Rate**

43. For the original 140,000 Dth/d of system capacity on the Joint Pipeline, Southern offers Firm Transportation Service (FT), Firm Transportation-No Notice Service (FT - NN), Interruptible Transportation Service (IT), and Park and Loan Service (PAL) pursuant to its FERC Gas Tariff. Southern proposed to charge Southern Company Services, Inc (SCS), the shipper on the SSEIII Project, an incremental rate for the 375,000 Dth/d of new capacity on the SSEIII Project and for 225,000 Dth/d of the 360,000 Dth/d of the new capacity on the Joint Pipeline. For the remaining 135,000 Dth/d of additional capacity on the Joint Pipeline, Southern proposed to charge its system rates.

44. Southern notes that, in paragraph 31 of the August 27 Order,³⁷ the Commission stated the following:

While Southern provides interruptible transportation service on the Joint Pipeline for its system customers, it has not proposed to provide the incremental service on an interruptible basis. In its tariff filing implementing the incremental rate to be submitted not less than 30 days and not more than 60 days prior to commencing service, Southern is required to provide for interruptible transportation service over the capacity dedicated to incremental service and to explain how the revenues from such service will be credited.

45. Southern submits that, consistent with Commission policy,³⁸ the appropriate rate for interruptible transportation on an expanded, integrated system is the system-wide interruptible rate, even if the firm portion of the expansion is incremental. Specifically, the Commission found in *Transco* that where expansion capacity will be an integrated part of an existing system, the interruptible shipper's use of the capacity "will not be distinguishably assignable to either the existing or expansion facilities on an operational basis."³⁹

³⁷128 FERC ¶ 61,198 at P 31.

³⁸*See Transcontinental Gas Pipeline Co.*, 128 FERC ¶ 61,223 (2009) (*Transco*); *Rockies Express Pipeline, LLC*, 119 FERC ¶ 61,069 (2007) (*Rockies Express*); *Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077 (2006) (*Kern River*).

³⁹128 FERC ¶ 61,223, at P 23 (2009).

46. Southern states that it would not be able to discern whether the interruptible shippers were using incremental or existing capacity, given shippers' broad rights to use receipt and delivery points on Southern's system, unless interruptible shippers were delivering gas from and to the exact points that match the firm SCS capacity. Accordingly, Southern states that the Commission's existing policy on this issue should appropriately be applied here. Southern proposes to use its system-wide IT rates for interruptible transportation service over the capacity dedicated to incremental service and to reflect the billing determinants associated with such interruptible service in the derivation of its system rates. According to Southern, any other result would be directly contrary to the Commission's policy set forth in *Rockies Express*, where the Commission found that it was "not appropriate" to design an interruptible rate on the incremental costs of the expansion project where the service will be rendered on the expanded integrated system.⁴⁰

47. Southern respectfully requests that the Commission clarify that the incremental interruptible rate which Southern is ordered to file should be its system-wide interruptible rates. If the Commission denies such clarification, Southern requests, in the alternative, that the Commission grant rehearing of this issue on the basis that it has not consistently applied its policy on the establishment of interruptible rates for incremental facilities that are constructed as part of an integrated system.

Discussion

48. The Commission clarifies that Southern may charge its system-wide rate for the interruptible service referenced in Paragraph 31 of the August 27 Order, crediting revenues for interruptible service consistent with its recent section NGA rate case settlement.⁴¹ Southern is required in Ordering Paragraph (H) of the August 27 Order to file tariff sheets not less than 30 days and not more than 60 days prior to commencing service.

2. Fuel rates

49. Southern notes also that, in paragraph 32 of the August 27 Order, the Commission states the following with respect to the fuel rates to be charged for the expansion of the Joint Pipeline and the SSEIII Project:

⁴⁰*Rockies Express*, 119 FERC ¶ 61,069 at P 67, *citing* Kern River, 117 FERC ¶ 61,077 at P 339-62.

⁴¹*Southern Natural Gas Co.*, 130 FERC ¶ 61,004 (2010).

Southern proposes to roll the fuel costs for both the expansion of the Joint Pipeline and the SSEII I Project into its existing fuel rate, contending that such an approach will result in a lower fuel rate on Southern's system. We will allow Southern to charge its system Zone I fuel rate for the system service provided on the Joint Pipeline and the intrazone fuel rate for Zone 3 for the incremental service provided for [Southern Company Services, Inc. (SCS) as its initial fuel charge for service over the Joint Pipeline and SSEIII Project.⁴²

50. Southern interprets such paragraph as the Commission granting Southern's request to charge its system-wide fuel rates for the incremental service to be provided to SCS, and states that such approval is consistent with Southern's proposal set forth on page 6 and Exhibit P of the application filed in Docket No. CP09-36. Southern suggests that the Commission did not mean to limit the fuel rate for service provided for SCS to the intrazone fuel rate as stated in paragraph 32 of the order. Southern's fuel rates set forth in its tariff are based on a shipper's zone of receipt and zone of delivery. Although deliveries to SCS under its firm service agreement are intended to be made in Zone 3, receipts will not necessarily be in Zone 3. Thus the intrazone fuel rate, which applies where gas is both received and delivered within the same zone, will not always apply to service to SCS.

51. Accordingly, Southern respectfully requests that the Commission clarify that Southern may charge its generally applicable system-wide fuel rate based on its current methodology of calculating fuel and that the Commission did not intend to limit Southern to charging the intrazone (Zone 3-3) fuel rate as specified in the August 27 Order.

Discussion

52. The Commission clarifies that the August 27 Order did not limit Southern to charging the intrazone (Zone 3-3) fuel rate; rather, Southern may charge its generally applicable system-wide fuel rate for the proposed service.

The Commission orders:

(A) Clarifications and rehearing are granted as discussed in the text of this order.

(B) Southern shall file a representation that its proposed AFUDC accruals for

⁴²128 FERC ¶ 61,198 at P 32.

the project comply with the revised policy conditions. In the alternative, if Southern 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) Southern 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)

Nathaniel J. Davis, Sr.,
Deputy Secretary.