113 FERC ¶ 63,039

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Trans-Elect NTD Path 15, LLC — Docket No. ER05-17-002

INITIAL DECISION

(Issued December 21, 2005)

APPEARANCES

Jeff DiSchiullo, Esq., David Shaffer, Esq., Douglas Waikart, Esq., Al Statman, Esq., for Trans-Elect NTD Path 15, LLC.

James Walsh, Esq., for San Diego Gas & Electric Company.

Anna Valdberg, Esq., for Southern California Edison Company.

Larry Chaset, Esq., for California Public Utilities Commission.

Charles Middlekauff, Esq., for Pacific Gas & Electric Company.

Marcia Hooks, Esq., Jason Stanek, Esq., for the Federal Energy Regulatory Commission.

DAVID I. HARFELD, Presiding Administrative Law Judge.

TABLE OF CONTENTS

Factual Background and Procedural History 3

Issues 6

I. Should NTD include certain prepaid expenses relating to reserve obligations as rate-base items? 7

a. NTD's position 7
b. The Joint Parties' position 9
c. PG&E's position 9
d. Commission Trial Staff's position 9

e. Decision... 10

II. What is the proper methodology for calculating NTD's allowance for working capital? And, what is the proper amount of the allowance?.. 13

a. NTD's position.. 13
b. The Joint Parties' position.. 14
c. PG&E's position.. 16
d. Commission Trial Staff's position... 17
e. Decision... 18

III. What is the proper methodology for calculating NTD's allowance for funds used during construction and what is the proper amount for such allowance?.................................... 20

a. NTD's position.. 21
b. The Joint Parties' position.. 23
c. PG&E's position.. 23
d. Commission Trial Staff's position... 23
e. Decision... 25

IV. Should NTD modify its TO Tariff to make it consistent with the TO Tariffs of the other PTOs as proposed by the Joint Parties?.. 27

V. Is there a potential for over-recovery of costs, and, if so, should the Commission take action in this docket to eliminate such over-recovery?.. 28

a. Summary of the issue and parties' positions............................ 28
b. Decision... 29

Conclusion.. 30

Order.. 31

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

1. California's Path 15 is a major corridor of electrical transmission lines that extends south to north through the state.[1] Historically, Path 15 transmission lines have been constrained and unable to accommodate the desired flow of hydropower from the Pacific Northwest to Southern California and the desired flow of energy from Southern California to Northern California.[2] In May 2001, the Secretary of Energy authorized the Western Area Power Administration ("Western") to explore ways to relieve Path 15's capacity constraints and increase reliability through transmission expansion in the Path 15 corridor.[3] Through a competitive selection process, Western chose Trans-Elect Inc. ("Trans-Elect") and Pacific Gas & Electric ("PG&E") to join Western in developing and constructing a transmission line upgrade and related substation upgrades (collectively, "Path 15 Upgrade" or "Project").[4] Specifically, Western, Trans-Elect, and PG&E ("Project Participants") agreed to build a 500 kV transmission line within the existing Path 15 transmission corridor and to make related modifications to PG&E's preexisting substations.[5] The Project Participants completed construction, and the Path 15 Upgrade commenced commercial operation on December 22, 2004 (NTD's Initial Brief at 4).

2. On April 30, 2002, the Project Participants filed with the Commission a letter agreement ("Letter Agreement") pursuant to section 205 of the Federal Power Act ("FPA"). The Letter Agreement sets forth the ownership and funding arrangements, as well as the rate-making principles for the recovery of costs, associated with the Path 15 Upgrade. On June 12, 2002, the Commission accepted the Letter Agreement and issued an order approving the Letter Agreement's rate-making principles.[6] However, the order also required the Project Participants to make subsequent filings with the Commission to address concerns regarding non-rate principles in the Letter Agreement.[7]

3. In January 2003, Trans-Elect filed a notice of intent and a subsequent application with the California Independent System Operator Corporation ("ISO") to become a

---

[1] *Western Area Power Admin.*, 99 FERC ¶ 61,306 (2002).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Western Area Power Admin.*, 99 FERC ¶ 61,306 (2002).

[7] *Id.* On March 25, 2004, the Commission approved a settlement agreement among the California Public Utilities Commission, Trans-Elect, and Trans-Elect's subsidiary company, Trans-Elect NTD Path 15, LLC, addressing disputes about the Letter Agreement. *Western Area Power Admin.*, 106 FERC ¶ 61,295 (2004).

Participating Transmission Owner ("PTO") and to turn over operational control of its entitlements in the Path 15 Upgrade to the ISO. On August 15, 2003, the ISO submitted to the Commission for filing revisions to the Transmission Control Agreement ("TCA") between it and the existing PTOs to reflect the transmission entitlements Trans-Elect intended to turn over to the ISO's control. By order issued October 14, 2003, the Commission accepted for filing the revisions to become effective after January 1, 2004.[8]

4. On June 30, 2004, the Commission accepted for filing the Coordinated Operations and Interconnection Agreement ("COIA") entered into by PG&E, Trans-Elect NTD Path 15 ("NTD" or "Company"), which is Trans-Elect's subsidiary for purposes of the Project, and Western, to become effective July 1, 2004.[9] The COIA addresses some of the concerns the Commission left open in approving the Letter Agreement by providing for the interconnection and coordinated operation of the Path 15 Upgrade with PG&E's existing transmission system in an orderly and reliable manner.[10]

5. On October 4, 2004, NTD filed with the Commission its proposed Transmission Revenue Requirement ("TRR") and Transmission Owner Tariff ("TO Tariff"), under section 205 of the Federal Power Act ("FPA"), to recover its costs relating to the Path 15 Upgrade. On October 8, 2004, the Commission issued a notice of NTD's filing and set the date for all interested parties to intervene.[11] Motions to intervene were filed by San Diego Gas & Electric Company ("SDG&E"); the Transmission Agency of Northern California; the California Municipal Utilities Association; the American Public Power Association; the Northern California Power Agency; PG&E; the ISO; the Cities of Redding and Santa Clara, California; M-S-R Public Power Agency; Southern California

---

[8] *California Independent System Operator Corp.*, Letter Order, Docket No. ER03-1217-000 (Oct. 14, 2003).

[9] *Pacific Gas & Electric Co.*, 107 FERC ¶ 61,335 (2004).

In a related proceeding, on September 7, 2004, the ISO submitted to the Commission for filing revisions to the TCA and the ISO Tariff to reflect the transmission entitlements Western intended to turn over to ISO control. Several intervenors challenged the filing. By order issued November 5, 2004, the Commission directed its Dispute Resolution Service ("DRS") to convene a meeting to address the appropriate compensation level for Western's contribution to the Project. *The California Independent System Operator Corp.*, 109 FERC ¶ 61,153 (2004). On April 15, 2005, the DRS reported to the Commission that the parties were unable to resolve their disputes. The Commission has not yet set for hearing the Western compensation issue, captioned Docket No. ER04-1198-000 ("Western Docket").

[10] *Pacific Gas & Electric Co.*, 107 FERC ¶ 61,335 (2004).

[11] *Trans-Elect NTD Path 15, LLC*, Notice of Filing, Docket No. ER05-17-000 (Oct. 8, 2004).

Edison Company ("SCE"); American Transmission Company LLC; Modesto Irrigation District; California Public Utilities Commission ("CPUC"); Wisconsin Public Power Incorporated; WPS Resources Corp.; and Wisconsin Electric Power Company.

6. On December 2, 2004, the Commission issued an order accepting and suspending NTD's filing and establishing hearing procedures, which were held in abeyance pending settlement discussions.[12] The Commission set for hearing the issues of whether NTD's TRR and TO Tariff are just and reasonable.[13] On December 10, 2004, the Chief Administrative Law Judge ("Chief Judge") appointed a settlement judge and initiated settlement procedures. The parties, however, were unable to reach settlement. The Chief Judge terminated settlement procedures on February 7, 2005, and initiated hearing procedures with the Presiding Judge, subject to a Track II procedural schedule.

7. The parties convened before the Presiding Judge for a pre-hearing conference on February 22, 2005. In accordance with the Presiding Judge's procedural schedule, CPUC filed direct and answering testimony on April 25, 2005, and SCE, SDG&E, and CPUC ("Joint Parties") jointly filed direct and answering testimony. The Presiding Judge allowed SDG&E to file additional direct and answering testimony out-of-time on April 26, 2005.[14]

---

[12] *Trans-Elect NTD Path 15, LLC*, Order Accepting and Suspending Filing and Establishing Hearing and Settlement Judge Procedures, Docket No. ER05-17-000 (Dec. 2, 2004).

[13] *Id.* The Commission also denied consolidation of the ER04-1198-000 and ER05-17-002 dockets, and granted the untimely motions to intervene that had been filed as of that date. *Id.*

[14] On April 29, 2005, NTD filed a motion to strike portions of the testimony submitted by CPUC, the Joint Parties, and SDG&E. Specifically, NTD argued that the challenged testimony addressed compensation issues related to Western's entitlements in the Project, which NTD maintains are the subject of the Western Docket and thus beyond the scope of this proceeding. *See generally supra* n. 9, at 4. On May 16, 2005, Staff and the Joint Parties filed answers to NTD's motion. Staff generally opposed the motion to strike, arguing that portions of the challenged testimony may be relevant to this proceeding. The Joint Parties argued that NTD, by agreement, is funding portions of the project, to which Western will hold entitlements, and therefore Western's rights in the project are germane to this proceeding. By order dated May 17, 2005, the Presiding Judge granted in part and denied in part NTD's motion. *Trans-Elect NTD Path 15, LLC*, Order Granting In Part and Denying In Part Trans-Elect NTD Path 15, LLC's Motion to Strike, Docket No. ER05-17-002 (May 17, 2005). Specifically, the Presiding Judge found that portions of the testimony pertain directly to the Western Docket and thus are beyond the scope of the instant proceeding, but other portions of the testimony may be relevant.

8. On June 20, 2005, Staff filed portions of its direct and answering testimony and exhibits. The Presiding Judge allowed Staff to file additional exhibits out-of-time on June 21, 2005.[15] On July 15, 2005, the Joint Parties and PG&E filed their cross-answering testimony and exhibits.[16] On August 24, 2005, NTD filed its rebuttal testimony and exhibits. The hearing commenced on September 19, 2005, and concluded on September 20, 2005.[17] The parties filed Initial Briefs on October 24, 2005, and Reply Briefs on November 14, 2005.[18]

ISSUES

9. The parties filed a Joint Statement of Contested Issues on September 19, 2005. The parties contest five issues:

(1) Should NTD include certain prepaid expenses relating to reserve obligations as rate-base items?

(2) What is the proper methodology for calculating NTD's allowance for working capital? And, what is the proper amount of the allowance?

---

[15] On June 23, 2005, Staff filed a corrected copy of Exhibit S-7. On August 3, 2005, Staff filed an Errata to Exhibit S-11.

[16] On September 2, 2005, the Joint Parties filed a revised Exhibit JNT-4.

[17] On September 30, 2005, the Joint Parties filed with the Commission a motion to consolidate Docket Nos. ER05-17-002 and ER04-1198-000. At this stage, the Commission has not acted on the motion.

On October 7, 2005, NTD filed an answer to the Joint Parties' motion, and simultaneously made a "Motion for Affirmative Finding and/or Summary Disposition." In its motion for an affirmative finding, NTD asked the Commission to find that the Joint Parties are collaterally estopped from challenging Commission orders issued in Docket Nos. ER02-1672-000, ER04-1198-000, and ER05-17-000. Specifically, NTD argued that the Joint Parties should be estopped from claiming that Western's cost recovery proposals should affect NTD's TRR. Alternatively, NTD sought summary disposition of the issue of Western's cost recovery proposals' impact on NTD's TRR. By order dated October 19, 2005, the Presiding Judge found that NTD's requested relief was beyond the scope of this proceeding and denied the motion for summary disposition ("October 19 Order"). *Trans-Elect NTD Path 15, LLC,* Order Denying Summary Disposition, Docket No. ER05-17-002 (Oct. 19, 2005).

[18] Also on November 14, 2005, NTD filed a corrected copy of its Initial Brief.

(3) What is the proper methodology for calculating NTD's allowance for funds used during construction (AFUDC), and what is the proper amount for this allowance?

(4) Should NTD modify its TO Tariff to make it consistent with the TO Tariffs of the other PTOs as proposed by the Joint Parties?

(5) Is there a potential for over-recovery of costs, and, if so, what action, if any, should the Commission take in this docket to eliminate such over-recovery?

I. Should NTD include certain prepaid expenses relating to reserve obligations as rate-base items?[19]

10. Pursuant to private contracts with its lenders, NTD agreed to fund fully a debt service reserve account and a liquidity reserve account prior to receiving financing.[20] NTD proposes to include in its TRR as rate-base items the amounts it incurred to comply with the reserve obligations ("Reserve Expenses"). Specifically, NTD seeks to include in rate base its prepaid debt service reserve of $8.27 million, and its prepaid liquidity reserve of $2.5 million (NTD's Initial Brief at 5).

(a) NTD's Position:

11. NTD argues that the Commission should allow it to include the Reserve Expenses in its rate base (NTD's Initial Brief at 7–11). In sum, the Company alleges: (1) the financing agreements between NTD and its lenders obligate the Company to incur the Reserve Expenses (NTD's Initial Brief at 8); and (2) the reserve obligations represent standard provisions in project-financed transactions and do not differ from other types of prepayments that the Commission typically approves for rate-base treatment (NTD's Initial Brief at 6). The Company further asserts that Staff has not carried its burden to show that the Reserve Expenses are imprudent costs (NTD's Initial Brief at 6–10; NTD's Reply Brief at 7–11).

12. In support of its contentions, NTD claims that project financing typically costs borrowers more than other types of financing and that the Commission has relaxed "certain restrictions on project-financed projects in order to foster competition" (NTD's Initial Brief at 7).

---

[19] In the Joint Statement of Issues, the parties also contested the following issue: If so, should the interest earned by NTD on the funds in its reserve accounts be reflected as a credit to its TRR, and what amount should each credit be? However, the parties resolved this issue at the hearing. *See* Transcript at p. 51, lines 1–7.

[20] Exhibit NTD-24 at p. 3.

13. Moreover, NTD argues that its financing agreements with lenders impose affirmative obligations upon the Company to fund the reserve accounts (NTD's Initial Brief at 8). Specifically, the Company explains that, due to several risk factors associated with the Project, investors demanded funding of the reserve accounts as security (NTD's Initial Brief at 8). The Company also notes that it incurred actual costs as a result of the Reserve Expenses (NTD's Initial Brief at 8).

14. The Company further argues that the Reserve Expenses were prudent and that Staff has not carried its burden to show the costs to be imprudent (NTD's Initial Brief at 8–10). The Company suggests that the costs were prudent because the Project "would not have been financed and built without the company's willingness to assume the prepayment obligations demanded by the lender" and because the objective of the Project—to relieve congestion along the Path 15 corridor—benefits ratepayers by reducing congestion costs (NTD's Initial Brief at 8–10). According to the Company, the prudence of costs should be assessed at the time the costs are incurred (NTD's Initial Brief at 9).

15. Finally, NTD challenges Staff's reliance on three prior Commission decisions, namely *Trailblazer Pipeline Co.*,[21] *Otter Tail Power Co.*,[22] and *Enbridge Pipelines*.[23] According to the Company, *Trailblazer* held that an applicant may not recover prepayments through rate base where the applicant has failed to explain sufficiently what expenses the prepayments are meant to cover (NTD's Initial Brief at 10). The Company argues that it has "articulated clearly and fully the source and content of the prepayment reserves," and thus *Trailblazer* is inapposite (NTD's Initial Brief at 10).[24]

16. Likewise, NTD disagrees that *Otter Tail* pertains (NTD's Reply Brief at 9–10). NTD interprets *Otter Tail* to hold that, where a utility fails to establish the purpose for maintaining bank balances or to show that the balances relate to services paid by the ratepayers, the utility may not include the balances in rate base (NTD's Reply Brief at 9). NTD alleges that it has established the purpose of the Reserve Expenses—to secure project financing—and that the Reserve Expenses benefit ratepayers in the form of monetary savings (NTD's Reply Brief at 9). Therefore, argues NTD, *Otter Tail* does not apply. Instead, the Company cites *Delmarva Power & Light Co.*, 24 FERC ¶ 61,199 at 61,453 (1983), for the point that the Commission will allow rate-base treatment of bank

[21] *Trailblazer Pipeline Co.*, 50 FERC ¶ 61,188 (1990) ("*Trailblazer*").

[22] *Otter Tail Power Co.*, 4 FERC ¶ 63,046, *aff'd*, 12 FERC ¶ 61,169 (1980) ("*Otter Tail*").

[23] *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042 (2004) ("*Enbridge*").

[24] *Id.* at p. 10.

balances where lenders require cash deposits as a condition to borrowing short-term debt. According to NTD, *Delmarva* applies by analogy to NTD. Therefore, the Commission should allow NTD to include its Reserve Expenses in rate base since its lenders required cash deposits as a condition to receiving financing (NTD's Reply Brief at 9–10).

17. Moreover, NTD disputes Staff's reliance on *Enbridge*. According to NTD, the Commission in *Enbridge* allowed a pipeline to recover, through an increase in the pipeline's debt interest rate, the costs of debt consolidation and refinancing associated with existing loans (NTD's Reply Brief at 10). In contrast, NTD argues that it will not be able to recover any amount associated with the Reserve Expenses if they are not included in rate base (NTD's Reply Brief at 10). That result, says NTD, would conflict with the Commission's approval of the Company's proposed capital structure (NTD's Reply Brief at 10). Moreover, NTD urges that *Enbridge* requires the Commission to consider equitable factors in determining rate treatment and that disallowance of the Reserve Expenses would be "punitive and unreasonable" (NTD's Reply Brief at 10). Accordingly, NTD requests the Presiding Judge to reject Staff's arguments and allow the Company to include the Reserve Expenses in its rate base.

(b) The Joint Parties' Position:

18. The Joint Parties take no position on this issue.

(c) PG&E's Position:

19. PG&E takes no position on this issue.

(d) Commission Trial Staff's Position:

20. Staff argues that the Commission should disallow NTD from including the debt and liquidity reserve expenses in its rate base. According to Staff, Commission policy states that "only costs associated with used and useful plant and equipment and working capital are to be included in the rate base" (Staff's Initial Brief at 7). Staff contends that NTD's reserve accounts do not benefit ratepayers and that, under *Otter Tail*,[25] prepayments that do not benefit ratepayers should not receive rate-base treatment (Staff's Initial Brief at 6–7).

21. Moreover, Staff maintains that costs incurred to secure project financing typically are not recovered through rate base, and it is irrelevant whether or not the costs are required by contract or actually incurred (Staff's Initial Brief at 7–8).[26] According to

[25] *Otter Tail Power Co.*, 4 FERC ¶ 63,046 (1978), *aff'd*, 12 FERC ¶ 61,169 (1980).

[26] Staff cites to 18 C.F.R. Part 101, Account No. 165 (2005) for the point that the Commission typically defines "prepayments" as "advance payments of expenses such as

Staff, NTD's Reserve Expenses are analogous to cost of debt and are properly considered below-the-line expenses chargeable to the stockholders (Staff's Reply Brief at 3–4).[27] Additionally, Staff witness Rappolt testified that NTD will recover its principal and interest payments through its typical return on investment and thus should not also include these expenses in rate base (Staff's Reply Brief at 4; S-1 at 12). Staff also cites *Enbridge*,[28] in which the Commission disallowed a pipeline project participant from including in its rate base a prepaid debt expense and held that these types of expenses are properly reflected through rate of return (Staff's Initial Brief at 7). Staff asserts that the Reserve Expenses are appropriately included and recovered through the Company's rate of return, not within rate base (Staff's Initial Brief at 8; Staff's Reply Brief at 3).

22. Furthermore, Staff refers to Commission precedent to show that the key issue is not whether the Reserve Expenses are prudent (Staff's Reply Brief at 4).[29] To the contrary, Staff maintains that prudence is not the sole factor in determining rate-base treatment and that NTD's Reserve Expenses do not qualify for rate-base treatment regardless of prudence (Staff's Reply Brief at 4). Staff also notes that NTD failed to seek an advisory opinion from the Commission to support its inclusion of the Reserve Expenses in rate base (Staff's Reply Brief at 5). Accordingly, Staff concludes that NTD should remove the Reserve Expenses, representing $10,773,091, from the Company's proposed rate base (Staff's Reply Brief at 5).

(e) Decision:

23. Considering NTD's and Staff's respective positions, I find that NTD should not include the Reserve Expenses in its rate base. Including the cost of prepaid debt and liquidity expenses in rate base contravenes the Commission's regulations, as well as Commission precedent, and NTD has provided no persuasive reason to depart from established Commission practice.

24. At the outset I note that NTD's prudence-based arguments throughout its Initial and Reply Briefs lack merit. NTD alleges repeatedly that it prudently incurred the costs of the Reserve Expenses that it now seeks to include in rate base (NTD's Initial Brief at 8–11; Reply Brief at 8, 10, 11). In arguing prudence alone, the Company misses the

---

insurance, rents, taxes, or interest" (Staff's Initial Brief at 6, n. 15).

[27] Staff explains that "'[b]elow-the-line' expenses represent costs, in income, that are the responsibility of the stockholders. 'Line' refers to the utility operating income, appearing on the income statement" (Staff's Reply Brief at 3).

[28] *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042 (2004).

[29] Staff cites *Transcontinental Gas Pipe Line Corp.*, 59 FPC 1237 at 1239 (1977), *aff'd sub nom., Tennessee Gas Pipeline Co. v. FERC*, 606 F.2d 1094, 1123 (D.C. Cir. 1979), *cert. denied*, 445 U.S. 920 and 447 U.S. 922 (1980).

point. At issue in this case is not simply whether NTD's costs were prudent. The issue is whether and how the Company's expenses are includable in jurisdictional rates. Regardless of whether NTD's costs were prudent, NTD may only include in its rate base costs that do not produce unjust and unreasonable rates.[30]

25. Moreover, the Commission's regulations simply do not contemplate inclusion of prepaid debt and liquidity reserves in rate base. NTD's contention that its Reserve Expenses should receive rate-base treatment is premised upon its categorization of the expenses as "prepayments." However, the regulations define "prepayments" as "amounts representing prepayments of insurance, rents, taxes, interest, and miscellaneous items."[31] NTD's Reserve Expenses differ in nature from prepayments for insurance, rents, taxes, and interest, which all represent predictable and regular future expenses that directly benefit ratepayers through the operation of the utility.

26. I concur with Staff that NTD's Reserve Expenses reflect more closely the type of prepaid debt expenses that the Commission recently precluded from rate base in *Enbridge*.[32] The pipeline in *Enbridge* proposed to include in its rate base costs it incurred in refinancing debt. To support its proposal, the pipeline made arguments mirroring those that NTD has made in this proceeding. Specifically, the pipeline argued that: (1) "[T]he Commission generally allows recovery of the transaction costs arising from financing or refinancing of utility operations;" (2) the pipeline's lenders "required that [the] debt costs be included in its proposed rate base as a condition to obtaining" the loan; (3) the expenses were not imprudent; and (4) the refinancing saved ratepayers money.[33] The Commission, however, rejected the pipeline's arguments and held that, because "the costs at issue were incurred to consolidate and refinance the preexisting debts into the…loan,…those costs are appropriately treated as costs of debt capital, properly

[30] In *Transcontinental Gas Pipe Line Corp.*, 59 FPC 1237 (1977), *aff'd sub nom., Tennessee Gas Pipeline Co. v. FERC*, 606 F.2d 1094, 1123 (D.C. Cir. 1979), *cert. denied*, 445 U.S. 920 and 447 U.S. 922 (1980), the Commission held that rate-base inclusion, even if prudent, is not mandated and "only prudent investments for utility property that are used and useful to provide service to customers should be compensated." *Id.* at 1239.

[31] 18 C.F.R. Part 101, Account No. 165 (2005).

[32] Although *Enbridge* deals with a pipeline and not an electric utility like NTD, the Supreme Court has recognized that the Natural Gas Act and the Federal Power Act are "substantially identical" and has treated precedents under either statute as interchangeable." *See Arkansas Louisianan Gas Co. v. Hall*, 453 U.S. 571, 577 (1981).

[33] *Enbridge*, 109 FERC at 61,183.

reflected through rate of return, and not through rate base as working capital costs."[34] Issues relating to NTD's rate of return are not germane to this proceeding.[35]

27. NTD correctly notes that *Enbridge* distinguished working capital costs from costs of debt and held that prepayments of "working capital assets are eligible for rate base treatment."[36] NTD's Reserve Expenses, however, are more appropriately characterized as costs of debt, and therefore *Enbridge* does not support NTD's position. The Commission explained in *Enbridge* that "[w]orking capital consists of cash and other liquid assets, such as materials and supplies, which a company must have on hand to meet the current costs of operations until it is reimbursed by its customers."[37] NTD's Reserve Expenses, in contrast, are illiquid because they are held in reserve for the *lender's benefit* indefinitely and therefore do not directly benefit the utility's customers.[38] Moreover, the Reserve Expenses cannot properly be considered operational costs. Therefore, I reject NTD's attempt to distinguish the *Enbridge* case. Like the pipeline's debt expense in *Enbridge*, NTD's Reserve Expenses do not fit within the category of working capital.

28. In its Reply Brief, NTD argues alternatively that the Commission recognized in *Enbridge* the importance of equitable considerations in determining rate treatment (NTD's Reply Brief at 11). Although NTD notes that the Commission rejected the pipeline's equitable arguments in *Enbridge* only because they were moot, NTD fails to name any equitable considerations that would justify departing from established Commission precedent in this case (NTD's Reply Brief at 11). I find NTD's arguments lack substantive legal or factual merit.[39] Accordingly, I hold that inclusion of the Reserve

---

[34] *Id.* at 61,182.

[35] As the Joint Parties note in their Reply Brief, the Commission already dealt with rate-of-return issues in its approval of the Project Participants' Letter Agreement (Joint Parties' Reply Brief at 5–6).

[36] *Enbridge*, 109 FERC at 61,182.

[37] *Id.* at 61,182.

[38] *Otter Tail Power Co.*, 4 FERC ¶ 63,046 (1978), *aff'd* 12 FERC ¶ 61,169 (1980), held that "mere maintenance of funds on deposit does not make the cost an allowable rate base item. To be includable in rate base, the deposits must, among other things, be useful to the ratepayers." *Id.* at 65,357.

[39] I also reject NTD's argument that denying rate-base treatment of the Company's Reserve Expenses is at odds with the Commission's approval of NTD's proposed 50/50 capital structure (NTD's Reply Brief at 10). Nothing in the Commission's June 12 Order approving NTD's capital structure suggests that the Commission consents to the Company including all costs associated with obtaining financing for the Project in rate

Expenses in NTD's rate base would result in unjust and unreasonable rates, and consequently NTD should remove the Reserve Expenses from its filings.

II. What is the proper methodology for calculating NTD's allowance for working capital? And, what is the proper amount of the allowance?

29. Pursuant to private agreements, NTD's lenders required the Company to fund a working capital reserve as a condition to receiving financing (NTD's Initial Brief at 11). Accordingly, NTD initially included in its TRR as a rate-base item a working capital allowance ("WCA") in the amount of $8.7 million to reflect the working capital obligation imposed by its lenders (NTD's Initial Brief at 11). Subsequently, the Company amended its claimed WCA to $7.26 million (NTD's Initial Brief at 11). The Joint Parties and Staff challenge the Company's method of calculating the WCA. Under their methodology, the Joint Parties conclude that NTD should reduce its WCA to either $267,465 or $304,613 (JNT's Initial Brief at 18). Similarly, Staff proposes a figure of $300,812 (Staff's Initial Brief at 10).

(a) NTD's Position:

30. The Company argues that the Commission's rule (also referred to as the "45-day convention" or "Commission's convention") for calculating WCA, which Staff and the Joint Parties endorse, does not apply in NTD's case (NTD's Initial Brief at 12–13). According to NTD, the 45-day convention is inapposite because NTD seeks a working capital adjustment rather than a *cash* working capital allowance (NTD's Initial Brief at 12). The Company also claims that the Commission's convention serves only as a proxy and should not apply when an applicant's working capital requirements are "known, quantifiable, and prescribed by contract" (NTD's Initial Brief at 12). Moreover, the Company alleges that the 45-day convention does not reflect binding Commission policy (NTD's Initial Brief at 12–13). Rather, states NTD, the Commission ordinarily does a case-by-case review to determine the appropriate allowance for a utility (NTD's Initial Brief at 13).[40]

---

base. *Western Area Power Admin.*, 99 FERC ¶ 61,306, *reh'g denied*, 100 FERC ¶ 61,331 (2002). In fact, the Commission noted that the June 12 Order was only a preliminary step to allow "the Path 15 Participants to move forward and not the last opportunity for the Commission to review matters that are subject to its jurisdiction." *Id.* at 62,281.

[40] In support, NTD cites *Calculation of Cash Working Capital Allowance for Electric Utilities*, FERC Stats. & Regs. Proposed Regs. 1982–1985 ¶ 32,373 (1984), *termination order*, 53 FERC ¶ 61,052 (1990), *reh'g denied*, 54 FERC ¶ 61,193 (1991) (declining to adopt a new rule for the working capital allowance and instead deciding to continue assessing working capital on a case-by-case basis).

31. Accordingly, NTD asserts that in this case the Commission should accept the Company's proposed WCA because it was "prudently-incurred" and is "contractually-mandated"[41] and because the Commission's convention would deny NTD recovery of actual[42] and prudent costs (NTD's Initial Brief at 11, 13).

32. Specifically, NTD proposes to recover $7.2 million worth of working capital (NTD's Initial Brief at 14). This figure reflects the costs NTD incurred in complying with the Depositary Agreement, a private contract with its lenders, adjusted downward to conform to "familiar rate-making conventions" (NTD's Initial Brief at 14). NTD explains further that, because of the perceived risk of the Path 15 Upgrade project, the Company's lenders' required it to furnish $9 million of initial working capital (NTD's Initial Brief at 11). In its proposed TRR, NTD adjusted the $9 million downward to conform to "familiar rate and accounting concepts under the Commission's FPA regulations" (NTD's Initial Brief at 14). Subsequently, NTD adjusted its claimed WCA downward again to $7.2 million to reflect the actual payment lag of 75 days by the ISO (NTD's Initial Brief at 14).[43] Ultimately, NTD stresses prudence as the key factor in determining the proper WCA (NTD's Reply Brief at 15). In sum, the Company argues that because it actually and prudently incurred[44] a working capital obligation of $7.2 million, the Commission should permit NTD to include that amount in its rate base.

(b) Joint Parties' Position:

33. The Joint Parties determine the Company's WCA to be either $267,465 or $304,613 (JNT's Initial Brief at 18).[45] The Joint Parties claim that the Commission

---

[41] NTD notes that "financing for the Path 15 Upgrade would not have been secured but for the working capital allowance" (NTD's Reply Brief at 12).

[42] NTD avers that actually incurred costs are presumptively prudent and recoverable in jurisdictional rates (NTD's Reply Brief at 13). To support this contention, NTD cites *New England Power Co.*, 31 FERC ¶ 61,047 at 61,082, *reh'g denied*, 32 FERC ¶ 61,112 (1985), *aff'd*, *Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986) (citing *W. Ohio Gas Co. v. Public Utils. Comm'n of Ohio*, 294 U.S. 63, 72 (1935)).

[43] Initially, NTD assumed a 90-day lag period, but "evidence" and "experience" showed that the actual lag was the shorter 75-day period (NTD's Initial Brief at 14).

[44] Citing *New England Power Co.*, 31 FERC at 61,084, NTD emphasizes that "prudence is determined at the time of the utility's actions, not in hindsight" (NTD's Initial Brief at 15). Moreover, NTD cites *Ozark Gas Transmission Sys. v. FERC*, 897 F.2d 548, 552 (D.C. Cir. 1990), *order on remand*, 56 FERC ¶ 61,011, *reh'g denied*, 57 FERC ¶ 61,030 (1991), for the point that the Commission should not rigidly apply a policy that "fails to recognize a utility's unique circumstances or that countermands its own policy goals" (NTD's Initial Brief at 15, n. 23).

[45] The value the Joint Parties recommend depends on the resolution of Issue No. 5

applies an established policy for determining WCA (JNT's Initial Brief at 18). Specifically, the Commission offers utilities two alternatives in calculating WCA (JNT's Initial Brief at 19). A utility may provide a lead-lag study to justify its proposed WCA (JNT's Initial Brief at 19). Alternatively, in the absence of a lead-lag study, a utility must calculate WCA based on an assumed 45-day payment lag (JNT's Initial Brief at 19). The Joint Parties argue that NTD failed to perform a lead-lag study, and consequently the 45-day convention applies (JNT's Initial Brief at 19).

34. Moreover, the Joint Parties dispute NTD's method for calculating WCA. According to the Joint Parties, NTD incorrectly applies a lag period that "measures the delay between *provision of service* and receipt of payments from the ISO" (JNT's Initial Brief at 20) (emphasis added). Instead, the Joint Parties argue that the Commission mandates a lag period that measures the delay between the *payment by the utility* of its operational expenses and the receipt of payments from the ISO (JNT's Initial Brief at 20). Furthermore, the Joint Parties aver that NTD has not reported when it actually pays its O&M expenses, and therefore has provided no basis to deviate from the 45-day convention (JNT's Initial Brief at 20–21).[46] Concerning NTD's proposal, the Joint Parties conclude that the claimed WCA is "so inflated as to be *prima facie* unjust and unreasonable" (JNT's Reply Brief at 3).

35. The Joint Parties also dispute NTD's use of all project-related costs, including certain non-cash items, in calculating WCA (JNT's Initial Brief at 21–22). According to the Joint Parties, the Commission allows a utility to include only funds necessary to meet its immediate cash obligations and does not permit inclusion of non-cash items in WCA (JNT's Initial Brief at 21). Namely, the Joint Parties allege that NTD improperly includes in WCA items unrelated to operations and maintenance, such as "return to shareholders, depreciation, and taxes," as well as NTD's "prepayments accounts" (JNT's Initial Brief at 21).[47]

---

of this proceeding. Pursuant to Issue No. 5, the Joint Parties propose two alternative adjustments to the Company's operation and maintenance expenses ("O&M expenses"). The amount of O&M expenses allowed in turn impacts the WCA. Accordingly, the Joint Parties propose a WCA of $267,465 in the event that the Joint Parties' first alternative is adopted under Issue No. 5. Alternatively, if their second proposal is adopted, the Joint Parties propose a WCA of $304,613.

[46] The Joint Parties note that NTD "provides no support to indicate that the Commission has not applied the 45-day convention when a lead-lag study has not been presented" (JNT's Reply Brief at 4).

[47] The Joint Parties also challenge NTD's claim that Commission policy does not apply since the Company seeks a working capital, rather than *cash* working capital, adjustment (JNT's Reply Brief at 3). According to the Joint Parties, "there is no doubt that the amount [NTD] is seeking falls into the cash working capital category" (JNT's Reply Brief at 3). The Joint Parties explain that NTD's accounting statements label the

36. The Joint Parties maintain that NTD's private agreements with its lenders, in particular the Depositary Agreement, do not justify including all project-related costs in WCA in derogation of Commission policy (JNT's Initial Brief at 22; JNT's Reply Brief at 5). The fact that a private agreement requires a utility to incur an expense, explain the Joint Parties, does not mean that the expense is prudent (JNT's Initial Brief at 22; JNT's Reply Brief at 5). Furthermore, a utility cannot use private contracts "as pretenses to charge unjust and unreasonable rates" (JNT's Reply Brief at 5). Rather, the Joint Parties aver, proposed rates resulting from private, non-jurisdictional contracts "can be reviewed to determine if the contract price results in unjust and unreasonable rates" (JNT's Initial Brief at 23).

37. Additionally, the Joint Parties claim that the Depositary Agreement does not even require NTD to include non-cash items in its WCA, to use a particular method in calculating the WCA, or to seek a specific dollar amount through its WCA (JNT's Initial Brief at 23–26). In fact, the amount of working capital prescribed by the Depositary Agreement does not reflect the amount NTD actually requests for its WCA (JNT's Initial Brief at 25–26). The Joint Parties argue that the Commission should not be bound by the Depositary Agreement if the Company itself does not observe the terms of the agreement (JNT's Initial Brief at 25).

38. Finally, the Joint Parties assert that the unique risks NTD claims are associated with the Project do not justify departing from standard Commission policy (JNT's Reply Brief at 5–6). The Joint Parties note that the Commission approved portions of the Project Participant's Letter Agreement, granting NTD several rate incentives to compensate for the unique risks of the Path 15 project (JNT's Reply Brief at 5–6). Namely, the Commission approved a three-year rate moratorium, a 13.5% return on equity, and a 50/50 target capital structure (JNT's Reply Brief at 6). Consequently, the Joint Parties argue that NTD "is already being fully and adequately compensated for whatever 'additional' costs or risks it incurred in financing the Path 15 Upgrade" (JNT's Reply Brief at 6).

39. Accordingly, the Joint Parties ask that the Commission reject NTD's proposed WCA and apply the 45-day convention to reduce the Company's WCA to $267,465 or $304,613.

(c) PG&E's Position:

40. PG&E takes no position on this issue.

---

amount in question as "Cash Working Capital" (JNT's Reply Brief at 3). Furthermore, NTD's WCA is not based on the types of expenses that ordinarily support a working capital adjustment (JNT's Reply Brief at 3–4).

(d) Commission Trial Staff's Position:

41. Staff requests that the Commission reject NTD's proposed WCA and instead accept Staff's figure of $300,812 (Staff's Initial Brief at 10). Under Staff's interpretation of the regulations, "cash working capital is the amount of cash needed by a utility to meet its operating expenses during the gap period between when expenses are *paid* and when revenues are *received* for service" (Staff's Initial Brief at 9).[48] Like the Joint Parties, Staff alleges that the Commission's 45-day convention must apply to NTD (Staff's Initial Brief at 13). According to Staff, Commission policy provides that a utility may provide a lead-lag study to justify a WCA based on the utility's actual cash working capital requirements (Staff's Initial Brief at 9). In the absence of a lead-lag study, however, a utility must use the 45-day convention and base WCA on 45 days of estimated O&M expenses, minus fuel and purchased power (Staff's Initial Brief at 9).[49] In contrast, Staff notes that NTD calculates WCA based on 75 days' worth of the entire cost of service (Staff's Initial Brief at 9–10).

42. For several reasons, Staff maintains that NTD's methodology is flawed. First, Staff avers that NTD's accounting statements illustrate that in this proceeding the Company is seeking a *cash* working capital allowance and not the broader working capital allowance as NTD claims (Staff's Initial Brief at 10; Staff's Reply Brief at 9).[50] Second, Staff argues essentially that NTD missed its chance to obtain an exception to the 45-day convention. Staff states that the Company should have requested an advisory opinion from the Commission to determine the appropriateness of an exception, and, having failed to do so, may not now deviate from Commission policy (Staff's Initial Brief at 11). Third, Staff alleges that the Company's proposed WCA "unreasonably increases the annual cost-of-service," and the ratepayers should not be expected to bear the cost of an "excessive" and "seemingly arbitrary" initial working capital requirement (Staff's Initial Brief at 12).

43. Fourth, Staff maintains that private contracts, such as the ones between NTD and its lenders, do not control the formulation of jurisdictional rates (Staff's Initial Brief at

---

[48] Staff cites 18 C.F.R. § 35.13(h)(12) (2005).

[49] In support of the 45-day convention, Staff cites *Lockhart Power Co., Opinion No. 29* (1979); *Carolina Power and Light Co., Opinion No. 19-A*, 6 FERC ¶ 61,154 (1979); and *Louisiana Power & Light Co.*, 14 FERC ¶ 61,075 at 61,120–23 (1981) ("*Louisiana Power*").

[50] While Staff concedes a distinction between working capital and cash working capital, Staff notes that the amount listed for "cash working capital" on NTD's working capital statement is identical to the amount listed for the "working capital requirement" on NTD's cost-of-service statement (Staff's Reply Brief at 9).

13; Staff's Reply Brief at 10–11).[51] Regardless of the relevance of the private contracts, the Company has not established a relationship among the terms of the Depositary Agreement, the WCA it actually seeks, and the WCA it would receive using a lead-lag study (Staff's Initial Brief at 13; Staff's Reply Brief at 12).[52] Moreover, because the record contains no evidence of when NTD pays its expenses and receives its revenue for service, Staff claims "the Commission's established policy should determine the level of working capital" (Staff's Initial Brief at 13; Staff's reply Brief at 12).

44. In sum, Staff concludes that applying NTD's method of calculating WCA would result in unjust and unreasonable rates (Staff's Initial Brief at 13). Accordingly, Staff recommends that the Commission reject NTD's proposed WCA and apply the 45-day convention to determine the appropriate WCA (Staff's Initial Brief at 13; Staff's Reply Brief at 13). Under Staff's methodology, NTD should receive a WCA of $300,812 (Staff's Initial Brief at 13; Staff's Reply Brief at 13).

(e) Decision:

45. After considering the positions of the parties, I find that NTD's calculation of its WCA must be rejected and the Commission's 45-day convention applied. Staff's proposal uses the correct methodology and establishes the proper WCA for the Company. Therefore, I hold that NTD may include in its rate base a WCA of $300,812.

46. Under the Commission's regulations, a utility company may recoup an amount for cash working capital, which the regulations define as "average monthly working cash requirements that reflect the extent to which day-to-day operational utility service revenues are received later or earlier than cash disbursements necessary to provide the services."[53] Although the regulations do not prescribe a particular methodology for calculating the WCA, a long history of Commission precedent provides a clear framework. Specifically, the Commission has held that, in the absence of a lead-lag study approximating the utility's cash working capital needs or demonstrated special circumstances or hardships that would justify a departure from the established formula, a utility should use the Commission's 45-day convention.[54] Under the 45-day convention,

---

[51] Staff also argues that NTD has not sought a $9 million WCA, as the Company claims the Depositary Agreement requires, and thus the Commission likewise should not be constrained by the agreement (Staff's Reply Brief at 11).

[52] Staff notes that the Depositary Agreement prescribes $9 million worth of working capital, but NTD only seeks $7,257,095 (Staff's Reply Brief at 8–9).

[53] 18 C.F.R. § 35.13(h)(12) (2005).

[54] *Lockhart Power Co., Opinion No. 29* (1979); *Carolina Power and Light Co., Opinion No. 19-A*, 6 FERC ¶ 61,154 (1979); and *Louisiana Power & Light Co.*, 14 FERC

a utility may claim a WCA equal to 45 days' worth of its O&M expenses less purchased power costs.[55]

47. *Louisiana Power* is particularly instructive. In *Louisiana Power*, although a lead-lag study was available, the utility calculated its proposed WCA using the Commission's 45-day convention.[56] Because the lead-lag study was defective, the Commission held that the 45-day rule was the proper method for computing the utility's WCA.[57] In so holding, the Commission made clear that the goal with respect to working capital is to best approximate the "true conditions of [the utility's] cash working capital needs and set the cash working capital allowance accordingly."[58]

48. Although NTD correctly notes that the Commission does not rigidly apply the 45-day convention as a per se rule, the Company has provided no evidence that its proposed WCA approximates its actual working capital needs. Specifically, NTD did not perform a lead-lag study and failed to demonstrate special circumstances or hardships sufficient to justify departure from longstanding Commission policy. Furthermore, NTD provided no evidence of when it pays its bills. In the absence of such evidence, the Commission requires that the 45-day convention apply to determine a utility's WCA.

49. Even if the Commission accepted the NTD's use of a 75-day lag period, the Company's proposed WCA contains expenses that are not properly includable in WCA. As the Joint Parties point out, utilities may only include in WCA funds necessary to meet immediate cash obligations related to operations and maintenance (JNT's Initial Brief at 21–22). In contrast, NTD includes items unrelated to operations and maintenance, such as "return to shareholders, depreciation, taxes…and prepayments accounts," in its WCA. These expense items must be removed from any WCA calculation ultimately approved (JNT's Initial Brief at 21).

50. Moreover, I reject NTD's argument that the unique risks associated with the Path 15 Upgrade justify departure from the Commission's rules. In its June 12, 2002 Order accepting the Project Participants' Letter Agreement, the Commission recognized the unique aspects of the Project and accordingly granted NTD significant concessions through its rate of return.[59] Specifically, the Commission approved a three-year rate

---

¶ 61,075 (1981).

[55] *Louisiana Power & Light Co.*, 14 FERC ¶ 61,075 (1981).

[56] *Louisiana Power & Light Co.*, 14 FERC at 61,120.

[57] *Louisiana Power & Light Co.*, 14 FERC at 61,122–61,123.

[58] *Louisiana Power & Light Co.*, 14 FERC at 61,121.

[59] *Western Area Power Admin.*, 99 FERC ¶ 61,306 (2002).

moratorium, a 13.5% return on equity, and a target 50/50 capital structure.[60] NTD fails to justify further special treatment in the form of an exception to the ordinary working capital rules.

51. Accordingly, I find that NTD has not justified its departure from established Commission rules. Therefore, I hereby deny NTD's claimed WCA of $7.27 million. I further find that Staff properly followed the Commission's rules when calculating the Company's WCA, and I therefore order NTD to amend its WCA to Staff's proposed figure of $300,812.[61]

III. What is the proper methodology for calculating NTD's allowance for funds used during construction and what is the proper amount for such allowance?

52. The Commission permits utilities to recover the costs of financing construction through an "allowance for funds used during construction" ("AFUDC").[62] The Commission's regulations define AFUDC as "the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed" by the regulations.[63] To determine the allowance to which a utility is entitled, the costs of construction are accumulated until the plant goes into service.[64] As the Commission explained in *Louisiana Power*, "[w]hen the plant goes into service the accumulated financing costs are added to rate base. The utility then begins to recover the costs through depreciation charges and the return allowance."[65]

53. The regulations detail a formula for calculating AFUDC, which takes into account, among other things, a cost base consisting of the amount of funds borrowed to finance construction.[66] The rate to be applied against the cost base ("AFUDC rate" or "interest rate") must be determined annually.[67] Moreover, the Commission permits compounding,

---

[60] *Id.*

[61] The Joint Parties' proposed WCA figures depend on the resolution of Issue No. 5, *infra* Part V., in their favor. Because I find that there is no Issue No. 5 at stake in this proceeding, I must reject the Joint Parties' proposed WCAs.

[62] *Louisiana Power & Light Co.*, 14 FERC at 61,114.

[63] 18 C.F.R. Part 101, Electric Plant Instructions 17 (2005).

[64] *Louisiana Power & Light Co.*, 14 FERC at 61,118, n. 30.

[65] *Id.* at 61,118, n. 30.

[66] 18 C.F.R. Part 101, Electric Plant Instructions 17.

[67] *Id.*

which allows a utility to include previously capitalized AFUDC in the cost base to which the AFUDC rate applies.[68] The reason for compounding is that "AFUDC is a cost of construction similar to labor, materials and other elements of construction."[69]

54. Both NTD and Staff use the formula prescribed by the regulations to calculate the Company's AFUDC. The parties' methods differ, however, in how the AFUDC is compounded. Compounding the AFUDC monthly, NTD calculates and includes in its proposed TRR an AFUDC of $22,358,736 (NTD's Initial Brief at 16). Conversely, Staff uses semiannual compounding and arrives at an AFUDC of $21,517,560 (Staff's Initial Brief at 15).

(a) NTD's Position:

55. In calculating its proposed AFUDC, the Company applies "non-annual" interest rates set forth in its Statement AO to the Commission-prescribed AFUDC formula and compounds the AFUDC monthly (NTD's Initial Brief at 15–20). This approach yields a claimed AFUDC of $22,358,736 (NTD's Initial Brief at 16).

56. NTD argues that monthly compounding "more accurately reflects the AFUDC costs incurred by NTD" and that Staff's method "has not been shown to be just and reasonable" (NTD's Initial Brief at 17, 20). NTD concedes that its method departs from Commission policy by applying "non-annual" interest rates to compute monthly AFUDC balances and by compounding AFUDC on a monthly basis (NTD's Initial Brief at 17). The Company asserts, however, that special circumstances justify a departure from the ordinary rules (NTD's Initial Brief at 15, 17). Specifically, NTD argues that the Company is a start-up, project-financed enterprise and that the Commission makes AFUDC determinations on a case-by-case basis for those entities because of "unique problems associated with calculating AFUDC" (NTD's Initial Brief at 15–16).[70]

---

[68] Amendments to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) 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, Docket No. RM75-27, Order No. 561, 57 FPC 608, 612 (1977), *reh'g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶ 61,050 (1978) ("Order 561").

[69] *Id.* at 612.

[70] In support, NTD cites *Gulfstream Natural Gas Sys., L.L.C.*, 94 FERC ¶ 61,185 at 61,337 (2001) ("*Gulfstream*"). NTD also cites *Alliance Pipeline Co.*, 80 FERC ¶ 61,149 at 61,602 (1997) ("*Alliance*"), for the point that "historical capital balances and cost rates used in the standard AFUDC formula may not exist or may not result in an appropriate measurement of the cost rate for funds used in construction" for start-up, project-financed enterprises (NTD's Initial Brief at 15).

57. Moreover, NTD asserts that traditional Commission rules do not readily apply to NTD because the Company experienced a mid-year change in construction financing (NTD's Initial Brief at 17). Namely, in the year 2003, NTD initially received a temporary unsecured development loan and then mid-year secured a permanent construction loan at a lower rate (NTD's Initial Brief at 17–18). In calculating its AFUDC, the Company applies two "non-annual" interest rates that correspond to the periods of the two loans in order to reflect the mid-year change (NTD's Initial Brief at 18).[71] By contrast, the Company maintains that the regulations dictate use of a *single* annual interest rate in calculating AFUDC (NTD's Initial Brief at 18). According to NTD, under the Commission's method, "the significantly lower debt rate associated with the permanent loan would not be reflected in AFUDC calculations until…some 3 ½ months after the high-interest development loan was taken out," which would increase costs to ratepayers (NTD's Initial Brief at 18). Furthermore, NTD witness Drzemiecki explains that NTD's use of monthly compounding permits "recognition of [the] mid-year financing change" (NTD's Reply Brief at 16).

58. Additionally, NTD avers that its method fairly compensates the Company for its cost of financing and "comports with the spirit of Order No. 561 by compensating NTD for construction cost outlays using actual debt rates in place during the time periods in which AFUDC balances accrued" (NTD's Initial Brief at 18–19).

59. In its Initial and Reply Briefs, NTD also contests Staff's Reduced Rate Method for calculating the Company's AFUDC. According to NTD, there is no Commission precedent for applying the Reduced Rate Method (NTD's Initial Brief at 19). Moreover, NTD witness Drzemiecki characterizes Staff's method as internally inconsistent because, while it "stays true to the semi-annual compounding principal of Order No. 561, it fails to abide by the regulations and instructions directing use of an *annual* AFUDC rate" (NTD's Reply Brief at 17). In fact, NTD asserts that strictly applying the Commission rules yields an AFUDC amount nearly $12 million higher than the Company's proposal (NTD's Initial Brief at 19–20). The Company also criticizes Staff's method for not fairly compensating NTD for its incurred costs[72] and claims that Staff improperly focuses on Order No. 561 rather than NTD's incurred costs as the basis for its method (NTD's Initial Brief at 20; NTD's Reply Brief at 17). Although NTD agrees that Staff's method "allows rate payers to realize the 'benefit of lower AFUDC costs associated with the new

[71] To explain, NTD uses the interest rate that corresponds to the development loan during the period of that loan and then uses the interest rate that corresponds to the permanent construction loan once that loan takes effect mid-year (NTD's Initial Brief at 18).

[72] NTD explains that "the Commission has an obligation to *both* rate payers *and* regulated utilities" (NTD's Reply Brief at 18).

financing,'" NTD maintains that the Company's approach affords the same benefit to ratepayers (NTD's Reply Brief at 17).

(b) The Joint Parties' Position:

60. The Joint Parties take no position on this issue.

(c) PG&E's Position:

61. PG&E takes no position on this issue.

(d) Commission Trial Staff's Position:

62. In calculating the Company's AFUDC, Staff uses the formula prescribed by the regulations and applies semiannual compounding to arrive at a proposed AFUDC of $21,517,560 (Staff's Initial Brief at 15).

63. Staff addresses two discrete issues with regard to the Company's AFUDC: (1) does the Commission permit monthly compounding of AFUDC? (2) Does the Commission require a utility to use a *single* annual AFUDC rate for each year that the utility calculates AFUDC?

64. First, Staff maintains that NTD's use of monthly compounding is improper. According to Staff, Order No. 561 carries the force of law[73] and clearly establishes that AFUDC may be compounded no more frequently than semiannually (Staff's Initial Brief at 16).[74] Staff argues that NTD fails to justify its departure from the Commission policy (Staff's Initial Brief at 17). More precisely, Staff states that "there is nothing inherent in

---

[73] Staff cites *Pacific Gas and Electric Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974), for the point that agencies can create binding policy through rulemaking procedures (Staff's Initial Brief at 17, n. 51).

[74] Staff refers to several cases in which the Commission has disallowed a utility's use of monthly compounding and required semiannual compounding instead (Staff's Initial Brief at 17, n. 52). Specifically, Staff cites *Ingleside Energy Center, LLC*, 112 FERC ¶ 61,101 at P81 (2005); *Iroquois Gas Transmission, L.P.*, 64 FERC ¶ 62,211 at 64,267 (1993); *Endicott Pipeline Co.*, 55 FERC ¶ 63,028 at 65,154 (1991). Staff also avers that the Commission held in *Kuparuk Transportation Co.*, 45 FERC ¶ 63,006 (1998), *aff'd in part and modified in part on other grounds*, 55 FERC ¶ 61,122 at 61,371 (1991), that "when the Commission uses the word 'permit' in Order No. 561, it means the company may, but is not required to, compound as frequently as semiannually…and does not mean the company may compound more frequently than semiannually" (Staff's Initial Brief at 16, n. 50).

a project-financed venture that suggests the return on its AFUDC needs to be compounded monthly" (Staff's Initial Brief at 17).[75]

65. To comply with Order No. 561, Staff compounds the Company's AFUDC semiannually (Staff's Reply Brief at 19). Staff alleges that the Commission does not prescribe a method for compounding semiannually, and therefore Staff elects to use the reduced rate method (Staff's Reply Brief at 14, 17–18). Specifically, Staff witness Steffy ("Steffy") converts each of the Company's AFUDC rates, as they are set forth in Statement AO, into an equivalent monthly rate, which "when applied and compounded monthly has the effect of compounding AFUDC semiannually" (Staff's Initial Brief at 21; Staff's Reply Brief at 19). Moreover, Staff maintains that, contrary to NTD's assertion, semiannual compounding does not yield an increase to the Company's rate base.[76] Rather, based on Steffy's approach, Staff proposes an AFUDC of $21,517,560, which represents a decrease to rate base of $841,176 and a decrease to the overall rate of return $166,821 from NTD's proposal (Staff's Initial Brief at 15).

66. As to the second issue, Staff disagrees with NTD that the regulations contemplate a *single* annual AFUDC rate (Staff's Initial Brief at 21; Staff's Reply Brief at 14, 17). In fact, Staff avers that, although the regulations require the AFUDC rate to be stated on an

[75] Staff addresses at length the *Alliance* and *Gulfstream* cases, which NTD cites for the point that the Commission makes AFUDC determinations based on the individual facts of each case for project-financed enterprises (Staff's Reply Brief at 13–17). According to Staff, *Alliance* and *Gulfstream* are distinguishable. Staff interprets *Alliance* and *Gulfstream* as merely recognizing that "a newly formed project-financed entity…requesting authorization to construct natural gas pipeline facilities, may not have established its capital structure and/or secured its construction financing and thus…may not possess the data required under the Commission's formula to calculate its AFUDC rates" (Staff's Reply Brief at 15). By contrast, Staff notes that NTD has secured financing, completed construction, and begun commercial operation (Staff's Reply Brief at 16). Therefore, Staff claims, NTD differs from the utilities in *Alliance* and *Gulfstream* because it knows the construction financing costs to use with the Commission-prescribed AFUDC formula (Staff's Reply Brief at 16). Moreover, Staff argues that NTD failed to request Commission authorization to depart from the AFUDC provisions of the regulations or Order No. 561 (Staff's Reply Brief at 16). Staff also states that "in neither *Alliance* nor *Gulfstream* did the Commission grant a waiver to these Companies with respect to compounding AFUDC semiannually, which is the issue in this proceeding" (Staff's Reply Brief at 16–17).

[76] Exhibit NTD-23 illustrates what AFUDC would result assuming compliance with Order No. 561 and use of a single annual AFUDC rate. NTD's calculations in Exhibit NTD-23 yield an AFUDC of $34,129,878. However, Staff states that Exhibit NTD-23 incorrectly disregards the mid-year change in AFUDC rates (Staff's Reply Brief at 18).

annual basis, the Commission requires adjustments to the AFUDC rate to reflect rate changes during the year (Staff's Initial Brief at 21; Staff's Reply Brief at 17). Consistent with the regulations, Steffy adopts the interest rates set forth in NTD's Statement AO, which change mid-year, to compute AFUDC (Staff's Initial Brief at 18). Staff explains that Steffy's calculations properly take into account the mid-year change in NTD's financing and that ratepayers will benefit from the lower AFUDC costs associated with the new financing (Staff's Initial Brief at 19, 21). Moreover, Staff maintains that stating the AFUDC rate on an annual basis does not preclude a mid-year change from being "factored into semiannual compounding of the AFUDC" (Staff's Reply Brief at 17). Staff further refutes the Company's assertion that "it is inconsistent to compound semiannually while at the same time accounting for mid-year changes in AFUDC rates" (Staff's Reply Brief at 18).

67. In sum, Staff argues that the reduced rate method complies with Order No. 561, while taking into account the mid-year change in the Company's AFUDC rates (Staff's Reply Brief at 19). Using the reduced rate method to compound the Company's AFUDC semiannually, Staff claims the appropriate AFUDC is $21,517,560 (Staff's Reply Brief at 20). Accordingly, Staff requests that the Company's proposed AFUDC be rejected.

(e) Decision:

68. After considering the respective positions of NTD and Staff, I uphold NTD's methodology for calculating AFUDC and the resulting figure of $22,358,736. Although NTD's methodology does not strictly comply with the Commission's rules, it represents a reasonable attempt to deal with the special financing arrangements experienced by the Company. Significantly, Staff has not shown that NTD's method results in unjust and unreasonable rates.

69. To clarify the issue at stake here, I first address NTD's argument that Staff's method is inconsistent insofar as it uses "non-annual" AFUDC rates while applying semiannual compounding. NTD's assertion appears to be that 18 C.F.R. § 35.13(h)(15) (2005) requires use of a *single* annual rate for calculating AFUDC. The Company, however, interprets the regulations erroneously. I agree with Staff that § 35.13 merely provides that utilities must state their AFUDC rates on an annual basis and does not mandate use of a single annual rate. Both parties correctly incorporate NTD's mid-year change in financing into their determination of the proper AFUDC rate. Therefore, I find that NTD has failed to show that Staff's methodology contravenes the regulations insofar as it does not use a single annual AFUDC rate. Likewise, NTD's use of what it terms "non-annual" interest rates complies with the regulations.

70. The key issue is whether NTD's use of monthly compounding impermissibly violates the regulations. Turning to that issue, I note that NTD's method conflicts with Order No. 561, but I nonetheless find that NTD has justified a departure from the

ordinary rules for compounding AFUDC. In Order No. 561, the Commission ruled that utilities may compound AFUDC because "AFUDC is a cost of construction similar to labor, materials and other elements of construction."[77] Order No. 561 also sets a general rule that utilities may compound no more frequently than semiannually.[78] In *Kuparuk,* the Commission prohibited a pipeline from compounding its AFUDC on a monthly basis, but in so doing the Commission noted that the pipeline had provided no reason why the Commission's general rule should not apply.[79]

71. NTD's use of monthly compounding conflicts with the general rule laid out in Order No. 561 that a utility should not compound AFUDC more frequently than semiannually. Nonetheless, NTD, unlike the pipeline in *Kuparuk*, provides persuasive reasons for a departure from the ordinary rule. The Company has shown that the unique aspects of the Path 15 Upgrade required special construction financing arrangements. Specifically, NTD terminated a temporary high-interest loan midway through the 2003 year and secured a lower interest permanent construction loan at that time. Because of this mid-year financing change, the Commission's methodology for compounding AFUDC does not readily apply to NTD. In particular, a strict application of semiannual compounding fails to account for mid-year changes in financing experienced by a utility. That the Commission's rules do not fit NTD's unique circumstances is reflected by the fact that both the Company and Staff devised specialized methodologies for compounding the AFUDC.

72. To account for the mid-year financing change, NTD compounds its AFUDC on a monthly, rather than semiannual, basis. The Company's approach allows for a straightforward calculation of its AFUDC. By using monthly compounding, the Company is able to adjust its AFUDC calculations to track the mid-year change in financing as it occurred, thereby allowing ratepayers to benefit from the lower costs associated with the new financing.

73. Staff does not dispute the Company's stated AFUDC rates, and, in contrast to Staff's approach, the Company's method avoids the need to use complex formulas to convert those rates to make them compatible with semiannual compounding. NTD applies a method that recognizes the incompatibility of the Commission's rules to its situation and appropriately accounts for its special financing arrangements. Moreover, Staff fails to show that NTD's method results in unjust and unreasonable charges to ratepayers.

---

[77] *Order No. 561*, 57 FPC at 612.

[78] *Id.* at 612.

[79] *Kuparuk Transportation Co.*, 45 FERC ¶ 63,006 (1998), *aff'd in part and modified in part on other grounds*, 55 FERC ¶ 61,122 at 61,371 (1991).

74. In contrast to NTD's methodology, Staff adopts a reduced rate method for compounding the Company's AFUDC. Staff's novel approach is intended to mimic the result that semiannual compounding would achieve, while taking into account the Company's mid-year change in financing. Staff's method, like NTD's, does not strictly follow the mandates of Order No. 561. Staff does not straightforwardly apply semiannual compounding as contemplated by Order No. 561. Nothing in Order No. 561 sanctions use of the reduced rate method or other formulas intended to approximate semiannual compounding. Staff's method represents an attempt to comply with the Commission order, but Staff fails to demonstrate the effectiveness of the reduced rate method at achieving the results of semiannual compounding. Moreover, NTD correctly notes that there is no Commission precedent for applying the reduced rate method.

75. I find that NTD's methodology for calculating AFUDC has not been shown to be unjust and unreasonable. Accordingly, I affirm NTD's proposed AFUDC of $22,358,736.

IV. Should NTD modify its TO Tariff to make it consistent with the TO Tariffs of the other PTOs as proposed by the Joint Parties?

76. In their protests to NTD's filing in this docket, the Joint Parties requested that NTD make several changes to its TO Tariff to conform with the TO Tariffs of the other PTOs (JNT-1 at 20). Specifically, the Joint Parties proposed the following changes:

- Replace the term "CAISO" with "ISO" and the term "CAISO Tariff" with "ISO Tariff" (JNT-1 at 21).

- Include the phrase "and shall be subject to FERC approval" in the final sentence of the definition of "Direct Assignment Facilities" (JNT-1 at 21).

- Revise the definition of "Transmission Control Agreement" to match the definition used by the other PTOs (JNT-1 at 21).

- Include in the definition of "Transmission Revenue Requirement" the statement, "The costs of any transmission facility turned over to the Operational Control of the ISO shall be fully included in the Participating TO's TRR" (JNT-1 at 21–22).

- Replace the term "TSR" with the term "Entitlement" (JNT-1 at 22).

77. The Joint Parties assert that their proposals will create consistency and prevent confusion and future litigation with respect to the TO Tariffs (JNT's Initial Brief at 27). Likewise, Staff witness Steffy testified that, with the Joint Parties' proposed modifications, "there will be less confusion in the future" (Staff's Initial Brief at 23).

78. Prior to the hearing, NTD agreed to make the proposed changes to the extent that the changes do not impact the Company's TRR (Exhibit S-12). In its Reply Brief, NTD states that "[n]o party has suggested that the proposed tariff modifications could…impair NTD's right to recover prudently incurred investment costs," and therefore the Company "considers this issue resolved" (NTD's Reply Brief at 19). Accordingly, per agreement of the parties, NTD is ordered to modify its TO Tariff to reflect the changes proposed by the Joint Parties.

V. Is there a potential for over-recovery of costs, and, if so, what action, if any, should the Commission take in this docket to eliminate such over-recovery?

(a) Summary of the Issue and Parties' Positions:

79. Issues No. 1–3 above address and resolve potential over-recoveries by NTD with regard to inclusion in its TRR of certain prepayment obligations, an allowance for working capital, and an allowance for funds used during construction. Moreover, the Joint Parties and PG&E raise the additional issue of potential over-recovery by NTD of its investment costs as a result of inclusion in its TRR of the cost of transmission capacity held by Western (referred to herein as "the cost recovery issue").

80. The Letter Agreement agreed upon by the Project Participants and approved in part by the Commission forms the basis for the cost recovery issue. In certain provisions of the Letter Agreement, the Project Participants agreed on the following entitlement allocations for recovery of investment costs in the Project. Western will receive 10% of the Path 15 Upgrade transmission capacity; PG&E will receive 18%; and NTD will receive 72% (Staff's Initial Brief at 26). NTD and Western, however, provided financing in amounts out-of-proportion to their shares of the entitlements. Specifically, NTD funded approximately 81.5% of the costs of the Project, while Western contributed only 0.5% of the costs (Staff's Initial Brief at 27). Protestors have questioned the appropriateness of these funding arrangements in both the Western Docket and the instant docket.

81. First, at issue in the Western Docket is the potential for over-recovery by Western as a result of its claimed 10% entitlement in the Path 15 Upgrade.[80] The Commission has not acted yet on a motion by the Joint Parties to consolidate the instant proceeding with the Western Docket.

[80] *The California Independent System Operator Corp.*, 109 FERC ¶ 61,153 (2004); *see generally supra* n. 9, at 4.

82. Second, the Joint Parties and PG&E put at issue in the instant docket the NTD cost recovery issue. Specifically, in its proposed TRR, NTD requests recovery of the full 81.5% it invested in the Project as opposed to the 72% representing its entitlement in the Path 15 Upgrade (Staff's Initial Brief at 27). The Joint Parties and PG&E allege that, if Western and NTD both recover the amounts they request, the Project Participants will potentially over-recover from ISO ratepayers (PG&E's Initial Brief at 9–13; JNT's Initial Brief at 28–34). The Joint Parties offer two alternative courses of action to prevent over-recovery by NTD, and they ask the Presiding Judge to adopt one of their suggestions (JNT's Initial Brief at 34–35). PG&E proposes a third alternative (PG&E's Initial Brief at 13).

83. NTD responds that the Presiding Judge's October 19 Order rejecting the Company's motion for summary disposition resolved this issue (NTD's Initial Brief at 21–22). Likewise, Staff maintains that "attempting to resolve this issue in this proceeding without knowing the outcome in the [Western Docket] is premature and may create an unnecessary or inappropriate remedy" (Staff's Initial Brief at 32). Therefore, Staff concludes that "no adjustments, if any, should be made to NTD Path 15's TRR on the basis that Western may over recover its revenues, until the Western issues are resolved in the [Western Docket]" (Staff's Reply Brief at 29).

(b) Decision:

84. As NTD correctly notes, the Presiding Judge's October 19 Order fully disposed of the NTD cost recovery issue.[81] NTD filed a motion for summary disposition on October 7, 2005, requesting a conclusive finding that NTD's cost recovery should not be affected by Western's percentage entitlement in the Path 15 Upgrade. NTD's motion basically rephrased Issue No. 5 and requested that the Presiding Judge summarily rule for NTD on this issue.[82] On October 19, 2005, the Presiding Judge issued an order denying the Company's motion. The October 19 Order held that the requested relief, i.e. resolution of Issue No.5 in favor of the Company, exceeded the scope of the instant docket insofar as it encompassed the issues of Western's participation in the Path 15 Upgrade and the funding structure of the Project.[83] Therefore, NTD correctly interprets the October 19 Order as removing Issue No. 5 from the instant docket.

---

[81] *See Trans-Elect NTD Path 15, LLC*, Order Denying Summary Disposition, Docket No. ER05-17-002 (Oct. 19, 2005).

[82] The Joint Parties request that the Presiding Judge find that NTD's cost recovery should be affected by Western's percentage entitlement in the Project. Thus, NTD's motion requested resolution of this same issue but merely stated it differently.

[83] *Trans-Elect NTD Path 15, LLC*, Order Denying Summary Disposition, Docket No. ER05-17-002 (Oct. 19, 2005).

85. To make my prior ruling clear, I will more fully explain why Issue No. 5 exceeds the scope of this docket. In their Initial Brief, the Joint Parties phrase their argument on Issue No. 5 as follows: "whether there is a potential over recovery of costs if NTD Path 15's TRR includes costs associated with capacity that it did not turn over to the ISO" (JNT's Initial Brief at 29). Issue No. 5 however is more nuanced than that. Specifically, the issue, as argued and briefed by the parties, is whether NTD may potentially over-recover if its TRR includes costs associated with *Western's* 10% entitlement. As properly phrased, Issue No. 5 is inseparable from the issue of Western's cost recovery pending in the Western Docket and cannot be decided with Western absent from this proceeding.[84] Western's claim for costs associated with its 10% entitlement forms the basis for the Joint Parties' and PG&E's arguments in the instant docket that NTD's cost recovery proposals could result in over-recovery. The Commission has made it clear that the issue of Western's cost recovery proposals is to be decided in the Western Docket. To rule on the interconnected issue of NTD's cost recovery proposals could prematurely determine the issue that the Commission has expressly carved out for consideration in the Western Docket.[85]

86. I hereby affirm my October 19 Order, as summarized above. Specifically, I find that any issues of potential over-recovery by NTD as a result of Western's cost recovery proposals exceed the scope of this proceeding.

CONCLUSION

87. All arguments made by the parties, which have not been discussed and/or adopted by this decision, have been considered and are rejected. Wherefore, I find that:

1. NTD has not shown inclusion of its debt and liquidity reserve account expenses as rate-base items to be just and reasonable, and therefore it should remove those expenses from its TRR;

[84] As Staff and NTD explain, the Commission's order in ER04-1198-000 stated that "Western is entitled to recover the amount of its project investment (approximately $1.3 million) plus interest on the investment…. With regard to the recovery of amounts above Western's investment of approximately $1.3 million, …the record before us does not provide sufficient evidence to determine whether Western's compensation, as proposed by CAISO, is just and reasonable." *The California Independent System Operator Corp.*, 109 FERC ¶ 61,153 at P 28 (2004).

[85] Moreover, resolution of the Western over-recovery issue could moot Issue No. 5 in the instant docket, which would prevent the need to affect NTD's recovery of its investment costs.

2. NTD has not proven that its methodology for calculating the working capital allowance results in just and reasonable rates. Staff's methodology of applying the Commission's 45-day convention should be adopted, and NTD should include in its calculation only O&M expenses, minus fuel and purchased power. The proper amount for NTD's working capital allowance is $300,812;

3. NTD has justified deviation from Commission policy for calculating AFUDC, and therefore its use of monthly compounding and its proposed AFUDC of $22,358,736 should be affirmed;

4. NTD has agreed to make the changes to its TO Tariff as suggested by the Joint Parties, and therefore NTD should make those changes accordingly;

5. Insofar as it encompasses questions not addressed by Issues No. 1–3, Issue No. 5 exceeds the scope of this proceeding, and therefore is a non-issue and will not be decided in this case.

ORDER

88. It is ordered that subject to review on exceptions or on the Commission's own motion, as provided in the Commission's Rules of Practice and Procedure, within thirty (30) days of the issuance of the Final Order of the Commission adopting the Initial Decision in this proceeding, all parties shall take the appropriate action to implement the rulings in this decision.

David I. Harfeld
Presiding Administrative Law Judge