JONES DAY

COMMENTARY

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# FERC Announces Initiatives Regarding Income Tax Cost Recovery for Pipelines and Utilities

**IN SHORT**

**The Situation:** The *United Airlines, Inc. v. FERC* decision and the reduction of corporate income tax rate in the Tax Cut and Jobs Act significantly lowered the tax costs able to be included in the jurisdictional rates of interstate natural gas pipelines, oil pipelines, and electric utilities.

**The Development:** The Federal Energy Regulatory Commission issued a series of decisions seeking to begin the process of companies passing on these tax savings to their consumers.

**Looking Ahead:** FERC will finalize its approach after receiving public comments, and subsequent proceedings are expected to last well into 2019.

On March 15, 2018, the Federal Energy Regulatory Commission ("FERC"), announced significant initiatives regarding the recovery of tax costs by jurisdictional interstate natural gas pipelines, oil pipelines, and electric utilities. These initiatives are a reaction to two tax-related developments: the D.C. Circuit's *United Airlines, Inc. v. FERC* decision issued in July 2016 and the Tax Cuts and Jobs Act ("TCJA").

## The *United Airlines* Decision

In *United Airlines*, the court remanded an oil pipeline rate case because FERC failed to demonstrate that there was no double recovery of income tax costs where a pipeline owned by a master limited partnership ("MLP") charged rates reflecting both an income tax allowance and a rate of return on equity calculated using the discounted cash flow methodology. FERC responded to the *United Airlines* decision by issuing a revised policy statement on the recovery of income tax allowances. Under the new policy statement, FERC jurisdictional entities organized as MLPs can no longer include an income tax allowance in the cost of service collected through their customers' rates. In a separate Notice of Proposed Rulemaking ("NOPR"), discussed further below, FERC also proposed to change its regulations to permit interstate natural gas pipelines owned by MLPs to voluntarily submit a limited rate filing to remove the income tax allowance from their rates.

In addition, FERC found in the policy statement that the record in the proceeding did not provide a basis to address the *United Airlines* double-recovery issue for other entities that may be similarly situated to MLPs. Non-MLP partnerships and other pass-through entities subject to FERC's rate authority will need to address this double recovery issue in future proceedings.

FERC warned that it would consider initiating investigations against those pipelines that take no action to reduce their rates in response to the TCJA.

## The Impact of the Tax Cuts and Jobs Act

The TCJA lowers corporate income tax rate from 35 percent to 21 percent. For FERC-jurisdictional companies charging cost-based rates, income taxes are a cost of providing service, and currently effective rates may no longer accurately reflect their reduced tax expenses. The actual impact of the TCJA on any particular company will depend on the industry and a number of other factors.

In its NOPR addressing interstate natural gas pipelines, FERC proposes to change its regulations to: (i) require interstate pipelines to make an informational filing demonstrating the impact of the corporate income tax reduction (and, if applicable, the removal of income tax allowances by MLPs, as noted above); (ii) permit interstate pipelines to make limited rate filings to reflect the change in corporate income taxes from 35 percent to 21 percent; and (iii) require intrastate pipelines to modify their FERC-regulated interstate service rates if they modify their state-regulated intrastate service rates. FERC also gave interstate pipelines other options to address the effect of the TCJA, including committing to submit a full Natural Gas Act section 4 rate case by the end of the year, explaining how their current rates continue to be just and reasonable, or taking no action. That said, FERC warned that it would consider initiating investigations against those pipelines that take no action to reduce their rates in response to the TCJA (and, if applicable, the revised income tax policy statement). FERC also explained that any rate reduction by an interstate pipeline would be a reduction to its maximum recourse rate, which may have no effect on most existing negotiated rate contracts. Comments on the NOPR will be due 30 days after its publication in the *Federal Register*.

As to the owners of electric transmission facilities, FERC issued show cause orders requiring 48 public

utilities to propose tariff revisions implementing the corporate income tax reduction or to explain why they should not be required to do so. These public utilities fall into one of two groups: those that charge stated rates for transmission service and those that charge rates calculated by a formula rate that fixes the federal income tax at the pre-TCJA 35 percent level. These utilities must respond to FERC within 60 days of the issuance of the orders.

FERC also issued a Notice of Inquiry ("NOI") seeking information on the additional impacts of the TCJA on jurisdictional rates. In particular, the NOI requests comment on how FERC should address accumulated deferred income tax amounts after the corporate income tax rate reduction, as well as whether other features of the TCJA, such as changes to bonus depreciation rules, require FERC action. Finally, FERC is seeking assistance in identifying whether and how other jurisdictional transmission and nontransmission rates should change, including those charged by nonpublic utilities. Comments on the NOI will be due 60 days after its publication in the *Federal Register*.

## THREE KEY TAKEAWAYS

1. MLPs can no longer include an income tax allowance in the cost of service collected through their customers' rates under FERC's revised income tax policy statement.
2. Under FERC's NOPR, interstate gas pipelines will have an opportunity to reduce their rates to reflect changes in tax law and FERC's income tax policy.
3. Significant work remains ahead with respect to other impacts of the Tax Cut and Jobs Act, including the development of an approach for accumulated deferred income taxes.

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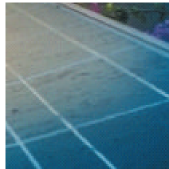
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