January 30, 2018

The Honorable Kevin J. McIntyre
Chairman
Federal Energy Regulatory Commission
888 First Street NE
Washington, DC 20426

Dear Chairman McIntyre:

I am writing you on behalf of the Interstate Natural Gas Association of America (INGAA) in response to letters that you received from the American Public Gas Association (APGA), various state advocates, and the Natural Gas Supply Association, dated January 3, 9, and 17 respectively. INGAA is the trade association that advocates regulatory and legislative positions of importance to the natural gas pipeline industry. Our 27 members comprise the vast majority of interstate natural gas transmission pipeline operators subject to the Commission's Natural Gas Act (NGA) jurisdiction.

In the letters, APGA and others urge the Commission to require all jurisdictional natural gas pipelines to submit compliance filings, pursuant to section 5 of the NGA, addressing the impacts of the Tax Cuts and Jobs Act of 2017 (TCJA) on their maximum recourse rates. As explained below, application of the changes resulting from the TCJA to the rates of interstate natural gas pipelines will not be as straightforward as APGA and others suggest.

As the Commission knows, whether a rate is just and reasonable is determined by the end result, that is, the overall rate, and not any individual component of that rate.[1] APGA's request that the Commission issue a generic order compelling pipelines to adjust an individual component of their respective recourse rates will in many cases not yield a just and reasonable result.

The Commission has enacted policies over the last 30 years to foster competitive markets for pipeline transportation that have created distinct challenges for interstate natural gas pipelines that may not be faced by regulated utilities with franchised service territories. Pipelines often must meet competition by providing transportation and/or storage services to customers at discounted or below maximum rate negotiated rates. Most, if not all, negotiated rate agreements provide for fixed rates throughout the term of the agreement without regard to a pipeline's recourse rates. Thus, customers receiving service under negotiated or discounted rates likely are not bearing the full costs of income taxes (or any other cost-of-service component) and will not necessarily benefit from any reduction to recourse rates. The market conditions faced by interstate natural gas pipelines are in stark contrast to the situation of

[1] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

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state-regulated utilities with franchised service territories that typically are able to collect their maximum rates and pass through costs in routine rate cases.

The APGA request is contrary to Commission policy favoring full rate proceedings, and is contrary to the law governing freely negotiated settlement agreements. Furthermore, the APGA request would compel the Commission to open settlement agreements that may have rate moratoriums and to assign values to the cost components of black-box settlements. Lastly, the request disregards how the normalization rules of the Internal Revenue Code relate to any alleged excess accumulated deferred income tax (ADIT) balances maintained by interstate pipelines.

I. The Commission's Policy Preference for Complete Rate Reviews

The APGA request is contrary to the Commission's policy preference for approving rates only after a holistic analysis of all relevant cost-of-service and revenue components in a full rate proceeding under sections 4 or 5 of the NGA.[2] In explaining this preference, the Commission recognized that not all of a pipeline's cost-of-service or revenue components change in unison.[3] Full rate case proceedings are the preferred method for revising rates, because "all components of the cost-of-service may be considered and any decreases in an individual cost component can be offset against increases in other cost components."[4] This preference for the holistic analysis of all the cost-of-service and revenue components is crucial to ensuring interstate pipeline rates are just and reasonable. The end result produced by isolating only changes to individual cost components that reduce a pipeline's rate would be unjust and unreasonable.

Section 5 of the NGA provides a mechanism for APGA and others to challenge whether the rates of an individual pipeline are just and reasonable. A full section 5 proceeding will examine the effect of the tax rate in the context of a pipeline's overall business. Initiating a proceeding to address all facets of a pipeline's cost-of-service and any alleged over-recovery comports with guidance from the U.S. Court of Appeals for the D.C. Circuit that pursuant to section 5 it must be demonstrated that a pipeline's overall rate (not any individual rate component) is unjust and unreasonable before an alternative can be shown to be just and reasonable.[5] Here, the parties are requesting inappropriately that the Commission compel rates to be adjusted to reflect the reduction in income taxes without consideration of pipelines' other cost-of-service components.

II. The *Mobile-Sierra* Doctrine

The Commission's ability to reopen rates resulting from freely negotiated agreements is limited by the *Mobile-Sierra* doctrine, which originated from two U.S. Supreme Court decisions issued in 1956.[6] Specifically, the Supreme Court found that the Federal Power Commission, FERC's

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[2] *See ANR Pipeline Co.*, 110 FERC ¶ 61,069 at P 18 (2005).
[3] *See Id.*
[4] *Id*.
[5] *"Complex" Consol. Edison Co. of New York*, 165 F.3d at 1001.
[6] *United Gas Pipeline Co. v. Mobile Gas Serv. Corp*, 350 U.S. 332 (1956); *Fed. Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

predecessor, could not modify contractually determined rates without finding that the rate "is so low as to adversely affect the public interest."[7] The Supreme Court has since extended the doctrine to situations where rates are alleged to be too high.[8] Thus, the Commission would need to meet this extremely high burden before it could disrupt contractually determined rates.

III. Black-Box Settlements

Because it is all inclusive, APGA's request does not recognize that many parties have negotiated "black-box" settlements. The Commission has recognized that the purpose of such settlements is to develop an agreed upon settlement rate and not to identify the individual cost-of-service or revenue components that were agreed to by the parties.[9] Black-box settlements are the product of negotiated compromises on a variety of issues and, by definition, do not specify a particular tax allowance. There is no practical way to determine whether the parties to a black-box settlement agreed to any specific income tax allowance. Consequently, it would be impracticable and arbitrary for the Commission to compel pipelines under black-box settlements to reduce the corporate income tax cost component of a settlement rate that never identified individual cost components."[10]

Furthermore, APGA's request would call into question the many rate case settlement agreements that include rate moratoriums forbidding any settling party from seeking a rate revision for some specified period.[11] In sum, APGA's request runs counter to longstanding Commission policy to encourage rate case settlements and to allow them to remain undisturbed.[12]

IV. Alleged Excess ADIT Balances and The Internal Revenue Code's Normalization Rules

Regardless of how the change in corporate tax rate to 21 percent pursuant to the TCJA is ultimately reflected in interstate natural gas pipelines' recourse rates, two points are clear about the disposition of the excess ADIT and related regulatory liabilities resulting from the reduced corporate tax rate. First, any reduction to a pipeline's ADIT would not create any cash that could be refunded to customers. ADIT is a non-cash item. The reduction would be accomplished through journal entries.

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[7] *Sierra Pac. Power Co.*, 350 U.S. at 355.
[8] *See e.g., Morgan Stanley Capital Grp., Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty.*, 554 U.S. 527 at 550 (2008) ("Under the *Mobile-Sierra* presumption, setting aside a contract rate requires a finding of 'unequivocal public necessity'").
[9] *See e.g., El Paso Natural Gas Co.*, 132 FERC ¶ 61,139 at P 82 (2010).
[10] Moreover, in contested settlement proceedings, the Commission has acknowledged its reluctance to revise settlements, because modifications to individual terms of the settlement could "upset the delicate balance achieved in the settlement. *El Paso Natural Gas Co.*, 54 FERC ¶ 61,316 at p. 61,915 (1991).
[11] *See e.g., Natural Gas Pipeline Co.*, 162 FERC ¶ 61,069 at P 15.
[12] *See e.g., Tennessee Gas Pipeline Co.*, 45 FERC ¶ 61,208 at p. 61,617 (1988) ("Public policy strongly favors the finality of settlement agreements.").

Second, to the extent a pipeline was to return an excess ADIT balance to ratepayers more rapidly than allowed by the required amortization methods,[13] the pipeline would violate the normalization requirements of the Internal Revenue Code of 1986 and would be denied the benefits of the use of accelerated tax depreciation, a result that the Commission historically has been reluctant to compel.[14] The pipeline also would be forced to pay a tax penalty equal to the amount by which it reduced the excess tax reserve more rapidly than permitted by normalization rules.[15]

Conclusion

INGAA urges the Commission to move cautiously and to avoid a one-size-fits-all approach to addressing the reductions in corporate income tax rates. In many cases, permitting interstate natural gas pipelines to act based on their unique circumstances (i.e., competitive market forces; alternative rate structures including discounts and negotiated rate contracts; rate settlements including provisions for rate moratoriums and refiling requirements, and black-box settlements) may be the more efficient and effective method to account for regulatory impacts of the reduced statutory corporate tax rate. The implementation of the normalization regulations for adjusted ADIT balances alone will be a significant undertaking. For the reasons summarized above, initiating the show cause proceeding affecting all interstate natural gas pipelines requested by APGA is likely to result in neither a prompt, equitable and administratively efficient resolution of this matter nor in rate reductions of the magnitude speculated by APGA.

Respectfully,

Donald F. Santa
President & CEO

cc: Hon. Neil Chatterjee
Hon. Richard Glick
Hon. Cheryl A. LaFleur
Hon. Robert F. Powelson

[13] The TCJA maintains the normalization requirements of the Internal Revenue Code of 1986 for utility property, including pipelines. *See* Subtitle C, Part 1, section 1561(d). Pursuant to normalization requirements, pipelines must amortize the regulatory liability associated with the excess ADIT balance resulting from the change in the corporate tax rate when computing their costs-of-service and when reflecting operating results in their regulated books of account. To achieve this, pipelines must amortize the regulatory liability based on the average rate assumption method, or they can do so ratably on an average remaining life basis of the utility property.

[14] *Koch Gateway Pipeline Company*, 74 FERC ¶ 61,088 at 61,277 (1996).

[15] *See* TCJA section 1561(d)(4)(A).