THE UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates	)))	Docket No. RM18-12-000

MOTION FOR LEAVE TO ANSWER AND ANSWER OF
THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Pursuant to Rules 212 and 213 of the Federal Energy Regulatory Commission's ("FERC" or "Commission") Rules of Practice and Procedure, 18 C.F.R. § § 385.212 and 385.213, the Interstate Natural Gas Association of America ("INGAA") hereby moves for leave to answer and answers the comments filed by various parties in this docket. Although the Notice of Inquiry ("NOI") does not expressly provide for reply comments, the Commission allows answers where a responsive pleading will assist the Commission's analysis, provide useful and relevant information, or otherwise facilitate a full and complete record for purposes of rendering a decision.[1] INGAA's limited response should be permitted as it will assist the Commission's analysis, provide useful and relevant information, and otherwise facilitate a full and complete record on the important issues raised in the NOI.

INGAA is a trade association that advocates regulatory and legislative positions of importance to the interstate natural gas pipeline industry in the United States. INGAA's 27 members represent the vast majority of interstate natural gas transmission pipeline companies in the U.S. INGAA's members, which operate approximately 200,000 miles of interstate natural gas

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[1] *See, e.g., Tuscarora Gas Transmission Co.*, 120 FERC ¶ 61,022 at P 4 (2007); *Transwestern Pipeline Co.*, 109 FERC ¶ 61,062 at P 7 (2004); *Transcontinental Gas Pipe Line Corp.*, 108 FERC ¶ 61,230 at P 3 (2004); *Algonquin Gas Transmission Co.*, 108 FERC ¶ 61,195 at P 8 (2004); *ANR Pipeline Co.*, 107 FERC ¶ 61,250 at P 11 n.4 (2004); *Columbia Gas Transmission Corp.*, 106 FERC ¶ 61,128 at P 15 (2004); *El Paso Natural Gas Co.*, 104 FERC ¶ 61,303 at P 11 (2003).

pipelines, serve as an indispensable link between natural gas producers and consumers. Its U.S. members are regulated by the Commission pursuant to the Natural Gas Act.[2]

INGAA responds to the argument made by commenters that the elimination of a tax allowance for MLPs and potentially other pass-through entities must result in the expeditious return of excess ADIT to customers of such pipelines. For the reasons stated in INGAA's comments, ADIT issues relating to MLPs and other pass-through entities should be deferred until the Commission rules on parties' rehearing requests of the Revised Policy Statement and applies any new policy resulting from a rehearing order in individual pipeline rate proceedings. However, if the Commission chooses to render a ruling on this issue in this rulemaking proceeding, it should hold that to the extent MLPs or other pass-through entities are not permitted a tax allowance, current shippers are not entitled to any of the remaining accumulated deferred income taxes ("ADIT") and related regulatory liabilities held by such entities. As discussed below, a mandatory return of these rate base credits as a tracked refund would conflict with Commission and court precedent and would constitute unlawful retroactive ratemaking.

BACKGROUND

In the NOI, the Commission noted that the reduction in the federal corporate income tax rate from 35 percent to 21 percent in the Tax Cuts and Jobs Act ("TCJA")[3] would require pipelines to re-measure their ADIT balances and establish either a regulatory asset or liability as appropriate. To the extent pipelines have excess ADIT resulting from the change in tax rate, pipelines must account for the excess ADIT through an amortization of the regulatory liability as set forth in the

[2] 15 U.S.C. §§ 717-717w.

[3] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

TCJA.[4] In adopting SFAS 109, the Commission addressed changes in tax rates that might give rise to an excess or deficiency in deferred taxes. The Commission stated:

> Since the issuance of Order No. 144 in 1981, the FERC's regulations have required companies to determine the income tax allowance included in jurisdictional rate levels on a fully normalized basis. Also, Order No. 144 requires an entity to compute the income tax component in its cost of service by making provision for any excess or deficiency in deferred taxes under the following circumstances: (1) if the entity has not provided deferred taxes in the same amount that would have accrued had tax normalization been applied for tax effects of timing difference transactions originating at any time prior to the test period; or (2) *if, as a result of changes in tax rates,* the accumulated provision for deferred taxes becomes deficient in or in excess of amounts necessary to meet future tax liabilities as determined by application of the current tax rate to all timing difference transactions originating in the test period and prior to the test period.[5]

The circumstances described above that give rise to a potential return or collection of excess or deficient ADIT are codified in the Commission's regulations.[6]

The Commission has specifically required that when tax rates change, the entity shall adjust its deferred tax liabilities and assets for the effect of the change, and set up a regulatory asset or liability to reflect the probable future recovery or return of the deficient or excess ADIT.[7] The bulk of the NOI seeks comments on the mechanics of addressing the excess or deficient ADIT resulting from the reduction in the tax rate under the TCJA.

At the end of the NOI (at PP 24-25), the Commission seeks comments on the treatment of ADIT for partnerships. The Commission notes that in its recent Revised Policy Statement, the Commission "determined that MLPs will no longer be permitted to recover an income tax allowance" and that other pass-through entities would need to address the double recovery concern

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[4] 26 U.S.C. § 15611(d)(4).
[5] Accounting for Income Taxes, Docket No. AI93-5-000 (1993) (emphasis added).
[6] 18 C.F.R. § 154.305(d).
[7] Accounting for Income Taxes, Docket No. AI93-5-000 at 8 (1993). *See also Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes,* Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,559-60 (1981) (requiring excess or deficient ADIT resulting from a change in tax rates to be made up through an approved ratemaking method such as the *South Georgia* method.).

that led the Commission to disallow tax allowances for MLPs. Thus, the Commission sought comment on the effect on ADIT of eliminating the tax allowance for MLPs and potentially other non-MLP pass-through entities. The Commission framed the question as follows:

> For such MLPs and pass-through entities, commenters should address whether previously accumulated sums in ADIT should be eliminated altogether from cost of service or whether those previously accumulated sums should be placed in a regulatory liability account and returned to ratepayers.[8]

Thus, in the NOI, the Commission recognized that in contrast to a change in tax rates, which is a subject addressed in the statute and Commission regulations, a total elimination of a tax allowance in rates does not, and should not, necessarily result in a requirement to return ADIT. There are two separate subjects involved, excess ADIT created by reduced tax rates and how to address ADIT in light of the Commission's new policy that MLPs and other pass-through entities may not be entitled to an income tax allowance in their cost of service.

In its initial comments, INGAA submitted that it would be premature to address ADIT issues pertaining specifically to MLPs and other pass-through entities until the Commission addresses the requests for rehearing of the Revised Policy Statement and applies any new policy in individual pipeline rate proceedings. Because it would be unlawful for the Commission to implement the Revised Policy Statement as a rule requiring the elimination of a tax allowance for MLPs or for any other pass-through entities, MLP and other pass-through pipelines must be permitted to propose tax allowances in their individual rate proceedings, and address any concerns about a double recovery in such proceedings. ADIT issues for MLPs and other-pass-through entities are dependent on the overriding issue of whether such entities will be entitled to a tax allowance. Therefore, INGAA proposed that the Commission address ADIT balances of these entities at the same time in these individual rate proceedings.

[8] NOI at P 25.

ANSWER

In contrast to INGAA's suggestion that the Commission defer ruling on partnership ADIT issues until the Revised Policy Statement is clarified and applied, some commenters request the Commission to declare as part of this rulemaking proceeding that all ADIT on the books of MLPs and other pass-through entities be considered excess ADIT and provided to customers.[9] While the TCJA requires that public utilities and interstate natural gas pipelines may flow back any excess plant-based ADIT no more rapidly than over the life of the underlying assets, some of these commenters also argue that MLPs and other pass-through entities should be required to provide the ADIT to shippers over periods shorter than the life of the assets. These commenters argue that the requirement in the TCJA to amortize excess or deficient ADIT over the life of the asset does not apply to MLPs and other pass-through entities because the change in tax rate effectuated by the TCJA does not impact these entities. Instead, the potential rate impact on such entities is caused by the Commission's stated intention in the Revised Policy Statement to change its policy to eliminate a tax allowance altogether for MLPs, and possibly for other pass-through entities. This difference, commenters allege, supports a different, faster amortization period for ADIT.

The Canadian Association of Petroleum Producers ("CAPP"), for example, argues (at 9-10) that the statutory constraint requiring corporate pipelines to return excess ADIT created by the reduction in tax rates no more rapidly than over the life of the underlying assets does not apply to MLPs and other pass-through entities. CAPP, therefore, requests the Commission to require these entities to flow through excess ADIT to customers over a shorter five-year period. The *United*

[9] *See* Comments of Canadian Association of Petroleum Producers, *United Airlines* Petitioners, Indicated Shippers, American Public Gas Association, Process Gas Consumers & American Forest and Paper Association and the Oklahoma Attorney General.

Airlines Petitioners make a similar request.[10] They argue (at 28-29) that due to the unique circumstances of the Revised Policy Statement, a more "expeditious" amortization period based on individual pipeline circumstances would be appropriate. They note that "in the case of an overfunded ADIT balance caused by a tax rate change, the pipeline still anticipates incurring future tax liability that will be recovered through an income tax allowance," but that is no longer true for MLP pipelines.

The TCJA did not change the normalization rules applicable to MLPs or other pass-through entities. MLPs and other pass-through entities have never been "taxpaying entities," yet normalization rules apply to them and it is clear as a matter of law that an MLP is the "taxpayer" for purposes of the normalization rules of the Internal Revenue Code ("Code"). While Section 701 of the Code provides that a partnership is not a separate taxpaying entity and that partnership income is taxed directly to the partners,[11] the determination of whether income has arisen or an expense has been incurred is made at the partnership level pursuant to Code Section 703. Code Section 168(f)(2) provides that accelerated depreciation is not available for any public utility property if the taxpayer does not use a normalization method of accounting. Thus, the ability of an MLP to claim accelerated depreciation with respect to its public utility property under the normalization rules of Code Section 168(i)(9), and the MLP's partners to receive their allocable share of that depreciation, is an MLP-level determination (i.e., the "taxpayer" subject to the normalization method of accounting provisions of Code Section 168(i)(9) is the MLP). Just as before the TCJA and the Revised Policy Statement, the pipeline itself is the entity that decides

[10] The parties seeking refunds of excess ADIT balances simply assume that customers have actually paid for the ADIT balances on pipelines' books. This assumption ignores that many pipelines are providing service at discounted rates due to the competitive nature of the marketplace for interstate gas pipeline transportation or are paying rates based on black box settlements that do not contemplate any specific level of tax allowance. In such circumstances, the excess ADIT balances do not necessarily reflect payments from customers.
[11] Code Section 168(i)(9).

whether to take accelerated depreciation in the first place, giving rise to ADIT under the required normalization process and determining the partnership's (and thus its partners') income and expense amounts. Nothing has changed as a result of either the TCJA or the Revised Policy Statement that would make MLPs or other pass-through entities that own public utility property no longer subject to the normalization "constraints."[12]

INGAA acknowledges that any excess ADIT that may result from the Commission's implementation of the new policy announced in the Revised Policy Statement differs from excess ADIT resulting from the change in the corporate income tax rate. INGAA disagrees with the conclusions commenters draw from this difference and with the fundamental premise of the commenters' position that MLPs and other pass-through entities are not subject to the normalization requirement. In fact, rather than justifying a shorter amortization period for the return of ADIT, the potential elimination of a tax allowance for MLPs and other pass-through entities in Commission-approved rates removes any basis to require the provision to customers of ADIT recorded during prior periods that is not related to the change in tax rates. Instead, if and when an income tax allowance is removed from a pipeline's rates, the pipeline's ADIT and any related regulatory liability previously recorded should also be removed from the rate base and related cost of service. In other words, the answer to the question posed by the Commission in the NOI as to "whether previously accumulated sums in ADIT should be eliminated altogether from cost or service" is "yes".[13] Contrary to the assertions described above, there is no basis for a

[12] Even if refunding ADIT did not constitute a normalization violation, there are numerous tax and policy justifications for not requiring return of ADIT to customers, particularly on as expedited a timeframe as requested by commenters. *See* Initial Comments of Enbridge Energy Partners, L.P. and Spectra Energy Partners, LP at 6-13, 18-23, Docket No. RM18-12-000 (filed May 21, 2018).

[13] As a point of clarification, the use of the term "sums" by the Commission in the NOI could be interpreted incorrectly to mean that there is a cash reserve that has been fully pre-funded by customers. The ADIT balances only represent an accounting computation for taxes that will be due in the future. Due to many factors, including historical contracts and returns, it is speculative to presume that an equal amount has been actually collected by a pipeline in past revenues.

requirement to give these amounts to current or future shippers through rates or other means as discussed below.

The United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") has opined on circumstances that are similar to the elimination of a tax allowance that might result from the Revised Policy Statement. In *CPUC v. FERC*, the D.C. Circuit addressed the issue of whether a pipeline should be required to return deferred taxes that had accumulated in connection with accelerated depreciation of a pipeline's own gas production costs after the Natural Gas Policy Act ("NGPA") substituted fixed ceiling prices for cost-based rates.[14] The Court rejected the argument that the ADIT balance should be returned to customers or that the balance should be credited to rate base.[15]

In so doing, the Court rejected the assertions made by commenters attempting to support an argument for giving shippers ADIT held by MLPs and other pass-through entities. The Court first rejected the argument that the Commission's stated expectation in Order No. 144 that pipelines would not enjoy a "permanent tax savings" should result in a return of the ADIT to customers. The Court found that this expectation did not mean that "the validity of tax normalization depends on its indefinite continuation, regardless of changing circumstances."[16] Instead, it found that the change in pricing scheme enacted in the NGPA "mooted the whole question to which normalization was an answer."[17]

The Court also rejected the argument that allowing the pipeline to keep the deferred tax balance would result in a "windfall" for the pipeline, finding that such "windfall" was simply a function of the accounting system FERC chose to address tax timing differences and that a

[14] *Cal. Pub. Utils. Comm'n v. FERC*, 894 F.2d 1372 (D.C. Cir. 1990) ("CPUC v. FERC").
[15] *Id*. at 1379-1380.
[16] *Id.* at 1382.
[17] *Id*.

"windfall" would have accrued to customers had FERC chosen a different method.[18] The Court cited to the Commission's findings in Order No. 144 that customers do not own an equitable interest in a utility's deferred tax account.[19] In addition, the Court found that the deferred tax balance was comprised of rates previously collected by the pipeline and requiring the return of these balances would constitute impermissible retroactive ratemaking.[20]

The potential elimination of a tax allowance in the rates of MLPs and other pass-through entities is similar to the elimination of the cost-based rate scheme at issue in *CPUC v. FERC*. Both changes would result in pipelines no longer recovering income tax costs in their costs of service. If the Commission implements the policy announced in the Revised Policy Statement, it would "wipe[] out the premise of tax normalization" in ratemaking in the same way as the NGPA's switch in pricing scheme for pipeline-owned production.[21] In addition, a requirement that such pipelines return to shippers any ADIT once the Revised Policy Statement is implemented would effectively require a return of rates paid during prior periods and would constitute retroactive ratemaking. The Commission may not *impose* a retroactive rate alteration and, in particular, may not order reparations.[22]

Furthermore, most pipeline rates are set by black box settlements and there would be no practical basis for requiring a pipeline with such rates to provide any specific amount of ADIT to customers. There is no allocation to individual cost components in black box settlements. Thus, there is no basis to determine how much of a particular rate represents ADIT. While pipelines are

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[18] *Id*.
[19] *Id.* at 1379, *citing* Order No. 144, *Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes*, FERC Stats. & Regs., Regulations Preambles ¶ 30,254 at 31,539 (1981), Order No. 144-A (Order Denying Rehearing), FERC Stats. & Regs., Regulations Preambles ¶ 30,340 (1982), *aff'd, Public Systems v. FERC,* 709 F.2d 73 (D.C. Cir. 1983).
[20] *Id.* at 1379-80.
[21] *Id*. at 1379.
[22] *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, n.8 (1981).

required to make appropriate accounting entries, such entries do not govern ratemaking. There is no legal basis for the Commission to require that a portion of rates approved by the Commission and collected during prior periods now be deemed a past overcollection to be given back to shippers.

The commenters' proposal for an expedited return of ADIT also would eliminate the infrastructure investment incentive provided through accelerated depreciation and have an immediate and dramatic effect on the pipeline industry. As explained by the Internal Revenue Service ("IRS"), Congress' decision to allow taxpayers, including pipelines, to take accelerated depreciation for certain qualifying assets in calculating their federal income tax liability was intended "to stimulate investment," not "to subsidize the consumption of any products or services, including utility products or services."[23] The immediate effect of the commenters' proposal would be to claw that incentive back from pipelines and hand it to shippers on an accelerated timeframe. Rather than amortizing ADIT amounts over the remaining life of the assets, the commenters ask the Commission to make a cash call on pipelines and require immediate accelerated payment or other transfer to shippers of potentially hundreds of millions of dollars per year. The effect of this requirement and reversal of expectations cannot be understated. As demonstrated by the market's reaction to the Revised Policy Statement, the market reaction to the drastic proposal put forth by the commenters would be swift and severe.

While INGAA believes the Commission cannot require MLPs and other pass-through entities to pay the ADIT balance to customers if the Commission denies such pipelines an income tax allowance, and that any return of excess ADIT on an expedited basis would have significant negative effects, INGAA also believes that it is not necessary for the Commission to render a ruling

[23] *See* Internal Revenue Bulletin 233 (September 7, 2017) (citing S. Rep. No. 91-552, at 17) (1969).

on this issue as part of the instant rulemaking for the reasons stated in INGAA's initial comments. Subsequent action on rehearing of the Revised Policy Statement, or in individual pipeline rate proceedings, may render the issue moot.

In addition, the Commission should await action by the IRS on this issue. While the Commission may no longer allow a pass-through entity to recover a tax allowance in rates, that does not mean that ADIT, which is a loan from the government, will never be repaid to the IRS. In Order No. 144, the Commission expressly disposed of the "erroneous premise that a loan is being made by ratepayers to utilities," through the normalization process.[24] Rather, as the Commission explained, "[t]he loan analogy is clearly wrong to the extent that it implies that ratepayers have an ownership claim or equitable entitlement to the loaned monies."[25] The IRS has repeatedly confirmed that partnerships are subject to the tax normalization rules.[26] In the event a partnership is sold, the accelerated depreciation will be recaptured from partners by the government at the time of the sale, regardless of whether there is a tax allowance included in rates. The Commission should not take any action that may conflict with the IRS. It is highly likely that if any dollars are to be flowed through to ratepayers, the IRS will require compliance with normalization requirements. INGAA urges the Commission to consult with the IRS before deciding this complex issue.

[24] Order No. 144 at p. 31,539.
[25] *Id*. (internal citations omitted).
[26] Private Letter Rulings 8922015 (February 28, 1989) and PLR 201816005 (April 20, 2018).

CONCLUSION

For the aforementioned reasons, the Commission should either defer ruling on the effect of the Revised Policy Statement on ADIT held by MLPs and other pass-through entities in this rulemaking proceeding, or find that to the extent such entities are not permitted a tax allowance in rates there is no requirement that any funds collected during prior periods go to current or future shippers.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents upon the parties designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission for the above-captioned docket in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Washington, D.C. this 5th day of June, 2018.

Ammaar Joya