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REPORT



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FERC Acts to Address Decrease in Federal Corporate Income Tax Rate

*By Kenneth Jaffe, Sean Atkins, Michael Kunselman,
and Michael Kellermann**

The authors of this article explain recent Federal Energy Regulatory Commission actions in response to the Tax Cuts and Jobs Act to decrease the federal corporate income tax rate recovered in rates, including the issuance of two show-cause orders, a Notice of Proposed Rulemaking, and a Notice of Inquiry.

The Federal Energy Regulatory Commission (“FERC”) on March 15, 2018, took a number of actions in response to the Tax Cuts and Jobs Act to decrease the federal corporate income tax rate recovered in rates, including the issuance of two show-cause orders, a Notice of Proposed Rulemaking¹ (“NOPR”), and a Notice of Inquiry² (“NOI”). FERC also issued a Revised Policy Statement on Treatment of Income Taxes³ disallowing a pipeline rate income tax allowance for a master limited partnership (“MLP”).

Signed into law by the President on December 22, 2017, the Tax Cuts and Jobs Act reduces the federal corporate income tax rate from a maximum 35 percent to a flat 21 percent rate, effective January 1, 2018. Because FERC-jurisdictional rates can account for income tax, a decrease in the federal corporate income tax rate means that the rates of some public utilities (i.e., entities engaged in transmission or wholesale sales of electricity) and interstate natural gas and oil pipelines must also be lowered or adjusted.

- Two orders to show cause were issued under Federal Power Act (“FPA”) Section 206 in Docket No. EL18-62-000, et al.⁴ and Docket No. EL18-72-000, et al.⁵ to ensure certain public utilities address the impact of the new 21 percent corporate tax rate on their transmission rates, with responses due by May 14, 2018.

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¹ <https://www.ferc.gov/whats-new/comm-meet/2018/031518/G-1.pdf>.

² <https://www.ferc.gov/whats-new/comm-meet/2018/031518/E-1.pdf>.

³ <https://www.ferc.gov/whats-new/comm-meet/2018/031518/G-2.pdf>.

⁴ <https://www.ferc.gov/whats-new/comm-meet/2018/031518/E-3.pdf>.

⁵ <https://www.ferc.gov/whats-new/comm-meet/2018/031518/E-2.pdf>.

- The NOPR initiated in Docket No. RM18-11-000 addresses interstate natural gas pipeline rates, proposing a mandatory informational filing as well as voluntary steps that natural gas pipelines can take to revise their rates to address both the Tax Cuts and Jobs Act and the Revised Policy Statement. Comments responding to the NOPR will be due 30 days after its publication in the *Federal Register*.
- The NOI, opened in Docket No. RM18-12-000, seeks comments on potential additional impacts of the Tax Cuts and Jobs Act on FERC-jurisdictional rates, with comments due 60 days after its publication in the *Federal Register*.

SHOW-CAUSE ORDERS

Two orders to show cause were issued to address the rates of 48 public utilities. Many public utilities use formula rates to recover their cost of service for transmitting electricity, and the cost of paying the reduced federal income tax would typically be reflected in these utilities' annual transmission revenue requirements. But the utilities named in these orders have either stated transmission rates or transmission formula rates with a fixed line item for the federal corporate income tax rate, and they must address how the change to the federal corporate income tax will affect their rates.

To ensure that the current 21 percent rate is reflected in these utilities' transmission revenue requirements, the orders direct these utilities to either propose revisions to their transmission rates to reflect the tax rate change or to show cause why they should not be required to do so. Although FERC generally does not permit single-issue ratemaking, the show-cause orders indicate that FERC will consider proposals to review these tax-rate-related revisions on a single-issue basis.

The utilities named in the show-cause orders were given until May 14, 2018 to submit their responses.

REVISED POLICY STATEMENT

The Revised Policy Statement was born out of a U.S. Court of Appeals for the D.C. Circuit decision where the court held that FERC had failed to show why a "double recovery" of investors' tax costs does not result by allowing an MLP to recover both an income tax allowance and a return based on the discounted cash flow methodology. In response to that case, FERC solicited comments as to how to resolve the double recovery issues but ultimately

concluded that the policies were irreconcilable.⁶ Under the Revised Policy Statement, FERC will no longer allow MLP natural gas or oil pipelines to recover an income tax allowance in their cost of service. Recognizing that this court decision could also impact non-MLP partnerships, FERC will require all partnerships seeking an income tax allowance to address the double recovery concern.

NOTICE OF PROPOSED RULEMAKING

For interstate natural gas pipelines, the NOPR proposes to require a one-time informational filing (called the FERC Form 501-G) in response to both the Tax Cuts and Jobs Act and the Revised Policy Statement. The NOPR also suggests options for pipelines to make a voluntary rate filing addressing the effect of the Tax Cuts and Jobs Act and the Revised Policy Statement, or to explain why no action is needed.

Consistent with the corporate tax rate reduction, interstate natural gas pipelines must now calculate their federal income tax allowance based on a 21 percent flat rate. The tax rate reduction will also reduce accumulated deferred income taxes (“ADIT”) on the books of rate-regulated companies. In addition, the Tax Cuts and Jobs Act establishes a 20 percent deduction (subject to certain exceptions) of “qualified business income” from certain pass-through businesses like a partnership or S corporation for a taxpayer other than a corporation.

The NOPR proposes to require interstate natural gas pipelines to file the new FERC Form 501-G to provide the financial information for FERC to evaluate the impact of the Tax Cuts and Jobs Act and Revised Policy Statement. Subject to certain exceptions, all interstate natural gas pipelines would be required to file the FERC Form 501-G in staggered groups, beginning 28 days from the date of any final rule.

The NOPR also proposes four options for interstate natural gas pipelines to address the effects of the Tax Cuts and Jobs Act and the Revised Policy Statement:

- File a limited Natural Gas Act (NGA) Section 4 filing, along with the proposed FERC Form No. 501-G, to reduce the pipeline’s rates to reflect the new federal corporate tax rate and the elimination of MLP tax allowances.
- Commit to file a prepackaged uncontested rate settlement or, if that is impossible, a general NGA Section 4 rate case to revise rates, along with the proposed FERC Form No. 501-G.

⁶ On March 15, 2018, FERC also issued an order on remand in response to the D.C. Circuit’s decision.

- File a statement included with the proposed FERC Form No. 501-G explaining why a rate adjustment is unnecessary.
- File the proposed FERC Form No. 501-G, but take no additional action.

This proposal would only apply to the cost-based rates of an interstate natural gas pipeline. Market-based rates will not be subject to the proposed rule.

While FERC normally does not allow pipelines to change any single cost component outside of a general NGA Section 4 rate proceeding, FERC is considering permitting an exception to that policy in this instance. FERC intends the limited NGA Section 4 filing to streamline the process, enabling customers to benefit quickly from any rate reductions.

For Hinshaw and Natural Gas Policy Act of 1978 (“NGPA”) Section 311 pipelines, FERC proposes to provide separate procedures to address their rates. Hinshaw pipelines and NGPA Section 311 pipelines are intrastate natural gas pipelines permitted to sell or transport gas in interstate commerce under a limited jurisdiction certificate. Under Section 284.123(b)(1) of the existing regulations, any Hinshaw or Section 311 pipeline that has elected to use its intrastate rates for interstate service is already required to file a reduction of its interstate rates if its intrastate rates are reduced for the tax rate change. Under the NOPR, FERC proposes to add a new Section 284.123(i) to apply to pipelines that have elected to establish their interstate rates under Section 284.123(b)(2). These pipelines would be required to file a new rate election if their intrastate rates are changed to reflect the reduced corporate income tax rate under the Tax Cuts and Jobs Act. This filing would be made within 30 days after the reduced intrastate rates become effective and would require the pipeline to either elect to use its intrastate rates for the interstate service or file a new cost and revenue study supporting its interstate rates. As with the interstate pipelines, these provisions do not apply to market-based rate services.

Comments on the NOPR’s proposals are due 30 days following publication of the NOPR in the *Federal Register*.

NOTICE OF INQUIRY

The NOI seeks comments on potential additional impacts of the Tax Cuts and Jobs Act on the FERC-jurisdictional rates of public utilities, interstate natural gas pipelines, and oil pipelines. Most FERC-jurisdictional electric transmission and non-transmission rates, the majority of interstate natural gas transportation rates, and some oil pipeline rates are based on the cost of service. Calculating the cost of service involves taking into account all expenses, including income taxes, and adding a reasonable return on capital. In light of the federal tax law changes, FERC has specifically requested comments on the impact on ADIT and bonus depreciation.

Due to differences between IRS requirements and FERC accounting and ratemaking policies, ADIT balances are collected by public utilities, interstate natural gas pipelines, and oil pipelines from customers in anticipation of paying taxes at a later date. Because of the federal corporate income tax rate reduction, a portion of an ADIT liability previously collected from customers may no longer be necessary and may need to be returned. FERC seeks comments on a number of related issues, including:

- How to preserve rate base neutrality until excess and deficient ADIT have been fully settled, and whether and how adjustments should be made to modify the rate base.
- Issues relating to the flow-back or recovery of plant-based and non-plant-based ADIT.
- Whether, and if so, how, FERC should address excess ADIT removed from certain entities' books after December 31, 2017, due to sale or retirement.
- Accounting issues relating to recording the amortization of excess and deficient ADIT.
- Whether a one-time filing, potentially consisting of supporting worksheets, should be submitted to show the computation of excess or deficient ADIT and the corresponding flow-back or recovery.
- The effect of the elimination of the income tax allowance for MLPs and other pass-through entities on ADIT in light of the Revised Policy Statement.

FERC also requests comments relating to bonus depreciation, a tax incentive given to companies to encourage investment. The Tax Cuts and Jobs Act makes changes to bonus depreciation, including prohibiting its use relating to the acquisition of certain utility assets. Topics for comment include:

- The effect of the bonus depreciation changes under the Tax Cuts and Jobs Act.
- Whether FERC should take action to address bonus-depreciation-related issues.

Comments on the NOI addressing these issues are due 60 days after publication of the NOI in the *Federal Register*.

NO IMMEDIATE ACTION ON OIL PIPELINE RATES

At this time, FERC has decided not to take industry-wide action related to the Tax Cuts and Jobs Act's impact on oil pipeline rates. Because the majority of oil pipelines set their rates by indexing, and not cost-of-service ratemaking,

oil pipelines may adjust their rates annually as long as the rates are below applicable indexed ceiling levels. FERC will be reassessing the oil pipeline index in 2020, based on cost changes between 2014 and 2019, so FERC concluded that the 2020 ceiling adjustment will reflect the effects of the Tax Cuts and Jobs Act and Revised Policy Statement. However, oil pipelines must still report an income tax allowance and cost of service consistent with the Tax Cuts and Jobs Act and Revised Policy Statement when filing Form No. 6, page 700.