164 FERC ¶ 61,030
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Kevin J. McIntyre, Chairman;
Cheryl A. LaFleur, Neil Chatterjee,
Robert F. Powelson, and Richard Glick.

Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs — Docket No. PL17-1-001

ORDER ON REHEARING

(Issued July 18, 2018)

1. In this order the Commission dismisses the requests for rehearing and clarification of its Revised Policy Statement on Treatment of Income Taxes (Revised Policy Statement)[1] addressing the decision of the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) in *United Airlines*,[2] and provides guidance regarding the treatment of Accumulated Deferred Income Taxes (ADIT) where the income tax allowance is eliminated from cost-of-service rates under the Commission's post-*United Airlines* policy.

## I. Background

2. In *United Airlines*, the D.C. Circuit held that the Commission failed to demonstrate there was no double recovery of income tax costs when the Commission permitted SFPP, L.P. (SFPP), then a master-limited partnership (MLP) pipeline,[3] to recover both an income tax allowance and a return on equity (ROE) determined by the discounted cash flow (DCF) methodology. In response, the Commission issued a notice of inquiry and received comments regarding how to address any double recovery

[1] *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, Revised Policy Statement, 162 FERC ¶ 61,227 (2018).

[2] *United Airlines, Inc. v. FERC*, 827 F.3d 122 (D.C. Cir. 2016).

[3] At the time of SFPP's 2008 West Line rate case, SFPP was a wholly owned subsidiary of an MLP. *SFPP, L.P.*, Opinion No. 511-C, 162 FERC ¶ 61,228, at P 9 (2018).

resulting from the Commission's current income tax allowance and rate of return policies.[4]

3. On March 15, 2018, the Commission issued the Revised Policy Statement. The Revised Policy Statement superseded the Commission's 2005 Income Tax Policy Statement[5] and provided new guidance that the Commission will generally not permit MLP pipelines like SFPP to recover an income tax allowance in their cost of service. The Commission explained that an impermissible double recovery of investors' tax costs results from granting an MLP pipeline both an income tax allowance and a DCF ROE. The Revised Policy Statement did not provide guidance regarding implications of the *United Airlines* decision for other partnership and pass-through business forms that are not MLPs like SFPP. Instead, the Commission stated that it would address such issues in subsequent proceedings. The Commission received a number of requests for rehearing or clarification of the Revised Policy Statement.[6]

4. Also on March 15, 2018, the Commission issued a Notice of Inquiry in Docket No. RM18-12 on the effects of the Tax Cuts and Jobs Act of 2017[7] on Commission-jurisdictional rates.[8] Among other items, the Commission sought comment on the

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[4] *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, FERC Stats. & Regs ¶ 35,581 (2016).

[5] *Inquiry Regarding Tax Allowances*, 111 FERC ¶ 61,139 (2005).

[6] Requests for rehearing or clarification of the Revised Policy Statement were filed by Interstate Natural Gas Association of America (INGAA); Association of Oil Pipe Lines (AOPL); Master Limited Partnership Association; Dominion Energy, Inc.; Kinder Morgan, Inc. Gas Pipelines; the Tallgrass Pipelines; SFPP; Enable Mississippi River Transmission, LLC and Enable Gas Transmission, LLC (Enable); TransCanada Corporation (TransCanada); EQT Midstream Partners, LP (EQT Midstream); Enbridge Energy Partners, L.P. and Spectra Energy Partners, LP (Enbridge and Spectra); and Plains Pipeline, L.P (Plains). In addition, Congress members Pete Olson and Gene Green submitted comments. OFI SteelPath, Inc. also submitted comments, and a motion in response was filed by R. Gordon Gooch.

[7] 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) (Tax Cuts and Jobs Act).

[8] *Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates*, 83 Fed. Reg. 12,371 (2018), FERC Stats. & Regs. ¶ 35,582 (2018)

treatment of ADIT for MLP pipelines (and potentially other pass-through entities) to the extent that the income tax allowance is eliminated from cost-of-service rates following the Commission's post-*United Airlines* policy. Among other things, the Commission asked 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.[9] The Commission received numerous comments that discuss this issue.[10]

## II. Discussion

5. As discussed below, the Commission dismisses the requests for rehearing of the Revised Policy Statement. In addition, the Commission provides guidance that if an MLP or other pass-through pipeline eliminates its income tax allowance from its cost of service pursuant to the post-*United Airlines* policy, the Commission anticipates that ADIT will similarly be removed from the cost of service.

6. The Revised Policy Statement and the guidance provided in this order do not establish a binding rule, but are instead expressions of general policy intent designed to provide guidance by notifying entities of the course of action the Commission intends to follow in future adjudications.[11] The Commission will have to fully support and justify

(ADIT NOI). The Commission incorporates by reference the record in Docket No. RM18-12.

[9] *Id.* P 25.

[10] *See* comments on the ADIT NOI submitted in Docket No. RM18-12 by the *United Airlines* Petitioners and Aligned Shippers (*United Airlines* Petitioners); Natural Gas Indicated Shippers; Canadian Association of Petroleum Producers (CAPP); Process Gas Consumers Group and American Forest and Paper Association; American Public Power Association and American Municipal Power, Inc. (APPA and AMP); Central Electric Power Cooperative, Inc., *et al.*; Mike Hunter, Oklahoma Attorney General; American Public Gas Association (APGA); Delaware Municipal Electric Corporation, Inc.; Enable; TransCanada; Enbridge and Spectra; AOPL; INGAA; Tallgrass Pipelines; Plains; Boardwalk Pipeline Partners, LP; Kinder Morgan Entities; EQT Midstream; National Grid; Dominion Energy, Inc. Gas Pipelines; and SFPP, Calnev Pipe Line, LLC and Kinder Morgan Cochin, LLC.

[11] *Pacific Gas & Electric Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974).

the application of this guidance in individual cases.[12] The Commission emphasizes that when applied in specific cases, opportunity will be afforded to affected parties to challenge or support the revised policies through factual or legal presentation and to present any issues and arguments regarding the application of these policies to the entities at issue as may be appropriate in the circumstances presented.

### A. Requests for Rehearing of the Revised Policy Statement

7. The Commission's normal practice is to dismiss requests for rehearing of policy statements and reserve any further discussions of the issues contained therein for specific proceedings in which the policy is applied. Natural Gas Act (NGA) section 19(a) provides for parties to request rehearing only when they are "aggrieved by an order issued by the Commission."[13] As discussed above, the Revised Policy Statement is not a binding rule that is "finally determinative of the issues or rights to which it is addressed," but rather, only "announces the agency's tentative intentions for the future."[14] Therefore, no entities are aggrieved by the Revised Policy Statement, which does not, in and of itself, finally determine the rights and duties of any entities. The Commission accordingly dismisses the requests for rehearing.

8. While the Commission declines to reconsider the policy announced in the Revised Policy Statement, it will consider the issues and arguments raised in the rehearing requests in the context of specific cases in which they apply. An entity such as an MLP pipeline will not be precluded in a future proceeding from arguing and providing evidentiary support that it is entitled to an income tax allowance and demonstrating that its recovery of an income tax allowance does not result in a double-recovery of investors' income tax costs.

### B. Treatment of ADIT under the Revised Policy

9. If an MLP pipeline's income tax allowance is eliminated from cost-of-service rates under the Commission's revised policy, additional sums will not be recorded in accounts for current income taxes and ADIT going forward. However, the Commission recognizes there is uncertainty regarding the treatment of previously accumulated sums in ADIT prior to an MLP pipeline's elimination of its income tax allowance. Recognizing

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[12] *Id.* at 39 ("A policy statement announces the agency's tentative intentions for the future. When the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued.").

[13] 15 U.S.C. § 717r (2012).

[14] *Pacific Gas & Electric*, 506 F.2d at 38.

the need for Commission guidance on this issue, the Commission included this issue in the ADIT NOI in Docket No. RM18-12. Specifically, the Commission sought comment regarding whether, to the extent the income tax allowance is eliminated from an MLP or pass-through entity's cost of service following the revised policy, 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.[15] The Commission received numerous comments on both sides. In general, comments representing customer interests argued that previously accumulated ADIT should be returned to ratepayers,[16] while comments representing pipeline interests argued that ADIT should be eliminated from cost of service.[17]

10. As discussed below, the Commission provides guidance that an MLP pipeline (or other pass-through entity) no longer recovering an income tax allowance pursuant to the Commission's post-*United Airlines* policy may also eliminate previously-accumulated sums in ADIT from cost of service instead of flowing these previously-accumulated ADIT balances to ratepayers. This guidance is consistent with: (1) Commission and Internal Revenue Service (IRS) regulations; (2) Commission precedent that shippers do not have an ownership interest in previously accumulated sums in ADIT; and (3) D.C. Circuit precedent suggesting that returning the ADIT amounts would violate the prohibition against retroactive ratemaking.[18]

### 1. ADIT

11. In general, ADIT balances arise from timing differences between the method of computing book accounting income used in developing the total cost of service for Commission ratemaking purposes on the one hand, and the method of computing the actual taxes payable to the IRS and state governments for the same time period. For example, for book accounting and the ratemaking process a pipeline's test period cost of

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[15] ADIT NOI, FERC Stats. & Regs. ¶ 35,582 at P 25.

[16] *See, e.g.*, comments on the ADIT NOI submitted by the *United Airlines* Petitioners; Natural Gas Indicated Shippers; CAPP; Process Gas Consumers Group and American Forest and Paper Association; APPA and AMP; Central Electric Power Cooperative, Inc., *et al.*; Mike Hunter, Oklahoma Attorney General; APGA; and Delaware Municipal Electric Corporation, Inc.

[17] *See, e.g.*, comments on the ADIT NOI submitted by Enable; TransCanada; Enbridge and Spectra; AOPL; and Plains.

[18] *Public Utilities Comm'n of State of Cal. v. FERC*, 894 F.2d 1372 (D.C. Cir. 1990).

service assumes a tax deduction based upon straight-line depreciation of its pipeline assets, yet the IRS allows the pipeline an earlier deduction based upon Modified Accelerated Cost Recovery System (MACRS) depreciation rates as long as the benefits of the increased deduction are not flowed through to ratepayers.[19] The annual differences between a cost-of-service tax allowance and the income taxes payable are recorded as current deferrals of income taxes.[20] The current deferrals of income taxes are added to the beginning of the period's ADIT to calculate the end of the year's ADIT balance. Under the normalization of tax costs used in the ratemaking process, the income taxes that are ultimately owed to the IRS for which payment is deferred in the early years due to accelerated depreciation are matched[21] to the payment under the Commission's ratemaking policies' straight-line depreciated costs.[22] Generally, in the early years of an asset's life, ADIT balances increase because a pipeline's cost of service reflects a higher tax allowance than the pipeline's IRS obligations. In a pipeline's later years, the situation

[19] In addition, if the Commission did not normalize tax costs to correspond to straight-line depreciation, then IRS regulations would prohibit the pipeline from using accelerated depreciation for determining its tax liability. 26 U.S.C. §§ 167, 168(i)(9)(A).

[20] *See* General Instruction 18, *Comprehensive Interperiod Income Tax Allocation*, and Special Instructions Accounts 410.1, 410.2, 411.1, and 411.2 of the Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act. 18 C.F.R. pt. 201 (2017).

[21] "The primary rationale for tax normalization is matching: the recognition in rates of the tax effects of expenses and revenues with the expenses and revenues themselves." *Regulations Implementing 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 31,522 (1981), *reh'g denied*, Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 (1982), *aff'd, Public Systems v. FERC*, 709 F.2d 73 (D.C. Cir. 1983).

[22] The normalization method differs from the "flow-through" method where the tax allowance for regulatory ratemaking purposes reflects the actual amount of taxes paid in each year. Under the flow-through method the then-current ratepayers realize the tax benefits of the entire tax deduction in the year the deduction is taken, whereas the tax expenses will be charged to future ratepayers in the later years when the deferred tax payments are made. Normalization avoids the problem whereby the timing difference subsidizes current ratepayers at the expense of future ratepayers and avoids the need for the entity to increase rates in an asset's later years to cover payment of deferred taxes. *Public Systems*, 709 F.2d at 75-76, 80.

reverses. Thus, normalization requires shippers receiving service in the early years of an asset's life to pay their properly allocated share of the pipeline's tax expenses.

12. As part of the normalization methodology as it applies to calculating a cost of service, the pipeline must include ADIT balances in its rate base. This ensures that regulated entities do not earn a return on cost-free capital based upon timing differences: (a) when pipelines recover the normalized tax costs in rates using straight-line depreciation; and (b) when taxes are actually paid to the IRS using accelerated depreciation.[23] These timing differences create "cost-free" capital because the pipeline may use these funds without paying either a return to equity investors or interest on debt.[24] In a cost-of-service proceeding, the Commission requires the pipeline to deduct the sums in the ADIT liability accounts from rate base so the pipeline does not improperly earn a return on amounts funded by cost-free capital.[25] Including ADIT in rate base generally lowers rates because the pipeline does not earn a return on the deferred taxes.[26]

### 2. Commission Guidance

13. The Commission provides guidance that when an MLP pipeline's income tax allowance is eliminated from cost of service, previously accumulated ADIT balances may also be eliminated.[27] As a result, such pipeline would not be required to return such

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[23] Once accelerated depreciation has caused the asset to fully depreciate for federal and state income tax purposes, the pipeline begins to pay the deferred taxes and ADIT decreases. Ultimately, at the end of the property's service life, the ADIT liability will be reduced to zero.

[24] *Arco Pipe Line Co.*, Opinion No. 351, 52 FERC ¶ 61,055, at 61,238 (1990).

[25] The deduction of ADIT from rate base reflects the lower cost of service that a utility achieves by its use of the cash flow from deferred taxes in place of debt and equity capital. Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 at 30,128.

[26] *Public Systems*, 709 F.2d at 83.

[27] Pursuant to this policy, a natural gas pipeline would eliminate any balances recorded in Accumulated Deferred Income Taxes (Account 190), Accumulated Deferred Income Taxes – Accelerated Amortization Property (Account 281), Accumulated Deferred Income Taxes–Other Property (Account 282), and Accumulated Deferred Income Taxes–Other (Account 283). Similarly, to the extent any excess ADIT has been transferred to Other Regulatory Liabilities (Account 254) or any deficient ADIT has been transferred to Other Regulatory Assets (Account 182.3), the pipeline would remove the balances related to ADIT.

ADIT to shippers, nor would such ADIT be subtracted from rate base. This guidance is consistent with: (1) normalization principles as provided by Commission and IRS regulations; (2) D.C. Circuit and Commission precedent that shippers do not have an ownership interest in previously accumulated sums in ADIT; and (3) D.C. Circuit precedent that returning ADIT paid by shippers in previously effective rates after those rates have been modified to no longer reflect a tax allowance may violate the prohibition against retroactive ratemaking and the requirement that action under NGA section 5 be prospective only.[28] While some commenters argue that these ADIT sums should be returned to ratepayers, these arguments are unpersuasive as discussed below. However, to the extent the Commission addresses these issues in future proceedings, the Commission will consider any arguments regarding not only the application of this policy to the facts of the case, but also any arguments regarding the underlying validity of the policy itself.

### a. Normalization Principles in Commission and IRS Regulations

14. If the Commission does not permit an entity to recover an income tax allowance in its rates, there appears to be no rationale for requiring such entity to record current or deferred income taxes on its books. As discussed above, ADIT is a regulatory construct to ensure that regulated entities do not earn a return on cost-free capital based upon timing differences between federal and state tax liability and Commission ratemaking.[29] The purpose of normalization is matching the pipeline's cost-of-service expenses in rates with the tax effects of those same cost-of-service expenses.[30] If there is no income tax allowance in Commission rates, there is no basis for the "matching" function of normalization, including ADIT.[31] Commission and IRS regulations regarding

[28] *Public Utilities*, 894 F.2d 1372. Although certain statutes and regulations discussed herein are not specifically applicable to oil pipelines, the Commission finds no basis for treating oil pipelines differently from natural gas pipelines for purposes of this ADIT guidance. *See infra* P 14 n.32.

[29] *Arco*, 52 FERC at 61,238.

[30] "The primary rationale for tax normalization is matching: the recognition in rates of the tax effects of expenses and revenues with the expenses and revenues themselves." Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,522.

[31] *See Public Utilities*, 894 F.2d at 1382 (noting that "[t]ax normalization sought to 'match' the timing of a customer's contribution toward a cost with enjoyment of any offsetting tax benefit," but finding the passage of the NGPA which resulted in El Paso no

normalization for natural gas pipelines only apply to entities with an income tax allowance component in their regulated cost-of-service rates.[32] Moreover, the Commission requires entities to make adjustments for excess or deficient ADIT only where "the item is included in the jurisdictional cost-of-service."[33] For example, a change in the federal tax rates giving rise to excess deferred taxes would trigger the Commission and IRS normalization requirements.[34]

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longer using cost-of-service rates "mooted the whole question to which normalization was the answer").

[32] *See* 18 C.F.R. § 154.305(a) ("An interstate pipeline must compute *the income tax component of its cost-of-service* by using tax normalization for all transactions."); 18 C.F.R. § 154.305(b)(1) ("Tax normalization means computing *the income tax component* as if transactions recognized in each period for ratemaking purposes are also recognized in the same amount and in the same period for income tax purposes."); 18 C.F.R. 154.305(b)(4) ("*Income tax component* means that part of the cost-of-service that covers income tax expenses allowable by the Commission."); *see also* 26 U.S.C. § 168(i)(9)(A) ("the taxpayer must, in computing its *tax expense for purposes of establishing its cost of service for rate-making purposes* …use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes….") (emphasis added). Although these rules are not specifically applicable to oil pipelines subject to Commission regulation, the same principles apply. *See Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,837-38 (1985). The Commission sees no reason that oil pipelines should be treated differently from natural gas pipelines for purposes of the ADIT guidance discussed in this Order. *See also* CAPP Comments at 4 ("The conceptual foundation of the ADIT account *presumes* that the entity whose rates are in issue will be subject to income tax expense in the future, and that at least a portion of those expenses have been *deferred*, but not extinguished.").

[33] *Algonquin Gas Transmission Co.*, 76 FERC ¶ 61,075, at 61,449 (1996); *see also* 18 C.F.R. § 154.305(c)(2) ("rate base reductions or additions" for ADIT "must be limited to deferred taxes related to rate base, construction, or other *costs and revenues affecting jurisdictional cost-of-service*") (emphasis added).

[34] The Commission's requirements relating to excess or deficient ADIT balances apply where the discrepancy is "a result of changes in tax rates" or where "the rate applicant has not provided deferred taxes in the same amount that would have accrued had tax normalization always been applied." 18 C.F.R. § 154.305(d)(1).

### b. Ratepayers Have No Ownership Interest in ADIT

15. The Commission and D.C. Circuit have rejected arguments based on the misconception that ADIT is a cash reserve over which ratepayers have an ownership claim or equitable interest.[35] Consistent with these holdings, the Commission has also explained that ADIT is not a true-up or tracker of money owed to shippers.[36]

16. Rather, as noted above, ADIT records the amount of income taxes that the pipeline has collected due to normalization and which it will eventually owe the federal government (not ratepayers) but which have been deferred pending the reversal of the timing difference such as accelerated depreciation. The balances recorded in ADIT accounts reflect deferred taxes that are ultimately owed to the IRS. Once the tax obligations are settled, the associated ADIT amounts are eliminated. For example, when the pipeline must pay these deferred taxes to the federal government as a result of a sale of the asset, the ADIT associated with the asset is eliminated (not returned to shippers).[37]

### c. Retroactive Ratemaking

17. In addition, requiring an MLP pipeline that eliminates its income tax allowance from cost of service under the revised policy to refund ADIT to customers appears to violate the rule against retroactive ratemaking.[38] The rule against retroactive ratemaking bars "the Commission's retroactive substitution of an unreasonably high or low rate with

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[35] *Public Systems*, 709 F.2d at 85 (rejecting the notion "that ratepayers have an ownership claim" to the ADIT balance); *Public Utilities*, 894 F.2d at 1381 ("The Commission and this Court have both rejected" "the notion that under normalization accounting customers enjoy an equitable interest in a utility's deferred tax account."); Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,539 (addressing the "erroneous premise that a loan is being made by ratepayers to utilities" through the normalization process and stating that ratepayers do not "have an ownership claim or equitable entitlement to the 'loaned monies'"); *id.* at 31,539 n.75 ("This is not to say that customers do not pay rates that recover deferred taxes. They do. But paying deferred taxes in rates does not convey an ownership or creditor's right.").

[36] *Lakehead Pipe Line Co. L.P.*, 75 FERC ¶ 61,181, at 61,594 (1996). Moreover, there would be practical problems with maintaining such a tracker as many oil pipeline rates have never been subject to a cost-of-service rate proceeding. For these pipelines, no cost-of-service income tax allowance has been established.

[37] *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at PP 158-162 (2002).

[38] *Public Utilities*, 894 F.2d 1372.

a just and reasonable rate."[39] Under the NGA, the Commission only has the authority to address over-recovery by prospectively changing a pipeline's rate under NGA section 5, and may not retroactively refund over-collected amounts.[40] Requiring an MLP pipeline whose tax allowance is eliminated to flow-back to ratepayers ADIT that was lawfully collected under previously filed and approved rates would raise retroactive ratemaking concerns. The Commission would be retroactively applying its post-*United Airlines* policy that permitting MLP pipelines to recover an income tax allowance results in a double recovery by requiring such pipelines to refund either the income tax allowance expenses or deferred tax reserves recovered under past rates. Any attempt to refund such amounts to customers would rest on an impermissible post hoc finding that the past rates were not just and reasonable.[41]

18. This analysis is supported by the D.C. Circuit's decision in *Public Utilities*, which held that requiring a pipeline to credit ratepayers for earnings on an excess ADIT balance or refund the balance to ratepayers where the pipeline switched from cost-of-service rates to ceiling prices violated the rule against retroactive ratemaking. As the court found in *Public Utilities*, ADIT "is composed entirely of rate revenue that [the pipeline] has already collected. Refund of such property, or its earnings, would effectively force [the pipeline] to return a portion of rates approved by FERC, and collected by [the pipeline]."[42] The D.C. Circuit explained that to the extent any basis for requiring the credit to ratepayers rested on the view that the pipeline's prior cost-of-service rates were "in retrospect too high"[43] or "unjust and unreasonable"[44] then the credit for earnings on previously accumulated ADIT sums violated the rule against retroactive ratemaking.

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[39] *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).

[40] Under the Interstate Commerce Act, retroactive reparations are similarly not available for a Commission-initiated investigation, and reparations that can be awarded following a successful complaint against an oil pipeline are generally limited to two years prior to the filing date of the complaint. 49 U.S.C. app. § 16(3); *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 698-700 (D.C. Cir. 2006).

[41] *See Public Utilities*, 894 F.2d at 1382-84.

[42] *Id.* at 1383.

[43] *Id.* at 1380.

[44] *Id.* at 1382.

### d. Arguments that ADIT Should Be Returned to Ratepayers Are Unavailing

19. The alternative approach raised in the ADIT NOI and supported by some customer interests is to require that previously accumulated sums be placed in a regulatory liability account and returned to ratepayers. These commenters assert that the entire ADIT balance that was included in historical costs of service and collected in order to cover future tax liabilities is excess and should be flowed-back to ratepayers, just as the Commission does where a portion of the ADIT balance is overfunded due to a decrease in tax rates.[45] They argue that eliminating the ADIT balance is inappropriate because the balance represents sums contributed by ratepayers.[46] They argue that the ADIT balance resulting from the income tax allowance that was permitted under the Commission's 2005 Income Tax Policy Statement will be completely overfunded for MLP pipelines that are no longer eligible for an income tax allowance.[47] These arguments rest upon false premises.

20. The Commission is unpersuaded by arguments that the elimination of the income tax allowance should be treated like a reduction in income tax rates and flowed through in rates using the Average Rate Assumption Method (ARAM), the Reverse South Georgia Method (RSGM)[48] or a different method.[49] This is a false analogy. There is a critical distinction between adjustments to amortize excess or deficient ADIT to be included in future rates to account for changes in income tax rates, as opposed to a complete elimination of the income tax allowance. When income tax rates are merely reduced and an income tax allowance remains in *future* cost of service, it is appropriate to credit any excess in ADIT in the *future* cost of service.[50] In contrast, when the income

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[45] *See, e.g., United Airlines* Petitioners Comments 19-28; CAPP Comments at 5-9.

[46] *See, e.g.*, Comments of Process Gas Consumers Group and American Forest and Paper Association at 7; CAPP Comments at 5-6; Comments of Mike Hunter, Oklahoma Attorney General at 7-8; APGA Comments at 6-7.

[47] *United Airlines* Petitioners Comments at 15, 26-28.

[48] *See* ADIT NOI, FERC Stats. & Regs. ¶ 35,582 at P 17.

[49] *See, e.g., United Airlines* Petitioners Comments at 25, 28-31 (requesting an expedited amortization period); CAPP Comments at 5, 10-12 (requesting a five-year amortization period).

[50] As discussed above, the obligation to amortize excess ADIT is only triggered when the pipeline has a tax obligation and there is an excess in ADIT caused by "changes in tax rates" or where "the rate applicant has not provided deferred taxes in the same

tax allowance is eliminated due to the post-*United Airlines* policy, there are no income tax costs recognized in rates at all, meaning that both the income tax allowance and ADIT must be completely removed and there is no excess or deficient ADIT balance to amortize in the cost of service. In this scenario, returning ADIT to future shippers would be little more than returning rates collected for providing prior period service which is retroactive ratemaking.

21. Some commenters representing customer interests cite statements emphasizing that while pipelines collect from ratepayers more taxes than the pipeline pays under normalization in early years (i.e. adding to ADIT balances), shippers are made whole because pipelines in later years collect less in taxes from ratepayers than they are paying (i.e. reducing ADIT balances).[51] They essentially argue that the pipelines previously over-collected for future tax expenses that will be owed to the federal government, and that not returning such amounts gives the pipelines a "windfall."[52] Such commenters are essentially arguing for retroactive ratemaking and for returning rate collections associated with prior period service.[53]

22. Moreover, rates designed pursuant to the normalization principles described above do not "over-collect" the pipeline's tax expenses in the early years. Rather, such rates require shippers receiving service in the early years to pay their properly allocated share

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amount that would have accrued had tax normalization always been applied." 18 C.F.R. § 154.305(d); *see also Algonquin*, 76 FERC at 61,449; *United Airlines* Petitioners Comments at 29 ("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, and still includes an [income tax allowance] in its cost of service that can be adjusted to correct its ADIT collections."), *but see id.* at 25 ("The current situation is novel in that MLP pipelines have no future tax liability that will be recovered through an [income tax allowance].").

[51] *See, e.g., United Airlines* Petitioners Comments at 14 (noting the Commission stated that "[a]ny excess or deficiency in the deferred tax reserve does not … result in a windfall to either shareholders or ratepayers since the balances will systematically be subject to a reconciliation in future rates") (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,554).

[52] *Id.* at 22-23, 28, 30.

[53] *See Public Utilities*, 894 F.2d at 1382 (rejecting the argument that if excess ADIT was not returned to ratepayers, the pipeline would receive a "windfall" because the tax expenses collected in past years would never be returned to ratepayers).

of the pipeline's tax expenses for the period of their service.[54] For example, if a shipper only takes service in the early years and then leaves the system, it has paid its appropriate share of the pipeline's tax expenses; the shipper has not paid an excessive amount that it could only recoup by remaining on the system into the later years. It follows that, if the Commission determines part way through the overall normalization period that the pipeline is not entitled to any tax allowance, the Commission cannot require the pipeline to return to shippers ADIT amounts collected in prior rates without engaging in retroactive ratemaking. That is because those ADIT amounts represent tax expenses that the Commission previously found were properly allocated to the approved rates in effect prior to the Commission's finding that the pipeline is not entitled to a tax allowance.[55]

The Commission orders:

The requests for rehearing or clarification of the Revised Policy Statement are dismissed, as discussed in the body of this order.

By the Commission. Commissioners LaFleur and Glick are concurring with a joint separate statement attached.

( S E A L )

Kimberly D. Bose,
Secretary.

[54] The Commission's primary justification for its decision to adopt tax normalization was "the matching principle: as a matter of fairness, customers who pay an expense should get the tax benefit that accompanies the expense.... To do otherwise would subsidize present customers at the expense of future ones." *Public Systems*, 709 F.2d at 80.

[55] *See United Airlines* Petitioners Comments at 13 ("the ADIT amount reflects how much a pipeline was deemed to have recovered in past rates that is associated with future costs, not what has been collected dollar-for-dollar in rates").

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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(Issued July 18, 2018)

LaFLEUR, Commissioner, and GLICK, Commissioner, *concurring*:

In companion orders issued today, the Commission (1) affirms the Revised Policy Statement on Treatment of Income Taxes (Revised Policy Statement) issued in response to the decision of the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) in *United Airlines*;[1] (2) provides guidance regarding the treatment of Accumulated Deferred Income Taxes (ADIT) where the income tax allowance is eliminated from cost-of-service rates under the Commission's post-*United Airlines* policy; and (3) issues a Final Rule that establishes procedures for the Commission to determine which jurisdictional natural gas pipelines may be collecting unjust and unreasonable rates in light of the income tax reductions provided by the Tax Cuts and Jobs Act and the Commission's revised policy and precedent concerning tax allowances to address the double recovery issue identified by *United Airlines*. These are significant orders, and we write separately to provide some additional thoughts regarding these decisions.

First, with respect to the ADIT guidance issued today, we confess to some frustration that the rate benefits that customers and shippers would otherwise receive from the Revised Policy Statement may be significantly reduced by the treatment of ADIT announced in today's orders. As a matter of equity, we believe that the arguments for applying previously-accrued ADIT balances to reduce future rate base where a tax allowance is eliminated are compelling. However, based on the arguments presented in this docket regarding the Commission's *authority* to mandate those reductions on a generic basis, it appears that such a directive would run afoul of the rule against retroactive ratemaking, as interpreted by the D.C. Circuit in *Public Utilities Commission of State of California v. FERC*.[2] Nonetheless, we note that today's order is simply guidance, and to the extent that customers or shippers in individual proceedings argue that such a reduction is legal in specific cases, we will consider those arguments on the appropriate record.

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[1] *United Airlines, Inc. v. FERC*, 827 F.3d 122 (D.C. Cir. 2016).

[2] 894 F.2d 1372 (D.C. Cir. 1990).

Second, we believe that today's Final Rule sharply highlights the need for a legislative fix to the lack of refund authority in Section 5 of the Natural Gas Act (NGA).[3] Under current law, the Commission's ability to protect natural gas customers against unjust and unreasonable rates is compromised by its inability to set a refund date. We believe that current law provides a perverse incentive for protracted litigation and creates an asymmetry of leverage between pipelines seeking a rate increase under Section 4 of the NGA and complainants or the Commission under Section 5.

With respect to the Final Rule, we believe that our lack of refund authority affected the balance the Commission was able to strike in today's order. It is a clear tenet of cost-of-service ratemaking that tax savings should flow through to ratepayers, and the Commission is rightly pursuing that goal in the Final Rule. However, because our Section 5 "stick" under the NGA cannot effectively deliver timely relief to customers, the Final Rule proffers a series of "carrots" in the hope that pipelines will exercise their Section 4 filing rights to quickly flow those tax benefits back to their customers. While we think the balance struck in the Final Rule is reasonable in light of our limited refund authority, we believe that the Commission would be better equipped to protect customers if the law were amended.

Accordingly, we respectfully concur.

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| Cheryl A. LaFleur | Richard Glick |
| Commissioner | Commissioner |

[3] Commissioner LaFleur has been on record in support of Section 5 reform for several years. *Northern Natural Gas Co.*, 133 FERC ¶ 61,111 (2010) (LaFleur, Comm'r, dissenting).