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Energy

Concerns About FERC Tax Allowance Policy Raised by Shippers, Pipeline Operators

The Federal Energy Regulatory Commission is stuck between the competing interests of oil and gas pipelines and shippers as it reworks a tax policy.

The revision was necessary after a federal court ruling this summer. It could have significant impact on both pipelines and shippers, depending on FERC's thinking.

In response to the court ruling, FERC issued a notice of inquiry Dec. 15 seeking comments from industry and trade groups about how it should proceed in ensuring that partnership pipelines do not receive double recovery of tax income expenses in the rates they charge their customers, such as shippers, to use their pipelines to move products such as oil, natural gas and gasoline and natural gas liquids such as methane and propane.

FERC and industry attorneys say that any such changes to FERC's income tax allowance policy, which was issued as policy statement in 2005, could have significant implications for the oil and gas pipeline industries, as well as the electric power sector.

''FERC's in a little bit of a difficult situation to come up with a compromise that's going to make everyone happy,'' Levi McAllister, a partner at Morgan, Lewis & Bockius LLP who focuses on FERC proceedings, told Bloomberg BNA Dec. 15.

''That's why FERC is putting this [notice] out there to the industry, saying, 'What should we consider? Where should we go from here?' Because we're at this interesting point where you want to make sure that the shippers or transit customers are paying just and reasonable rates that are fair,'' he said.

But, he said, at the same time, pipelines need to be able to attract sufficient investment to be able to build new energy infrastructure and transmission lines.

Emily Pitlick Mallen, a partner at Van Ness Feldman LLP who works with oil and natural gas clients, said that she thinks FERC won't get rid of its income tax recovery policy in total, but will make specific changes to it.

''I think FERC is very aware of the ripples that extend across industry and they're trying to interpret the court's mandate as narrowly as possible,'' she told Bloomberg BNA Dec. 15.

The oil pipeline industry association doesn't interpret the court's ruling that pipelines incur a double recovery of income tax costs that were passed down to customers.

''Current FERC policy does not allow for double recovery of income tax costs, and we look forward to a future FERC Order demonstrating this,'' John Stoody, vice president of government and public relations at the Association of Oil Pipe Lines, told Bloomberg BNA in a statement.

''A FERC action changing the current rate setting approach could jeopardize the addition of needed new pipeline capacity,'' he said.

FERC's Tax Policy Litigation History FERC's 2005 income tax policy has a history in the courts. It first was upheld by the U.S. Court of Appeals for the District of Columbia Circuit in 2007. Most recently it was shot down in a ruling in July and sent back to the agency to revise.

The D.C. Circuit ruled in favor of a consortium of shippers who filed suit against FERC over tax recovery associated with Kinder Morgan's Santa Fe Pacific Pipeline, a partnership pipeline that moves refined oil products. The court found that FERC failed to sufficiently justify that there is no double recovery of taxes for partnership pipelines receiving a tax allowance in addition to the discounted cash flow return on equity (*United Airlines, Inc. v. FERC*, 827 F.3d 122, 2016 BL 212635, D.C. Cir., No. 15-1107, 7/1/16).

Master limited partnerships and limited partnerships are common structures among oil and gas pipeline companies today because partnerships don't have to pay business taxes but instead the profits and losses are ''passed through'' to the individual general partners, who pay the taxes. FERC calls these ''pass through entities.'' This differs from a corporation, which has to pay state and federal taxes on the business entity as a whole and whose shareholders have to pay taxes on their earnings.

Public comments are due 45 after the notice publishes in the Federal Register.

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