FERC Tax Policy Change Hurts Pipeline MLPs, DC Circ. Told

By Keith Goldberg

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The Federal Energy Regulatory Commission misinterpreted a 2016 D.C. Circuit ruling that scrapped a pipeline income tax allowance to craft an unlawful policy removing a tax perk for pipeline master limited partnerships, a pair of pipeline companies told the appeals court Friday.

Kinder Morgan unit SFPP LP and two units of pipeline MLP Enable Midstream Partners LP are challenging FERC's **2018 policy statement** that it would no longer allow pipeline MLPs, which don't pay corporate-level taxes, to recover income tax allowances in their cost-of-service rates.

The commission crafted the policy in response to **the D.C. Circuit's 2016 ruling** that scrapped SFPP LP's tax allowance that several airlines and oil companies had complained resulted in a double recovery for the liquids pipeline MLP's investors. But SFPP and Enable told the appeals court in a brief Friday that the ruling in United Airlines Inc. v. FERC held only that FERC didn't justify its conclusion that the tax allowance didn't result in a double recovery for MLP investors when combined with approved equity returns calculated by a discounted cash flow formula.

“It did not require a particular result, such as the result reached by the revised statement,” SFPP and Enable said in their brief. “FERC failed to consider the impacts that the revised statement’s holding would have on competition and the financial health of the pipelines that it regulates.”

That includes estimates of $30 billion in losses of MLP market values, as well as pipeline companies' **abandoning the MLP structure** for a traditional corporate structure, the companies said.

Enable and SFPP claimed FERC ignored evidence that shows that granting MLPs both income tax allowances and discounted cash flow-derived equity returns doesn't result in a double recovery.

The companies said FERC's new policy statement creates a disparity between pipeline companies organized as MLPs and ones organized as traditional C-corporations. In particular, the statement conflicts with a “fundamental premise of FERC’s discounted-cash-flow model, that securities markets are efficient” by only applying that premise to pass-through pipelines owned by C-corporations, Enable and SFPP said in their brief.

“FERC’s holding, recognizing tax liabilities for C-corporations but denying them to

MLPs, does not result in parity," the companies said. "Income tax liability is a cost-of-service component that regulated pipelines must ... be permitted to recover, regardless of their organizational structure."

FERC's revised policy statement scrapping income tax allowances for pipeline MLPs was a companion to a rule directing gas pipelines to file a report estimating their so-called return on equity — essentially, their investor returns that are baked into the rates they charge — before and after the Tax Cuts and Jobs Act of 2017, which slashed corporate tax rates from 35% to 21%.

When introduced **in March 2018**, FERC's revised pipeline tax policies jolted the pipeline industry, which fretted that they could lead to more rate investigations by FERC and rate challenges by pipeline shippers. But FERC's final rule issued in July 2018 provided a potential outs that allowed companies to voluntarily reduce their rates and avoid a rate probe.

In issuing the final rule, FERC rejected requests from Enable, SFPP and other pipeline companies to reconsider the policy statement on income tax allowances, though it emphasized that the guidance wasn't a binding rule. But less than two weeks after issuing the statement, FERC denied tax allowances for SFPP and Enable unit Enable Mississippi River Transmission LLC's bid, citing the policy statement.

SFPP and Enable launched their D.C. Circuit challenges **in September**. In their brief Friday, the companies said FERC wrongly rejected Enable MRT's proposed income tax allowance, even though competing pass-through pipelines wholly owned by traditional corporations would be allowed, and didn't even give Enable a chance to show that there would be no resulting double recovery.

That hurt Enable MRT's ability to attract investment compared with its direct competitors who are permitted to keep income tax allowances in their rates, Enable and SFPP said in their brief.

"Such disparity results in reduced equity returns for investors in Enable, which may produce lower credit ratings and higher capital costs," the companies said. "Such a clearly discriminatory policy unfairly targets MLPs like Enable and SFPP that, in actuality, present no double recovery concerns."

Representatives for Kinder Morgan and Enable declined comment Monday.

A FERC spokesperson said that the commission doesn't comment on pending litigation.

Enable is represented by Mark F. Sundback, Kenneth L. Wiseman, William M. Rappolt and Andrew P. Mina of Sheppard Mullin Richter & Hampton LLP, as well as in-house by assistant general counsel Jonathan F. Christian.