



## FERC Finalized Rule Positive for MLPs; Cue the Relief Rally

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Yesterday after market close, the FERC finalized its policy rule for natural gas pipelines as it relates to tax changes. This represents a follow up to its policy revision announced on March 15th. In short, the final rule provides additional clarity and is less punitive towards MLPs than some had feared. The final ruling goes a long way to relieving the uncertainty associated with FERC's initial announcement and how the policy would be implemented. This alleviates the overhang for particular MLPs and the space broadly, hence today's relief rally. In this piece, we discuss the three key positives for MLPs listed below:

- MLPs don't necessarily have to eliminate the income tax allowances (ITA) in their cost-of-service rates at this time.
- A natural gas MLP pipeline with a C-Corp parent is eligible for an income tax allowance.
- Pipelines owned by MLPs can choose to eliminate accumulated deferred income tax (ADIT)\* from the pipeline's cost of service if they take their tax allowance to zero (don't have to provide backpay for customers).

In addition to filing a one-time report (Form 501-G) with the FERC, interstate natural gas pipelines have four options to address changes to revenues (pipeline rates) as a result of the lowered tax rate.

1. Make a section 4 filing to reduce rates to reflect the lowered tax rate. Any pipeline that chooses to do this will not be subject to a FERC-initiated rate case for three years if the pipeline's estimated ROE is 12% or less.
2. Commit to an uncontested rate settlement or section 4 rate case. (In other words, commit to a negotiated rate with customers.) If a pipeline commits to file before December 31, 2018, FERC will not initiate a section 5 rate investigation before then.
3. Explain why no rate change is necessary.
4. Take no further action other than filing the one-time report.

### **MLPs don't necessarily have to eliminate the ITA in their cost of service rates at this time.**

Even though FERC decided that MLPs including ITA in their cost of service rates results in a double recovery of tax costs for the MLP pipeline, the final rule doesn't require MLP pipelines to eliminate ITA at this time. The final rule states that an MLP pipeline choosing option 1 above can either eliminate their income tax allowance and ADIT **OR** continue to receive an income tax allowance at the lower federal tax rate (21%) in their cost-of-service rates. For MLPs choosing the latter, ADIT balances will have to be adjusted to reflect the lowered corporate tax rate. After the initial policy revision, there was concern that the FERC would potentially review negotiated rate agreements. The availability of option 2 effectively addresses this issue and is positive for pipeline MLPs with negotiated rates.

### **A natural gas MLP pipeline with a C-Corp parent is eligible for an ITA.**

A natural gas pipeline company organized as an MLP whose financials are fully consolidated on the federal income tax return of its C-Corp parent is eligible for an ITA. This is positive for companies with C-Corp parents. With this clarification in the final ruling, it will be interesting to see what management teams say on their 2Q earnings calls regarding this topic.

\*ADIT balances result from differences between the calculation of taxable income for the IRS and the method of calculating income for regulatory accounting purposes used to determine pipeline rates. An ADIT liability is created when a pipeline's rate includes more tax than the tax that is actually paid by the pipeline.



**Pipelines owned by MLPs can choose to eliminate ADIT from the pipeline's cost of service if they also choose to eliminate their income tax allowance.**

With the final rule, ADIT is automatically eliminated from an MLP pipeline's cost of service if the pipeline chooses to eliminate its income tax allowance. For some MLPs, there was a concern that ADIT would become a liability that would be amortized over time as a refund payment to customers. By eliminating ADIT, MLPs will not have to provide backpay to their customers — alleviating that potential concern. This clarification may also serve as helpful context for rate settlement negotiations (option 2 above). Going forward, ADIT balances would not accumulate. An ADIT liability decreases rate base, while an ADIT asset increases rates. The removal of an ADIT liability could have positive implications for an MLP's rate base, but it will depend on the specific pipeline.

**Bottom Line**

The final ruling from the FERC is positive for the MLP space as it provides more clarity – addressing several questions that had arisen from the initial policy revision (such as the impact to MLPs with C-Corp parents) and allaying some concerns around how the policy would be implemented. The final ruling is generally more lenient towards MLPs than what was likely feared, alleviating the overhang for certain names as well as the space more broadly. While it will take time for companies to digest the ruling and evaluate their options (which include doing nothing besides filing the one-time report), we would expect more commentary from management teams in the days ahead. It's also important to note that many MLPs did not expect a significant impact from FERC's policy revision announcement in March 15th, and that would likely hold true with today's final rule.

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