

**Date:** March 16, 2018

**To:** PCA Clients

**From:** Pension Consulting Alliance, LLC ("PCA")

**RE: Brief Comment on Federal Energy Regulatory Commission ("FERC") March 15, 2018 Ruling on Tax Regulations for Master Limited Partnerships ("MLPs")**

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PCA believes that yesterday's ruling by the FERC on MLP's treatment of income tax will only affect the businesses of select MLPs. The FERC's announcement sparked a 4.6% widespread sell-off of MLPs yesterday; however, the sector rebounded today. In our opinion, the sell-off was overdone and included many MLPs whose businesses are unlikely to be directly affected by the FERC ruling.

## Background

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On March 15, 2018, the FERC announced:

- 1) it would no longer allow MLPs to recover income tax expense in their regulated pipeline tariffs. This ruling is a negative for midstream MLPs that have a high proportion of FERC-regulated interstate pipelines; and
- 2) a Notice of Proposed Rule-making ("NOPR") related to the impact of the Tax Cuts and Jobs Act on FERC-regulated natural gas and oil pipelines. The FERC is allowing companies and industry associations to provide feedback on the proposed changes, which could potentially also impact C-Corps.

The FERC announcements only impact FERC-regulated interstate natural gas and oil pipelines and specifically those assets where a cost-of-service method is used to set revenues. They do not affect revenues that are based on either a negotiated rate method, or a market-based method. The cost of service is the revenue a regulated pipeline must collect from customers to recover its costs to operate, which include operating and maintenance expenses, general and administrative expenses, and depreciation and income tax (the income tax allowance). Based on the FERC rule change, income tax allowances are not allowed in cost of service calculations. For C-Corps, the income tax allowance will be recovered at a lower rate (21% vs. 35%).

The FERC announcement is in response to the July 2016 U.S. Court of Appeals for the District of Columbia Circuit decision in *United Airlines vs. FERC* remanding FERC to demonstrate that there is no "double recovery" of income tax costs. As part of the case, the plaintiffs (including United Airlines, Delta Airlines, Southwest Airlines, U.S. Airways, BP West Coast Products, Chevron, ExxonMobil, Valero, and Tesoro) challenged the FERC's prior methodology, which they argued permitted MLPs to "double-recover" their taxes given that it included both (1) a sufficient after-tax rate of return, and (2) a tax allowance policy. Yesterday, the FERC announced that it will no longer allow the tax allowance policy.

## NOTES AND DISCLOSURES

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