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Accounting

Pipelines Might Face New Burdens From Easement Rule Proposal

Pipeline companies might have major paperwork headaches if proposed changes to accounting for land easements go through.

The changes, recently proposed by the Financial Accounting Standards Board, will require all new or modified land easements to be assessed under new leases rules, ASC 842, upon their adoption to see if they are or contain a lease.

Energy, utility, oil & gas, railroad, and telecommunications companies—or any entity with land easements—would face significant burdens to identify, independently account for and value their right of way easements upon adoption of the leases rules, practitioners told Bloomberg BNA.

The leasing rules take effect 2019 for public companies, but it can also be early adopted this year or in 2018. If approved, the easement changes would take effect on the same dates as the leasing rules.

''What we typically see with pipeline companies, as well as electric utilities, is they use a series of contiguous easements—there could be thousands of land owners that give you the right to cross over their land,'' James Barker, partner at Deloitte & Touche LLP, said. ''Going forward, every one of those individual arrangements technically has to be assessed under this new standard. It's pretty major.''

Land easements are transactions whereby a company gets the right to access, cross, or use someone else's land for a specified purpose. Terms of easements can vary, and they drive the accounting differences that exist today—some require prepayment, some payments over time. Others have stated terms, or are perpetual.

Many of the land easements are identical to one another so the new accounting exercise mightn't be as frightening, Barker said. Still, the proposed changes have the potential to require more easements to be accounted for as leases going forward.

Ballooning Balance Sheets Companies that pay for their easements over time could therefore see their balance sheet figures balloon from additional debt and additional assets that weren't previously reflected on their financial statements. The debts and assets have to be recorded if the companies' easements qualify as leases going forward, practitioners said.

Under this rule, ''worse case, it could affect their debt covenant compliance if they have additional liabilities going on their balance sheet,'' Barker, said. ''Companies need to make sure when they put new lease liabilities on their books—not just for easements but all leases—so they don't have a problem with their existing debt covenants.''

Companies currently embroiled in trying to pin down easements likely would be affected if those contracts aren't completed before they adopt the new leasing rules. The guidance is effective in 2019 but can be early-adopted this year.

PennEast Pipeline Company LLC, which was put together by a consortium of six energy companies; Dominion Energy Inc.'s Atlantic Coast Pipeline; EQT Midstream Partners LLP, Consolidated Edison Inc. and other group's joint venture named Mountain Valley Pipeline; or, any company with land easements, but are still negotiating them, would all find the rules highly relevant.

PennEast, for example would run a 36-inch pipeline from Dallas, Luzerne County, to Pennington, Mercer County, New Jersey—a distance of approximately 115 miles. But most of the homeowners along its proposed route have put up significant resistance.

''More than 60 percent of homeowners along the route have told PennEast that 'we will not give you an easement on our farm, we don't need this harmful pipeline, and we're not going to voluntarily give up our land,' '' Jennifer Danis, a senior staff attorney at Eastern Environmental Law Center, told Bloomberg BNA. ''Homeowners along the troubled Atlantic Coast Pipeline and Mountain Valley Pipeline could also potentially face condemnations.''

The accounting changes would affect each company differently, depending on the accounting they follow today. Some have reported land easements as an intangible asset, some as leases. Others either capitalize the cost as part of property, plant and equipment (PP&E), or expense them as executory contracts.

TransCanada Weighing Rules Already one major pipeline operator has taken note of the proposal. Energy infrastructure company TransCanada, which operates the Keystone Pipeline, told Bloomberg BNA it's weighing the rules for impacts.

''TransCanada is aware of the proposed update regarding land easements, however, we have not completed our analysis of what, if any, impact this would have to TransCanada's business,'' TransCanada's vice president and controller Glenn Menuz told Bloomberg BNA in an email. ''We will review this proposal, as well as a final standard if implemented, for impacts on TransCanada's business as we complete our analysis on the Lease standard effective 2019.''

Earlier this year TransCanada received approval for a U.S. presidential permit, the company said, to build The Keystone XL, a proposed 36-inch-diameter crude oil pipeline that runs from Hardisty, Alberta, to Steele City in Nebraska.

''Ninety percent of its agreements with landowners are signed,'' a company spokesman told Bloomberg BNA. ''There are approximately 90 or so remaining easements in Nebraska that we have yet to come to agreements on,'' he said.

Existing Arrangements Unaffected The rule changes don't apply to current or old land easements, and therefore much of its impact would be muted, practitioners said. Still, it could be a significant change in a company's accounting practice to have to define and value those easements on an individual basis.

''Even though pipeline companies may not have to go back and redo their accounting on existing right of way easements, under this new [leases] definition we're talking about any and all easements that are secured from landowners from 2019 forward,'' James Bradbury, a natural resources and business lawyer in Fort Worth, Texas, told Bloomberg BNA.

''We have built a lot of pipeline infrastructure throughout the nation in the past few years but we have many more pipelines that have yet to be built, so going forward those rules would be applicable to a lot of individual landowner easements,'' he said.

The issue was brought to FASB when accountants began evaluating the new leases rules, ASC 842. As companies started evaluating their contracts, questions arose about whether land easements must be evaluated under the new leases model.

What makes the rules palatable is the practical expedient—type of exception—FASB included in the proposed changes, practitioners said. If a company has been accounting for its easements as something other than leases, then it can continue to do so for those that currently exist.

This exception would ease adoption issues. Moreover, much of the easements won't meet the definition of a lease because companies wouldn't get to lease accounting if the landowner continues to use the land.

An example would be a case where an electric utility runs lines across a farmer's field and the farmer still uses the field to plant crops or graze cattle. ''The utility doesn't control that land but they're using it to run their wires over, so that's an example of what we call shared use,'' Barker said. ''In those shared use scenarios you would not expect to have a lease because the customer does not have exclusive use of the property.''

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