Inquiry Regarding the Commission’s Policy for Recovery of Income Tax Costs)
Docket No. PL17-1-000

REQUEST FOR REHEARING
OR, ALTERNATIVELY, CLARIFICATION
OF THE ASSOCIATION OF OIL PIPE LINES


AOPL urges the Commission to grant rehearing and reverse its decision to deny an income tax allowance to pipelines organized as MLPs. The Supreme Court has made clear that the Commission must implement its ratemaking authority over regulated

\(^1\) AOPL is a nonprofit trade association that represents the interests of oil pipelines regulated by the Commission. AOPL members transport approximately 96 percent of the crude oil and refined petroleum products shipped through pipelines in the United States.
entities “to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.” *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope*). The Revised Policy Statement does not satisfy this standard. Prior to the issuance of the Revised Policy Statement, AOPL and others demonstrated to the Commission that eliminating the income tax allowance for MLP pipelines would cause immediate financial harm to MLP pipelines in contravention of the Commission’s obligations under *Hope*. The Commission’s response was: “This is not the case.” Revised Policy Statement at P 44. Unfortunately, the aftermath of the Revised Policy Statement has shown the Commission was incorrect.

There is no longer any need to speculate about the effect of the Commission’s decision. The market has answered the question: MLPs have lost over $30 billion in market capitalization since the Revised Policy Statement was issued, and financial analysts predict further financial harm to MLP pipelines. Wells Fargo Equity Research reported on March 24, 2018, that “The FERC ruling causes MLPs typically thought of as safest and lowest risk . . . to suddenly seem entirely otherwise. You could make the argument that the FERC ruling is almost equivalent to Congress disqualifying a majority of pipelines as qualifying income under the tax code.”

The Commission must act promptly to reverse the Revised Policy Statement in order to mitigate the damage to MLP pipeline finances and restore market confidence in the industry. Failure to act will continue harm to the financial stability of FERC regulated pipelines and destabilize a critical aspect of the energy value chain that is vital to the success of the domestic oil and gas industry.
To the extent the Commission does not grant rehearing, AOPL requests the Commission to clarify that the Revised Policy Statement is not a final rule, and may be challenged to the extent it is applied in individual pipeline proceedings.

I. BACKGROUND

On December 15, 2016, the Commission issued a notice of inquiry in the above docket. *Inquiry Regarding the Commission’s Policy for Recovery of Income Tax Cost,* 157 FERC ¶ 61,210 (2016) (“NOI”). The NOI was issued in response to the decision of the United States Court of Appeals for the District of Columbia Circuit in *United Airlines v. FERC,* 827 F.3d 122 (D.C. Cir. 2016). The petitioners in *United Airlines* argued that the discounted cash flow (“DCF”) rate of return methodology the Commission uses to set cost-of-service rates provides MLP pipeline investors a return on equity sufficient to pay their taxes, and that giving MLP-owned pipelines an income tax allowance in addition to the pre-investor-tax rate of return constitutes “double recovery” of income taxes. The court concluded that the Commission had “not provided sufficient justification for its conclusion 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” and remanded the issue to the Commission for further explanation. *Id.* at 136-37. The NOI sought comments regarding the “concerns presented by *United Airlines*” with respect to any potential double-recovery of income tax costs as well as “the practical application” of any proposals made by commenters. NOI at PP 18, 20.

Numerous parties filed comments urging the Commission to maintain its current income tax allowance and rate of return policies, including AOPL, the Interstate Natural
Gas Association of America ("INGAA"), the Edison Electric Institute, the American Gas Association, and the Master Limited Partnership Association, as well as various individual oil pipeline owners and other regulated entities.

AOPL’s comments explained that the Commission’s established income tax allowance policy is consistent with legal precedent regarding the recovery of income tax costs and was upheld by the D.C. Circuit. *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007) ("ExxonMobil"). As AOPL discussed, the Commission’s longstanding income tax allowance policy appropriately recognized that income taxes are a cost of operating a pipeline that regulated entities are entitled to recover regardless of whether they are structured as a corporation or a partnership. AOPL further explained that the Commission’s rate of return policy is reasonable both on its own and in conjunction with the income tax allowance policy, and does not result in any impermissible “double-recovery” of income taxes for MLP pipelines. On the contrary, empirical data included in the record comparing the market-based returns of comparable natural gas pipelines owned by both MLPs and corporations showed that the market-based returns observed for MLP pipelines are not systematically higher than those for corporate pipelines.

The Revised Policy Statement rejected AOPL’s arguments and concluded that MLP pipelines are not entitled to an income tax allowance. The Revised Policy Statement lacks merit and should be reversed for the reasons discussed below.
II. STATEMENT OF ISSUES AND SPECIFICATION OF ERRORS

The following Specification of Errors and Statement of Issues are provided pursuant to Rule 713(c)(1) and Rule 713(c)(2).

1. **The Commission erred in failing to demonstrate how the Revised Policy Statement complies with Hope’s requirement to ensure that regulated entities earn returns sufficient to maintain their credit and attract capital.** The returns for regulated entities must “be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.” *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); see also *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 693 (1923). Here, the Commission erred by ignoring the evidence presented by AOPL and other commenters that abandoning the Commission’s current policies could have significant adverse effects on the financial integrity of MLP pipelines. FERC’s action fails to meet the requirements of reasoned decisionmaking because it fails “to consider an important aspect of the problem” and “runs counter to the evidence.” *Motor Vehicle Mfrs. Ass’n*, 463 U.S. at 43. If FERC were to ignore the recent market response to its ruling, that would further fall short of reasoned decisionmaking. Where a party “‘offer[s] evidence that is new in relation to what [wa]s before the Commission in its earlier determinations and sufficiently compelling to require reconsideration of the earlier resolution,’” FERC’s “‘failure to respond meaningfully to the evidence renders its decision[] arbitrary and capricious.’” *Petro Star Inc. v. FERC*, 835 F.3d 97, 102 (D.C. Cir. 2016) (citing *Tesoro Alaska Petroleum Co. v. FERC*, 234 F.3d 1286, 1288, 1294 (D.C. Cir. 2000)).

2. **The Commission erred by failing to engage in reasoned decisionmaking by adopting the United Airlines court’s double recovery theory without conducting an independent review of the relevant issues.** A judicial decision cannot replace an administrative judgment that “the agency alone is authorized to make.” *Securities and Exchange Comm’n v. Chenery Corp.*, 318 U.S. 80, 88 (1943) (*Chenery I*). Where agency action is remanded for lack of adequate explanation, the agency has a duty to “deal with the problem afresh.” *SEC v. Chenery Corp.*, 332 U.S. 194, 200-201 (1947) (*Chenery II*). The agency must also “examine the relevant data and articulate a satisfactory explanation for its action, including a ‘rational connection between the facts found and the choice made.’” *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S.
29, 43 (1983) (quoting Burlington Truck Lines, Inc. v. U.S., 371 U.S. 156, 158 (1962)). Here, FERC failed to engage in a fresh look at the problem or provide a reasoned basis for its decision, but instead simply adopted as fact the theoretical question posed by United Airlines.

3. **The Commission erred in failing to grapple with the empirical evidence that the Commission’s prior policies did not result in “double recovery” of income tax costs for MLP pipelines.** The record evidence in this proceeding demonstrates that a review of historical DCF returns for various corporate and MLP pipelines does not show MLP returns to be systematically higher than the returns investors demand from corporations over time. The assumption underlying the “double recovery” theory that the DCF methodology produces higher returns for MLP pipelines than corporate pipelines is therefore not supported by empirical data. FERC’s decision “runs counter to the evidence” and thus lacks a reasoned basis. *Motor Vehicle Mfrs. Ass’n*, 463 U.S. at 43.

4. **The Commission erred in failing to adequately explain its departure from the important policy goals underpinning its prior income tax allowance methodology.** The Commission’s prior income tax allowance policy was intended to serve important goals such as (1) ensuring comparability in rates between MLP pipelines and corporate pipelines, and (2) encouraging investment in pipeline infrastructure through the use of the MLP organizational form. “[W]here an agency departs from established precedent without a reasoned explanation, its decision will be vacated as arbitrary and capricious.” *ANR Pipeline Co. v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995). “An agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.” *Greater Boston Television Corp. v. F.C.C.*, 444 F.2d 841, 852 (D.C. Cir. 1970). The Commission is also “obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress.” *Permian Basin Area Rate Cases*, 390 U.S. 747, 791 (1968). Here, the Commission abdicated its responsibility by failing to adequately explain its rejection of the important policy reasons underlying its prior policy of permitting an income tax allowance for both corporation-owned and MLP-owned pipelines.
III. REQUEST FOR REHEARING

A. The Commission Erred in Failing to Demonstrate How the Revised Policy Statement Complies with Hope’s Requirement to Ensure that Regulated Entities Earn Returns Sufficient to Maintain Their Credit and Attract Capital.

The Supreme Court has made clear that the returns for regulated entities must “be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.” Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944); see also Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679, 693 (1923). The Commission therefore has the obligation to ensure that any policy it adopts regarding the income tax allowance and ROE for MLP pipelines does not impair their ability to obtain financing and raise capital. Here, the Commission erred by ignoring the evidence presented by AOPL and other commenters that abandoning the Commission’s current policies could have significant adverse effects on the financial integrity of MLP pipelines.

As AOPL’s witness Dr. John Graham explained, if the income tax allowance were removed, either directly or through an adjustment in the ROE, the result was likely to be an immediate drop in the price for MLP units. Graham Decl. at 11. Dr. Graham based his conclusion both on economic theory as well as empirical evidence, citing the dramatic drop in MLP unit prices in 1995 when the Commission issued its Lakehead decision, which held that MLP pipelines would no longer be allowed an income tax allowance on income attributable to the partnership interests held by individuals. Id. at 12. In addition,
as Dr. Graham explained, if the tax allowance were removed, “the financial condition of MLP pipelines could become more tenuous.” Graham Decl. at 13.

As Dr. Graham explained, removing the income tax allowance for MLP pipelines would also put them at a permanent competitive disadvantage against corporate pipelines, because the cost-of-service tariff rates that MLP pipelines would be permitted to charge would be capped at levels materially below those of corporate pipelines for the same services. See Graham Decl. at 13. That could “make it more difficult for MLP pipelines to compete for capital against corporation-owned pipelines, since lenders might view an MLP pipeline as less creditworthy and equity investors might view the MLP pipeline as a less attractive investment.” Id.

The response of the Revised Policy Statement to the evidence presented by AOPL (and similar comments by INGAA and other parties) is entirely inadequate and fails to meet the minimum requirements of reasoned decisionmaking. The following is the Commission’s complete discussion of the issue:

Pipelines claim that removal of the income tax allowance for MLPs will deny pipelines adequate recovery under Hope and deter investment. This is not the case. Notwithstanding the absence of an income tax allowance, MLP pipelines will continue to recover their costs and a reasonable return for investors. United Airlines … merely [denies] MLP pipelines the double recovery of their income tax costs.

Revised Policy Statement at P 44. In other words, the Revised Policy Statement simply denies that there will be a negative effect on MLP pipelines’ ability to raise capital, without citation to any proof or consideration of the actual evidence in the record.

FERC’s action therefore fails to meet the basic requirements of reasoned decisionmaking
because it fails “to consider an important aspect of the problem” and “runs counter to the evidence.” *Motor Vehicle Mfrs. Ass’n*, 463 U.S. at 43.

In fact, recent events have borne out AOPL’s warnings. Immediately following the issuance of the Revised Policy Statement, the prices of publicly-traded MLP units dropped dramatically.² Some have estimated that approximately $30 billion of market value has been lost as a direct result of the Revised Policy Statement.³ The collapse of MLP unit prices has shaken market confidence in the MLP structure, which will inevitably make it more expensive and challenging for MLP pipelines to raise capital. The Commission’s casual disregard for the practical consequences of its policy reversal is contrary to *Hope* and the basic obligation to provide a reasoned decision for agency action.

The Commission should take administrative notice of the recent market turmoil and swiftly reinstate its prior policy in order to restore market confidence in MLP pipelines. Failing to account for market realities would be an abdication of FERC’s responsibility to protect the financial integrity of the entities it regulates and would fail to meet the requirements of reasoned decisionmaking. Where a party “offer[s] evidence

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that is new in relation to what [wa]s before the Commission in its earlier
determinations and sufficiently compelling to require reconsideration of the earlier
resolution,’” FERC’s “‘failure to respond meaningfully to the evidence renders its
decision[] arbitrary and capricious.’” Petro Star Inc. v. FERC, 835 F.3d 97, 102
(D.C. Cir. 2016) (citing Tesoro Alaska Petroleum Co. v. FERC, 234 F.3d 1286,
1288, 1294 (D.C. Cir. 2000)).

B. The Commission Erred by Failing to Engage in Reasoned Decision-

In United Airlines, the D.C. Circuit held that the Commission had not “provided
sufficient justification for its conclusion 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,” and remanded the issue to the Commission for further review and
explanation. 827 F.3d at 136, 137. Instead of engaging in independent review, however,
the Commission simply adopted as a fact “the fundamental premise of United Airlines
that an income tax allowance for MLP pipelines leads to a double-recovery.” Revised
Policy Statement at P 23. But that “premise” was what FERC was required to
“demonstrate” and justify, United Airlines, 827 F.3d at 134, 136, not accept as a given,
especially where, as here, the record evidence demonstrates there is no double recovery.
Indeed, the court made clear that “to the extent FERC has a reasoned basis for granting a
tax allowance to partnership pipelines, it may do so.” Id. at 135.

A judicial decision “cannot be made to do service for an administrative judgment”
that “the agency alone is authorized to make.” Securitites and Exchange Comm’n v. Chenery Corp., 318 U.S. 80, 88 (1943) (Chenery I). Where agency action is remanded for lack of adequate explanation, the agency has the authority and indeed the duty to “deal with the problem afresh” on remand. SEC v. Chenery Corp., 332 U.S. 194, 200-201 (1947) (“Chenery II”). Here, FERC failed to engage in a fresh look at the problem or provide a reasoned basis for its decision. By simply adopting as fact the theoretical question posed by United Airlines, the Revised Policy Statement failed to “appreciat[e] the complexities of the problem,” respect the “statutory policies” at issue, or engage in responsible consideration of the facts, as it was required to do. Chenery II, 332 U.S. at 209. In short, the Revised Policy Statement is not the product of reasoned decisionmaking and must be reversed.


The “double-recovery” theory is based on the assumption that the DCF returns for MLP pipelines are higher than the DCF returns that would be observed for corporations and that when this higher return is combined with the income tax allowance, the MLP pipeline will “double-recover” its income tax costs in its cost-of-service rates. The underlying assumption that the DCF methodology produces higher returns for MLP pipelines than corporate pipelines, however, is not supported by empirical data. FERC’s decision thus “runs counter to the evidence” and lacks a reasoned basis. Motor Vehicle Mfrs. Ass’n, 463 U.S. at 43.
As the record evidence presented by INGAA in this proceeding demonstrates, a review of historical DCF returns for various corporate and MLP natural gas pipelines does not show MLP returns to be systematically higher than the returns investors demand from corporations over time. INGAA’s comments were supported by the testimony of Barry Sullivan, who analyzed whether the Commission’s DCF methodology produces a higher ROE for MLP pipelines than for corporate pipelines. Mr. Sullivan performed three different analyses of DCF returns, each of which showed that the Commission’s established income tax and ROE policies do not produce systematically higher ROEs for MLP pipelines than corporate pipelines.

The Revised Policy Statement disputes the significance of the INGAA studies, claiming they fail to account for differences in risk among the various entities reviewed and were based on a relatively small sample size. Revised Policy Statement at P 33. But the Revised Policy Statement does not fundamentally dispute the accuracy of the INGAA studies. Nor does the Revised Policy Statement grapple with the complete lack of evidence in the record that MLP pipelines have higher DCF returns than corporate owned pipelines, as would be expected if the “double recovery” theory were correct. Indeed, the Commission acknowledges that “[i]t is true that the United Airlines double-recovery theory would predict that, assuming all other factors are exactly equal, investor-level tax differences would create a differential between MLP and corporate pipeline DCF returns.” Revised Policy Statement at P 33.

Ultimately, the Revised Policy Statement dismisses the empirical studies as irrelevant, stating that the “holding in United Airlines would not change [even] if the
pipeline commenters were to conclusively establish that … corporate pipeline DCF returns exceeded MLP pipeline DCF returns.” Revised Policy Statement at P 30. According to the Commission, regardless of the real-world evidence, MLP pipelines must “necessarily” be double-recovering their income tax allowance because of the “basic application of DCF theory and the understanding that investors consider the tax consequences of their investments.” Revised Policy Statement at P 29. Again, the Commission fails to discharge its duty to justify its decision with evidence by simply assuming the answer to the question it was charged with investigating.

The Commission erred in relying solely on theoretical concerns in the absence of any empirical evidence showing that DCF returns for MLP pipelines are systematically higher than those for corporate pipelines, particularly given the drastic consequences to MLP pipeline finances of the remedy adopted by the Commission. The Supreme Court has made clear that in ratemaking, it “is not theory but the impact of the rate order which counts.” Hope, 320 U.S. at 602. In other words, theoretical concerns regarding the pre-tax nature of the MLP return, which are not supported by market reality, should not be a basis for departing from the Commission’s prior policies particularly where there has been no showing of any practical difference in the resulting rates for corporate and MLP pipelines.


The Commission’s prior policy of permitting an income tax allowance for all regulated oil pipelines was the result of careful consideration of the applicable policy
issues. The Revised Policy Statement erred by reversing course without grappling with the important goals that underlay the prior policy, including (1) the Commission’s policy of ensuring comparability in rates between MLP pipelines and corporate pipelines, and (2) Congress’s and the Commission’s goal of encouraging investment in pipeline infrastructure through the use of the MLP organizational form.

“[W]here an agency departs from established precedent without a reasoned explanation, its decision will be vacated as arbitrary and capricious.” *ANR Pipeline Co. v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995). “An agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.” *Greater Boston Television Corp. v. F.C.C.*, 444 F.2d 841, 852 (D.C. Cir. 1970).

In addition to the requirements of reasoned decisionmaking, the Commission has a fundamental obligation to consider how its ratemaking rulings affect important Congressional and Commission policies. As the Supreme Court has explained, the requirements of *Hope* regarding risk-appropriate returns that are sufficient to attract capital are pertinent but “scarcely exhaust the relevant considerations.” *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968). The Commission therefore “cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to
its protection by Congress.” Id. at 791 (emphasis added). Here, the Commission failed to fully address the important policy reasons underlying its prior policy of permitting an income tax allowance for both corporation-owned and MLP-owned pipelines.

The Commission’s previously existing policy of permitting a full income tax allowance for both corporations and partnerships was supported by important policy concerns. See Inquiry Regarding Income Tax Allowances, 111 FERC ¶ 61,139, at P 1 (2005) (“2005 Policy Statement”). For example, the Commission cited the importance of maintaining comparable treatment of MLP pipelines and corporate pipelines with respect to ratemaking and observed the incongruity in denying an income tax allowance to a partnership pipeline when the same assets held by a corporation would be entitled to an income tax allowance. Id. at PP 33-36, 38 & n.33.4

The Commission further explained that the MLP form was important for encouraging investment in energy infrastructure and held that “termination of the allowance would clearly act as a disincentive for the use of the partnership format.” Id. at PP 26, 30, 36. The Commission noted the “substantial amount of existing investment”

4 The 2005 Policy Statement’s decision to permit an income tax allowance for all regulated entities, was consistent with FERC’s approach to setting ROEs for all oil pipelines using the DCF method that determines the appropriate rate of return investors expect based on a proxy group of publicly-traded MLP oil pipelines. Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity, 123 FERC ¶ 61,048, at P 2 (2008) (“ROE Policy Statement”). The Commission concluded that a proxy group of MLP pipelines generated ROEs that were reasonable for all oil pipelines and were unlikely to be significantly different from the returns that corporate pipelines would generate, consistent with FERC’s longstanding presumption that all oil pipelines “fall within a broad range of average risk.” Id. at PP 7, 57-66 and Appendix B.
affected by the income tax allowance policy. *Id.* at P 33 n.30. For example, the record in that proceeding indicated that “75 percent of $14.4 billion in energy infrastructure invested for the years 2001 through 2003 [was] in pass-through entities,” and that the market capitalization of MLP pipelines was approximately $38.5 billion at the time of the policy statement. *Id.* The Commission noted that the use of the MLP form helped to facilitate large infrastructure projects in part because it permits risk sharing among various parties, including municipalities and public power entities that may be prohibited from owning corporate stock, and permits “greater flexibility in making contributions in-kind” and distributing earnings. *Id.* at PP 29, 36. The Commission also cited Congress’s intent to encourage investment through the use of the MLP form. *Id.*

On judicial review, the D.C. Circuit upheld the 2005 Policy Statement. The court concluded that the Commission’s “explanation in support of this policy choice is reasonable” and was not inconsistent with *BP West Coast ExxonMobil*, 487 F.3d at 951.

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5 As the record here shows, those numbers have significantly increased. As the Master Limited Partnership Association noted in its comments, MLPs invested approximately $177 billion in capital in energy infrastructure between 2007 and 2016, and are expected to invest another $60 billion through 2020. The market capitalization of MLPs involved in oil and gas pipeline operations was approximately $350 billion as of the end of 2016.

6 The Commission noted that investment by municipalities and other tax exempt entities in MLP pipelines would tend to reduce the costs for ratepayers by lowering the weighted marginal tax rates used to calculate the income tax allowance. 2005 Policy Statement at P 37. The comments of American Transmission Company LLC (“ATC”) in this proceeding further discussed how the partnership-type model permits investment by tax exempt entities and other benefits of this organizational form. ATC Comments at 11, 13-17.
In holding that the Commission had “weigh[ed] the relevant policy concerns,” the court specifically relied on the Commission’s findings that termination of the income tax allowance would create a disincentive for regulated entities to use the partnership form and that pipelines “operating as limited partnerships should receive a full income tax allowance in order to maintain parity with pipelines that operate as corporations.” *Id.* at 950, 953.

The Revised Policy Statement fails to give adequate consideration to the policy reasons underlying the 2005 Policy Statement and fails to provide a reasoned basis for departing from them. The decision is therefore arbitrary and capricious and must be reversed.

There can be no dispute that if an MLP pipeline is denied an income tax allowance, it will (all else equal) not be able to justify rates at the same level as a corporate-owned pipeline with comparable operations. Indeed, the Revised Policy Statement appears to acknowledge that it will result in lower tariff rates for MLP pipelines. Revised Policy Statement at P 41. Calculating the income tax allowance and ROE in generally the same way for all pipelines regardless of entity type, by contrast, allows for parity in rates – a goal the 2005 Policy Statement determined was important.

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7 The Revised Policy Statement indicates that by denying MLP pipelines an income tax allowance, it will “enabl[e] MLP-owned pipelines to provide lower tariff rates to shippers.” Revised Policy Statement at P 41. But what the Revised Policy Statement euphemistically refers to as “enabling” lower rates, is in fact the forced reduction of MLP pipeline rates below those of comparable corporation-owned pipelines.
The Revised Policy Statement erred in departing from that prior policy without adequate explanation.

The Revised Policy Statement further fails to explain its departure from the Commission’s longstanding policy to facilitate investment in energy infrastructure consistent with Congressional tax policy. See 2005 Policy Statement at P 1 & P 33 n.30. In 1987, Congress withdrew incentives for most enterprises to be publicly-traded partnerships by taxing them as corporations. Pub. L. 100-203, 101 Stat. 1330-403 (1987) (codified at IRC § 7704). However, Congress permitted certain specific industries, including “pipelines transporting gas, oil, or products thereof,” to use that form and be taxed as partnerships.” IRC § 7704(d)(1)(E). In singling out this narrow category of companies, Congress plainly intended to facilitate investment in those sectors by providing a tax-efficient means to raise capital. See Opinion No. 511, at PP 253-256 (discussing legislative history). The Revised Policy Statement’s denial of an income tax allowance for MLP pipelines reduces the allowable tariff rates for MLP pipelines below those permissible for otherwise identical corporation-owned pipelines, which plainly undercuts Congress’s goal of facilitating investment in oil pipeline and other energy infrastructure by encouraging the use of the MLP form. Opinion No. 511, at P 262; 2005 Policy Statement at P 36.

The Revised Policy Statement states that Congress “did not provide explicit instructions” regarding how to implement the 1987 tax legislation in the ratemaking context. Revised Policy Statement at P 39 & n.72. The Revised Policy Statement relies on BP West Coast, which stated that “[t]he mandate of Congress in the tax amendment
was exhausted when the pipeline limited partnership was exempted from corporate
taxation.” 374 F.3d at 1293. But that holding responded to the argument that the
Congressional mandate required the Commission to permit a full tax allowance. 374
F.3d at 1292 (“no precedent for the proposition that we should compel the Commission
… to adopt a rate structure bringing it into line with the perceived intent of Congress to
achieve objectives in general”). While Congress’s action did not mandate any specific
ratemaking approach, the Commission plainly has the discretion to take Congressional
tax policy into account in setting rates and to structure its ratemaking policies to align
with tax incentives created by Congress. Indeed, the Commission has historically
attempted to accommodate tax benefits conferred by Congress through ratemaking, and
the courts have upheld such decisions as a permissible exercise of the Commission’s
ratemaking expertise. See, e.g., City of Charlottesville, 774 F.2d at 12-07-1216
(upholding Commission’s calculation of pipeline income tax allowance on a “stand-
alone” basis without reducing it to reflect tax savings resulting from use of a consolidated
corporate return); Papago Tribal Utility Authority v. FERC, 776 F.2d 828, 832 (9th Cir.
1985) (holding in the case of investment tax credits that the Commission’s
“normalization” approach is permissible because it “serves the public interest” and
“accommodates the utility’s need for investment capital by permitting the utility to
generate more capital internally”). Moreover, Congress’s policy of encouraging pipeline
infrastructure development has also historically been the Commission’s policy. See 2005
Policy Statement at PP 30, 33, 36. The Revised Policy Statement fails to adequately
explain its departure from that longstanding policy.
IV. REQUEST FOR CLARIFICATION

To the extent it denies rehearing, the Commission should clarify that the Revised Policy Statement is not a Final Rule and does not preclude pipelines from seeking an income tax allowance in individual rate proceedings. Unlike formal rules that have been duly promulgated through the notice and comment procedure of the Administrative Procedure Act, policy statements do not have the force of law. See Pacific Gas & Electric Co. v. FPC, 506 F.2d 33, 38 (D.C. Cir. 1974). “An agency cannot escape its responsibility to present evidence and reasoning supporting its substantive rules by announcing binding precedent in the form of a general statement of policy.” Id. Instead, “[w]hen the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued.” Id.

Given that the Commission has issued a policy statement and not a formal rule, the Commission should clarify that MLP pipelines are not precluded in individual rate proceedings from seeking an income tax allowance and presenting all evidence and arguments in support of an income tax allowance that they may choose to present and that the Commission will consider such arguments based on the record developed in such proceedings.
CONCLUSION

AOPL respectfully requests that the Commission grant rehearing or, alternatively, clarification as set forth above. AOPL urges the Commission to act promptly in order to mitigate the significant negative effects of the Revised Policy Statement on MLP pipelines and their investors.

Respectfully submitted,

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April 16, 2018
CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document on each party designated on the official service list compiled by the Secretary for this proceeding.

Dated at Washington, D.C. this 16th day of April, 2018.

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