UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

REQUEST FOR CLARIFICATION, RECONSIDERATION AND REHEARING OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Pursuant to Rules 212 and 713 of the Federal Energy Regulatory Commission's ("Commission" or "FERC") Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713, the Interstate Natural Gas Association of America ("INGAA") hereby requests clarification, reconsideration and rehearing of the Revised Policy Statement on Treatment of Income Taxes ("RPS") issued in this docket on March 15, 2018.[1] INGAA requests that the Commission grant rehearing or reconsider its conclusion that INGAA and other commenters failed to demonstrate that MLPs will not double recover income taxes if they continue to be provided with a tax allowance. INGAA further requests that the Commission clarify that, in future rate proceedings, an MLP pipeline will be permitted to propose and present evidence of (1) an income tax allowance that reflects the pipeline's individual facts and circumstances and addresses double-recovery concerns, and (2) adjustments to ROE, or other rate adjustments, that reflect the pipeline's individual risk factors.

[1] 162 FERC ¶ 61,227 (2018).

I. BACKGROUND

A. The *United Airlines* Opinion

In *United Airlines,* the U.S. Court of Appeals for the District of Columbia Circuit granted a petition for review of orders issued by FERC concerning the rates of SFPP, L.P.[2] In relevant part, the Court concluded that "FERC has 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."[3] The Court found FERC's explanation of its conclusion of no double recovery deficient based on two related findings: (1) the discounted cash flow ("DCF") method determines the "pre-tax" investor return required to attract investors in both corporations and partnerships; and (2) if MLPs are provided with a tax allowance, MLP investors will receive a higher return than shareholders in a corporation, which would violate the requirement that returns to equity owners should be commensurate with returns on investments in other enterprises having corresponding risks.[4] Consequently, the Court remanded the case to FERC to consider mechanisms for which "the Commission can demonstrate that there is no double recovery."[5]

B. FERC's Notice of Inquiry

In response to the Court remand, the Commission issued a Notice of Inquiry seeking comments on how to address any double recovery that might result from the combination of its current income tax allowance and rate of return policies.[6] The Commission noted that *Hope* requires not only that equity returns be commensurate for investments in enterprises having

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[2] *United Airlines, Inc. v. FERC,* 827 F.3d 122 (D.C. Cir. 2016).
[3] *Id.*
[4] *Id.* at 136*, citing Fed. Power Comm'n v. Hope Nat. Gas Co,* 320 U.S. 591, 603 (1944) ("*Hope").*
[5] *Id.* at 137.
[6] *Inquiry Regarding the Commission's Policy for Recovery of Income Taxes,* 157 FERC ¶ 61,210 (2016) ("NOI").

similar risks, but that the return must be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.[7]

The Commission adopted the Court's finding that it failed to demonstrate that there was no double recovery of taxes if MLPs are allowed a tax allowance. Therefore, it requested comments suggesting methods that do not result in a double recovery but which allow regulated entities to earn a return consistent with *Hope*.[8] The Commission also stated that if a commenter advocated for the elimination of an income tax allowance for partnerships in favor of relying on the return on equity ("ROE") for the recovery of investor-level taxes, it should address whether any changes to the Commission's ROE policies are necessary to ensure that the ROE reflects appropriate tax costs.[9] Commenters were instructed to support their proposals with "data, theoretical analyses, empirical studies, or any other evidence."[10]

C. INGAA's Comments on the NOI

In response to the NOI, INGAA presented empirical studies based on both financial theory and years of data that demonstrate that MLP investors do not receive a double recovery of taxes if the MLP receives a tax allowance in its regulated rates. INGAA presented Dr. Merle Erickson's life-cycle analysis of comparative returns of MLPs and corporations taking into account all taxes paid by both types of entities and their investors, including taxes paid by MLP investors on the sale of their units. This study showed that when all taxes paid by the two organizations and their investors were taken into account, the taxes and after-tax cash-flows of MLPs and corporations do not meaningfully differ. This evidence shows that removing MLP tax allowances is not needed to ensure parity between the returns of MLP unitholders and corporate

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[7] *Id.* at P 8.
[8] *Id.* at P 17.
[9] *Id.* at P 20.
[10] *Id.* at P 19.

investors. Conversely, eliminating MLP tax allowances would destroy the parity sought by the Commission and penalize MLP investors by providing lower returns for commensurate risks.

INGAA also presented several empirical studies performed by economist and former Supervisor of FERC's Office of Administrative Litigation, Barry Sullivan, including a comprehensive study of the returns of 23 MLP and corporate pipelines over a ten-year period. The premise of this study is that if there were a distinct tax included in the returns demanded and received by MLP investors and a lack of parity between the equity returns of the two types of investors, it would be expected that MLP returns would be higher than corporate returns. Mr. Sullivan's comprehensive analysis showed that the returns of MLPs and corporations do not meaningfully differ. Thus, the study demonstrates through empirical evidence that to whatever extent taxes may be theoretically included in MLP investor returns, they do not create any meaningful difference in the returns earned by investors in the two types of organizations.

D. FERC's Revised Policy Statement

In its RPS, the Commission erroneously found that none of the comments undermined the conclusion that a double recovery results from granting an MLP both an income tax allowance and a DCF ROE.[11] With respect to the two studies INGAA submitted to demonstrate there is no double recovery of taxes, FERC found that the studies were irrelevant, were based on subjective assumptions and failed to isolate the impacts of taxes on the relative returns of MLPs and corporations. Consequently, the Commission stated that it "will no longer permit MLPs to recover a tax allowance in their cost of service."[12]

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[11] RPS at P 2.

[12] RPS at P 8. The Commission stated that partnerships that are not MLPs will be addressed in subsequent proceedings. *Id*.

II. SPECIFICATIONS OF ERROR

1. The Commission erred by finding that MLP investors will double recover taxes based on the unsupported theory that taxes are included in the DCF return included in the MLP's rates.

2. The Commission erred by arbitrarily and capriciously rejecting INGAA's life-cycle analysis intended to test the assumption of a lack of parity between equity investors of MLPs and corporations based on the circular reasoning that an income tax allowance for MLP pipelines leads to a double recovery, and that the study is based on subjective assumptions.

3. The Commission erred by arbitrarily and capriciously rejecting INGAA's empirical studies of pipeline returns, including one study of the returns of 23 pipelines over a ten-year period, finding that the comparative level of MLP and corporate returns is not relevant to whether there is a double recovery of taxes, and because the studies fail to isolate the effect of taxation from the other risk and market factors affecting pipeline returns.

4. The Commission erred by summarily rejecting INGAA's arguments concerning a lack of parity and failing to ensure that investors in corporations and MLPs with corresponding risks earn similar returns in violation of *Hope.*

5. The Commission erred by failing to reconcile the elimination of a tax allowance for MLPs with the Commission's previous findings, which were upheld by the D.C. Circuit, that providing MLPs with a tax allowance is necessary to maintain parity between corporations and MLPs.

6. Unless clarified herein and as requested in the Commission's companion NOPR on the implementation tax changes, the Commission erred by enacting a substantive rule in violation of the Administrative Procedure Act ("APA").

7. Absent clarification, the Commission erred by finding that an MLP pipeline is not permitted to include an income tax allowance to the extent it has investors that are corporations and are subject to double taxation.

III. EXECUTIVE SUMMARY

As interpreted in the RPS, the theory of a double recovery of taxes underlying the Commission's removal of a tax allowance for MLP pipelines is not well-founded and is contradicted by the only empirical evidence in the record compiled in this proceeding. Attached to this rehearing request is an Affidavit of Robert B. Hevert, a financial consultant that has testified in numerous FERC and state commission proceedings on financial and regulatory issues. For the reasons explained by Mr. Hevert and discussed further below, the double recovery theory embraced by the Commission is based on several assumptions that do not comport with financial theory and regulatory principles. Rather than restore the required parity in the returns of MLP and corporate investors, the elimination of a tax allowance in the rates of MLPs will result in a lack of parity and increase the risks to investors in MLP pipelines.

The Commission's rejection of the empirical studies submitted by INGAA that disprove the notion that MLP pipeline investors have recovered more tax costs and earned higher returns than corporate investors due to an alleged double recovery of taxes is not well-reasoned. The Commission's dismissal of these studies as irrelevant because they do not cure the double recovery of taxes relies upon circular reasoning. The Commission relied on the validity of the very assumption that these empirical studies are intended to test to find them irrelevant. The Commission's other criticisms of these studies, including that they are based on subjective assumptions and do not isolate the impact of taxes on return, do not withstand scrutiny. To the contrary, the Commission's acknowledgement that risk and other market factors "can subsume

any effects of taxation" on returns further demonstrates the flaw in the theory that the DCF return provided to MLP investors must include the taxes these investors will be required to pay on MLP income.[13]

INGAA requests the Commission, consistent with the legal status of a general statement of policy, to clarify that MLP pipelines will be permitted to propose income tax allowances and any other appropriate rate adjustments, including adjustments to ROE, in their individual rate proceedings, and will be permitted to submit evidence in support of any such proposals. Income tax allowance proposals will specifically address the court's double recovery concerns in *United Airlines*. Rate adjustment proposals could include an upward adjustment in their regulated ROEs in recognition of the higher risks MLPs may face if not permitted, in whole or in part, an income tax allowance. Mr. Hevert explains that the elimination of a tax allowance would have several impacts that result in higher risks for MLP pipelines as compared to corporate pipelines, including (1) investors' views of heightened regulatory risk; (2) the dilution of Earnings Before Interest and Taxes ("EBIT") and Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA"); (3) increased financial leverage and financing requirements; (4) reduced retained earnings and the resultant need to access external capital; (5) the continued reduction in authorized ROEs resulting from the Commission's Two-Stage DCF model (as applied to MLPs); and (6) MLP investors' higher tax rates when compared to corporations.

Elimination of the tax allowance, and associated reduction in cash flow and credit metrics, would constrain MLPs' access to debt and equity markets and inhibit MLPs' ability to attract capital, all of which would be perceived by investors of MLPs as increasing the risks of investing in MLPs.

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[13] *Id.*

Mr. Hevert notes that there are many possible ownership structures underlying MLPs and that the RPS ignores the complexity of these different organizational structures. Because of the differences in the corporate structures of pipelines and the fact that the heightened risks described by Mr. Hevert may have varying impacts on each enterprise, INGAA requests the Commission to clarify that in future rate proceedings an MLP pipeline may propose and present evidence to support (1) an income tax allowance that reflects the pipeline's unique facts and circumstances and which addresses the court's concern in *United Airlines*, and (2) an upward adjustment to ROE or other rate adjustments that are necessary and appropriate to reflect the pipeline's specific risks.[14]

INGAA further seeks clarification that to the extent an MLP or other pass-through pipeline is owned by a corporation(s), the pipeline be given a tax allowance to the extent of such corporate ownership. In this instance, the income generated by the pipeline will be subject to double taxation in the same manner as the income of a corporate pipeline. There is no basis to treat these types of organizations differently.

IV. ARGUMENT

A. The Commission Erred by Simply Accepting the Assumption Underlying the Double Recovery Theory and Rejecting INGAA's Empirical Evidence

In its comments, INGAA showed that the Court's opinion on the double recovery issue did not preclude the Commission from demonstrating on remand that there is no double recovery of taxes if MLPs are granted a tax allowance. The Court did not constrain the options available to the Commission in responding to its remand. INGAA supported this conclusion with the plain

[14] INGAA's request that the Commission recognize the increased risks of eliminating a tax allowance by allowing a pipeline to propose an upward adjustment in the ROE is not intended to be a concession that the removal of a tax allowance is appropriate or lawful, that such ROE adjustment alone is an adequate substitute for a tax allowance, or that any other adjustments may not also be appropriate.

language of the opinion, as well as administrative law principles and judicial precedent establishing that the Commission is not foreclosed on remand from properly supporting an earlier conclusion, *i.e.,* in this case that the inclusion of a tax allowance in an MLP pipeline's rates does not result in a double recovery of income tax costs.[15]

The need for the Commission to re-examine the issue is especially important in the context of establishing an industry-wide policy. As the Commission stated in the NOI:

> The Commission recognizes the potentially significant and widespread effect of this holding upon the oil pipelines, natural gas pipelines, and electric utilities subject to the Commission's regulation. The importance of the income tax policy for partnership entities extends well beyond the particular interests of the parties to the *United Airlines* proceeding. . . . Accordingly, this NOI seeks further information as the Commission re-evaluates its policies following the *United Airlines* decision.[16]

For the purpose of developing a policy statement at this time, the Commission is not limited to the stale record of the remanded SFPP proceeding. In both the NOI and the RPS, the Commission implicitly acknowledged that it is free on remand to support its earlier conclusion that there is no double recovery if it can provide a better explanation to the Court.[17] Despite this acknowledgment, however, the Commission made no attempt to do so in the RPS. Instead of engaging in an analysis of the evidence submitted by INGAA, the Commission simply relied on the theoretical assumption of a double recovery adopted by the Court. The Commission neither

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[15] *See* pages 5-9 of INGAA's Reply Comments and discussion of *SEC v. Chenery Corp.,* 332 U.S. 194 (1947) (On remand, the agency "reexamined the problem, recast its rationale and reached the same result."); *Radio Television S.A. de C.V. v. FCC*, 130 F.3d 1078, 1083 (D.C. Cir. 1997) (upholding agency's order on remand that reverted to a previous interpretation of the relevant statute). *See also Monsanto Co. v. FERC*, 963 F.2d 827 (5th Cir. 1992) (finding that remand order "rehabilitate[d]" previous order with further explanation was no longer arbitrary and capricious").

[16] NOI at P 2.

[17] In both the NOI and RPS, the Commission correctly refused to treat the Court's opinion as a binding holding that there is in fact a double recovery. *See, e.g.,* NOI at P 14 (Court decision based on FERC's failure to demonstrate no double recovery); NOI at P 15 (Commission may consider options for removing *any* duplicative tax recovery); NOI at P 18 (Commission policy of allowing partnerships a tax allowance *may* result in a double recovery); NOI at P 19 (inviting comments to resolve *any* double recovery); RPS at 2 (none of the commenters undermined the conclusion of a double recovery).

analyzed an unsupported theoretical assumption of a double recovery to determine its validity, nor analyzed the evidence submitted by INGAA that showed such assumption to be invalid.

1. <u>The Commission Erred by Finding that MLP Investors Will Double Recover Taxes if MLPs are Given a Tax Allowance.</u>

As stated above, the Court in *United Airlines* based its finding of a double recovery on FERC's failure to disprove the notion that the DCF "pre-tax" investor return does not already include the taxes that MLP investors must pay on the income attributed to them. The Court's use of the terms "pre-tax" return and "investors' DCF return", however, are imprecise which has led to confusion as to the basis of the Court's concern about a double recovery. Based on the Commission's discussion in the RPS, it is now clear how the Commission is interpreting the Court's decision. The Commission's interpretation of *United Airlines* does not comport with fundamental ratemaking principles and financial theory. The Commission should take the opportunity afforded by the Court to better explain the basis for its earlier conclusion that there is no double recovery of income taxes if an MLP is provided with a tax allowance.

In the RPS, the Commission interprets the Court's finding to be that the "ROE determined by the Commission's DCF methodology" already includes an income tax allowance."[18] Partially quoting from *United Airlines,* the Commission states in the RPS that "the [DCF ROE] determines the *pre-tax* investor return" that already reflects cash flow for both the (a) investor's tax costs and (b) the investor's post-tax return.[19]

The question raised by these statements is how are the taxes that an MLP investor must pay included in the MLP's DCF return? It cannot be disputed that the ROE established by the DCF method is comprised of a dividend yield and growth rate, and there is no separate tax component in that formula. Moreover, the ROE derived from the DCF model is not the return

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[18] RPS at P 6.

[19] *Id*. at P 21, *citing United Airlines,* 827 F.3d at 136.

actually *demanded by the investors in the MLP whose rates are being established* as the Commission seems to accept.[20] Rather, the DCF ROE is merely an estimate of investors' required return that is used to calculate a component of the pipeline's cost of service.

How then are investor taxes included in the DCF return? This conclusion has never been clearly articulated by either the Court in the *United Airlines* opinion, or by the Commission in the RPS. Indeed, taxes are a separately stated item in each pipeline's rate case cost of service.[21] Because taxes are not literally included in the calculation of an ROE under the DCF method, the theory must be that such taxes are *assumed* to be reflected in the corporate share or MLP unit prices that are factored into the dividend/distribution yield component of the DCF formula. If that is the theory, the "investors" that are theoretically demanding a return that includes taxes are the investors in the proxy group companies used in the DCF methodology, not the investors in the pipeline whose rates are being established.

There are several flaws in this theory. The first flaw is the assertion that investors in MLPs consider taxes when deciding the return they seek on their investment, and therefore the taxes on the MLP income that will be attributed to them *must* be included in that return.[22] The assumption underlying the double recovery theory can be broken down into two sub-parts: (1) an investor in an MLP will demand a return high enough to meet his/her investment objectives and to cover the taxes he/she will have to pay on the MLP income attributed to him/her; and (2) these

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[20] *See, e.g.,* RPS at P 16 ("the D.C. Circuit explained that the pre-investor DCF return must be sufficient to recover an MLP investor's tax costs in order to attract capital."); RPS at PP 17-18 (discussing the return MLP investors will demand); RPS at P 21 ("the [DCF ROE] determines the *pre-tax* investor return.").

[21] 18 C.F.R. § 154.312(m).

[22] The Court and the Commission also rely on the finding that because MLP investors collect a tax allowance twice, there is a lack of parity between the returns provided to corporation versus MLP investors. *See United Airlines* at 136 ("These facts support the conclusion that granting a tax allowance to partnership pipelines results in inequitable returns for partners in those pipelines as compared to shareholders in corporate pipelines.") and at 137 ("if FERC elects to impute partner taxes to the partnership pipeline entity, it must still ensure parity between equity owners in partnership and corporate pipelines."). In other words, the lack of parity is based on the same assumed double recovery of taxes.

taxes are in fact included in these returns. These assumptions, however, are not supported with any evidence and are pure supposition. There is no empirical or even anecdotal evidence in this record of the extent to which, if any, investors actually consider taxes in reaching a decision to invest in a pipeline, or of the return any particular investor in any pipeline actually requires. The price of a corporate share or MLP unit reflects a myriad of factors that affect investors' individual perceptions of risk and required return, including many that are not based on any objective criteria. Hevert Affidavit at PP 3-4. The DCF model is a theoretical method of estimating how perfectly rational investors with perfect information would price a particular security. There is no evidence that the model precisely mimics actual investors' decisions so that the Commission simply assumes—as it does in the RPS—that the return it derives from DCF calculations is sufficient to duplicate in its entirety an MLP pipeline's income tax allowance.

Indeed, as part of its criticism of INGAA's empirical studies discussed below, the Commission relies on the fact that there are a number of risk and market factors that determine pipeline returns.[23] The Commission goes as far as stating that these factors "can subsume any effects of taxation" on returns.[24] This acknowledgment illustrates the fallacy of the assumption underlying the double recovery theory. That is, there is no basis to assume that an MLP investor demands a return that includes the taxes on the income attributed to him/her by the MLP in light of the myriad of factors that the Commission concedes affect investor decisions. In fact, this assumption is also belied by the fact that tax rates are subject to change and in fact periodically do change. Thus, an assumption that investors demand that taxes based on current tax rates be included in the return they receive cannot be correct.

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[23] RPS at P 33.
[24] *Id.*

Even assuming, *arguendo,* that taxes on corporate dividends and/or allocated partnership income may to some undefined extent be among the many factors that an investor considers in determining the price it is willing to pay for a stock or MLP unit, that assumption does not and cannot establish that taxes on MLP income are in fact included in the return that investors anticipate, much less receive, when they decide how much to pay for the investment. The Commission's leap of logic from the fact that taxes may be a consideration in determining the price an investor is willing to pay for an MLP unit to a conclusion that these taxes are in fact included in the return to the MLP unit holder is unsupported and not well-reasoned. There simply is no basis in the record before the Commission to support its implicit assumption of a one-for-one relationship between the amount of taxes that an MLP unit holder is required to pay on the MLP's income and any theoretical amount of taxes that is assumed to be in the return that the MLP investor seeks when it purchases a unit.

Second, the fallacy of the assumption underlying the double recovery theory is also demonstrated by the fact that different investors have different tax rates, and indeed some investors do not pay any taxes. At current tax rates, individuals pay anywhere up to 37% depending on their marginal tax bracket, corporations pay 21%, and pension funds and other types of institutional investors, for example, do not pay any tax. Therefore, any theory that investors demand and receive taxes in the income they derive from the investment necessarily suggests that investors in each tax classification demand and receive a different rate of return. But that is not how the price of MLP units or corporate shares is determined. Prices are determined by the market, and each share or unit is available at any given time at the same market price regardless of its tax liability on the income generated by that investment. As found

by Mr. Hevert, the assumption that the DCF-based ROE necessarily includes a measure of expected taxes for all investors, at all times, cannot be corroborated. Hevert Affidavit at P 4.

Third, the theory that investors demand and receive taxes in the return they demand becomes even more tenuous when the investors in question are not the investors in the entity whose rates are being set, but investors in the proxy group companies that are used to calculate a return pursuant to the DCF formula. As discussed above, if the assumption is that the "DCF return" includes these taxes, the theory assumes that investors in the proxy companies demand and receive taxes at the same level as the investors in the MLP whose rates are being determined. Because those investors are assumed to receive those taxes in the DCF return, they do not need a tax allowance. The disconnect between (1) a theoretical level of taxes that investors in a proxy group demand and receive in their return and (2) the taxes that investors in the enterprise whose rates are being set will have to pay is apparent. Even if the DCF formula were to theoretically include some amorphous amount of taxes demanded by a disparate group of investors in several proxy group companies, there is no basis for assuming that the amount of purportedly included taxes are representative of the taxes that are payable by the investors of the MLP whose rates are being established.[25]

As the agency with expertise in pipeline ratemaking, it is incumbent on the Commission to engage in a critical analysis of the facts and better explain to the Court the basis for its conclusions. The Court relies and in fact generally defers to the Commission due to its expertise on ratemaking matters.[26] The Commission should provide its best analysis of the ratemaking and

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[25] The DCF return at issue in *SFPP* and *United Airlines* was based on a proxy group comprised entirely of MLPs. Any theoretical inclusion of taxes in the DCF return approved for SFPP would be based on assumed investor expectations of investors in those proxy group companies. A finding of a double recovery of taxes cannot simply be assumed in all cases and for all proxy companies.

[26] *See ExxonMobil Oil Corp. v. FERC,* 487 F.3d 945, 951 (D.C. Cir 2007); *Missouri Public Service Comm'n v. FERC,* 215 F.3d 1, 3 (D.C. Cir. 2000).

financial concepts in question, as well as the empirical evidence, and ensure that ratemaking principles are applied properly to produce rates that are just and reasonable and include commensurate returns for companies with commensurate risks as required by *Hope.*

2. The Commission Erred by Rejecting the Empirical Evidence Demonstrating that the Assumptions Underlying the Double Recovery Theory are Invalid.

In response to the Commission's request in the NOI for empirical studies, evidence and data, INGAA submitted two studies that demonstrate that there is no double recovery of taxes if MLPs are provided a tax allowance. These studies demonstrate that (1) the assumptions underlying the double recovery theory are simply not supported by the evidence and (2) MLPs must be provided with a tax allowance to ensure parity between equity owners in the two types of organizational forms as required by *Hope*, and acknowledged in *United Airlines*.[27] The Commission's rejection of this empirical evidence primarily because it conflicted with the assumptions underlying the double recovery theory is circular and not based on reasoned decision-making.

a. The Commission Erred by Rejecting Dr. Erickson's Life-Cycle Analysis.

Dr. Erickson's study shows that when measured over time, the total taxes paid by unitholders of MLP-owned pipelines are comparable to the total taxes paid by corporations and their investors. This "life-cycle" analysis demonstrated that when viewed over a five-year time period, after-tax cash flows to MLP and corporate investors are very similar. Dr. Erickson's study demonstrates that any theoretical analysis that focuses on just a portion of the taxes paid by the two types of investors does not accurately capture and compare after-tax returns. Specifically, by failing to account for the deferred taxes that an MLP investor will pay on distributions at the time of sale, the theoretical finding of a lack of parity based on a double

[27] 827 F.3d at 137.

recovery of taxes is flawed. Moreover, if MLP investors were receiving a double recovery of taxes, their after-tax cash flow would logically be expected to be higher than that of corporate investors.

In the RPS, FERC rejected Dr. Erickson's analysis for two reasons, neither of which stand up to scrutiny. In paragraph 23, the Commission states that:

> Erickson's life-cycle model does not undermine the fundamental premise of *United Airlines* that an income analysis for MLP pipelines leads to a double recovery. Whether or not the overall MLP and corporate tax burdens are equivalent or different, if the investor tax costs are incorporated into the DCF returns, then the income tax allowance for MLP pipelines leads to a double recovery.

This conclusion is circular. The notion that investor tax costs are incorporated into the DCF return is an *assumption.* If it is *assumed* MLP investors demand and receive a return that includes its tax costs, then there is a double recovery. Moreover, if it is *assumed* that MLP investors double recover taxes, it can be further assumed there is a lack of parity between the two types of investors. In other words, the Commission rejects Dr. Erickson's study by simply relying on the validity of the assumption that the study is intended to test and refute.

The Commission's finding that it does not matter "whether or not the overall MLP and corporate tax burdens are equivalent or different" cannot be squared with the very premise of the theory underlying the double recovery of taxes. The Court's concern with a lack of parity between the two types of investors is based on the notion that "the overall MLP and corporate tax burdens" are different. That is, the finding of a double recovery is based on the fact that an MLP investor pays taxes only on the income attributed to it, while the corporate investor pays taxes on both the pipeline income and dividends. A lack of parity between the two types of investors that was an essential element of the Court's finding.[28] Rather than being irrelevant, the

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[28] *Id*. at 136.

level of taxes paid by the two types of investors is at the very core of the Court's theoretical finding. Importantly, in the RPS, the Commission has not challenged a major premise of Dr. Erickson's life-cycle analysis. That is, to determine whether the returns of MLP and corporate investors are not in parity due to differences in tax liabilities, all tax liabilities of each type of investor must be considered. When so considered, there is no lack of parity between corporate investors and MLP investors when a tax allowance is provided to MLP pipelines.

The second reason offered by FERC for rejecting Dr. Erickson's analysis is that the analysis is based on subjective assumptions. In paragraph 24, the Commission states as follows:

> Erickson's life-cycle model does not necessarily establish that overall MLP tax levels are actually comparable to corporate tax levels or that an income tax allowance equalizes returns. Like similar hypothetical models, the results of Erickson's proposal rely upon subjective assumptions.

FERC then cites to other parties' arguments that the results of Erickson's model would change if his assumptions were changed in certain ways.

The criticism that Dr. Ericskon's study is based on subjective assumptions is not well-founded. All analytical models are based on assumptions and the results of all such models will change if the assumptions of the models change. And while the Commission recites some assumptions that other parties suggest changing, the Commission does not conclude that Dr. Erickson's assumptions are unreasonable, nor does the Commission discuss whether the changes in the model's assumptions proposed by these other parties are necessary to render the study reliable. The simple fact that Dr. Erickson uses assumptions and other parties suggest changes in these assumptions, even if such alternative assumptions might also be deemed reasonable, is not meaningful. Unless the assumptions underlying Dr. Erickson's analysis are shown to unreasonably skew the study's results, the fact that there may be other assumptions that could have also been used does not undermine Dr. Erickson's study.

Although the Commission in the RPS identifies a couple of alternative assumptions proposed by other parties, it did not evaluate them. For instance, the Commission cites to the comments of both Thomas Horst and the Brattle Group who note that Dr. Erickson's study does not take into account the time value of money and a step-up in an MLP's tax basis of depreciable property.[29] Even assuming *arguendo* that these assumptions are valid, they do not materially change the results of Dr. Erickson's study. As noted by Mr. Horst, Dr. Erickson concluded based on his life-cycle analysis that a corporation and its shareholders would pay combined taxes of $326 and MLP unitholders would pay $336. Given the small difference of $10, Dr. Erickson concluded that the total taxes owed by the two organizations were similar. After incorporating his proposed adjustments, Mr. Horst concludes that the MLP unitholders tax would remain at $336 but that the combined taxes of the corporation and its shareholders would increase to $348. The changed assumptions, therefore, have the effect of changing an additional MLP tax of $10 to an additional combined corporation and shareholder tax of $12.[30] In light of this small difference, Dr. Erickson's conclusion that the two types of entities pay a similar level of taxes remains valid even with Mr. Horst's assumptions.

In addition to supporting Dr. Erickson's conclusion that the relative taxes paid by MLPs and corporations are similar, Mr. Horst's results also demonstrate that while there may be more than one reasonable assumption underlying a given study, that fact does not invalidate the results of the study. Neither the Commission nor any commenter in this proceeding challenged the fundamental point of Dr. Erickson's life-cycle analysis, which is that <u>all</u> taxes applicable to MLPs, corporations and their respective investors must be considered to evaluate the parity of returns of the two types of organizations. When that is done, the total taxes, after-tax cash flows

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[29] RPS at P 24.

[30] *See* Table 1 on page 11 of Mr. Horst's Reply Comments.

and returns earned by the two types of investors are similar. A showing that the relative taxes and after-tax cash flows of the two types of investors are similar or comparable is all that is required to provide both organizations a tax allowance.[31]

b. The Commission Erred by Rejecting Mr. Sullivan's Empirical Studies.

INGAA presented several studies prepared by Barry Sullivan that demonstrate that over long periods of time the returns earned by MLP pipelines are not consistently higher than the returns of corporate pipelines with comparable risk. Mr. Sullivan examined the returns of several groups of pipelines. First, he updated the 2008 data pertaining to the proxy companies utilized in the underlying *SFPP* proceeding. Second, he compared the rates of return on equity of several pairs of affiliated MLP and corporate pipelines to observe whether there was a difference in the returns generated by the two types of organizations within the same family. Third, Mr. Sullivan compared dividend/distribution yields and IBES growth rates of twenty-three pipelines over a ten-year period. Based on the results of all three studies, Mr. Sullivan concluded that the returns of MLPs and corporations were comparable and that the empirical evidence did not support the double recovery theory.

The Commission's rejection of these studies is also circular and not well-reasoned. Like its response to Dr. Erickson's life-cycle analysis, the Commission essentially found that regardless of the level of returns of MLPs and corporations, the "DCF return" would still, in theory, include investor-level tax costs, and therefore, MLPs would double recover taxes if they were also given a tax allowance.[32] This circular reasoning cannot withstand scrutiny. The purpose of Mr. Sullivan's empirical studies is to test the theoretical assumption of a double

[31] The requirement of comparability recognizes that ratemaking is an art, not a science. *See Cities of Bethany, et al., v. FERC*, 727 F.2d 1131, 1138 (D.C. Cir. 1994); *Alabama Elec. Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

[32] RPS at P 30.

recovery. It is no answer to say the study is irrelevant because regardless of empirical evidence of relative returns, there is still a double recovery. The Commission never explains why, if there is a double recovery of taxes, MLP returns are not uniformly higher when examined over a ten-year period.

The Commission also states that, even if INGAA established that corporate returns exceeded MLP returns, that would "merely demonstrate that MLP investors' tax burden was less than corporate investors' dividend tax burden."[33] This finding is internally inconsistent with other Commission findings in the RPS. First, FERC's tying of return differences directly to tax burden differences contradicts its own findings that there are numerous risk factors that affect return, not just taxes.[34] Second, if the Commission's assumption of a direct nexus between tax burden and return were valid, INGAA's showing that the returns of MLPs and corporations were roughly comparable demonstrates that the tax burdens in the returns are roughly comparable and there is no double recovery or lack of parity.

The other reason offered by the Commission for its rejection of Mr. Sullivan's empirical studies is that they do not control for these numerous risk and market factors and therefore do not isolate the effect of investor-level income taxes on the DCF returns.[35] The Commission states that these differences in risk and other market factors can subsume any effects of taxation on the relative levels of MLP and corporate returns.[36]

The Commission's conclusion does not follow from the recited facts. INGAA agrees that every pipeline, whether an MLP or a corporation, faces different types and levels of risks unique to each company. In the absence of any evidence or showing that either form of organization

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[33] *Id.*
[34] *Id.* at PP 33-35.
[35] *Id.*
[36] *Id.* at P 33.

faces higher or lower systematic risks from factors other than taxes, it is reasonable to assume that the claimed tax differences would result in higher MLP returns in a large sample of 23 pipelines over a large time period of ten years. The retort that there are other risk factors that affect returns does not show that INGAA's studies are flawed. To show that the studies are flawed for this reason, it would need to be proven that one or more of these other risk and market factors systematically affect one type of investor more than the other. In the absence of such a showing, these other factors cannot be assumed to affect the results of these studies.

As discussed above, rather than invalidate Mr. Sullivan's studies, the Commission's acknowledgement that there exist a number of factors other than tax that impact returns demonstrates that there is no one-for-one relationship between the taxes that investors theoretically demand and the taxes that are actually recovered in their return. It is simply impossible to isolate the impact of taxes on investor decisions as to the price they are willing to pay and the return they require. The double recovery theory is based on a tax difference that is *assumed* to exist in the minds of MLP investors that causes them to demand a return that includes the taxes on MLP income. In contrast, INGAA's conclusion that there is no double recovery of taxes is based on empirical evidence that demonstrates that the assumed double recovery is not true.

c. The RPS Fails to Provide Parity in Returns for MLPs and Corporations and Contravenes Commission and Court Precedent.

The Commission relies on the same circular conclusion to reject INGAA's and other commenters' argument that removing a tax allowance from MLP rates would put MLP pipelines at a competitive disadvantage relative to corporate pipelines by *creating* a lack of parity. In paragraph 43, the Commission rejects this argument based on the Court's theoretical finding "that granting MLP pipelines an income tax allowance results in inequitable returns for partners

as compared to corporate stakeholders" because it allows the former to "recover their income tax costs twice", and therefore removal of the tax allowance for MLPs is needed to restore parity. Thus, the Commission's response to INGAA's parity argument suffers from the same circular reasoning that assumes the validity of the very assumption being tested.

Moreover, the Commission's response to the need for parity cannot be reconciled with the Commission's previous findings or the Court's opinion in *ExxonMobil v. FERC* affirming those findings.[37] In *ExxonMobil,* the D.C. Circuit upheld the Commission's former policy of permitting a tax allowance for MLP pipelines, finding that a tax allowance for MLP pipelines is necessary for MLP-owned pipelines "to maintain parity with pipelines that operate as corporations."[38] The D.C. Circuit expressly held in *United Airlines* that it was not overturning *ExxonMobil*.[39] Consequently, *ExxonMobil* remains binding precedent.

To comply with *ExxonMobil*, the Commission must ensure that its tax and return policies maintain the required parity in investor returns. To do so, the Commission must do more than rely upon a theoretical assertion of a double recovery of taxes. It must analyze the empirical evidence submitted by INGAA and adequately explain why the data submitted by INGAA does not reveal systematic differences in the tax liabilities and returns of the two organizational structures that would be expected to be observed if there was in fact a double recovery of taxes in only the returns of MLPs.

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[37] *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007).
[38] *Id.* at 952-53 (internal punctuation omitted).
[39] The court recognized that petitioners had not sought to overturn *ExxonMobil*, which the panel would be "unable to do in any case absent an *en banc* decision from the Court."

B. FERC Should Clarify That, in Future Rate Proceedings, MLP Pipelines Are Allowed to Propose and Provide Evidence Supporting a Tax Allowance, adjustments to ROE, and Other Rate Adjustments.

As noted by Mr. Hevert, and as amply demonstrated in a Request for Clarification of the RPS filed by the Master Limited Partnership Association, there are multiple forms of MLP structures and the Commission's reliance on a single MLP as a basis to revise its prior policy statement and exclude a tax allowance for other MLPs is not reasoned decision-making. Thus, the Commission must clarify that the RPS does not preclude a pipeline from the opportunity in individual rate proceedings to include and justify tax allowances as an element of their cost of service.

Providing this opportunity as a matter of right is required by the Commission's choice of announcing this policy in a policy statement. It is well-established law that a statement of policy does not establish a "binding norm" or a substantive rule that has the force of law.[40] As the D.C. Circuit held:

> A policy statement announces the agency's tentative intentions for the future. When 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. 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.[41]

Consequently, the RPS does not establish precedent and is not binding in future cases in which pipeline rates are established.

Given that the Commission has opted to proceed through a policy statement, and defer judicial review of the policies announced in the RPS until the policies are applied in individual cases, the Commission should clarify that:

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[40] *Pac. Gas & Electric Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974) ("*PG&E")*.

[41] *Id., quoted in Panhandle Eastern Pipeline Co. v. FERC*, 198 F.3d 266, 269 (D.C. Cir. 1999) (emphasis added). *See also SFPP, L.P.,* Opinion No. 511, 134 FERC ¶ 61,121 at P 233 (2011); *Marathon Oil Co. v. Trailblazer Pipeline Co.,* 111 FERC ¶ 61,236 at PP 57-68 (2005).

1. The RPS does not impose legally binding requirements and does not have the force of law. *Nat'l Mining Ass'n v. Mccarthy,* 758 F.3d 243, 251-53 (D.C. Cir. 2014).

2. MLP pipelines are therefore not precluded from seeking a tax allowance and demonstrating why such tax allowance does not result in a double recovery of income taxes;

3. MLP pipelines have the right to provide evidence to be evaluated in rate case hearings explaining why some or all of the income tax liability it generates is not recovered solely through the pre-investor tax DCF return;

4. In proceedings in which MLPs propose a tax allowance, the Commission will not impose any additional burden on pipelines as a result of the RPS; and

5. MLP pipelines are entitled to seek adjustments to their rates that may be appropriate or necessary.

C. The Commission Should Clarify that MLPs Will be Given a Tax Allowance to the Extent They Are Owned by Corporations.

As discussed above, the assumption underlying the double recovery theory is that MLP investors demand a return that includes the tax attributed to them by the MLP. Even assuming, *arguendo,* that some investors in an MLP consider the tax effect of the distributions that the MLP will pay when the investor purchases its units, the Commission has failed to explain how this assumption applies to the corporate unitholder of an MLP or any other or pass-through entity type. The Commission also failed to account for the significantly different interests and objectives of a corporate owner of an MLP or other pass-through entity as compared to an individual investor. If the Commission chooses not to demonstrate the correctness of its previous conclusion that providing MLPs with a tax allowance does not result in a double recovery of taxes, then, at a minimum, the Commission should clarify that the DCF return does not recover the income taxes allocated to corporate unitholders of an MLP or other pass-through entities.[42]

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[42] In *BP West Coast Products LLC v. FERC,* 374 F.3d 1263 (D.C. Cir. 2004), the Court found that the Commission had not supported its then policy of allowing a tax allowance for corporate, but not individual or other, unit holders

According to the theory adopted in the RPS, the double recovery of taxes stems from the fact that the MLP and its investors are paying taxes on income only once, while the corporation and its investors, in combination, are paying taxes on the same income twice. In other words, the purported lack of parity between MLP and corporate investors stems from this double taxation on corporate income.

Assuming, *arguendo,* the validity of these assumptions, they would suggest that an MLP or other pass-through entity should be permitted a tax allowance to the extent it is owned by corporate unitholders. That is because the income attributed by an MLP to corporate investors would ultimately be taxed twice, once at the corporate level, and again as a tax on dividends to the corporate owner's investors. In other words, the tax liability of a corporate pipeline is no different than that of, for instance, a pipeline that is owned by an MLP which in turn is owned by a corporation. In both cases, the income of the pipeline is ultimately taxed to both the corporation and its shareholders. In fact, as further demonstrated below, denying one of these two types of investors an income tax allowance would result in a lack of parity between investors in an MLP pipeline and investors in a corporate pipeline.

The equivalency of tax liability for these two types of organizations could be shown below by the taxes that would be assessed on the income generated by the following three organizational structures:

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of a limited partnership. However, this case is no longer instructive on this point for several reasons. First, the opinion was based, in part, on the notion that the Commission's ruling was based on a "phantom" tax. *Id.* at 1287. This notion was subsequently discredited in *ExxonMobil* based on the Commission's more thorough explanation of why the taxes paid by corporate unit holders are "not 'phantom' and are properly attributed to the regulated entity." 487 F.3d at 954. Second, in its recent opinion in *United Airlines*, the Court disagreed with a major premise of *BP West Coast.* In *BP West Coast,* the Court rejected the double taxation rationale offered by the Commission for distinguishing between corporate and individual unit holders. The Court found that this difference "is a product of the corporate form, not of the regulated or unregulated nature of the pipeline or any comparable investment or the risks involved therein" 374 F.3d at 1291. In *United Airlines,* the Court reached the opposite conclusion finding that MLP investors would earn higher returns than corporate investors due to the double taxation on corporations. If the Commission continues to adopt this double recovery theory, there is no basis for eliminating a tax allowance to the extent MLPs are owned by corporations.

Corporation (Tax on Income)
Shareholder (Tax on Dividends) -- Double Tax

MLP (No Tax)
Individual Investor (Tax on Income) -- Single Tax

MLP (No Tax)
Corporate Investor (Tax on Income)
Shareholder (Tax on Dividends) -- Double Tax

The third organizational structure shown above describes the tax liability when a corporation completes a drop down transaction by transferring an interest in its pipeline assets to an MLP, which has occurred quite frequently in the past several years.[43] The corporation's decision to transfer assets to an MLP is not premised on any sort of pre-tax return calculation like the tax calculation the Commission assumes investors make when choosing to purchase stock in a corporation or units in an MLP. The objective of the corporation in this type of drop down transaction is to create a more efficient investment vehicle for raising capital for new pipeline development, without creating an additional level of taxation. Through the spin-off, the corporation would continue to be responsible for the taxes associated with the income allocated to it by the MLP. Even assuming, *arguendo,* that some investors theoretically demand and receive taxes in the return when determining the price they are willing to pay for an investment, this theoretical assumption cannot rationally be applied to a corporation that drops down an interest in its pipeline assets to an MLP but remains the tax-paying entity.

Application of the policy advanced in the RPS to this hypothetical corporation prior to and after its drop down of an interest in pipeline assets to an MLP illustrates the absurd results

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[43] *See*, *e.g.*, Valero Energy Partners LP's October 26, 2017 acquisition of Parkway Pipeline LLC, from Valero Energy Corp.; Dominion Midstream Partners, LP's December 1, 2016 acquisition of Questar Pipeline, LLC, from Dominion Resources, Inc.; EQT Midstream Partners, LP's October 1, 2016 acquisition of the Allegheny Valley Connector transmission and storage system from EQT Corporation; EQT Midstream Partners, LP's July 15, 2013 acquisition of Sunrise Pipeline from EQT Corporation; and El Paso Pipeline Partners, L.P.'s May 18, 2012 acquisition of Cheyenne Plains Gas Pipeline Company from El Paso Corporation.

that would ensue absent the requested clarification. Prior to the transaction, the first organizational structure shown above reflects the corporation's tax situation, and the corporation would be entitled to an income tax allowance. Following the drop down of an interest in the pipeline, the corporation would continue to be responsible for the taxes associated with the income allocated to it by the MLP, just as it was responsible prior to the drop down for income taxes generated from the same regulated assets prior to the spin-off. However, after the drop down, even though the MLP will generate nearly the same, or possibly even greater, income tax liability for the corporation, unless clarified the RPS appears to eliminate a tax allowance simply because an MLP became the regulated entity, or it is now owned in part by an MLP, and the public owns a minority interest in the same regulated assets. It is clear, and the Commission should confirm, that the income tax liability allocated to the corporate unitholder in an MLP is not covered by the pre-investor tax DCF return. The Commission should further allow other pipelines with different ownership structures to propose appropriate income tax allowances, and provide evidence in support of such allowances, in their future rate proceedings.

D. The Commission Should Clarify Pipelines' Rights to Propose Rate Adjustments in Future Rate Proceedings.

In addition to proposing a tax allowance that addresses the Court's concern in *United Airlines*, MLPs must be provided an opportunity in future rate proceedings to seek an upward adjustment to their DCF returns, or other supported upward adjustments, to account for the increased risks these companies will face. In its NOI, the Commission recognized that such an adjustment may be warranted. In paragraph 20 of the NOI, the Commission stated:

> If a commenter advocates eliminating the income tax allowance for partnerships and rely on a return on equity to recover investor tax costs, the comments should address whether any changes to the Commission's ROE policies are necessary to ensure that the return reflects appropriate tax costs for the particular entity whose rates are at issue.

Mr. Hevert describes the many incremental risks that will result from a removal of a tax allowance for MLPs that need to be reflected in MLP ROEs. Mr. Hevert first notes that perceived regulatory risk is an important consideration to both debt and equity investors and that the nature of regulation accounts for half of the factors considered by Moody's to determine credit ratings. Hevert Affidavit at P 15. One need look no further than the reaction of the market to the RPS on the day it was issued to ascertain the perception of MLP pipeline investors to the Commission's announced policy of removing the tax allowance in MLP rates. Natural gas MLPs lost on average 17 percent of their market value from the day the RPS was released through April 6, with the six companies included in the MLP average losing nearly $9 billion in aggregate market value in that same timeframe. Hevert Affidavit at P 13.

Investors' demonstrated perception of heightened risk can be explained by the numerous new and compounding risks created by the loss of a tax allowance described by Mr. Hevert. He explains that MLPs are required by the SEC to provide five years of "fixed charge" coverage ratios that compare the companies' EBIT to interest expense to determine the company's ability to meet its interest obligations. The loss of an income tax allowance will dilute EBIT coverage and thereby increase investors' risk. Hevert Affidavit at P 17. Similarly, the ratio of debt to EBITDA is one of two "core" ratios used by Standard & Poor's to assess financial risk. The loss of an income tax allowance reduces EBITDA and puts downward pressure on key measures of creditworthiness. Hevert Affidavit at P 18.

The reduction in EBITDA will reduce distributable cash and the market value of the company, and will create several additional dilutive and compounding effects, which in turn will diminish the company's ability to attract capital. The reduction in internally generated funds will require more external financing at the same time as increased risks and reduced credit metrics

make it more difficult and costly for MLPs to access the capital markets. The reduction in cash and constrained access to external capital may also limit the company's ability to develop a diversified portfolio of assets which otherwise would reduce risks. Hevert Affidavit at PP 19-22.

Mr. Hevert also points out these increased risks would compound the risks already created by the Commission's policy requiring that the long-term growth rate of MLPs, which is given 1/3 weight in the DCF formula, be reduced by 50 percent.[44] If the policy in the RPS is not reversed, MLPs will now be hit with a double whammy. The theory behind this 50% reduction in long-term growth rate is that because MLPs retain less cash to maintain greater distributions to its investors, they will have less cash to reinvest for growth. The elimination of the tax allowance will reduce an MLP's cash flow and its ability to access capital markets, and ultimately will diminish its ability to maintain the level of distributions to investors that make MLP investments attractive to investors. When combined with the 50% growth rate reduction in the DCF formula, the elimination of a tax allowance will reduce the companies' ability to maintain distributions at the same time the Commission's DCF formula assumes lower growth rates. These two regulatory actions cannot be reconciled. An upward adjustment to MLP ROEs is required.

Assuming, *arguendo,* there is an element of taxes included in the DCF return, as does the RPS, Mr. Hevert explains that the RPS fails to take into account the different ownership structures of MLPs, and the different tax rates applicable to corporate and MLP investor/owners. Hevert Affidavit at PP 28-29. For the reasons discussed more fully in Section C above, Mr. Hevert notes that to the extent MLPs are owned by corporations, there must be some recognition of the corporate owners' tax position. *Id.* at P 28. In addition, the different tax rates applicable

[44] Hevert Affidavit at PP 23-24, *citing Composition of Proxy Groups for Determining Gas and Oil Pipeline Return Equity,* 123 FERC ¶ 61,048 (2008).

to MLP and corporate investors needs to be reflected in an increased ROE. As Mr. Hevert explains, when the 20% deduction for pass-through entities is taken into account, the tax rate applicable to MLP investors, assuming a 50/50 split in individual and corporate investors, is 24.8%. The tax rate on dividends remains at 20 percent. Thus, if it is assumed, as does the Commission in the RPS, that MLP investors demand that these taxes be included in their returns, MLPs would logically demand higher returns. To reach parity, MLPs would have to be given a higher rate of return. In his Affidavit, Mr. Hevert provides illustrative examples of how these different tax rates could be converted into quantitative ROE adjustments. For purposes of this request for clarification, reconsideration and rehearing, INGAA merely requests that the Commission recognize the need for an adjustment to be determined in individual proceedings on a case-by-case basis and clarify that pipelines have the right to file for such adjustments in rate proceedings.

Mr. Hevert also addresses the assumption that removing the income tax allowance is needed to create parity in returns, or in risk, with corporate entities. Hevert Affidavit at P 5. Simply put, there is no evidence that the returns of MLPs have been higher than those of corporations when both types of organizations were provided a tax allowance in their rates. Instead of reducing MLP risks to a level commensurate with corporations, the RPS will introduce additional elements of risk that would require increments of return to adequately compensate MLP investors, and to maintain the financial integrity required to access capital, as required by the *Hope* and *Bluefield* standards. *Id.*

E. Absent Clarification of the Rights Requested Above, As Well as Requested Clarification of its Companion Notice of Proposed Rulemaking Regarding Implementation of the New Tax Law, the Commission Has Unlawfully Enacted a Rule in Violation of the APA.

As discussed above, because the Commission has chosen to promulgate a policy statement, the policy announced in the RPS does not establish legally binding requirements or have the force of law.[45] In determining whether an agency order is a general statement of policy or a substantive rule, courts consider the agency's own characterization of the order, and whether the agency has treated the order as a general statement or policy or a binding substantive rule.[46]

The Commission's NOPR implementing the Tax Cuts and Jobs Act recently issued in Docket No. RM18-11-000 creates doubt about the nature of the stated "policy" in the RPS. In the NOPR, the Commission proposes to require all interstate natural gas pipelines that file a Form 2or 2A to file a specific form, Form No. 501-G, on an excel spreadsheet, to present a cost and revenue study. The Commission made the following statements about the incorporation of the RPS in the Form 501-G:

1. The Form No. 501-G "includes an abbreviated cost and revenue study estimating (1) the percentage reduction in the pipeline's cost of service resulting from the Tax Cuts and Jobs Act and the Revised Policy Statement, and (2) the pipeline's current ROEs before and after the reduction in corporate income taxes and the elimination of income tax allowances for MLPs." NOPR at P 26.

2. "The Form No, 501-G is an Excel spreadsheet with formulas that, when the respondents populate the form, will calculate an indicated percentage rate reduction reflecting only the corporate income tax rate reduction provided by the Tax Cuts and Jobs Act and the elimination of the MLP tax allowance by the Revised Policy Statement." NOPR at P 32.

3. "[F]or pass-through entities, FERC Form No. 501-G assumes a federal and state income tax expense of zero. As the Commission states in the Revised Policy Statement, all partnerships seeking to recover an income tax allowance

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[45] *Nat'l Mining Ass'n v. McCarthy,* 758 F.3d 243, 251-53 (D.C. Cir. 2014); *PG&E. supra.*

[46] *PG&E,* 506 F.2d at 377, *citing Texaco, Inc. v. FPC,* 412 F.2d 740, 742, 744 n.8 (3rd Cir. 1969); *Nat'l Mining,* 758 F.3d at 252-53.

> will need to address the double-recovery concern. If a partnership not organized as an MLP believes that a federal or state income tax expense is permissible notwithstanding *United Airlines*, proposed section 154.404(a)(3) provides that it may submit that statement with supporting documentation to justify why it should continue to receive an income tax allowance and to reduce its maximum rates to reflect the decrease in the federal income tax rates applicable to partners pursuant to the Tax Cuts and Jobs Act." NOPR at P 36.

Unless the Commission clarifies that MLPs are not required to eliminate a tax allowance in the Form 501-G, and that other pass-through entities do not have a burden to justify a tax allowance, the NOPR demonstrates that the Commission is treating the RPS not as a statement of future intention but as a binding legal requirement that has the force of law.[47] Such requirements would be clear indicia that the Commission has adopted a substantive rule and not a statement of policy. As a result, unless clarified, the Commission must comply with the APA to promulgate the rule announced in the RPS, rehearing of the rule is appropriate, and an order on rehearing on the rule would be appealable.

[47] INGAA will be filing comments in response to the Commission's NOPR, Docket No. RM18-11.

V. CONCLUSION

WHEREFORE, for the foregoing reasons, INGAA respectfully requests clarification, reconsideration and rehearing of the Commission's RPS.

Respectfully Submitted,

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DATE: April 16, 2018

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents upon the parties designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission for the above-captioned docket in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

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

Ammaar Joya