The Association of Oil Pipe Lines (“AOPL”) hereby submits its reply comments in response to the initial comments filed concerning the 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 in United Airlines v. FERC, 827 F.3d 122 (D.C. Cir. 2016) (“United Airlines”). AOPL is a nonprofit trade association that represents the interests of oil pipelines regulated by the Federal Energy Regulatory Commission (“FERC” or “Commission”).

The comments of AOPL, the Interstate Natural Gas Association of America (“INGAA”), the Edison Electric Institute (“EEI”), and others are in broad agreement with retaining the Commission’s existing policies for determining the income tax allowance and rate of return on equity (“ROE”) for FERC-regulated entities. For the reasons discussed below, AOPL does not agree with the comments filed by the various pipeline shippers, electricity customers, and other individuals (collectively, “Opposing Commenters”) that urge the Commission to remove the income tax allowance for master
limited partnership (“MLP”) pipelines and other regulated service providers, such as electric transmission companies, that are structured as tax-pass-through entities.1

**EXECUTIVE SUMMARY**

The NOI sought comments on whether the Commission’s current income tax allowance and ROE policies result in a double-recovery of income tax costs for MLP pipelines and similar tax pass-through entities, and, if so, whether any adjustments should be made to the Commission’s current policies. The record established in this proceeding demonstrates there is no double-recovery of income tax costs for MLP pipelines and no basis to amend the Commission’s current policies.

The “double-recovery” argument presented to the court in *United Airlines* and which the Opposing Commenters continue to press here is based on the theory that the pre-investor-tax ROE generated by the Commission’s discounted cash flow (“DCF”) methodology is higher for MLP pipelines than corporate pipelines and the use of the

1 While *United Airlines* concerned income tax recovery by an MLP pipeline, the NOI, and thus the comments filed herein, address the impact of the court decision on other tax pass-through entities as well. Indeed, the Opposing Commenters do not limit their proposals to MLPs or pipelines, and in many cases urge “the complete elimination of any income tax allowance” for all regulated entities structured as “tax-flow-through” companies. American Public Gas Association Comments at 5; see also Concerned Cooperatives at 1 (the Commission should “require all public utilities that are organized as pass-through entities to remove any federal income tax allowances from their cost-based generation and transmission rates”); CAPP Comments at 9; Liquids Shippers Group Comments at 1; Western Tennessee Municipal Group Comments at 2. AOPL’s reply comments, however, primarily respond to initial comments that address the impact on pipelines.
allegedly higher MLP ROE in conjunction with an income tax allowance results in a “double-recovery” of income tax costs for MLP pipelines. For example, in the *United Airlines* case, the shipper petitioners claimed the DCF ROE for MLP pipelines included a “built-in tax allowance” that caused the ROE for MLP pipelines to exceed the ROE for corporate pipelines by 367 basis points. The essential factual predicate for the “double-recovery” argument, however, has been shown not to be true, and, indeed, the Shipper Petitioners – and Dr. Thomas Horst himself, the expert witness that alleged the 367 basis point differential – have now abandoned the testimony on which the shippers relied at the court.

As the study performed by Barry Sullivan on behalf of INGAA demonstrates, empirical data comparing the market-based returns of comparable MLP and corporate natural gas pipelines over the past decade shows that the market-based returns for MLP pipelines are not systematically higher than those for corporate pipelines. Thus, the Commission’s existing ROE and income tax allowance policies result in comparable rates and returns for MLP and corporate pipelines – not higher rates for MLPs or a “double-recovery” of income tax costs.

In contrast to INGAA’s thorough, data-driven analysis, the Opposing Commenters provide no empirical support for their assumption that the ROE for an MLP will be higher than that of a corporation. Nor do they present any proof to support their theoretical speculation that the ROE for MLPs leads to any over-recovery – let alone “double-recovery” – of income tax costs. Indeed, the Opposing Commenters generally acknowledge that it is impossible to identify any amount of the DCF ROE that is
allegedly attributable to income tax costs, and they propose no adjustment to the DCF ROE on the ground that any attempt to do so would be “futile” and “unreliable.” The only commenter that attempts to demonstrate that MLP ROEs are higher than corporate ROEs because of an embedded income tax component is Dr. Horst, who submitted comments on his own behalf in this proceeding, but which none of the other Opposing Commenters adopted. As AOPL demonstrated in its Initial Comments, Dr. Horst’s study, which departs significantly from his prior analyses both in methodology and result, cannot be relied on because it is not based on any empirical data and, in fact, produces the opposite results if certain of its hypothetical assumptions are replaced by other, reasonable assumptions.

While the Opposing Commenters (apart from Dr. Horst) admit it is not possible to identify or quantify the alleged income tax component of the MLP ROE and provide no data to support their argument that the ROEs for MLP pipelines are higher than those for corporate pipelines, they ask the Commission to accept as a given their assertion that the DCF ROE allows for full recovery of income taxes and to eliminate the income tax allowance for regulated tax-pass-through entities based on that unsupported claim. The Opposing Commenters’ proposal to eliminate the income tax allowance is completely unjustified. As Dr. John Graham explained, in support of AOPL’s initial comments, there can be no question that regulated entities structured as MLPs generate income tax liability, and the D.C. Circuit has upheld the Commission’s policy of awarding an income tax allowance to MLPs on this basis. These very real, undisputed costs cannot simply be
disallowed based on theoretical speculation that the DCF ROE leads to “double-recovery.”

Indeed, the effect of the Opposing Commenters’ unsupported proposals would be to put MLPs at a permanent competitive disadvantage against corporate pipelines, as MLP costs of service and rates would be materially lower and there would be a substantially increased risk that MLPs would not be able to compete effectively for capital. As AOPL and INGAA demonstrated, abandoning the Commission’s current policies would likely have serious real-world consequences, including significant market instability, credit downgrades, higher debt costs and an increased risk of bankruptcy for MLP pipelines. These risks would present significant challenges to MLP pipelines at a time when substantial new investment is needed and when significant additional obligations regarding pipeline integrity and regulatory uncertainties (e.g., regarding indexing and annual reporting requirements) are facing the oil pipeline industry.

In sum, the Commission’s current income tax allowance and ROE policies are well-considered and should be maintained. The record evidence demonstrates that there is no “double-recovery” of income tax costs and thus no justification for abandoning the Commission’s established policies.

**DISCUSSION**

The Opposing Commenters argue that the Commission’s existing income tax allowance and ROE policies result in a “double-recovery” of income tax costs for MLP Pipelines. The Opposing Commenters, however, are unable to identify or quantify the
alleged income tax component in the ROE for MLP pipelines that purportedly results in a double-recovery of income tax costs when combined with the income tax allowance. Indeed, the Opposing Commenters claim it would be “futile” to attempt such an analysis and therefore propose no adjustments to the Commission’s established ROE policy. Instead, the Opposing Commenters urge the Commission simply to remove the income tax allowance for MLP pipelines. For the reasons discussed below, the Opposing Commenters’ arguments are contrary to the record evidence, which shows that MLP ROEs are not systematically higher than corporate ROEs and therefore do not result in any double-recovery when used in conjunction with the Commission’s established income tax allowance policy. In short, there is no justification for changing the Commission’s established ROE and income tax allowance policies because of theoretical arguments that have been shown to have no basis in reality.

I. There is No Valid Basis to Change the Commission’s Established ROE Policy, Which Does Not Generate Higher ROEs for MLP Pipelines or Result in a Double-Recovery of Income Tax Costs.

The “double-recovery” argument presented by shippers to the court in United Airlines, and which the Opposing Commenters continue to make here, is based on the assumption that pre-investor-tax ROEs generated by the Commission’s DCF methodology are higher for MLP pipelines than corporate pipelines, and that the use of this allegedly higher MLP ROE in conjunction with an income tax allowance in setting cost-of-service rates results in a double-recovery of income tax costs for MLP pipelines and higher overall returns for MLP pipelines than corporate-owned pipelines. For
example, in *United Airlines*, the shipper petitioners claimed the DCF ROE for MLP pipelines included a “built-in tax allowance” that caused the ROE for MLP pipelines to exceed the ROE for corporate pipelines. *See* Joint Initial Br. of Shipper Petitioners, D.C. Circuit Case No. 11-1479 at 20 (Sept. 4, 2105) (citing Prepared Answering Testimony of Thomas Horst on Behalf of ExxonMobil Corporation, Exhibit No. XOM-1 at 17-21, Docket No. IS08-390-002 (Jan. 26, 2009)).

Dr. Horst testified that, based on data from September 2008, the DCF ROE for MLP pipelines was 367 basis points higher than the ROE for corporate pipelines as a result of investor expectations regarding income taxes. Exhibit No. XOM-1 at 17, 21. Dr. Horst claimed that reducing the ROE for the MLP proxy group by 367 basis points would “eliminate the difference in the income tax treatment of MLP unitholdings versus corporate shareholdings.” *Id.* at 23.

Based on the record before it, the *United Airlines* court found that it was undisputed in that case that, “with a tax allowance, a partner in a partnership pipeline will receive a higher after-tax return than a shareholder in a corporate pipeline.” 827 F.3d at 136. The court further concluded that the Commission had failed to “ensure parity between equity owners in partnership and corporate pipelines,” and 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

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2 Dr. Horst’s prior testimony (Exhibit No. XOM-1) was included as Attachment B to the Declaration of John R. Graham submitted with AOPL’s Initial Comments.
return on equity.” Id. at 136-37. The court remanded the issue to the Commission to review its existing policies and “demonstrate that there is no double recovery.” Id.

The record established in this proceeding, however, makes clear that the DCF returns for MLP pipelines are not systematically higher than those for corporate pipelines, and indeed both the Shipper Petitioners and Dr. Horst have abandoned the testimony on which they relied for their arguments to the court in United Airlines. Thus, the Commission’s current policy of using the same general ROE and income tax allowance methodologies for both MLP and corporate pipelines results in tariff rates that are generally comparable for both types of entities – not higher rates for MLP pipelines or a “double-recovery” of income tax costs. In other words, notwithstanding the Opposing Commenters’ observation that the DCF ROE is a pre-investor tax return, the record herein shows there is no systematic difference in the actual DCF returns for MLPs and corporations observed in the market over time. The Opposing Commenters not only fail to demonstrate that income taxes are recovered through the DCF ROE, they themselves admit it would be “futile” and “impractical” to attempt to discern any such income tax recovery in the ROE. Concerned Cooperatives Comments at 5; Liquids Shippers Group Comments at 6. Thus, the uncontroverted record in this proceeding demonstrates there is no “double-recovery” of income tax costs to be remedied, and no adjustment to the Commission’s established policies needs to be made.

As INGAA’s comments in this proceeding demonstrate, 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 are 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 types of analyses, 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.

As Mr. Sullivan discusses in his testimony, he first reviewed the study of Dr. Horst that was submitted on behalf of shippers in the SFPP pipeline case under review in *United Airlines*. As noted, in that case, Dr. Horst claimed that the DCF ROE for MLP pipelines was 367 basis points higher than the ROE for corporate pipelines based on his review of data from 2008. But when Mr. Sullivan updated Dr. Horst’s study to the current period and adjusted it to remove companies that would not qualify as proxy companies under Commission precedent, Dr. Horst’s conclusion did not hold up. In fact, the DCF return for corporate pipelines was higher than those of MLP pipelines. See Sullivan Decl. at 26-48. Mr. Sullivan’s analysis is consistent with the Commission’s prior conclusion that Dr. Horst’s study was unreliable for several reasons, including errors in the analysis and the use of a group of corporations that included companies with significant exposure to non-pipeline activities and companies that lacked investment grade credit ratings. *SFPP, L.P.*, 137 FERC ¶ 61,220, at PP 300-305 (2011) (“Opinion No. 511-A”); see also Sullivan Decl. at 30-35.

Mr. Sullivan then analyzed the historical DCF returns over the past decade for a group of 23 companies with significant natural gas pipeline operations. Sullivan Decl. at
Mr. Sullivan’s analysis showed that “the variance in the DCF ROE for (1) a representative group of MLPs that own FERC jurisdictional natural gas pipelines and (2) a representative group of corporations that own FERC jurisdictional natural gas pipelines is not statistically significant.” Sullivan Decl. at 6. Mr. Sullivan also separately analyzed the yield and growth rate components of the DCF ROE for the same group of companies and found no systematic difference in either the yields or growth rates for MLP and corporate pipelines. Id. at 62-69. In other words, as Mr. Sullivan explained, the “evidence shows that MLP DCF ROEs, distribution yields and IBES growth rates are not systematically higher than corporate DCF ROEs, dividend yields and IBES growth rates.” Id. at 69.

Finally, Mr. Sullivan compared the DCF returns for five different pairs of MLPs and corporations from 2008 through the present. Sullivan Decl. at 5-62. The first four pairs compared the DCF returns for MLP natural gas pipelines and their corporate parents (i.e., Spectra Energy Partners LP and Spectra Energy Corporation; TransCanada Pipeline LP and TransCanada Corporation; Williams Partners, LP and The Williams Companies, Inc.; and Equitrans Midstream Partners, LP and EQT Corporation). The final pair compared the DCF returns of Boardwalk Pipeline Partners and Kinder Morgan Inc. Again, the results showed that the DCF ROEs for MLP pipelines do not systematically exceed the DCF ROEs for corporations. Although the difference in returns for each pair fluctuated over time, the MLPs do not consistently generate a higher DCF return over corporations during the period from 2008 through the present. As Mr. Sullivan concluded, “[b]ased on my empirical analysis, there is absolutely no support for the
contention that the income tax allowance results in a higher DCF ROE for MLPs over corporations.” Id. at 62.

With the exception of Dr. Horst, none of the Opposing Commenters put forward an alternative analysis or any evidence to support their assumption that MLPs will have higher ROEs than corporations under the Commission’s existing methodology. Nor do they make any attempt to identify or quantify the income tax costs that they claim are recovered through the MLP ROE and result in a double-recovery of income tax costs in conjunction with the income tax allowance. Instead, the Opposing Commenters claim it would be “futile,” “if not impossible,” to attempt to locate the alleged income tax component of the ROE, and state that any attempt to do so would be “unreliable” and “arbitrary.” See Concerned Cooperatives Comments at 5, Natural Gas Indicated Shippers Comments at 11, Shipper Petitioner Comments at 9. The Opposing Commenters’ inability to identify any amount of the ROE for MLP pipelines attributable to the alleged income tax component or show that their theories regarding pre-tax MLP ROEs make any practical difference to the actual ROEs generated by the Commission’s DCF methodology highlights the lack of support for their “double recovery” arguments.

The only commenter to urge the Commission to adopt a specific adjustment to the established ROE methodology to account for the alleged income tax component in the MLP ROE is Dr. Horst, who submitted comments on his own behalf. But his comments

3 CAPP claims the Commission could adjust the DCF ROE by reducing the ROE by the amount of the marginal tax rate used to set the income tax allowance. CAPP
are not supported by any energy market participant, including the shipper petitioners on
whose behalf he submitted testimony in the United Airlines case. Nor does his analysis
provide any valid basis for changing the Commission’s existing ROE policy. Dr. Horst
maintains that the pre-tax ROE required by investors in MLP pipelines is greater than the
pre-tax ROE required by shareholders in corporate pipelines, because, in his view, the
income tax burden from shareholder-level taxes is less than the income tax burden on
MLP partners. Horst Comments at 1-2. Dr. Horst contends that, in order to equalize the
ROE for MLP and corporate pipelines, the ROE for MLP pipelines should be reduced by
1.4 percentage points (i.e., 140 basis points). Id.

As AOPL explained in its Initial Comments, Dr. Horst’s analysis abandons his
conclusions in the SFPP case reviewed in United Airlines, in which he testified that the
Comments at 8. CAPP does not propose this method, however, and recognizes it would
be “unpredictable” and “susceptible to manipulation.” Id. CAPP’s approach also
inappropriately assumes that MLP unitholders would be taxed each year on 100% of their
cash distributions. See Graham Decl. at 6. Erin Noakes urged the Commission in setting
the ROE for a given regulated entity to consider various information regarding its
specific risks, including the details of its governance structure and sources of financing.
The Noakes comments fail to explain why such considerations cannot be raised in the
context of the Commission’s current ROE approach where relevant. Moreover, the
Noakes comments appear to acknowledge the futility of attempting to adjust the MLP
ROE to remove the alleged income tax component, explaining that “the market looks at
the bigger picture and prices [the various costs that an entity incurs] based on the total
package.” Noakes Comments at 12. Gordon Gooch contends that MLP cash
distributions should not be used to calculate the ROE under the Commission’s DCF
methodology. Gooch Comments at 74-75. The Commission addressed the
appropriateness of using MLP cash distributions in the DCF methodology in its 2008
ROE Policy Statement. Composition of Proxy Group for Determining Gas and Oil
Pipeline Return on Equity, 123 FERC ¶ 61,048, at PP 54-66 (2008). Mr. Gooch fails to
demonstrate that the Commission’s established policy produces unreasonable results.
returns for MLP pipelines were 367 basis points higher than those for corporate pipelines as well as his testimony in a subsequent SFPP proceeding in which he claimed that MLP pipeline returns were 238 basis points higher than those of corporate pipelines. AOPL Initial Comments at 31-32. Moreover, as Mr. Sullivan explains, Dr. Horst’s prior comparisons of MLP and corporate ROEs fail to demonstrate any systemic difference in returns between the two organizational forms because they are based on isolated “snap shots” of the market that reflect anomalous market conditions and fail to generate results that are representative of actual experience over the long term. See Sullivan Decl. at 35-41.

In addition, as AOPL previously explained, Dr. Horst’s current analytical method is substantially different from his prior approach. AOPL Initial Comments at 32. Instead of attempting to support his claims with empirical data from actual companies, Dr. Horst’s current proposal relies on various hypothetical assumptions. Id. As Dr. John Graham explained in his declaration in support of AOPL’s comments, Dr. Horst’s 140 basis point differential is based on hypothetical assumptions regarding several key variables, including cash distribution levels, retention percentages, growth rates and the length of time the investments are held. Graham Decl. at 8-11. Dr. Graham explained that, if other, reasonable assumptions are used, the results change and in fact show the opposite of Dr. Horst’s conclusion.

In short, Dr. Horst’s analysis fails to provide empirical data that identifies any amount of the MLP ROE allegedly attributable to income tax costs or provide any basis to adjust the Commission’s current ROE policies. Indeed, the same shipper petitioners in
United Airlines who sponsored the testimony of Dr. Horst in that case purporting to show that MLP returns are 367 basis points higher than corporate returns because of an embedded income tax component now do not rely on Dr. Horst’s testimony from that proceeding or his comments in this proceeding. In fact, they maintain that the type of analysis that Dr. Horst has conducted here is “unreliable” as a method for identifying the alleged income tax component of the MLP ROE or supporting an adjustment to the Commission’s established ROE policy. Shipper Petitioner Comments at 8-9. By distancing themselves from the Horst analysis, however, the Shipper Petitioners abandon the factual underpinning for their arguments on which the court relied in United Airlines.

The Opposing Commenters contend that this proceeding is not about “whether the United Airlines court was incorrect in its analysis and conclusion that including an income tax allowance in an MLP-owned pipeline’s cost of service causes a double recovery.” Shipper Petitioner Comments at 8. Instead, they claim the Commission has no authority to undertake an independent review of the issue, but must simply accept as a given that a double-recovery exists. Id. On the contrary, as AOPL previously explained, the Commission has full authority – and indeed the obligation – to take a fresh look at the issues on remand. AOPL Initial Comments at 9-10 (citing SEC v. Chenery Corp., 332 U.S. 194, 200-201 (1947)). As CAPP acknowledges (Comments at 2), United Airlines held only that the Commission had “not provided sufficient justification” for its current policy. 827 F.3d at 136. The court directed the Commission to review its policies and demonstrate on remand that that no double-recovery exists. Id. at 137. In fulfilling that obligation, the Commission is required to consider the relevant facts. It cannot simply
turn a blind eye to the record developed on remand, as the Opposing Commenters seem to urge.

In failing to put forward any empirical support for their “double recovery” argument, the Opposing Commenters instead simply rely on the assertion that the pre-investor-tax DCF ROE “necessarily” incorporates a full income tax allowance. Shipper Petitioner Comments at 8. For example, the Process Gas Consumers Group comments consist largely of a series of equations designed to prove the proposition that the DCF ROE is a pre-investor-tax ROE. See Process Gas Comments at 4-11. Such theoretical arguments, which as demonstrated are not supported by empirical data, should not be a basis for departing from the Commission’s established policies. Ultimately, the Opposing Commenters’ theoretical concerns fail to address the fundamental inequity that would result from their proposal to eliminate the income tax allowance for regulated entities structured as MLPs. As AOPL previously demonstrated, both MLP pipelines and corporate pipelines generate substantial amounts of taxable income from the provision of regulated services and the market-based DCF ROEs for MLP pipelines are comparable to those for corporate pipelines. See AOPL Initial Comments at 16-35. There is no justification for the ownership structure of the pipeline to result in significant differences in the regulated rates as the Opposing Commenters propose.

In sum, the uncontroverted record evidence in this proceeding demonstrates that the ROEs for MLP pipelines are no higher than those for corporate pipelines and there is no double-recovery of income tax costs. There is thus no basis to adjust the Commission’s established ROE policy.
II. There is No Justification for Eliminating the Income Tax Allowance as Shippers Propose.

The Opposing Commenters contend that, because it is impossible to identify any specific income tax component in the ROE for MLP pipelines, the Commission should instead simply eliminate the income tax allowance for MLP pipelines. The Opposing Commenters’ proposal is completely without merit. The Opposing Commenters cannot on the one hand be heard to argue that demonstrating the amount of income taxes in the ROE is “futile,” “if not impossible,” while on the other hand claiming the Commission should simply accept as a given that no income tax allowance is necessary because all income tax costs are fully reflected in the DCF ROE. Since the record here shows there is no double-recovery of income tax costs for the reasons discussed above, there is no basis to make any adjustment to the Commission’s existing income tax allowance policy.

As AOPL explained in its Initial Comments, the Commission’s income tax allowance policy is consistent with established legal precedent regarding the recovery of income tax costs and has been upheld by the D.C. Circuit. ExxonMobil Oil Corp. v. FERC, 487 F.3d 945 (D.C. Cir. 2007) (“ExxonMobil”). The Commission’s income tax allowance policy appropriately recognizes 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. United Airlines explicitly did not overturn the income tax allowance policy that was previously upheld by the D.C. Circuit (827 F.3d at 137), and there is no valid basis to depart from it here.
Recognizing the importance of the income tax allowance to all regulated entities, EEI urged the Commission “to carefully scrutinize and reject any proposals that would deny jurisdictional entities the recovery of income taxes or tax liability attributable to the operations of regulated businesses.” EEI Comments at 2-3. Instead, EEI requested that the Commission “take this opportunity to reaffirm that cost recovery for income taxes attributable to regulated business operations is necessary to ensure just and reasonable rates, consistent with the requirements of the U.S. Supreme Court’s decision in Hope.” EEI Comments at 3.⁴

INGAA similarly agreed that MLP pipelines “must be allowed an income tax allowance in order to have the opportunity to recover [their] full cost of service.” INGAA Comments at 4. As Dr. Graham and INGAA witness Dr. Merle Erickson show, both MLP and corporate pipelines generate significant income tax liability as a result of providing regulated services and there is no reasonable basis to assume that one organizational form will necessarily incur higher taxes than the other. See Graham Decl. at 2-8; Erickson Decl. at 3. Moreover, Mr. Sullivan’s analysis demonstrates that “inclusion of an income tax allowance for MLP pipelines does not result in systematically higher DCF ROEs for MLP-owned pipelines as compared to corporate-

⁴ Like AOPL (Initial Comments at 17 n.4), EEI cautioned that as “Congress continues to contemplate comprehensive tax reform,” the Commission “may be well-served to wait until a clearer picture develops as to Congress’s efforts before undertaking its own.” EEI Comments at 14 n.32.
owned pipelines.” INGAA Comments at 5-6. There is thus “no double recovery of income taxes resulting from an MLP receiving both a tax allowance and DCF-derived ROE.” Id. at 5. Instead, the Commission’s existing policy “places an MLP pipeline on an equal footing with a corporate-owned pipeline with respect to the opportunity to earn a fair return and avoids creating an unfair regulatory impediment to the MLP’s ability to recover its costs and maintain its financial integrity.” Id. at 10-11. Removal of the income tax allowance for MLPs would not ensure parity between MLP and corporate pipelines, but would put MLP pipelines at a permanent competitive disadvantage to corporate pipelines by capping MLP costs of service and tariff rates at levels significantly below those of corporate pipelines. See Graham Decl. at 13.

Indeed, as AOPL and INGAA discussed, failure to permit an income tax allowance for MLP pipelines would be inconsistent with the requirement that a regulated entity should be given the opportunity to earn a return that is “sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.” Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). As AOPL showed, “abandoning the Commission’s current policies could impair the ability of MLP pipelines to maintain their credit and attract capital and lead to credit downgrades, higher debt costs and an increased risk of bankruptcy for MLP pipelines.” AOPL Initial Comments at 35. INGAA similarly explained that a change to the Commission’s current policies “would threaten the financial integrity of natural gas pipelines organized as MLPs and erode their ability to maintain credit and attract the capital that is necessary for the development of new pipeline infrastructure.” INGAA
Comments at 2. In other words, “a change in policy would be a two-fold hit to MLPs: a reduction in revenues and a potential reduced ability to access both equity and debt markets at the same cost as they can today. . . .” *Id.* at 27.

The “destabilizing effect” that removal of the income tax allowance would have on the financial integrity of MLP pipelines would “undermine [their] viability as a vehicle for investment in natural gas and oil infrastructure,” directly contrary to Congress’s intent in the 1987 amendments to the Internal Revenue Code. INGAA Comments at 2, 27. “By authorizing pass-through taxation for MLPs, Congress created an incentive for investment in necessary infrastructure to provide oil and natural gas transportation.” *Id.* at 7. Removing the income tax allowance “would effectively remove the incentive Congress intended to encourage investment in energy infrastructure.” *Id.*

*see also* MLP Association Comments at 2-4 (citing views of Senate Finance Committee member Max Baucus that removal of full income tax allowance would “directly contravene[] the policy” Congress adopted in the 1987 amendments to the IRC and explaining that it was “certainly not [Congress’s] intention for pipelines operating as [MLPs] to be singled out for negative treatment relative to other pipelines solely because of their partnership status”).

“Eliminating the MLP tax allowance would shake the market’s confidence in MLPs,” INGAA Comments at 7, and could have wider implications for the domestic energy industry, which continues to struggle with low oil prices, as well as for the economy as a whole. MLP pipeline companies are a significant part of the economy, accounting for approximately $350 billion of market capital as of 2016. MLP
Association Comments at 6. Removal of the income tax allowance would send shock waves through the energy transportation sector and “throw the financial markets into upheaval.” Dominion Comments at 16.

The Liquids Shippers Group argues that whether the elimination of the income tax allowance for MLPs “would result in a disincentive to the partnership structure, or have other commercial or financial ramifications, is not only unknowable, but it is beyond the scope of the Commission’s regulatory obligations.” LSG Comments at 9. The Liquids Shippers Group ignores the directives of *Hope* and the evidence in this proceeding. The Supreme Court has made clear that the Commission has the obligation to ensure that its policies give regulated entities the opportunity to earn returns that are “sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.” *Hope*, 320 U.S. at 603. Here, the record shows that abandoning the Commission’s current policies could significantly impair the ability of MLP pipelines to do just that. *See* AOPL Initial Comments at 35-38. The Commission also has the discretion and, indeed, the duty, to consider other important policy goals such as not discouraging the use of MLPs and other tax-pass-through entities, which are widely used throughout the energy sector to support infrastructure investment including by oil and natural gas pipelines and electric transmission utilities, to meet our nation’s energy infrastructure needs; conforming to Congressional tax policy; and ensuring that the tariff rates for regulated entities that provide the same general service do not diverge significantly solely because of how they are structured for tax purposes. *See* AOPL Initial Comments at 38-44; *see also* INGAA Comments at 12-17, 26-28 (discussing
policies undergirding Commission’s established approach and the adverse financial consequences to MLP pipelines that would result from abandoning it); American Transmission Company Comments at 11, 13-17 (discussing importance of partnership-type model to electric transmission companies in attracting investment).

In short, the record in this case demonstrates there is no double-recovery of income tax costs and no basis to change the Commission’s current income tax allowance policy. The Commission’s income tax allowance policy is reasonable and was upheld by the D.C. Circuit in ExxonMobil. There is no reason to depart from it.

CONCLUSION

For the reasons stated above, AOPL respectfully submits that the Commission should retain its current income tax allowance and ROE policies.

Respectfully submitted,

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