166 FERC ¶ 61,142
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Cheryl A. LaFleur, Richard Glick,
and Bernard L. McNamee.

SFPP, L.P. — Docket Nos. IS08-390-010, IS08-390-011

OPINION NO. 511-D

ORDER ON REHEARING AND COMPLIANCE FILING

(Issued February 21, 2019)

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1. On April 16, 2018, SFPP, L.P. (SFPP) filed a request for rehearing of Opinion No. 511-C, which denied SFPP an income tax allowance in its cost of service.[1] On August 7, 2018, SFPP filed a motion to reopen the record to admit additional evidence regarding the income tax allowance issue. As discussed below, we deny SFPP's request for rehearing and motion to reopen the record.

2. On May 14, 2018, SFPP filed its Compliance Filing implementing Opinion No. 511-C. On June 8, 2018, Joint Shippers[2] and Tesoro Refining & Marketing Company LLC (Tesoro) submitted protests and comments. The protests challenge SFPP's proposed (1) elimination of accumulated deferred income taxes (ADIT), (2) litigation surcharge, and (3) Overpaid Refunds and Under-Collected Revenues reserve. As discussed below, we accept SFPP's Compliance Filing, but reject SFPP's proposal to create an Overpaid Refunds and Under-Collected Revenues reserve.

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[1] *SFPP, L.P.*, Opinion No. 511-C, 162 FERC ¶ 61,228 (2018).

[2] Joint Shippers include American Airlines, Inc., United Airlines, Inc., Delta Air Lines, Inc., Southwest Airlines Co., BP West Coast Products LLC, Chevron Products Company, ExxonMobil Oil Corporation, Phillips 66 Company, and Valero Marketing and Supply Company.

I. Background

3. In *United Airlines, Inc. v. FERC*,[3] the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) vacated in part and remanded Commission Opinion Nos. 511, 511-A and 511-B addressing SFPP's 2008 West Line cost-of-service rate case.[4] As relevant here, the D.C. Circuit held that the Commission failed to demonstrate there was no double recovery of income tax costs when the Commission permitted SFPP, a master-limited partnership (MLP) Pipeline,[5] to recover both an income tax allowance and a return on equity (ROE) determined by the discounted cash flow (DCF) methodology.[6] Prior to *United Airlines*, the Commission allowed all partnership entities (including MLP Pipelines) to recover an income tax allowance for the partners' tax costs much like a corporation receives an income tax allowance for its corporate income tax costs (2005 Income Tax Policy).[7]

4. On remand in Opinion No. 511-C, the Commission found that a double recovery results from granting an MLP Pipeline such as SFPP an income tax allowance and a DCF

[3] *United Airlines, Inc. v. FERC*, 827 F.3d 122 (D.C. Cir. 2016).

[4] *SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121 (2011), *order on reh'g*, Opinion No. 511-A, 137 FERC ¶ 61,220 (2011), *order on reh'g*, Opinion No. 511-B, 150 FERC ¶ 61,096 (2015).

[5] At the time of SFPP's 2008 West Line rate case, SFPP was a wholly owned subsidiary of an MLP. Opinion No. 511-C, 162 FERC ¶ 61,228 at P 9. An MLP Pipeline as used in this order is either a pipeline organized as an MLP or the wholly owned subsidiary of an MLP such as SFPP. An MLP is a special kind of partnership available to oil and gas pipelines in which limited partner units trade on public exchanges. For further discussion of the MLP Pipeline business form, see Opinion No. 511-C, 162 FERC ¶ 61,228 at P 9.

[6] To determine the ROE for a regulated entity, the DCF methodology uses a proxy group of publicly-traded entities (MLPs or corporations) with similar risk profiles to the regulated entity. The DCF methodology determines for each member of the proxy group a required investor return using the formula $k = D/P + g$, where D is the dividend (or distribution for an MLP) and P is the stock price and g is the growth rate. The DCF ROE is typically set at the median return in the proxy group. For further discussion of the DCF methodology, see Opinion No. 511-C, 162 FERC ¶ 61,228 at P 11.

[7] *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005) (2005 Income Tax Policy Statement).

ROE.[8] The Commission rejected SFPP's argument in its comments on remand and supplemental comments on remand that in *United Airlines* "the Court erred" when holding that a double recovery results from including both a DCF ROE and an income tax allowance in SFPP's cost of service.[9] Accordingly, the Commission denied SFPP an income tax allowance.[10]

5. The Commission has also addressed the income tax allowance issues involving MLP Pipelines in other proceedings. Following *United Airlines*, the Commission issued a notice of inquiry and received numerous comments regarding how to address any double recovery resulting from the Commission's current income tax allowance and rate of return policies in Docket No. PL17-1.[11] In response to those comments, on March 15, 2018, the Commission issued a Revised Policy Statement, which superseded the guidance in the Commission's 2005 Income Tax Policy Statement and provided new guidance that the Commission will generally not permit MLP Pipelines to recover an income tax allowance in their cost of service.[12] On July 18, 2018, the Commission issued its Revised Policy Statement Rehearing decision, which dismissed the requests for rehearing and clarification of the Revised Policy Statement and provided guidance regarding the treatment of ADIT where the income tax allowance is eliminated from cost-of-service rates under the Commission's post-*United Airlines* policy.[13]

II. Rehearing and Motion to Re-Open the Record

6. On rehearing, SFPP argues that Opinion No. 511-C reached an erroneous outcome in two respects. First, SFPP asserts that the Commission erred by concluding that a

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[8] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22.

[9] SFPP Comments on Remand at 5; Opinion No. 511-C, 162 FERC ¶ 61,228 at PP 22-29.

[10] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 28. The Commission also denied SFPP's request for a paper hearing regarding whether any adjustment is appropriate to the ROE of a tax pass-through entity that includes an income tax allowance in its cost of service. *Id.* P 30.

[11] *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, Notice of Inquiry, 157 FERC ¶ 61,210 (2016).

[12] *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, Revised Policy Statement, 162 FERC ¶ 61,227 (2018) (Revised Policy Statement).

[13] *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, 164 FERC ¶ 61,030 (2018) (Revised Policy Statement Rehearing).

double recovery resulted from permitting an income tax allowance for the tax costs incurred by its MLP parent's unitholders. SFPP filed the August 7, 2018 Motion to Reopen the Record seeking to further support these arguments.

7. Second, on rehearing and in the alternative, SFPP argues that the Commission should permit SFPP to recover a partial income tax allowance for the taxes arising from the proportion of SFPP's income allocated to its MLP parent's corporate general partner owner.

A. Opinion No. 511-C Correctly Held That A Double Recovery Results from Permitting An Income Tax Allowance For SFPP

1. Rehearing

a. SFPP's Rehearing

8. SFPP claims that the Commission in Opinion No. 511-C failed to adequately address the evidence and to provide a sufficient rationale for concluding that permitting SFPP to recover an income tax allowance would lead to a double recovery of investors' tax costs. SFPP argues that the Commission improperly relied upon *United Airlines* to find that a double recovery existed and to perfunctorily dismiss SFPP's arguments to the contrary.[14] SFPP argues that *United Airlines* merely held that the Commission had not previously justified its conclusions and that the Commission was obligated to consider the full record. In particular, SFPP argues that the Commission simply assumed that changes to SFPP's unit price (or the unit price of SFPP's MLP parent) would not eliminate the double recovery.[15] SFPP also challenges Opinion No. 511-C's observation that Table 1 in SFPP's post-*United Airlines* remand supplemental comments showed that a DCF ROE based on an MLP proxy group provided investors with a pre-tax investor return.[16] SFPP now seeks to disavow this table, arguing that it was superseded by further arguments involving the double-recovery issue. SFPP similarly argues that due to an over-reliance upon *United Airlines* the Commission failed to address SFPP's argument that there is no short-term period in which MLP investors will receive a higher return than corporate shareholders.[17]

[14] SFPP Rehearing at 8-15.

[15] *Id.* at 14.

[16] *Id.* (citing Opinion No. 511-C, 162 FERC ¶ 61,228 at n.51).

[17] *Id.*

9. In addition, SFPP raises a number of objections to the Revised Policy Statement and its purported application to SFPP. While acknowledging that Opinion No. 511-C never cited the Revised Policy Statement,[18] SFPP argues that the Commission implemented the Revised Policy Statement as a binding rule in Opinion No. 511-C without considering the factors specific to SFPP.[19] SFPP also argues that the Commission failed to address the evidence submitted in the Revised Policy Statement proceeding (Docket No. PL17-1) that demonstrated that there is no double recovery when an MLP receives an income tax allowance. SFPP argues that in the Revised Policy Statement the Commission arbitrarily found that all MLPs should be denied an income tax allowance while addressing all other partnerships on a case-by-case basis. SFPP argues that the Commission provided no rational basis for treating MLPs such as SFPP differently than other pass-through entities.[20]

b. Discussion

10. We affirm the findings in Opinion No. 511-C that a double recovery results from granting SFPP an income tax allowance and a DCF ROE. Contrary to SFPP's claims, the Commission examined the record and the parties' comments on remand and reached a decision based on the following findings:

[18] *Id.* at 15.

[19] *Id.* at 15-19. SFPP also requested that the Commission hold this proceeding in abeyance pending the outcome of the rehearing requests on the Revised Policy Statement. An answer opposing SFPP's motion to hold the proceeding in abeyance was filed on May 1, 2018 by American Airlines, Inc. (formerly US Airways, Inc.), United Airlines, Inc., Delta Air Lines, Inc., Southwest Airlines Co., BP West Coast Products LLC, Chevron Products Company, ExxonMobil Oil Corporation, and Valero Marketing and Supply Company. On May 9, 2018, SFPP filed a motion for leave to answer and answer, and on June 11, 2018, SFPP filed supplemental information. This issue is now moot, as the Commission issued its July 18, 2018 order dismissing the requests for rehearing of the Revised Policy Statement. Revised Policy Statement Rehearing, 164 FERC ¶ 61,030.

[20] *Id.* at 17-19.

- MLPs do not incur income taxes at the entity level.[21] Instead, the partners, including both individual and corporate unitholders, are individually responsible for paying taxes on their allocated share of the partnership's taxable income.[22]

- The DCF methodology estimates the returns a regulated entity must provide to investors in order to attract capital.[23]

- To attract capital, entities in the market must provide investors (including individual and corporate unitholders) a pre-tax return, i.e., a return that covers investor-level taxes and leaves sufficient remaining income to earn investors' required after-tax return.[24] In other words, because investors must pay taxes from any earnings received from the partnership, the DCF return must be sufficient both to cover the investor's tax costs and to provide the investor a sufficient after-tax return.[25]

11. Based on the above findings, the Commission determined that "[g]iven that the DCF return is a 'pre-tax investor return,'[26] permitting SFPP to recover both an income

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[21] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22 (citing *United Airlines*, 827 F.3d at 136).

[22] *Id.* (citing 2005 Income Tax Policy Statement, 111 FERC ¶ 61,139 at P 33; *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 954 (D.C. Cir. 2007) (noting that "investors in a limited partnership are required to pay tax on their distributive shares of the partnership income, even if they do not receive a cash distribution")).

[23] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 11.

[24] *Id.* P 22 (citing *Kern River Transmission Co.*, Opinion No. 486-B, 126 FERC ¶ 61,034, at P 114 (2009) ("investors invest on the basis of after-tax returns and price an instrument accordingly")).

[25] *Id.*

[26] In *United Airlines*, the D.C. Circuit cited paragraphs 243-244 of Opinion No. 511 to support its finding that "the [DCF ROE] determines the pre-tax investor return required to attract investment, irrespective of whether the regulated entity is a partnership or a corporate pipeline," which included the following example:

> The investor desires a 6 percent after-tax return and has a 25 percent marginal tax rate. Thus, the security must have an ROE of 8 percent to achieve an after-tax yield of 6 percent. Assume that the distribution or dividend is $8. The investor will price the security at $100. Conversely, if the security price is $100 and the yield is $8, the Commission

tax allowance and a DCF ROE would lead to a double recovery of its income tax costs.[27] SFPP's rehearing does not challenge any of the above findings.

12. Furthermore, contrary to SFPP's claims, Opinion No. 511-C thoroughly addressed the evidence and arguments presented by SFPP.[28] The Commission responded to SFPP's arguments that (1) the market immediately increases the price of partnership units in response to the cash flow from an income tax allowance, thereby maintaining the same rate of return as if there was no income tax allowance,[29] (2) an income tax allowance is necessary to preserve parity between MLP and corporate-owned pipelines,[30] and (3) denying MLPs an income tax allowance would eliminate the tax benefit Congress intended to provide to pass-through entities.[31] The Commission also found no evidence that the pre-investor tax DCF ROE would fail to provide SFPP with sufficient returns.[32]

13. In response to SFPP's rehearing request, we reaffirm Opinion No. 511-C's finding that instantaneous stock price adjustments do not eliminate the double recovery that would result from permitting an MLP to recover an income tax allowance. Opinion No. 511-C explained that whether or not MLP unit prices adjust immediately (as SFPP argues) or more slowly, the double-recovery issue involves whether SFPP's income tax

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> determines that the required return is 8 percent. If the dollar distribution increases to $10, the investor will price the security at $125 because $10 is 8 percent of $125. The Commission would note that the security price is $125 and that the yield is $10, or a return of 8 percent. If the distribution is $6, the security price will drop to $75, a return of 8 percent. The Commission would observe a $75 dollar security price, a $6 yield, and a return of 8 percent. In all cases the ROE is 8 percent and the after-tax return is 6 percent based on the market-established return.

Opinion No. 511-C, 162 FERC ¶ 61,228 at P 16 n.32 (quoting *United Airlines*, 827 F.3d at 136 (citing Opinion No. 511, 134 FERC ¶ 61,121 at PP 243-244)).

[27] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 21.

[28] *Id.* PP 23-29.

[29] *Id.* PP 22-23.

[30] *Id.* P 25.

[31] *Id.* PP 26-27.

[32] *Id.* P 29.

costs have been recognized in its cost of service, and is separate from the post-rate case effects upon SFPP's MLP unit price (in this case, the unit price of SFPP's parent MLP, Kinder Morgan Energy Partners (KMEP)).[33] Rather, SFPP's DCF ROE is based upon a proxy group of seven MLPs and their DCF returns as of September 2008.[34] As Opinion No. 511-C explained, each of these seven MLPs in the proxy group must provide its investors with a sufficient pre-investor tax return to attract capital, and as a result, the DCF ROE produced by the proxy group will include investor-level tax costs.[35] The DCF ROE incorporates the investor-level income tax liability, and SFPP does not argue that it is subject to an additional income tax liability.

14. Moreover, while changes to our income tax policies may affect the unit price of regulated entities (whether SFPP's parent MLP or other MLPs in the proxy group), these changes to unit prices do not resolve the double-recovery problem or change any MLP's DCF return from a pre-investor tax return to an after-investor tax return. As Opinion No. 511-C explained, SFPP's own post-*United Airlines* remand comments in this proceeding conceded that an MLP unit will always provide a pre-investor tax return whether or not an MLP Pipeline receives an income tax allowance.[36] Although SFPP on rehearing now appears to disavow that aspect of its post-*United Airlines* remand comments,[37] SFPP's new position is not persuasive. If an MLP Pipeline obtains a new

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[33] *Id.* P 24.

[34] Those September 2008 proxy group returns predated the Commission's rulings in this case and are unaffected by the outcome of this proceeding involving SFPP.

[35] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22 n.48.

[36] *Id.* P 24 n.51. *See also supra* note 26.

[37] SFPP Rehearing at 14. Distancing itself from its post-remand comments, SFPP somewhat cryptically states that "[t]his table reflected a prior global, and now clearly unsupported, assumption that the DCF ROE always results in a pre-tax return for a *corporation*." *Id.* (Emphasis added.) This statement is puzzling for three reasons. First, Opinion No. 511-C relied upon the table's representation that *an MLP* recovers a pre-investor tax whether or not it recovers an income tax allowance, not any representation in the table regarding *corporations*. *See* Opinion No. 511-C, 162 FERC ¶ 61,228 at P 24 n.51. Second, while it is irrelevant because SFPP's proxy group does not include any corporations, the Commission is not aware of any argument made elsewhere by SFPP that the DCF return for a corporation does not include the investor-level dividend tax cost. In fact SFPP has argued the opposite in its other post-*United Airlines* filings. *See, e.g.,* SFPP Motion to Reopen the Record, August 7, 2018, Ex. 2 at 47 (example in Table 2, column 6, rows 13 and 16, describing the DCF ROE of a corporate proxy group as providing the shareholder's before-tax return). Third, by abandoning reliance upon

revenue source that increases distributions to investors (such as an income tax allowance), the unit price will rise until, once again, the investor receives the cash flow necessary to cover the investor's income tax liabilities and to earn an after-tax return that is comparable to other investments of similar risk.[38] Likewise, if the MLP's cash flows are reduced (such as via the removal of the income tax allowance) and consequently distributions decline, the MLP unit price will drop until the returns once again both cover investors' tax costs and provide the sufficient after-tax returns. Whether or not an MLP Pipeline receives an income tax allowance, the MLP's DCF return will always be a pre-investor tax return. Accordingly, permitting SFPP to recover both this pre-investor tax DCF ROE and an income tax allowance leads to a double recovery of investor-level tax costs.

15. Finally, we emphasize that such post-rate case changes to SFPP's MLP parent's unit price do not remedy Opinion No. 511-C's double-recovery concerns. Even if, SFPP's unit price immediately changes such that its percentage pre-investor tax DCF return is always the same whether or not it recovers an income tax allowance, this does not resolve the double-recovery issue as argued by SFPP. As explained above, the DCF ROE in SFPP's cost of service includes investor-level tax costs, and SFPP proposes an income tax allowance to recover those same costs. As Opinion No. 511-C explained, SFPP appears to argue that it should be permitted to recover duplicative costs in its cost of service because, as a result of any double recovery, its unit price will instantaneously rise in the market to account for the increased cash flows distributed to unitholders.[39]

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this table, SFPP is abandoning the only substantive illustration in its post-*United Airlines* remand comments and supplemental comments for why SFPP believed permitting it to recover an income tax allowance does not result in a double recovery.

[38] In other words, whether or not an MLP Pipeline recovers an income tax allowance, its investors decide whether to invest at a particular MLP unit price based upon the cash flow from the MLP unit and investors' knowledge that the cash flow must cover their after-tax return and tax liability. The income tax allowance merely allows the pipeline to increase the distributions (i.e., cash flows) to investors. These increased cash flows increase investor demand for the MLP unit and cause the MLP unit price to increase until the investor receives the percentage return that compensates the investor with a sufficient pre-investor tax return. *See supra* note 26.

[39] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 24 n.52 ("While an inflated cost of service will likely increase distributions to investors and potentially cause a pipeline's unit price to rise, such benefits to a pipeline's unitholders do not render the double recovery permissible. Under SFPP's theory, the Commission could increase SFPP's cost of service by allowing SFPP to incorporate duplicative costs, yet SFPP appears to claim

This argument is without merit. Regardless of the subsequent effects upon MLP unit prices, such double recoveries are contrary to fundamental cost-of-service principles in which a pipeline may recover a cost from ratepayers once, not twice. Subsequent inflation of the MLP unit price does not rectify a cost-of-service double-recovery.[40]

16. We also reject SFPP's related argument that, because the market MLP unit price instantaneously adjusts, "there is no short-term period in which MLP investors will receive a higher return than corporate shareholders."[41] As Opinion No. 511-C explained, the Commission ensures parity between MLP investors and corporate shareholders by disallowing the double recovery in MLPs' cost of service:

> Denying SFPP a duplicative income tax allowance also restores the parity between the rate treatment of MLPs (such as SFPP) and corporations by ensuring that neither double-recover tax costs. As discussed above, permitting SFPP to recover an income tax allowance leads to a double recovery. In contrast, no double recovery results when a corporation's cost of service includes an income tax allowance. Because the corporate income tax is not an investor-level tax, the corporate income tax is not reflected in the investor's DCF return.[42]

17. We also reject SFPP's assertion that the Commission implemented the Revised Policy Statement as a binding rule in Opinion No. 511-C without addressing the record. The holding in Opinion No. 511-C that SFPP may not recover an income tax allowance in its cost of service is based on the record in this proceeding. As discussed above, the Commission evaluated SFPP's arguments and evidence in reaching its determination, including SFPP's comments and supplemental comments on remand.[43]

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that because its parent's unit price would subsequently rise, the inclusion of duplicative costs in SFPP's cost of service is not unjust or unreasonable.").

[40] *Id.*

[41] Request for Rehearing at 14.

[42] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 25. Moreover, as Opinion No. 511-C explained, no double recovery results when a corporate pipeline's cost of service includes an income tax allowance because this so-called "first tier" corporate income tax is paid directly by the corporation, rather than by shareholders from the dividends used in the DCF methodology. *Id.* P 25 n.53.

[43] SFPP's rehearing also does not identify with specificity arguments that Opinion No. 511-C failed to address from Docket No. PL17-1 that SFPP believes are applicable to this SFPP West Line proceeding. The only specific argument SFPP's rehearing identifies

18. We dismiss SFPP's argument that in the Revised Policy Statement, the Commission arbitrarily treated MLPs differently from other pass-through entities by providing guidance that MLPs will not be permitted an income tax allowance but adopting a case-by-case approach for other pass-through entities. This argument is beyond the scope of this proceeding. Opinion No. 511-C addressed whether permitting SFPP to recover an income tax allowance in its cost of service in addition to the DCF ROE results in a double recovery. The treatment of the many other pass-through entity forms and whether they may be entitled to an income tax allowance is not at issue in this proceeding.[44] We have supported our holdings as applied to SFPP.

2. Motion to Reopen the Record

a. SFPP Motion and Shipper Answers

19. On August 7, 2018, SFPP filed a 251 page motion to reopen the record in this proceeding. SFPP proposes to include four exhibits. The proposed exhibits include SFPP's comments, reply comments and surreply comments, as well as the associated statements of Dr. James H. Vander Weide, in Docket No. PL17-1 (Exhibits 2-4),[45] and a statement of Dr. Michael J. Webb (Exhibit 1) providing evidence that MLP unit prices fell after the Revised Policy Statement and Opinion No. 511-C issued in March 2018. SFPP claims that the proposed exhibits provide evidence that there is no double recovery from including an income tax allowance in an MLP Pipeline's cost of service.

20. SFPP argues that reopening the record is appropriate because there has been a change in policy that goes to the heart of the case. SFPP asserts that the record developed in this proceeding was prior to the *United Airlines* decision and reflected adherence to the

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is that Opinion No. 511-C did not consider SFPP's arguments in Docket No. PL17-1 that SFPP's proxy group is entirely composed of MLPs. SFPP Rehearing at 15. However, Opinion No. 511-C expressly addressed that SFPP's proxy group is composed entirely of MLPs, and explained that this supported its double-recovery findings. *See, e.g.,* Opinion No. 511-C, 162 FERC ¶ 61,228 at P 29.

[44] In addition, as we explained, the record in the Revised Policy Statement proceeding does not provide a basis for addressing the double-recovery issue for pass-through business forms that are not MLPs like SFPP. Revised Policy Statement at PP 3, 45.

[45] Alternatively, SFPP moves to lodge these proposed exhibits. Motion to Reopen the Record at 21 n.45.

Commission's 2005 Income Tax Policy Statement and *ExxonMobil*.[46] Although SFPP filed comments and supplemental comments in this docket following the *United Airlines* remand decision, SFPP states that the Commission did not issue any procedures in this docket to allow for additional evidence to supplement the record following the *United Airlines* decision. Instead, SFPP states that the Commission issued the notice of inquiry and received comments from stakeholders, including SFPP, in Docket No. PL17-1. SFPP further argues that in the Revised Policy Statement Rehearing in Docket No. PL17-1, the Commission invited MLP Pipelines to demonstrate in future cases whether or not they are entitled to an income tax allowance by establishing that there is no double recovery.[47] SFPP argues that the Commission should reopen the record to afford SFPP the same opportunity that the Commission afforded other MLP Pipelines.[48] SFPP further argues that the exhibits in its Motion to Reopen the Record demonstrate that its recovery of an income tax allowance would not lead to a double recovery.[49]

21. SFPP asserts that when determining whether to reopen the record due to a change in policy, the Commission considers whether the party was on notice regarding the change in policy at the time the record was created. SFPP argues that although the participants knew that the policy was a debated issue in the proceeding prior to the *United Airlines* decision, at the time the record was created the 2005 Income Tax Policy Statement was settled law and the record was created only to defend the Commission's pre-*United Airlines* policy.[50] SFPP argues that reopening the record will promote administrative efficiency, because the Commission can issue a decision based on a complete record and the D.C. Circuit will have a complete record on appeal.[51]

22. SFPP also claims that the Commission must reopen the record in order to afford due process to SFPP. SFPP asserts that it has a significant property interest at stake and the risk that SFPP will be erroneously deprived of its right to be heard regarding its property interest is high because SFPP has not had an opportunity in this docket to meet

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[46] 487 F.3d 945.

[47] Motion to Reopen the Record at 5-9. SFPP also references *Interstate and Intrastate Natural Gas Pipelines; Rate Changes Relating to Federal Income Tax Rate,* Order No. 849, 164 FERC ¶ 61,031 (2018).

[48] Motion to Reopen the Record at 7, 11, 15-16, 20.

[49] *Id.* at 9-10, 13, 16, 21.

[50] *Id.* at 12-13.

[51] *Id.* at 17-21.

the newly established burden for supporting its income tax allowance.[52] SFPP argues that although it defended the inclusion of the income tax allowance against attacks from shippers in this proceeding, it did not have clear notice of the burden.

23. SFPP argues that when the D.C. Circuit previously invalidated Commission income tax policy in *BP West Coast*[53] leading the Commission to issue the 2005 Income Tax Policy Statement, the Commission afforded SFPP the opportunity to comment regarding how the 2005 Policy Statement should apply to SFPP's underlying case that was the subject of the *BP West Coast* decision.[54] SFPP also argues that the Commission has granted motions to reopen the record in other circumstances to address a court of appeals remand.[55] SFPP asserts that in other proceedings the Commission has allowed for paper hearings after the issuance of a policy statement.[56]

24. On August 22, 2018, Joint Shippers filed an answer to SFPP's motion. Joint Shippers assert that SFPP's motion to reopen the record reflects SFPP's effort to untimely raise additional arguments that could have been made on rehearing. Joint Shippers also argue that SFPP has not demonstrated extraordinary circumstances that justify reopening the record. Joint Shippers state that SFPP had sufficient opportunity to litigate whether including an income tax allowance results in a double recovery.

25. On September 10, 2018, SFPP filed a motion for leave to answer and answer to Joint Shippers' answer. SFPP argues that its motion is procedurally proper and supported by Commission precedent. Rule 213 of the Commission's Rules of Practice and Procedure prohibits answers to answers unless otherwise ordered by a decisional

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[52] *Id.* at 14-17, 20.

[53] *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004).

[54] Motion to Reopen the Record at 10-12 (citing *SFPP, L.P.*, 111 FERC ¶ 61,334, at PP 76-77 (2005)).

[55] *Id.* (citing *NYISO*, 110 FERC ¶ 61,244, at 62,005 (2005); *PUC v. Sellers*, 149 FERC ¶ 61,127, at 61,804-5 (2014)).

[56] *Id.* at 12-13 (citing *SFPP, L.P.*, 123 FERC ¶ 61,116 at P 12 (2008); *Texaco Ref. & Mktg., Inc. v. SFPP, L.P.*, 123 FERC ¶ 61,117 (2008); *Kern River Gas Transmission Co.*, 126 FERC ¶ 61,034 at P 21; *Duke Energy Guadalupe Pipeline, Inc.*, 123 FERC ¶ 61,057 (2008); *Martha Coakley v. Bangor Hydro-Electric Co.*, 147 FERC ¶ 61,234, at P 10 (2014)).

authority.[57] We will accept SFPP's answer as it assisted the Commission in its determination.

b. Discussion

26. As discussed below, we deny SFPP's motion to reopen the record. However, even if we were to consider the additional arguments SFPP seeks to include in this record, we would reject them as without merit.

27. SFPP has presented no basis to warrant reopening the record at this late stage in the proceeding that outweighs the need for finality in the administrative process. The Commission has discretion in deciding whether to reopen the record,[58] and "the general rule is that the record once closed will not be reopened."[59] SFPP has fully litigated in this proceeding the issue of whether including an income tax allowance in its cost of service in addition to the DCF ROE results in a double recovery. SFPP has presented its arguments regarding the double-recovery issue through briefing and expert testimony in the Commission proceeding prior to *United Airlines*,[60] briefing before the D.C. Circuit,[61] its comments and supplemental comments following the *United Airlines* remand,[62] and its request for rehearing of Opinion No. 511-C. There is no merit to SFPP's claim that it lacked notice of the double-recovery issue and was denied an opportunity to demonstrate whether or not it was entitled to an income tax allowance by establishing that there is no

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[57] 18 C.F.R. § 385.213(a)(2) (2018).

[58] 18 C.F.R. § 385.716; *Northwest Pipeline Corp.*, 76 FERC ¶ 61,068 at 61,240 (1996); *East Texas Electric Coop., Inc. v. Central and South West Services, Inc.*, 94 FERC ¶ 61,218, at 61,801 (2001).

[59] *East Texas*, 94 FERC at 61,801.

[60] *See, e.g.,* Ex. SFP-94 (Prepared rebuttal testimony of George R. Schink on behalf of SFPP); Initial Brief of SFPP at 49-64 (Sept. 30, 2009); Post-Hearing Reply Brief of SFPP, L.P. at 41-45 (Oct. 30, 2009); Brief Opposing Exceptions of SFPP at 6-22 (Feb. 22, 2010).

[61] Brief of Intervenor SFPP, L.P. in Support of Respondents, Case No. 11-1479, at 10-19 (D.C. Cir. filed Feb. 5, 2016).

[62] Comments on Remand of SFPP at 3-10 (August 25, 2016); Supplemental Comments of SFPP on Remand at 1-14 (November 30, 2016). The Commission allowed and considered SFPP's post-*United Airlines* remand comments in this proceeding. Opinion No. 511-C, 162 FERC ¶ 61,228 at PP 19-20, 23-30.

double recovery.[63] Further, the arguments made in SFPP's motion that consist of comments responding to the Revised Policy Statement in Docket No. PL17-1 could have been included in SFPP's comments on remand, supplemental comments on remand, or rehearing request in this proceeding. SFPP is procedurally barred from introducing new arguments that it failed to timely include in its request for rehearing.[64] Likewise, we reject SFPP's argument that reopening the record is necessary to afford SFPP due process, as SFPP has had multiple opportunities to be heard on this issue. The Commission will not permit SFPP to seek yet another bite at the apple at this late stage in a proceeding in which the income tax allowance has been a subject of dispute for more than a decade. "[L]itigation must come to an end at some point."[65]

28. In any event, SFPP's proposed evidence does not refute the Commission's findings that permitting SFPP to recover an income tax allowance would result in a double recovery. As an initial matter, SFPP's motion and the attached exhibits concede the Commission's key findings in Opinion No. 511-C:

- Opinion No. 511-C concluded "MLPs and similar pass-through entities do not incur income taxes at the entity level. Instead, the partners are individually responsible for paying taxes on their allocated share of the partnership's taxable income."[66] Likewise, as SFPP explains, "[t]he taxable income or taxable loss of a partnership (including an MLP) is allocated to the partners on an annual basis in accordance with their 'distributive shares' as determined by the partnership

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[63] Although SFPP claims that it did not have an opportunity to fully litigate the double-recovery issue due to the Commission's prior policy of permitting MLPs to recover an income tax allowance, the D.C. Circuit's prior *ExxonMobil* decision affirming the Commission's policy had reserved the double-recovery issue. *United Airlines,* 827 F.3d at 135. Moreover, the 2005 Income Tax Policy Statement was not a binding rule and the issue was to be fully litigated in specific cases, such as this SFPP rate case.

[64] *See Florida Power Corp.*, 63 FERC ¶ 61,208, at 62,570 (1993) (party was procedurally barred from introducing new arguments that it failed to raise in its request for rehearing in a timely manner and instead sought to include in a subsequent motion for clarification).

[65] *East Texas*, 94 FERC at 61,801 (quoting *Transwestern Pipeline Co.*, Opinion No. 238, 32 FERC ¶ 61,009, at 61,307 (1985)); *Southwest Power Pool, Inc.*, Opinion No. 562, 163 FERC ¶ 61,109, at P 222 (2018).

[66] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22.

agreement."[67] "Over the life of a partner's ownership of an interest in a partnership, that partner will be subject to tax on her share of the partnership's taxable income"[68]

- Opinion No. 511-C explained "The DCF methodology estimates the returns a regulated entity must provide to investors in order to attract capital."[69] SFPP likewise explains, "The Commission uses its DCF model equation to estimate the pipeline investor's required rate of return on equity…."[70]

- Opinion No. 511-C explained that, "[t]o attract capital, entities in the market must provide investors a pre-tax return, i.e., a return that covers investor-level taxes and leaves sufficient remaining income to earn investors' required after-tax return. In other words, because investors must pay taxes from any earnings received from the partnership, the DCF return must be sufficient both to cover the investor's tax costs and to provide the investor a sufficient after-tax ROE."[71] Similarly, SFPP states: "Investors make investment decisions based on their *after-tax* required return on investment rather than their *before-tax* required return on investment."[72] SFPP adds: "Because an investor makes investment decisions based on her required after-tax rate of return on investment, the investor must first know that her before-tax required rate of return on investment will be sufficient to allow the investor to earn an after-tax required rate of return on investment. If the investor requires a higher before-tax rate of return in order to earn an after-tax required return because of income taxation, then the investor will increase her before-tax required return above the after-tax required return so that she can recover both the income taxes on the investment and earn the after-tax required return."[73] Accordingly, SFPP acknowledges, "MLPs generally distribute cash flows to their

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[67] Motion to Reopen the Record, Ex. 2 at 6-7.

[68] *Id.* at 8.

[69] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22.

[70] Motion to Reopen the Record, Ex. 2 at 14, 39.

[71] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22.

[72] Motion to Reopen the Record, Ex. 2 at 15, 40 (Emphasis in original).

[73] *Id.* at 16, 41.

partners that are sufficient to recover the partners' income taxes and earn the partners' after-tax required return."[74]

- Therefore, Opinion No. 511-C concluded: "The DCF methodology 'determines the *pre-tax* investor return required to attract investment.'"[75] Likewise, SFPP states: "[T]he Commission's DCF model equation will measure the investor's before-tax required return on equity for the proxy companies included within the proxy group."[76]

Much like the Commission, SFPP concludes: "In *United Airlines*, the D.C. Circuit concluded that the Commission's DCF model is a before-tax rate of return on equity. SFPP and Dr. Vander Weide agree."[77] We emphasize that the above statements all support Opinion No. 511-C's determination that because the DCF ROE is a pre-investor tax return, permitting SFPP to recover an income tax allowance leads to a double recovery of investors' tax costs.[78]

29. Despite acknowledging the above facts, SFPP's Motion to Reopen the Record nonetheless alleges, based upon its filings in Docket No. PL17-1 (including affidavits of its expert Dr. Vander Wiede) (Motion to Reopen the Record, exhibits 2-4) and Dr. Webb's affidavit (Motion to Reopen the Record, exhibit 1), that the DCF model returns do not reflect investor income taxes and thus permitting SFPP to recover an income tax allowance would not lead to a double recovery of investor income tax costs.

30. In the Docket No. PL17-1 filings attached to the Motion to Reopen the Record, SFPP contends that the pre-tax investor return produced by a DCF of an MLP with a tax allowance is the equivalent of the investor's after-tax return. SFPP justifies this position on the basis that investors will not demand a higher pre-tax return because investors evaluating DCF returns in the market "recognize that their income taxes will be recovered through the income tax allowance."[79] In such circumstances, SFPP asserts that

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[74] *Id.* Ex. 4 at 10.

[75] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22 (quoting *United Airlines*, 827 F.3d at 136) (emphasis added).

[76] Motion to Reopen the Record, Ex. 2 at 40.

[77] *Id.* at 14.

[78] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 22.

[79] Motion to Reopen the Record, Ex. 2 at 14, 41-45; *see also* Ex. 4 at 13, 24 ("investors in an MLP recognize that, when their income taxes are recovered through the

investors treat the MLP investment as a tax-free bond.[80] According to SFPP's argument, MLP investors will only demand a higher pre-tax investor return if the MLP does not recover an income tax allowance.

31. We reject SFPP's assertions that an MLP investor's after-tax return always equals its pre-tax return when an MLP Pipeline recovers an income tax allowance for investors' income tax costs.[81] Contrary to SFPP's position, we find that whether or not an MLP Pipeline recovers an income tax allowance, the MLP investors' pre-tax DCF return will always exceed the investors' after-tax return. This is because MLP investors owe a tax on any income they receive whether or not a portion of a pipeline's rate is attributable to an income tax allowance.[82] We reject as illogical SFPP's argument that if MLP unitholders receive a 10 percent pre-investor tax return, the investors also will retain the same 10 percent return after the investors' pay taxes.[83] Notwithstanding the presence of an income tax allowance, the pre-investor tax ROE produced by the DCF analysis will exceed an investor's after-tax return.[84]

[income tax allowance], there is no need for them to require a grossed-up, before tax return to recover their income taxes and earn their after-tax required return").

[80] *Id.*, Ex. 4 at 18.

[81] *E.g.,* Motion to Reopen the Record, Ex. 2 at 43 (Table 1, Lines 11-15, showing the before-tax DCF ROE equaling the investor's after-tax return), 47 (Table 2, Lines 11-15, showing the before-tax DCF ROE and investor's pre-tax return equaling the investor's after-tax return), 51 (Table 3, lines 11-15 showing for a pipeline with an income tax allowance, the before-tax DCF ROE and investor's pre-tax return equaling the investor's after-tax return).

[82] *Id.*, Ex. 2 at 7-8. In other words, the Internal Revenue Code does not exempt from taxation income that results from the increases to rates resulting from the cost-of-service income tax allowance. Thus, suppose an income tax allowance increases a pipeline's rates, raising investor income from \$10 to \$12. Two things have occurred; first the investor's pre-tax income increased from \$10 to \$12 and second the investor now owes taxes on \$12 of income just as she owed taxes on the initial \$10. In other words, Commission policy does not shift the actual liability to pay income taxes from the MLP partners to the MLP itself.

[83] *E.g.,* Motion to Reopen the Record, Ex. 2 at 43 (Table 1, Lines 11-15, showing the before-tax DCF ROE equaling the investor's after-tax return).

[84] Likewise, if an MLP Pipeline's loss of its income tax allowance reduces rates and investor income, the unit price will decline until the investor once again earns an

32. We further observe that elsewhere in its Docket No. PL17-1 filings, SFPP concedes that whether or not an MLP Pipeline recovers an income tax allowance, funds to cover investor-level taxes are included in an MLP's distributions to investors.[85] These MLP distributions are the numerator in the DCF equation,[86] and, accordingly, the investors' pre-tax DCF return must by necessity exceed the investors' after-tax return once, as SFPP concedes, the investor pays its taxes from those distributions.[87]

33. Furthermore, SFPP's other filings in this proceeding contradict SFPP's arguments presented in its Docket No. PL17-1 filings that an MLP investor's pre-tax DCF return equals its after-tax return when Commission policy permits MLP Pipelines to recover an income tax allowance. Dr. Webb's affidavit, submitted as part of the Motion to Reopen the Record alongside the Docket No. PL17-1 filings, includes a table showing that whether or not an MLP receives an income tax allowance, the investors' DCF return will be a pre-tax return that differs from the investors' after-tax return.[88] Likewise, in SFPP's

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adequate pre-tax return.

[85] *Id.*, Ex. 4 at 21 (stating that even for entities with non-regulated assets without an income tax allowance, "[I]t also is reasonable for investors to expect that an MLPs distributions will be sufficient to recover their income taxes and earn their after-tax required return….").

[86] For an MLP, the DCF methodology determines for each member of the proxy group a required investor return using the formula $k = D/P + g$, where D is the MLP distribution, P is the unit price and g is the growth rate. *See supra* n.6.

[87] At times, SFPP's contradictions and inconsistencies obscure the path of its reasoning. In the Docket No. PL17-1 filings, SFPP repeatedly emphasizes that the pre-investor tax DCF return equals the after-investor tax return when a pipeline receives an income tax allowance because investors "recognize that their income taxes will be recovered through the income tax allowance." *Id.*, Ex. 2 at 14, 41-45; *see also id.*, Ex. 4 at 13, 24 ("investors in an MLP recognize that, when their income taxes are recovered through the [income tax allowance], there is no need for them to require a grossed-up, before tax return to recover their income taxes and earn their after-tax required return"). Yet, elsewhere, SFPP contends that the presence or absence of an income tax allowance is not essential to its theory. For example, in order to avoid conceding that the MLP Proxy Group produces a pre-investor tax return due to the ownership of non-regulated assets by MLP Proxy Group members, SFPP contends that an income tax allowance is no longer necessary to make an MLP's pre-tax DCF return always equal its after-tax return. *Id.*, Ex. 4 at 21-22.

[88] Motion to Reopen the Record, Ex. 1 at 8. According to Dr. Webb's Exhibit 1, if

post-remand comments and expert testimony submitted during the hearing proceeding, SFPP presented hypotheticals showing that an investor will demand a pre-tax return whether or not the pipeline receives an income tax allowance.[89]

34. We also are not persuaded by Dr. Webb's studies showing that the prices of MLP units fell significantly in reaction to the March 15, 2018 issuance of the Revised Policy Statement.[90] Even if we agreed with the studies' conclusions, the results are not relevant and do not undercut the holdings of Opinion No. 511-C. Rather, as the Commission stated in Opinion No. 511-C, "[t]his proceeding involves whether an income tax

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a regulated MLP Pipeline recovers an income tax allowance, he hypothesizes that the investor will receive a pre-tax return of 13.89 percent (Column D, line 10/Column D, line 1), pay a 28 percent individual income tax rate on that return (Column D, Line 11), and recover a net after tax return of 10 percent (Column D, line 14). Likewise, if an MLP Pipeline does not recover an income tax allowance, the share price will drop as demonstrated from $100 to $72 (Columns F, Line 1). As a result, the MLP Pipeline without an income tax allowance also earns a pre-tax return of 13.89 percent (Column F, Line 10/Column F, Line 1), pays a 28 percent individual income tax rate on that return (Column F, Line 11), and recovers a net after tax return of 10 percent (Column F, line 14).

[89] In its post-remand supplemental comments, SFPP presented a hypothetical showing that an MLP recovering both an income tax allowance and a DCF ROE earns the same 6.5 percent investor after-tax return as an MLP without an income tax allowance. *See* SFPP Supplemental Comments on Remand at 10 (Table 1, Column C and Column D). While the table in SFPP's supplemental comments on remand does not show the investors' pre-tax returns, because both pipelines were subject to a 35 percent investor-level tax, both must have recovered a 10 percent pre-tax investor return (i.e. 10 percent pre-tax investor return minus 35 percent tax equals a 6.5 percent after-tax return). Opinion No. 511-C, 162 FERC ¶ 61,228 n.51. Thus, in SFPP's own example, the cost-of-service double-recovery of income tax costs of the pipeline inflated the unit price until it earned the same pre-tax return as the pipeline without an income tax allowance. Likewise, in Exhibits SFP-98 and SFP-99, SFPP's expert presented hypotheticals that show that an investor in an MLP recovering an income tax allowance earns the same 9.207 percent investor after-tax return as an investor in an MLP without an income tax allowance. In the hypothetical, both pipelines were subject to a 32 percent investor-level tax and both recovered a 13.54 percent pre-tax investor return. *Compare* Ex. SFP-98 at column 4, lines 23 and 24 (MLP with an income tax allowance) *with* Ex. SFP-99 at column 4, lines 23 and 26).

[90] Motion to Reopen the Record, Ex. 1 at 8-9, 12-14, 21-26.

allowance should be included in SFPP's cost of service, not the post-rate case effects upon the unit price of SFPP's parent MLP."[91] Moreover, Opinion No. 511-C further explained that although eliminating the double recovery may cause MLP unit prices to decline, this does not justify perpetuation of the double recovery.[92] Dr. Webb's findings do not undermine the Commission's conclusion in Opinion No. 511-C that the DCF ROE alone (without an income tax allowance) precludes SFPP from recovering an adequate return:

> There is no evidence that the pre-investor tax DCF ROE will fail to provide SFPP with sufficient returns. The DCF ROE by itself provides the pipeline with a return commensurate with investments of corresponding risk and sufficient to attract capital, thereby satisfying the Supreme Court's standard in *Hope*. SFPP's proxy group (a) consists solely of entities of like risk selected pursuant to Commission policy and (b) contains other MLPs whose investors also incur partner-level tax costs. As discussed above, this return addresses investor tax costs while providing sufficient after-tax investor earnings to attract investment.[93]

35. Likewise, Dr. Webb's comparisons between MLP unit prices and corporate share prices are unconvincing. The Revised Policy Statement did not change the Commission's income tax policy for corporations and thus it is not surprising that according to Dr. Webb, corporate shares were not affected by the issuance of the Revised Policy Statement.[94] Similarly, it is not surprising that MLPs whose assets are not regulated by the Commission were not affected by a Commission decision that is only applicable to Commission regulated assets.

36. In sum, even putting aside the procedural deficiencies in SFPP's attempt to submit additional materials discussed above, the proposed evidence would not persuade us to alter the determinations in Opinion No. 511-C. Although SFPP has sought "to

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[91] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 24.

[92] *Id.* n.52.

[93] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 29 (citations omitted).

[94] Corporations pay an income tax prior to issuing dividends. Commission policy has long recognized that corporations and wholly owned subsidiaries of corporations can recover incurred income taxes as a recoverable cost-of-service item. The Revised Policy Statement and Opinion No. 511-C did not change this policy.

inundate the record with competing mathematical analyses,”[95] these analyses do not alter Opinion No. 511-C’s conclusions.

B. SFPP’s Alternative Argument That It Should Receive a Partial Income Tax Allowance for the Income Allocated To Its General Partner Lacks Merit

1. SFPP’s Rehearing

37. In the alternative, and to the extent that the Commission rejects SFPP’s proposal to recover a full income tax allowance, SFPP argues for the first time on rehearing that it should receive an income tax allowance for corporate income tax costs incurred by Kinder Morgan, Inc. (KMI), the general partner of SFPP’s parent MLP (KMEP). SFPP states that KMI is a corporation that pays a corporate income tax on KMEP’s income. SFPP states that 70 percent of KMEP’s income is allocated to KMI.[96]

38. SFPP justifies the proposed partial income tax allowance for KMI on the basis that KMI is similarly situated to a corporation that owns a pass-through pipeline (i.e., a pipeline that does not pay any taxes) as a wholly owned subsidiary. SFPP emphasizes that the Commission permits such pipelines to recover an income tax allowance for the corporate parent’s income tax costs. SFPP states that *ExxonMobil* further supports its position that the Commission should consider an owner’s tax costs.[97]

39. SFPP explains that 70 percent of its income is allocated to KMI even though KMI only holds a 12 percent equity stake in SFPP. SFPP explains that KMI owns 10 percent of SFPP via publicly-traded limited partner units and KMI owns an additional 2 percent via general partner interests.[98] SFPP explains that its parent KMEP has a provision in its partnership agreements for payment of incentive distributions to the general partner interests. SFPP states that, under these incentive distribution provisions, as total distributions increase, the general partner receives a larger share of the distributions, and will be allocated partnership income equal to the incentive distributions received. As a

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[95] *United Airlines, Inc. v. FERC*, 827 F.3d at 136.

[96] Request for Rehearing at 22.

[97] Request for Rehearing at 24-25 (citing *ExxonMobil*, 487 F.3d 945).

[98] SFPP’s Request for Rehearing provides additional detail regarding SFPP’s ownership structure. *Id.* at 21-22.

result, according to SFPP, the percentage of total MLP taxable income (including SFPP's income) allocated to KMI often exceeds KMI's percentage ownership of the MLP.[99]

2. Discussion

40. As discussed below, we reject SFPP's argument that it should receive a partial income tax allowance as both procedurally untimely and substantively flawed.

a. SFPP's Argument Is Procedurally Untimely

41. SFPP's argument, which it raises for the first time on rehearing, is procedurally untimely. The Commission typically rejects arguments raised for the first time on rehearing because (1) our regulations preclude other parties from responding to a request for rehearing,[100] and (2) such behavior is disruptive to the administrative process because it has the effect of moving the target for parties seeking a final administrative decision.[101] Throughout this proceeding, SFPP consistently and exclusively argued it should recover a full income tax allowance and did not present the alternative argument that it should recover an income tax allowance solely for the general partner's interest. SFPP persisted with this litigation strategy beginning with its initial filing in 2008, through the administrative law judge hearing proceeding, on exceptions before the Commission, and before the D.C. Circuit on appeal. Following the *United Airlines* remand of the Commission's decision to permit SFPP a full income tax allowance,[102] SFPP also failed

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[99] *Id.* at 22.

[100] 18 C.F.R. § 385.713 (2018).

[101] *Tenaska Power Servs. Co. v. Southwest Power Pool, Inc.*, 102 FERC ¶ 61,140, at 61,377 (2003); *Tennessee Gas Pipeline Co., LLC*, 142 FERC ¶ 61,025, at P 38 (2013); *SFPP, L.P.*, Opinion No. 522-A, 150 FERC ¶ 61,097, at P 30 (2015). *See also NRG Power Marketing, LLC v. FERC*, 862 F.3d 108, at 116-117 (D.C. Cir. 2017) (acknowledging that the Commission does not allow consideration of new evidence on rehearing).

[102] Following *United Airlines,* SFPP also neglected other opportunities in other proceedings to raise the argument that a partial income tax allowance should be presented for its general partner interest. Following the *United Airlines* decision, the Commission issued a Notice of Inquiry in Docket No. PL17-1 in December 2016 seeking comment regarding the appropriate response to the *United Airline* decision's double-recovery concerns. *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, Notice of Inquiry, 157 FERC ¶ 61,210 (2016). SFPP filed initial comments on March 8, 2017 and reply comments on April 17, 2017. In neither set of comments did SFPP raise the argument regarding the general partner that it now presents here for the first time.

to raise its argument involving a partial income tax allowance for the general partner in its August 25, 2016 comments and November 30, 2016 supplemental comments filed in response to the *United Airlines* decision. SFPP cannot raise this new argument on rehearing of the remand order, particularly where the other parties do not have an opportunity to respond.[103]

42. The untimely character of SFPP's argument is further demonstrated by the additional procedures that would be necessary to determine the appropriate income percentage allocated to KMEP's general partner KMI's share. SFPP's rehearing does not explain how it intends to implement its new partial income tax proposal, and, if the Commission contemplated SFPP's rehearing request, shippers would need the opportunity to fully respond to SFPP's new proposal. These issues likely would need to be addressed in additional hearing procedures that would further extend this decade-long litigation.

b. SFPP's Argument Is Also Substantively Flawed

43. We also deny SFPP's rehearing request as substantively flawed. First, we find that there is no basis to support any income tax allowance for the general partner KMI's tax costs. Second, we find that even if we were to permit an income tax allowance for the general partner, we would not adopt SFPP's proposal to award an income tax allowance based upon the allocation of 70 percent of SFPP's income to the general partner KMI.

i. SFPP Is Not Entitled to Any Income Tax Allowance for Its Corporate General Partner's Income Tax Liability

44. We deny SFPP's argument that it should be able to recover an income tax liability for the corporate tax liability incurred by its general partner, KMI. KMI is not, as SFPP claims, in "an identical position to a corporation that wholly owns" a pass-through subsidiary that is permitted to recover an income tax allowance for its corporate owner's tax costs.[104] As the Commission explained when addressing a similar argument in *Enable MRT*,[105] SFPP's argument "obscures the critical distinction between (a) a pipeline

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[103] 18 C.F.R. § 385.713(d)(1) ("The Commission will not permit answers to requests for rehearing"); *Tennessee Gas Pipeline Co., LLC*, 142 FERC ¶ 61,025 at P 38 (noting that the Commission generally rejects requests for rehearing that raise a novel issue that could have been previously presented in part because "our regulations preclude other parties from responding to a request for rehearing").

[104] SFPP Rehearing at 22.

[105] *Enable Mississippi River Transmission, LLC*, 164 FERC ¶ 61,075 (2018).

organized as a pass-through entity that is owned by an MLP that has corporate unitholders; and (b) a pipeline organized as a pass-through entity that is a wholly owned subsidiary of a corporation."[106] SFPP is a pipeline organized as a pass-through entity owned by an MLP, and KMI owns units in that MLP.[107] As the Commission elaborated in *Enable MRT*:

> An MLP incurs no tax liability prior to making the distribution to its unitholders that is reflected in the DCF model's determination of the MLP's ROE. Thus, the MLP's distribution includes funds that the corporate and individual unitholders may use to pay taxes on their share of the MLP's income. In contrast, a corporation that wholly owns a pass-through pipeline pays the corporate income tax prior to the investor-level dividend reflected in the DCF model's calculation of the pipeline's ROE. Thus, as Opinion No. 511-C explained, although a double-recovery results from granting a pipeline an income tax allowance to reflect the tax liability of corporate or other MLP unitholders, no double-recovery results from granting an income tax allowance to the *wholly owned subsidiary* of a corporation."[108]

Accordingly, SFPP has not provided a sufficient justification for finding that the double-recovery problem does not arise from affording a partial income tax allowance for KMI

(*Enable MRT*). *See also Trailblazer Pipeline Co. LLC*, 166 FERC ¶ 61,141, at PP 13, 28-29 (2019) (citing *Enable MRT* and explaining the difference between corporate owners of MLPs and corporate owners of other partnership forms).

[106] *Enable MRT,* 164 FERC ¶ 61,075 at P 35.

[107] SFPP's rehearing request makes no distinction between KMI's two percent general partner interests and KMI's ownership of 10 percent of the limited partner units. We agree with SFPP's equal treatment of its general and limited partnership interests. The limited partner units (including those owned by KMI) account for 98 percent of the equity in SFPP and the Commission has long relied upon the return to the limited partner units to measure an MLP Pipeline's required equity return to its owners. *See Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at PP 101-104 (2008) (explaining that the Commission determines an MLP's DCF based upon the publicly-traded limited partner shares and does not seek to determine a separate return for the general partner interest).

[108] *Id.* (emphasis original); *see also* Opinion No. 511-C, 162 FERC ¶ 61,228 at P 25.

nor has SFPP provided a sufficient basis for treating KMI differently than any other corporate investor in an MLP Pipeline.

45. We also reject SFPP's argument as inconsistent with the D.C. Circuit's opinion in *BP West Coast*.[109] SFPP seeks to treat its corporate MLP partner, KMI, differently from its non-corporate MLP partners. However, *BP West Coast* expressly overturned the Commission's then-policy of permitting a partial income tax allowance for only corporate MLP partners (including the general partner interest) while denying an income tax allowance for non-corporate MLP partners.[110] SFPP fails to support a different result here. SFPP's reliance upon *ExxonMobil* is not persuasive given that *ExxonMobil* reaffirmed the D.C. Circuit's concern in *BP West Coast* about awarding an income tax allowance to corporate MLP partners while denying an income tax allowance to MLP partners who were individuals.[111] Rather, as the *Enable MRT* order reaffirms, there is no basis for differentiating between corporate and individual MLP unitholders.[112]

ii. <u>SFPP Cannot Claim an Income Tax Allowance Based Upon the Allocation of 70 Percent of Its Income to KMI</u>

46. Although we reject SFPP's proposed recovery of any partial income tax allowance for the reasons set forth above, we also would reject SFPP's proposal to determine any such partial income tax allowance on the basis that the incentive distribution causes 70 percent of SFPP's income to be assigned to the KMI's comparatively small 12 percent equity share. SFPP's rehearing request presents the fundamental question whether income tax costs associated with the KMI general partner incentive distribution at the KMEP parent company level are properly recovered in SFPP's jurisdictional cost-of-service rates. The answer is no. We reject SFPP's argument for three separate reasons.

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[109] *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004).

[110] *Id.* at 1290.

[111] *ExxonMobil*, 487 F.3d at 948 (stating that by awarding an income tax allowance to both corporate and individual MLP unitholders, the Commission resolved the "principal defect" identified by *BP West Coast* "which was the inadequately explained differential treatment of the tax liability of individual and corporate partners").

[112] 164 FERC ¶ 61,075 at P 36 (holding that whether or not an MLP unitholder is a corporation or an individual, the unitholder's income tax costs are included in the DCF ROE); *see also Trailblazer Pipeline Co. LLC*, 166 FERC ¶ 61,141 at PP 37-39 (discussing *BP West Coast*, *ExxonMobil,* and *Enable MRT*).

47. First, permitting SFPP to recover an income tax allowance based upon the incentive distribution would provide SFPP an excessive return above that needed to attract capital. The Commission has long held that the publicly-traded MLP limited partner returns used in the DCF are a sufficient proxy for the general partner's return.[113] SFPP provides no basis for a different policy here. As Opinion No. 511-C concluded, a 12.63 percent DCF ROE provides sufficient return for investment in SFPP,[114] including recovery of investors' tax costs.[115] In this case, 98 percent of the equity in SFPP (including the majority of KMI's 12 percent total equity interest) arises from limited partner units that do not receive an incentive distribution[116] and whose investor-level taxes are recovered in the DCF return.[117] To the extent that the 12.63 percent DCF return is sufficient to attract capital from 98 percent of the equity in SFPP, SFPP has provided no support for the proposition that an additional return (such as the incentive distribution and the related tax costs) is necessary to attract capital to SFPP for the remaining 2 percent of equity provided by KMI's general partner interest.[118] In

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[113] *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at PP 101-104 (2008) (explaining that the Commission determines an MLP's DCF based upon the publicly-traded limited partner shares and does not seek to determine a separate return for the general partner interest), and *El Paso Natural Gas Co*., Opinion No. 528-A, 154 FERC ¶ 61,120 at PP 270-275 (2016) (Opinion No.528-A) (rejecting proposal to determine return for the general partner interest). The record supports a similar finding here. Compared to KMI's general partner two percent interest, KMI holds a more significant equity stake via the ownership of approximately 10 percent of the limited partner shares.

[114] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 47.

[115] *Id.* PP 22-30. The 12.83 percent DCF ROE in this proceeding is based upon market returns for the publicly-traded MLP limited partnership shares of the seven MLPs in SFPP's proxy group. Ex. SFP-5 at 9.

[116] KMI's equity stake consists of 10 percent of limited partner units and two percent of a general partner interest. The incentive distribution may be more correctly characterized as flowing to a two percent equity interest because this is KMI's actual general partner interest in SFPP. KMI's remaining 10 percent interest is in the limited partner units which do not receive an incentive distribution.

[117] *Enable MRT*, 164 FERC ¶ 61,075 at P 36 (holding that whether or not an MLP unitholder is a corporation or an individual, the unitholder's income tax costs are included in the DCF ROE).

[118] KMI's 10 percent equity interest from the limited partner shares constitutes the

particular, when, as here, the Commission has determined that a 12.63 percent return is sufficient to attract capital for SFPP, there is no reason to treat KMI as requiring a return of 442.05 percent for the two percent general partner interest or an additional 238.03 percent gross-up to that return to address tax costs associated with such a return.[119]

48. Second, if we were to adopt SFPP's proposal to permit an income tax allowance on the basis of the incentive distribution, it would lead to nonsensical results. The incentive distribution to the general partner increases only as KMEP becomes more profitable and KMEP's cash flows increase. SFPP's ratepayers should not be forced to pay increased rates because KMEP's increased profitability leads to higher incentive distributions and increased taxes associated with those distributions. Similarly, it would also be nonsensical to *reduce* SFPP's rates by lowering the income tax allowance merely because KMEP has become *less* profitable, leading to reduced incentive distributions and related tax costs for the general partner.

49. Third, we conclude that the stand-alone methodology also precludes granting an income tax allowance based upon the incentive distribution as requested by SFPP on rehearing.

50. By way of background, since the 1980s the Commission has used the stand-alone methodology to determine a regulated entity's income tax allowance when the regulated entity's income is consolidated on the tax return of its corporate parent (i.e., the regulated entity does not file its own tax return). Under the stand-alone methodology, a regulated entity's income tax allowance is based on the income and deductions specifically attributable to the regulated entity itself, not the income and deductions of the entire consolidated corporate group.[120] Thus, under the stand-alone methodology, the

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bulk of KMI's investment in SFPP. To the extent the limited partner shares failed to provide KMI with an adequate investor return, KMI would not have continued to hold those shares. Accordingly, there is no reason to provide KMI an additional return for the smaller two percent general partner equity interest.

[119] The 442.05 percent equity return is based upon allocating 70 percent of the SFPP company-wide 12.63 percent return to the 2 percent general partner interest, i.e., (12.63*.70/.02). We estimate that grossing-up the 442.05 percent equity return for the income tax allowance would effectively recognize in cost of service an income tax allowance that adds an additional 238.03 percent return to the general partner to recover the general partner's tax costs resulting from the incentive distribution, i.e., 238.03 = 442.05*(.35/(1-.35)).

[120] *City of Charlottesville v. FERC,* 774 F.2d 1205 (D.C. Cir. 1985).

Commission determines the income tax allowance using the same calculation that would be applied if the regulated entity (as opposed to the corporate parent) filed its own tax return. In practice, this means that the income tax allowance is calculated by applying the marginal income tax rate (currently 21 percent for corporations) to the regulated subsidiary's cost-of-service equity return.[121] The stand-alone methodology can be contrasted with the alternative, called the flow-through methodology. Under the flow-through methodology, the income tax allowance is based upon the lower effective tax rate that results from the corporate parent's ability on the consolidated return to offset taxable income with losses or deductions from the corporate parent's other subsidiaries.[122] Although the Commission relied upon the flow-through methodology at times prior to the 1980s, the Commission ultimately adopted the stand-alone methodology because it determined that the tax savings resulting from the regulated entity's affiliates should not be passed along to the regulated entity's "consumers when these same consumers did not pay the expenses which created the deductions for tax purposes."[123]

51. The Commission-adopted stand-alone methodology provides support for rejecting SFPP's rehearing request. As discussed above, under the stand-alone methodology, deductions or losses from an affiliated business do not offset the tax liability of the regulated entity.[124] Just as the stand-alone methodology precludes reductions to SFPP's income tax allowance as a result of the deductions and losses incurred by SFPP's affiliates, the stand-alone methodology precludes consideration of additional income tax costs (such as the incentive distribution) incurred as a result of SFPP's affiliated businesses.[125] It is inconsistent with the stand-alone methodology to increase the rates

[121] The way cost of service is determined, costs that serve as deductions (such as depreciation) are already factored into the entity's cost of service. Thus, the tax costs can simply be calculated by applying the tax rate to the equity return.

[122] For instance, under the flow-through methodology, the Commission might conclude that due to deductions, losses, and deferrals from other affiliated subsidiaries, the corporate parent only actually incurs a 15 percent tax rate as opposed to a 21 percent tax rate on the regulated entity's income and, accordingly, the income tax allowance should be based upon a 15 percent tax rate.

[123] *City of Charlottesville v. FERC*, 774 F.2d at 1208 (citation omitted). In other words, unlike the flow-through methodology, the stand-alone methodology allocates cost "on the basis of a causal link" between those costs and the services the regulated subsidiary provides to its ratepayers. *Id.* at 1211.

[124] *Id.*

[125] The incentive distribution results from the cash flows of all the entities owned by KMEP, not just SFPP. KMEP is a "large, complex enterprise" that owns five distinct

paid by SFPP's customers merely because, at the parent company level, elevated cash flows from affiliated business have increased cash flows to SFPP's parent, KMEP. Likewise, it would be inconsistent with the stand-alone methodology to decrease SFPP's rates because declining cash flows from SFPP's affiliates to KMEP have resulted in a smaller incentive distribution.

52. We acknowledge that the Commission previously accounted for the incentive distribution to determine SFPP's income tax allowance under the pre-*United Airlines* policy in Opinion Nos. 511 and 511-A.[126] However, in light of the *United Airlines* decision, and in considering SFPP's rehearing request, we no longer find persuasive the reasoning the Commission adopted regarding the incentive distribution in Opinion Nos. 511 and 511-A. Specifically, we no longer find persuasive Opinion No. 511 and Opinion No. 511-A's holding that the "historical stand-alone approach" must be modified to permit consideration of the incentive distribution for determining SFPP's income tax allowance under the circumstances presented here.[127]

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business segments, each containing multiple subsidiary business: (1) the products pipeline division (of which SFPP's West Line is only one part), (2) the CO_2 Pipelines, (3) the bulk terminals division, (4) the natural gas pipelines division, and (5) the KM Canada entities. Ex. SFP-38 at 17; SFPP April 15, 2011 Compliance Filing, Affidavit of Dale D. Bradley at P 5. SFPP's West Line provides a small percentage of KMEP's overall revenues. *See* SFPP Compliance Filing, "Tab D(1) – CONFIDENTIAL Mass Model 2007 OP511BV1.XLSX." Workpaper 1, Column E, Lines 12-19.

[126] SFPP, L.P., Opinion No. 522, 140 FERC ¶ 61,220 (2012) adopted a similar position in SFPP's 2009 East Line Rate case on the basis of the precedent established by Opinion Nos. 511 and 511-A. Opinion No. 522, 140 FERC ¶ 61,220 at PP 305-308.

[127] Opinion No. 511, 134 FERC ¶ 61,121 at PP 283-291; Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 356-359, 363-365. We emphasize that Opinion No. 511 and Opinion No. 511-A largely applied the stand-alone methodology to SFPP. As in the traditional standalone methodology, SFPP's income tax allowance was based upon the parent's income and SFPP's effective tax rate is not reduced to account for all the deductions or losses of other KMEP subsidiaries. Moreover, Opinion No. 511 also expressly relies upon the stand-alone methodology to reject a reduction in the tax allowance for unitholders' depreciation costs arising from their ownership of the MLP units. Opinion No. 511, 134 FERC ¶ 61,121 at PP 275-277, 309. *See also* Opinion No. 511-A, 137 FERC ¶ 61,220 at P 362 (explaining that section 743(b) deductions offset distributed income at the individual partner level and thus consideration of these deductions is not properly grounded in the stand-alone doctrine).

53. First, we are no longer persuaded by Opinion No. 511's statement that the incentive distribution tax costs can be recovered because they are a necessary "cost of raising capital" for SFPP.[128] Rather, the most appropriate tax costs to consider are the tax costs incurred by the limited partner investors who provide the overwhelming majority of the equity in SFPP and whose tax costs are, as SFPP's alternative rehearing argument concedes, reflected in the DCF ROE and, thus, do not require an income tax allowance.[129] As discussed above, under these circumstances, it does not seem necessary for SFPP to recover an income tax allowance as though 70 percent of SFPP's income incurs a corporate income tax in order to "attract capital."

54. Second, we are also no longer persuaded that the incentive distribution must be considered because it affects the partners' tax liability.[130] The incentive distribution (which results from cash flows at the parent level attributable to all of its affiliated pipelines) is akin to deductions and deferrals resulting from affiliates' losses. Just like the incentive distribution, these affiliate losses also affect the parent's tax liability (in this case the partner's tax liability). However, under the stand-alone methodology, the Commission only looks at the regulated entity itself and does not consider the deductions or deferrals created by these affiliated entities. Providing an income tax allowance for an incentive distribution would permit SFPP to have its cake (not reducing its income tax allowance for deferrals and deductions associated with affiliated business) while eating it too (increasing its income tax allowance as a result of increased cash flows resulting from affiliate businesses).[131]

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[128] *See supra* P 47; Opinion No. 511, 134 FERC ¶ 61,121 at P 288.

[129] We emphasize that under SFPP's argument, if all of the parent MLP's income is allocated to KMI, SFPP would argue that its income tax allowance should be based upon applying the then-effective 35 percent corporate tax rate to its *entire* equity rate base even though 88 percent of SFPP's equity investment arises from limited partner units that, as SFPP's alternative argument concedes, require no income tax allowance. *See* SFPP Rehearing, Docket No. IS09-437, at 17-20 (supporting the application of an income tax allowance at the then-applicable 35 percent corporate tax rate for the entirety of SFPP's equity rate base because, SFPP argues that on the record of that proceeding, "138 percent" of SFPP's income is allocated to the general partner).

[130] Opinion No. 511, 134 FERC ¶ 61,121 PP 288, 291; Opinion No. 511-A, 137 FERC ¶ 61,220, at PP 356, 359, 363, 365.

[131] In other words, Opinion Nos. 511 and 511-A permitted SFPP to determine its weighted average marginal tax rate based upon the allocation of income to KMI via the incentive distribution. However consistent with the standalone methodology, SFPP did

55. Third, Opinion No. 511's finding that "there is nothing illegal" about the incentive distribution is not applicable to the issues in this proceeding.[132] The legality of the incentive distribution is not the issue. Rather the issue is what costs SFPP should be permitted to recover in its cost-of-service rates.

56. Fourth, we also are no longer convinced that consideration of the incentive distribution is justified because it leaves ratepayers "no worse-off" than if SFPP (or its parent KMEP) had been organized as a corporation, which could recover an income tax allowance for corporate income tax costs.[133] This proceeding addresses the costs that may be included in SFPP's cost of service given SFPP's organization as an MLP Pipeline, not whether a different cost of service might result had SFPP been organized as a corporation or the wholly owned subsidiary of a corporation.[134]

57. Finally, we emphasize that the *United Airlines* decision required the Commission to review its prior holdings regarding incentive distributions. The distorting effect of the incentive distribution when determining the income tax allowance was relatively limited under the pre-*United Airlines* policy that permitted an income tax allowance for all MLP limited partners. Thus, at the time of Opinion Nos. 511 and 511-A, allowing SFPP to recover an income tax allowance based upon the incentive distribution merely changed whether the weighted average marginal income tax rate used in SFPP's cost of service was weighted more heavily to the then-existing 35 percent corporate tax rate or other tax rates, such as the then-existing 28 percent individual income tax rate.[135] However, as applied here in SFPP's rehearing request, the difference is between an income tax determined at the then-effective 35 percent corporate tax rate and no income tax allowance at all. This significant differential warrants more careful scrutiny, and, upon closer analysis, we have concluded that sound reasons exist for denying SFPP an income tax allowance based upon the incentive distribution.

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not and was not required to consider how affiliate losses and deductions affected the overall income tax liability arising from SFPP's income.

[132] Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 356-357.

[133] *Id.* PP 357, 363.

[134] *See e.g.,* Opinion No. 511-C, 162 FERC ¶ 61,228 at P 25 (explaining that parity between corporations and MLP Pipelines is established by denying MLPs an income tax allowance).

[135] *See, e.g.*, Ex. SFP-58.

58. Accordingly, for the reasons stated above, we conclude that SFPP should not be able to base its income tax allowance on the percentage of its income allocated to the general partner due to the incentive distribution.

III. Compliance Filing

59. On May 14, 2018, SFPP submitted its Compliance Filing to Opinion No. 511-C. The Compliance Filing calculates a revised cost of service for SFPP's West Line and revised West Line rates, as well as the estimated refund amounts for all West Line shippers. In addition to removing the income tax allowance consistent with Opinion No. 511-C, SFPP made a corresponding adjustment to ADIT. SFPP also updated its litigation surcharge and proposes to establish an Overpaid Refunds and Under-Collected Revenues Reserve.[136]

60. On June 8, 2018, Joint Shippers submitted comments and protests and Tesoro submitted a motion to intervene, protests and comments. Joint Shippers do not oppose SFPP's implementation of Opinion No. 511-C regarding ROE and the income tax allowance or SFPP's indexing adjustments to test period rates. However, Joint Shippers and Tesoro challenge SFPP's (1) ADIT adjustments, (2) litigation surcharge, and (3) Overpaid Refunds and Under-Collected Revenues Reserve. On July 11, 2018, SFPP filed reply comments.

A. Adit

61. As discussed below, the Commission finds that SFPP properly removed ADIT from its cost of service.

1. Background

62. ADIT balances generally arise from timing differences between the method of computing book accounting income used in developing the total cost of service for Commission ratemaking purposes on the one hand, and the method of computing the actual taxes payable to the Internal Revenue Service (IRS) and state governments for the same time period. For example, for book accounting and the ratemaking process a pipeline's test period cost of service assumes a tax deduction based upon straight-line depreciation of its pipeline assets, yet the IRS allows the pipeline an earlier deduction

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[136] SFPP also renewed its request to hold the proceeding in abeyance pending the resolution of the rehearing requests of the Revised Policy Statement. This issue is moot, as the Commission issued its July 18, 2018 order dismissing the requests for rehearing of the Revised Policy Statement. Revised Policy Statement Order on Rehearing, 164 FERC ¶ 61,030.

based upon Modified Accelerated Cost Recovery System (MACRS) depreciation rates as long as the benefits of the increased deduction are not flowed through to ratepayers. The annual differences between a cost-of-service tax allowance and the income taxes payable are recorded as current deferrals of income taxes. The current deferrals of income taxes are added to the beginning of the period's ADIT to calculate the end of the year's ADIT balance. Under the normalization of tax costs used in the ratemaking process, the income taxes that are ultimately owed to the IRS for which payment is deferred in the early years due to accelerated depreciation are matched[137] to the payment under the Commission's ratemaking policies' straight-line depreciated costs.[138] Generally, in the early years of an asset's life, ADIT balances increase because a pipeline's cost of service reflects a higher tax allowance than the pipeline's IRS obligations. In a pipeline's later years, the situation reverses. Thus, normalization requires shippers receiving service in the early years of an asset's life to pay their properly allocated share of the pipeline's tax expenses for the service they receive during that period.

63. As part of the normalization methodology as it applies to calculating a cost of service, the pipeline must reflect ADIT balances in its rate base. This ensures that regulated entities do not earn a return on cost-free capital based upon the timing differences between (a) when pipelines recover the normalized tax costs in rates using straight-line depreciation; and (b) when taxes are actually paid to the IRS using

[137] "The primary rationale for tax normalization is matching: the recognition in rates of the tax effects of expenses and revenues with the expenses and revenues themselves." *Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes*, Order No. 144, FERC Stats. & Regs. ¶ 30,254, at 31,522 (1981) (cross-referenced at 15 FERC ¶ 61,133), *reh'g denied*, Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 (1982), (cross-referenced at 15 FERC ¶ 61,133), *aff'd, Public Systems v. FERC*, 709 F.2d 73 (D.C. Cir. 1983).

[138] The normalization method differs from the "flow-through" method where the tax allowance for regulatory ratemaking purposes reflects the actual amount of taxes paid in each year. Under the flow-through method the then-current ratepayers realize the tax benefits of the entire tax deduction in the year the deduction is taken, whereas the tax expenses will be charged to future ratepayers in the later years when the deferred tax payments are made. Normalization avoids the problem whereby the timing difference subsidizes current ratepayers at the expense of future ratepayers and avoids the need for the entity to increase rates in an asset's later years to cover payment of deferred taxes. *Public Systems*, 709 F.2d at 75-76, 80.

accelerated depreciation.[139] These timing differences create "cost-free" capital because the pipeline may use these funds without paying either a return to equity investors or interest on debt.[140] In a cost-of-service proceeding, the Commission requires the pipeline to deduct the sums in the ADIT liability accounts from rate base so the pipeline does not improperly earn a return on amounts funded by cost-free capital.[141] Reflecting ADIT in rate base generally lowers rates because the pipeline does not earn a return on the deferred taxes.[142]

2. SFPP Compliance Filing, Protests and Comments

64. SFPP's Compliance Filing removed its income tax allowance. SFPP also made a corresponding adjustment to remove the ADIT of SFPP's partners, i.e., eliminate the deduction from rate base of ADIT liability accounts.[143]

65. Joint Shippers and Tesoro oppose SFPP's adjustment to remove ADIT. They argue that as a result of the elimination of SFPP's income tax allowance, the entire ADIT balance is overfunded and should be amortized to shippers.[144] Joint Shippers argue that permitting SFPP to eliminate ADIT would result in an undeserved windfall.[145] Joint Shippers argue that requiring SFPP to amortize the ADIT balance to shippers is no different from the Commission's approach for remedying overfunded ADIT caused by a

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[139] Once accelerated depreciation has caused the asset to fully depreciate for federal and state income tax purposes, the pipeline begins to pay the deferred taxes and ADIT decreases. Ultimately, at the end of the property's service life, the ADIT liability will be reduced to zero.

[140] *Arco Pipe Line Co.*, Opinion No. 351, 52 FERC ¶ 61,055, at 61,238 (1990).

[141] The deduction of ADIT from rate base reflects the lower cost of service that a pipeline achieves by its use of the cash flow from deferred taxes in place of debt and equity capital. Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 at 30,128.

[142] *Public Systems*, 709 F.2d at 83.

[143] *See* Compliance Filing, Verified Statement of George R. Ganz at PP 7-9.

[144] Joint Shippers Protest at 5-23; Tesoro Protest at 7-8.

[145] Joint Shippers Protest at 5, 13, 14.

tax rate decrease, except there, only a portion of the ADIT is overfunded whereas here, the entire ADIT balance is overfunded.[146]

66. Joint Shippers and Tesoro assert that the deferred tax reserve was intended to compensate for income tax liabilities in the future, but now the ADIT balance is no longer associated with any valid cost, as SFPP has no future tax liability that is properly recovered through an income tax allowance. Joint Shippers assert that the existing ADIT balance was recovered from *past* ratepayers who were harmed by the recovery of future investor tax liabilities not properly recoverable through an income tax allowance.[147]

67. Joint Shippers request that the Commission create a separate amortization mechanism for the ADIT balance with a related reduction to rate base. Joint Shippers argue that SFPP should amortize the ADIT over the refund period in this proceeding via a negative surcharge to the test period rates.[148] Tesoro also supports refunding the ADIT to shippers by amortizing it over the refund period as a deduction from SFPP's rates.[149]

3. SFPP's Reply Comments

68. SFPP argues that its ADIT calculation is correct, and that the shippers' proposal to amortize ADIT to ratepayers is incorrect.[150] SFPP argues that the shippers provide no support for seeking disparate treatment regarding the income tax allowance and ADIT.[151]

69. SFPP argues that ADIT is not a loan from shippers, but is analogous to an interest-free loan from the U.S. Treasury.[152] According to SFPP, the Commission recognizes that (1) the deferred income tax balance does not represent a fund to which shippers have entitlement and (2) payments made under a normalized tax allowance merely cover costs

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[146] *Id.* at 16-20.

[147] *Id.* at 17.

[148] *Id.* at 6, 17-18, 21-23.

[149] Tesoro Protest at 8 (quoting Ex. B at PP 7-9).

[150] SFPP Reply at 5-37.

[151] *Id.* at 32-33.

[152] SFPP Reply at 9. SFPP also argues that Joint Shippers' requested relief is unreasonable in light of pending rehearing requests on the Revised Policy Statement, Opinion No. 511-C and Opinion No. 522-B. *Id.* at 31.

attributable to that period.[153] SFPP also argues that the shippers' analogy to the context of an income tax rate reduction is inapposite. Where there is a tax rate decrease, SFPP states that the Commission views the portion of the loan from the U.S. Treasury related to the reduced income tax liability to have been forgiven, which results in income for the pipeline that reduces its cost of service and going-forward rates. The excess ADIT balance is amortized via a reduction to the income tax allowance. In contrast, SFPP asserts that here, the Commission required SFPP to remove its income tax allowance. SFPP claims that the ADIT balance is not overfunded, but instead has no applicability where SFPP does not have an income tax allowance.[154]

70. SFPP claims that ADIT is not a fund to which shippers have an equity interest. SFPP states that when an asset with an ADIT balance is sold in a manner that generates a depreciation recapture tax, the Commission views the income tax liability associated with the ADIT as paid, and the loan related to the liability as repaid in full by the pipeline, so ADIT is extinguished. SFPP asserts that in both the context of a tax rate reduction and sale of an asset, the ADIT balance is treated as a source of financing for the pipeline in which ratepayers have no equity interest. SFPP argues that in this proceeding, the ADIT balance never existed in the first place because under the Commission's revised policy there is no longer an income tax allowance from which to generate it.[155]

71. SFPP argues that the Commission's rationale for removing an income tax allowance from MLPs compels the removal of the associated ADIT. SFPP states that if the DCF ROE captures the partners' income tax liability, the ROE also captures any benefits of accelerated depreciation flowed to those partners. SFPP states that the liability (income tax expense) and asset (accelerated depreciation of those expenses) stem from the same source and there is no basis for affording them disparate treatment.[156]

72. SFPP represents that its rates from 1992 until the test period were the subject of litigation resolved by black-box settlements. SFPP argues that the shippers are barred from seeking to recover ADIT collected during the settlement period. SFPP claims that any amounts that it may have double recovered due to the prior income tax policy for the period 2005 through August 1, 2008 are covered by the settlement period, and the return of such amounts would violate the settlement and the rule against retroactive

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[153] *Id.* at 14.

[154] *Id.* at 16-18, 33.

[155] *Id.* at 16, 19-21, 34-36.

[156] *Id.* at 22, 34.

ratemaking.[157] SFPP also asserts that it has not over-collected anything after initiating this proceeding because those rates are subject to refund, and Opinion No. 511-C returns shippers to a position as if no income tax allowance had been collected during the refund period.[158]

73. SFPP notes that the shippers adopted the Brattle Report filed in Docket No. RM18-12 into their comments in this proceeding, along with additional witness affidavits.[159] In order to address the ADIT issues presented by the shippers, SFPP states that it included the Verified Statement of Dr. Michael Webb (Exhibit 1 to SFPP's Reply Comments). SFPP states that to the extent necessary, SFPP moves to reopen the record to include Dr. Webb's Verified Statement.[160] On July 26, 2018, Joint Shippers filed an answer arguing that it is unnecessary to reopen the record to admit Dr. Webb's Verified Statement as part of the formal evidentiary record.

4. Revised Policy Statement Rehearing

74. Subsequent to the above comments, on July 18, 2018, the Commission issued the Revised Policy Statement Rehearing, which provided guidance that where the income tax allowance is eliminated from cost-of-service rates under the Commission's post-*United Airlines* policy, the pipeline may also eliminate previously-accumulated sums in ADIT from cost of service instead of flowing these previously-accumulated balances to ratepayers.[161] The Commission explained that this guidance is consistent with

[157] *Id.* at 15, 25-31 (citing Docket Nos. OR92-8 and OR96-2, *et al.*).

[158] *Id.* at 26. SFPP also argues that if the proposal to amortize ADIT is accepted, (1) the ADIT balance should be amortized over the remaining life of the pipeline, not the refund period, and (2) ADIT should be subtracted from rate base to reflect new just and reasonable rates, not separately refunded through a negative surcharge. *Id.* at 31-32.

[159] Joint Shippers include Exhibit B, an Affidavit of Matthew P. O'Loughlin, and Exhibit C, an Affidavit of Daniel S. Arthur, in support of their comments and protest. Attachment 1 to Exhibit B is the following report that was filed in Docket No. RM18-12: *Analysis of the Effect of the Tax Cuts and Jobs Act and Revised Policy Statement Treatment of Income Taxes on Commission-Jurisdictional Rates*, Matthew P. O'Loughlin, Daniel S. Arthur, and Michael R. Tolleth, Docket No. RM18-12 (May 21, 2018) (Brattle Report). Tesoro includes Exhibit B, the Declaration of Peter K. Ashton in support of its protest.

[160] SFPP Reply at 4 n.5.

[161] Revised Policy Statement Rehearing, 164 FERC ¶ 61,030 at PP 10, 13.

(1) Commission and IRS regulations; (2) Commission precedent that shippers do not have an ownership interest in previously accumulated sums in ADIT; and (3) D.C. Circuit precedent suggesting that returning the ADIT amounts would violate the prohibition against retroactive ratemaking.[162] The Commission recognized that the guidance provided in the Revised Policy Statement Rehearing is non-binding and the Commission would have to fully support and justify its application in individual cases.[163]

5. Shippers' Supplemental Comments

75. Joint Shippers and Tesoro filed supplemental comments responding to both SFPP's Reply Comments and the Revised Policy Statement Rehearing.[164] Tesoro also adopts Joint Shippers' positions on ADIT and proposed remedy.[165]

76. Joint Shippers argue that there is good cause to grant leave to file the supplemental comments as (1) SFPP withheld arguments in support of a major component of its compliance filing until SFPP's reply comments, referring in particular to the Verified Statement of Dr. Webb, and (2) Joint Shippers should be afforded an opportunity to develop a record associated with the ADIT policy announced in the Revised Policy Statement Rehearing. Joint Shippers include a supplemental affidavit of Matthew P. O'Loughlin as Exhibit 1 to the supplemental comments. Tesoro also includes the Declaration of Peter K. Ashton in its supplemental comments that responds to Dr. Webb's statement.

77. Joint Shippers claim that under the Commission's tax normalization policies and precedent, SFPP's overfunded ADIT balance, which is not needed to cover future anticipated taxes, must be amortized to ratepayers. Joint Shippers assert that such policy of amortizing an overfunded ADIT balance back to ratepayers is illustrated where future

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[162] *Id.*

[163] *Id.* P 6.

[164] Joint Shippers Motion to File Surreply Comments and Surreply Comments (August 17, 2018) (Joint Shippers Surreply Comments); Tesoro Motion for Leave to File Supplemental Reply Comments and Supplemental Reply Comments (July 26, 2018).

[165] Tesoro adopts Joint Shippers' proposal to use a negative surcharge to refund the ADIT balance as well as the time-varying component associated with the refund balance. Tesoro Supplemental Reply Comments at 9-10 and attached Declaration of Peter K. Ashton.

tax liabilities are reduced when tax rates are reduced.[166] Joint Shippers argue that if SFPP is treated differently than a pipeline that experiences a tax rate decrease, it will collect a windfall profit.[167] Joint Shippers and Tesoro rely on the Commission's statement in Order No. 144 that "[a]ny excess or deficiency in the deferred tax reserve does not, however, result in a windfall to either shareholders or ratepayers since the balances will systematically be subject to a reconciliation in future rates."[168]

78. Joint Shippers and Tesoro claim that SFPP incorrectly characterizes the deferred tax component of ADIT as a loan from the U.S. Treasury. Joint Shippers argue that the shippers (not the Treasury) paid the rates that gave rise to the ADIT balance. Joint Shippers further argue that ADIT is not properly characterized as a loan, either from ratepayers or the government, but instead is a regulatory account established as part of the Commission's tax normalization policy to quantify the amount of deferred taxes.[169] Joint Shippers claim that ADIT balances account for a prepayment by shippers for an anticipated future expense, and as such, the goal is to maintain the deferred tax reserve as nearly as possible as a revenue neutral fund.[170] According to Joint Shippers, Commission precedent dictates that excess ADIT should be treated no differently than any other excess prepaid amount for a deferred cost and should be amortized back to ratepayers.[171] Similarly, Tesoro argues that ADIT was collected through rates charged to shippers for a non-existent tax and, as there is no future tax liability, must be refunded to shippers.[172]

79. Joint Shippers claim that SFPP and the Revised Policy Statement Rehearing mistakenly focus on the fact that shippers do not have an ownership interest in the ADIT balances, when neither the carrier nor the ratepayer have an ownership interest in ADIT. Joint Shippers state that ratepayers do not have an ownership interest in ADIT balances, as they represent prepaid sums for a specific anticipated future expense. Joint Shippers claim that as the pipeline also has no interest in the excess ADIT, under Commission

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[166] Joint Shippers Surreply Comments at 7-11, 18, 20-21, 24.

[167] *Id.* at 39-40.

[168] *Id.* at 15 (quoting Order No. 144, FERC Stats. & Regs. ¶ 30,254); *see also id.* at 18, 50; *see also* Tesoro Supplemental Comments at 6.

[169] Joint Shippers Surreply Comments at 12-14.

[170] *Id.* at 14-15.

[171] *Id.* at 17.

[172] Tesoro Supplemental Comments at 5-6.

policy excess ADIT should be amortized to ratepayers. Joint Shippers state that ADIT balances are contributed by ratepayers on a cost-free basis to the carrier and the ADIT balance is accordingly deducted from rate base. Joint Shippers claim that if SFPP's position were adopted, SFPP would begin as of 2008 to earn a return on the ADIT balance because that balance would be pocketed by SFPP and not deducted from rate base, transforming a sum that the Commission treats as cost-free capital into pure profit.[173]

80. Joint Shippers argue that SFPP's analogy to the Commission's policy of zeroing out ADIT balances when the pipeline's assets are sold fails to support the view that SFPP may zero out ADIT in the situation at hand. Joint Shippers point out that an asset sale is a taxable event whereby the anticipated future tax obligations become immediately due and payable and the Commission's policy is to remove the deferred tax balance from cost of service. Joint Shippers assert that the ADIT balance is only zeroed out when it is used to pay taxes. In contrast, Joint Shippers note that taxes on SFPP's assets have not been accelerated as a result of the Commission's decision prohibiting SFPP from including an income tax allowance in cost of service.[174] Further, Joint Shippers state that only normal ADIT, that is balances that are aligned with the future tax liability that is incurred at the time of sale, is zeroed out when an asset is sold. According to Joint Shippers, the same logic does not apply to excess ADIT that exceeds the anticipated tax liability.[175]

81. Joint Shippers argue that contrary to SFPP's position, the Commission does not permit pipelines to use deferred reserve accounts, such as ADIT and dismantlement, removal, and restoration (DR&R) to generate profits based on the underlying expense. By eliminating the overfunded ADIT balance, Joint Shippers argue that SFPP seeks to enjoy an undue windfall profit. Instead, Joint Shippers argue that to the extent ADIT or DR&R funds become overfunded, it is established Commission practice to amortize the excess funds back to ratepayers.[176]

82. Joint Shippers and Tesoro assert that, contrary to SFPP's claims, amortizing ADIT back to ratepayers would not violate settlement agreements with shippers.[177] First, Joint

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[173] Joint Shippers Surreply Comments at 17-18.

[174] *Id.* at 20.

[175] *Id.* at 19-21.

[176] *Id.* at 15-16, 31.

[177] *Id.* at 33 (citing *SFPP, L.P.*, 131 FERC ¶ 61,180 (2010); *SFPP, L.P.*, 134 FERC ¶ 61,201 (2011)); Tesoro Supplemental Comments at 7-9.

Shippers argue that adjusting prospective rates to account for an overfunded ADIT balance does not change any rate charged during the settlement period. Second, Joint Shippers and Tesoro argue that in any event, the settling shippers were expressly permitted to continue to pursue all claims (including those related to the settlement period) in this proceeding.[178]

83. Joint Shippers and Tesoro argue that the rule against retroactive ratemaking does not prohibit returning excess ADIT to ratepayers. According to Joint Shippers, the amortization of the ADIT balance to ratepayers does not represent a change in SFPP's past rates in effect prior to SFPP's rate filing in this case, or a prospective change to make up for unjust and unreasonable rates collected in the past.[179] Joint Shippers claim that the doctrine of retroactive ratemaking does not consider the time when a prepayment for a future anticipated cost is made.[180] Instead, the relevant issue according to Joint Shippers is how the ADIT funds are to be treated to resolve issues regarding SFPP's rate at issue in this proceeding prospectively.[181] Joint Shippers argue that retroactive ratemaking is not implicated by the proposed remedy to address the treatment of SFPP's excess ADIT balance going forward for prospective rates, where shippers have not sought refunds associated with periods prior to the rate filing in this matter.[182] Joint Shippers assert that retroactive ratemaking is not applicable as all participants have been on notice by virtue of the Commission's long-standing tax normalization policy that a carrier is required to reconcile over-recoveries of ADIT through prospective rate adjustments.[183] Joint Shippers argue that in *Town of Norwood*,[184] the D.C. Circuit found that the Commission's switch to tax normalization did not violate the rule against retroactive ratemaking.[185] Joint Shippers assert that when the corporate tax rate fell in 1986, the Commission found

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[178] Joint Shippers Surreply Comments at 33-38.

[179] *Id.* at 21-24.

[180] *Id.* at 25-26; *see also id.* at 40-41.

[181] *Id.* at 26; *see also id.* at 41.

[182] *Id.* at 21-24, 25-27; *see also id.* at 44-45.

[183] *Id.* at 21-24, 27-29.

[184] *Town of Norwood, Mass. v. FERC*, 53 F.3d 377 (D.C. Cir. 1995).

[185] Joint Shippers Surreply Comments at 29-30.

that amortizing excess ADIT to ratepayers did not constitute retroactive ratemaking,[186] and the Commission has relied on this logic in other contexts.[187]

84. Joint Shippers argue that the rule against retroactive ratemaking prohibits SFPP's proposal to zero out its ADIT balance. Joint Shippers point out that SFPP collected an income tax allowance in rates and deferred taxes. Joint Shippers argue that permitting SFPP to zero-out its ADIT balance retroactively (1) transforms cost-free capital that must be deducted from rate base into an increased rate base on which increased return would be provided, and (2) extinguishes the right of ratepayers under Commission normalization policies to an amortization back of overfunded ADIT balances. According to Joint Shippers, SFPP is proposing to apply the Commission's new policy retroactively such that it would double recover its investor income taxes for years but still pretend, for ADIT purposes, that the double recovery never happened.[188]

85. Joint Shippers and Tesoro challenge the Commission's reliance on *Public Utilities*[189] to find that the amortization of ADIT would constitute retroactive ratemaking in the guidance provided in the Revised Policy Statement Rehearing. In their view, *Public Utilities* is distinguishable because in that case the deferred tax reserve was collected through rates for gas sales that subsequently were made according to statutory ceiling rates as a result of the Natural Gas Policy Act, so there was no jurisdictional cost-based gas sales rate to adjust.[190] Joint Shippers claim that the Commission has rejected arguments premised on *Public Utilities* that amortization of excess ADIT or other overfunded deferred expense balances to ratepayers is restricted.[191] Tesoro argues that *Public Utilities* does not apply because SFPP's rates have been suspended and subject to a refund obligation in connection with this proceeding.[192] Tesoro states that similar

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[186] *Id.* at 30 (citing *El Paso Nat. Gas Co.*, 43 FERC ¶ 61,258 (1988)).

[187] *Id.* at 30-31.

[188] *Id.* at 31-32.

[189] *Public Utilities Comm'n of State of Cal. v. FERC*, 894 F.2d 1372 (D.C. Cir. 1990).

[190] Joint Shippers Surreply Comments at 44-46; *see also* Tesoro Supplemental Comments at 10-11.

[191] Joint Shippers Surreply Comments at 47-48.

[192] Tesoro Supplemental Comments at 11.

arguments that reparations are barred by retroactive ratemaking have been rejected in prior cases.[193]

86. Joint Shippers argue that the Revised Policy Statement Rehearing results in inconsistent treatment of MLP-owned pipeline and corporate pipeline ADIT amounts without providing any explanation. Joint Shippers assert that the Commission incorrectly implies that because MLP-owned pipelines no longer have an income tax in rates, there is no need to account for existing ADIT. Joint Shippers explain that where the ADIT balances were accumulated, MLP-owned pipelines did include an income tax allowance in rates. According to Joint Shippers, permitting carriers to eliminate these balances incorrectly assumes that the income tax allowance was eliminated retroactively instead of prospectively. Joint Shippers argue that the excess ADIT amount generated from the prior income tax allowance did not disappear and remains a source of cost-free capital that the carrier should not earn a return on, let alone retain as a windfall contrary to the Commission's tax normalization policy. Further, Joint Shippers argue that MLP-owned pipelines continue to recover an income tax component in their cost-of-service rates via the DCF ROE which includes investor-level taxes.[194] Finally, Joint Shippers and Tesoro argue that returning the excess ADIT to ratepayers is a just and reasonable remedy that is consistent with principles of fairness and equity, whereas permitting SFPP to extinguish ADIT and retain a windfall profit is not.[195]

87. In addition, Tesoro argues that the Revised Policy Statement Rehearing does not apply to SFPP's Compliance Filing because SFPP's rates from 2008 to present are subject to refund. As such, Tesoro argues that the Commission has the authority to order SFPP to return the ADIT balance.[196]

6. <u>Commission Determination</u>

88. We will consider the shippers' and SFPP's comments and supplemental comments on the ADIT issues, including all supporting affidavits and attachments. We find that these materials assisted us in the decision-making process regarding the ADIT issue.

89. SFPP's Compliance Filing eliminated income taxes from its cost of service. No party takes issue with the Compliance Filing's removal of the income tax allowance line

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[193] *Id.* at 13-16.

[194] Joint Shippers Supplemental Comments at 41-44.

[195] *Id.* at 48-53; *see also* Tesoro Supplemental Comments at 6.

[196] Tesoro Supplemental Comments at 3-5.

item. As discussed above, we reject SFPP's rehearing request for an income tax allowance; therefore, the findings of Opinion No. 511-C are unchanged. Accordingly, we find that the component of the Compliance Filing eliminating income taxes from SFPP's cost of service complies with Opinion No. 511-C. In addition, the Compliance Filing eliminated the recognition of ADIT balances of approximately $28,021,359 (as there is no longer an income tax allowance). Elimination of these ADIT balances results in the Compliance Filing's calculated rate base increasing by a like amount. As discussed below, we find that the previously accumulated sums in ADIT are properly eliminated and not amortized to shippers. The shippers' arguments and the record in this proceeding do not compel a different finding.[197]

a. SFPP Appropriately Eliminated the ADIT Balance

90. We find that it was appropriate for SFPP to eliminate its ADIT balance from its cost of service because (1) the income tax allowance was removed from cost of service, (2) shippers have no right to the sums previously accumulated in ADIT, and (3) requiring SFPP to return the previously accumulated sums in ADIT would be retroactive ratemaking.

91. Once an income tax allowance has been removed from cost of service, as is the case for SFPP, there is no basis to continue to include ADIT to normalize the pipeline's income tax costs. As SFPP is not permitted to recover an income tax allowance in its rates, there is no rationale for requiring SFPP to record current or deferred income taxes on its books. As explained above, ADIT is a regulatory construct to ensure that regulated entities do not earn a return on cost-free capital based upon timing differences between federal and state tax liability and Commission ratemaking. The purpose of normalization is matching the pipeline's cost-of-service expenses in rates with the tax effects of those same cost-of-service expenses. If there is no income tax allowance in Commission rates, there is no basis for the "matching" function of normalization, including ADIT. In addition, regulations regarding normalization for natural gas pipelines only apply to entities with an income tax allowance component in their regulated cost-of-service

[197] We recognize that the Revised Policy Statement Rehearing provided guidance of the course of action the Commission intended to follow in future adjudications and did not establish a binding rule. Revised Policy Statement Rehearing, 164 FERC ¶ 61,030 at P 6. We have thoroughly considered the arguments presented by the parties and the record in this proceeding in reaching our determinations regarding SFPP's rates in this order.

rates.[198] Although these rules are not specifically applicable to oil pipelines such as SFPP, the same principles apply.[199]

92. Furthermore, ratepayers have no equitable interest or ownership claim in ADIT. Rather, the Commission and the D.C. Circuit have rejected such claims.[200] Consistent with these holdings, ADIT is not a true-up or tracker of money owed to shippers.[201] Rather, ADIT records the amount of income taxes that the pipeline has collected due to normalization and which it will eventually owe the federal government (not ratepayers) but which have been deferred pending the reversal of the timing difference such as accelerated depreciation. The balances recorded in ADIT accounts reflect deferred taxes

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[198] 18 C.F.R. § 154.305(a) ("An interstate pipeline must compute *the income tax component of its cost-of-service* by using tax normalization for all transactions."); 18 C.F.R. § 154.305(b)(1) ("Tax normalization means computing *the income tax component* as if transactions recognized in each period for ratemaking purposes are also recognized in the same amount and in the same period for income tax purposes."); 18 C.F.R. § 154.305(b)(4) ("*Income tax component* means that part of the cost-of-service that covers income tax expenses allowable by the Commission."); *see also* 26 U.S.C. § 168(i)(9)(A) ("the taxpayer must, in computing its *tax expense for purposes of establishing its cost of service for rate-making purposes*…use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes….") (emphasis added).

[199] *See Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,837-38 (1985).

[200] *Public Systems*, 709 F.2d at 85 (rejecting the notion "that ratepayers have an ownership claim" to the ADIT balance); *Public Utilities*, 894 F.2d at 1381 ("The Commission and this Court have both rejected" "the notion that under normalization accounting customers enjoy an equitable interest in a utility's deferred tax account"); Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,539 (addressing the "erroneous premise that a loan is being made by ratepayers to utilities" through the normalization process and stating that ratepayers do not "have an ownership claim or equitable entitlement to the 'loaned monies'"); *id.* at 31,539 n.75 ("This is not to say that customers do not pay rates that recover deferred taxes. They do. But paying deferred taxes in rates does not convey an ownership or creditor's right.").

[201] *Lakehead Pipe Line Co. L.P.,* 75 FERC ¶ 61,181, at 61,594 (1996)). There would be practical problems with maintaining such a tracker as, unlike SFPP, many oil pipeline rates have never been subject to a cost-of-service rate proceeding. For these pipelines, no cost-of-service income tax allowance has been established.

that are ultimately owed to the IRS. Once the tax obligations are settled, the associated ADIT amounts are eliminated. For example, when the pipeline must pay these deferred taxes to the federal government as a result of a sale of the asset, the ADIT associated with the asset is eliminated (not returned to shippers).[202] Therefore, we find that SFPP appropriately eliminated ADIT from its cost of service.

93. Finally, returning ADIT to shippers violates the doctrine against retroactive ratemaking. The rule against retroactive ratemaking bars "the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate."[203] Under the Interstate Commerce Act (ICA), the Commission only has the authority to address over-recovery by prospectively changing a pipeline's rate, and may not retroactively refund over-collected amounts.[204] Requiring SFPP, whose tax allowance is eliminated, to amortize to ratepayers ADIT that was lawfully collected under previously filed and approved rates would infringe on the rule against retroactive ratemaking. To do so would, effectively, retroactively apply the holding in Opinion No. 511-C by requiring SFPP to refund either the income tax allowance expenses or deferred tax reserves recovered under past rates for service prior to the commencement of this proceeding. Any attempt to refund such amounts to shippers would be impermissible, as it would rest on a post hoc finding that SFPP's past rates were not just and reasonable.[205]

94. Rates designed pursuant to the normalization principles described above do not "over-collect" the pipeline's tax expenses in the early years. Rather, such rates require shippers receiving service in the early years to pay their properly allocated share of the pipeline's tax expenses for the period of their service.[206] For example, if a shipper only

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[202] *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at PP 158-162 (2002).

[203] *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).

[204] *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 698-700 (D.C. Cir. 2006). Although under the ICA, retroactive reparations can sometimes be awarded following a successful complaint against an oil pipeline, these reparations are, if available at all, limited to two years prior to the filing date of the complaint. 49 U.S.C. app. § 16(3).

[205] *See Public Utilities*, 894 F.2d at 1382-84, and *Associated Gas Distributors v. FERC*, 989 F2d. 809, 810 (D.C. Cir. 1990) (*per curiam*) (Williams, J. concurring) (the Commission may not "force a utility to reduce its current rates to make up for overcollections in previous periods").

[206] The Commission's primary justification for its decision to adopt tax normalization was "the matching principle: as a matter of fairness, customers who pay an expense should get the tax benefit that accompanies the expense.... To do otherwise would subsidize present customers at the expense of future ones." *Public Systems*, 709

takes service in the early years and then leaves the system, it has paid its appropriate share of the pipeline's tax expenses; the shipper has not paid an excessive amount that it could only recoup by remaining on the system into the later years. It follows that, if the Commission determines part way through the overall normalization period that the pipeline is not entitled to any tax allowance, the Commission cannot require the pipeline to return to shippers ADIT amounts collected in prior rates without engaging in retroactive ratemaking. That is because those ADIT amounts represent tax expenses that the Commission previously found were properly allocated to the approved rates in effect prior to the Commission's finding that the pipeline is not entitled to a tax allowance.

95. This analysis is supported by the D.C. Circuit's decision in *Public Utilities,* which held that requiring a pipeline to credit ratepayers for earnings on an excess ADIT balance or refund the balance to ratepayers where the pipeline switched from cost-of-service rates to ceiling prices violated the rule against retroactive ratemaking. The D.C. Circuit found that ADIT "is composed entirely of rate revenue that [the pipeline] has already collected. Refund of such property, or its earnings, would effectively force [the pipeline] to return a portion of rates approved by FERC, and collected by [the pipeline]."[207] The D.C. Circuit explained that to the extent any basis for requiring the credit to ratepayers rested on the view that the pipeline's prior cost-of-service rates were "in retrospect too high"[208] or "unjust and unreasonable,"[209] then the credit for earnings on previously accumulated ADIT sums violated the rule against retroactive ratemaking. Likewise, as SFPP's income tax allowance has been eliminated as a result of Opinion No. 511-C, flowing the previously accumulated ADIT balance to shippers going-forward would amount to little more than returning rates collected for providing prior-period service, which is retroactive ratemaking.

b. <u>The Shippers' Arguments for Amortizing ADIT to Ratepayers Lack Merit</u>

96. We reject the shippers' arguments that previously accumulated sums in ADIT should be amortized to them or that previously accumulated sums in ADIT should continue to be deducted from SFPP's rate base.

F.2d at 80.

[207] *Public Utilities*, 894 F.2d at 1383.

[208] *Id.* at 1380.

[209] *Id.* at 1382.

97. The shippers argue that the Commission's tax normalization policies provide that when a pipeline's ADIT balance is overfunded and not needed to recover future tax liability, the excess balance should be amortized to ratepayers. The fundamental flaw in the shippers' arguments is that they are based on the Commission's tax normalization policies and precedents for pipelines that continue to have an income tax allowance in cost-of-service rates,[210] whereas here, the Commission has ordered SFPP to eliminate its income tax allowance altogether and held "there is no basis for imputing the partners' income tax costs to SFPP's cost of service."[211] The shippers fail to acknowledge the critical distinction between (1) adjustments to amortize excess or deficient ADIT to be included in future rates to account for changes in income tax rates, and (2) a complete elimination of the income tax allowance from cost of service. Where an income tax allowance remains in the cost of service and there is excess ADIT resulting from a reduction in tax rates, it is appropriate to credit the cost of service to reflect that the pipeline currently needs to collect a lower level of tax expenses in rates to cover the tax liability for that year. Rather than returning the excess amounts to shippers related to past service, the pipeline's cost of service is adjusted on a going forward basis to reflect the fact that it now needs to collect less than what it anticipated to cover its future tax liabilities. In contrast, where there is no income tax allowance in Commission rates, there is no basis for the "matching" function of normalization and no liability for the deferred taxes reflected in ADIT. In the absence of ADIT, there is no ADIT adjustment to rate base or amortization allowance to be reflected in cost-of-service rates. In other words, under normalization, shippers that paid past rates for service on the pipeline under which the ADIT balance was accumulated paid their properly allocated share of the pipeline's costs for the transportation service they received.[212]

98. Likewise, the Commission's decision to deny SFPP an income tax allowance is not analogous to a change in the federal tax rates, as the shippers presume.[213] The shippers correctly state that the established policy in the case of a reduction in the federal tax rates is to amortize the excess ADIT to ratepayers. We agree that a change in the

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[210] *See, e.g.,* Joint Shippers Protest at 13-16 and Joint Shippers Surreply Comments at 13-15, 24, 28-30 (describing the Commission's normalization policies under Order No. 144 and the Reverse South Georgia Method).

[211] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 28.

[212] For example, if a shipper only takes service in the early years and then leaves the system, it has paid its appropriate share of the pipeline's tax expenses; the shipper has not paid an excessive amount that it could only recoup by remaining on the system into the later years.

[213] *See, e.g.,* Joint Shippers Protest at 16-17; Joint Shippers Surreply Comments at 8, 20, 24, 30.

federal tax rates giving rise to excess deferred taxes would trigger Commission and IRS normalization requirements. This is because when income tax rates are merely reduced and an income tax allowance remains in *future* cost of service, it is appropriate to credit any excess in ADIT in the *future* cost of service. Rather than returning the excess amounts to shippers related to past service, the pipeline's cost of service is adjusted on a going forward basis to reflect the fact that it now needs to collect less than what it anticipated to cover its future tax liabilities. Again, this is not the situation here. The Commission applied its post-*United Airlines* policy to deny SFPP an income tax allowance. Where there is no income tax allowance component in cost-of-service rates, there is no rationale for requiring SFPP to continue to account for ADIT. As explained above, when the income tax allowance is eliminated due to the post-*United Airlines* policy, there are no income tax costs recognized in rates at all. That means the income tax allowance must be completely removed and there is no excess or deficient ADIT balance to amortize in the cost of service.

99. The shippers' argument that the Commission is treating MLP Pipelines and corporate pipelines differently without explanation exhibits the same fatal flaw. The difference in ADIT treatment is a consequence of the Commission's decision to adopt the shippers' position in Opinion No. 511-C that allowing an MLP Pipeline such as SFPP to recover an income tax allowance results in a double recovery because the DCF ROE is a pre-investor tax return. The Commission found that no double recovery results when a corporation's cost of service includes an income tax allowance because the corporate income tax is not an investor-level tax.[214] As a result, corporate pipelines may continue to recover an income tax allowance and correspondingly account for deferred taxes in rates, whereas MLP Pipelines like SFPP may not. We find unpersuasive the shippers attempt to circumvent this distinction by arguing that SFPP does recover an income tax component because investor-level tax costs are reflected in the DCF ROE.[215] However, the Commission's determination in Opinion No. 511-C that the DCF methodology results in a return that includes investor-level taxes does not signify that MLP Pipelines recover an income tax allowance. On the contrary, as Opinion No. 511-C explained, "there is no basis for imputing the partners' income tax costs to SFPP's cost of service" when the taxes are an investor-level cost recovered in the investor-level DCF ROE.[216] The shippers incorrectly conflate the pre-investor tax ROE with an income tax allowance component in cost-based rates in which tax costs are incurred by or imputed to the regulated entity.

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[214] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 25.

[215] *See* Joint Shippers Surreply Comments at 43-44.

[216] Opinion No. 511-C, 162 FERC ¶ 61,228 at P 28.

100. The shippers contradict themselves in acknowledging that ratepayers do not have an ownership interest in the ADIT balance,[217] but claiming that principles of equity require the ADIT balance to be amortized to ratepayers to prevent SFPP from retaining a windfall profit.[218] As the shippers appear to concede, the Commission and the D.C. Circuit have consistently held that shippers do not have an equitable interest in ADIT.[219] ADIT is not money owed to past or future ratepayers, but rather deferred taxes that are ultimately owed to the government.[220] In addition, the shippers misconstrue the Revised Policy Statement Rehearing as claiming that the removal of ADIT upon the elimination of an income tax allowance is the same as the elimination of ADIT when an asset is sold. The Commission does not suggest this in the Revised Policy Statement Rehearing. Instead, the Commission merely referred to a sale of assets as an example of another situation where ADIT is eliminated and not returned to shippers to illustrate the point that shippers do not have an ownership claim over balances recorded in ADIT.[221]

101. We reject the shippers' claim that the elimination of the ADIT balance constitutes retroactive ratemaking. On the contrary, as discussed above, to direct SFPP to flow-back ADIT that was lawfully collected under past rates to shippers would violate the rule against retroactive ratemaking because the Commission's directive would rest on a retroactive application of Opinion No. 511-C's denying SFPP an income tax allowance. While the payment of the taxes may have been deferred, the sum in ADIT reflects income tax costs for prior shippers' service as determined by the straight-line depreciation used in cost-of-service rates. As explained above, this finding comports with the D.C. Circuit's decision in *Public Utilities*, which held that requiring a pipeline to credit ratepayers for earnings on an excess ADIT balance or refund the balance to ratepayers where the pipeline switched from cost-of-service rates to ceiling prices violated the rule against retroactive ratemaking.

102. The shippers do not provide compelling grounds for distinguishing *Public Utilities.* The shippers correctly assert that in *Public Utilities*, the gas sales were made according to statutory ceiling prices as opposed to the historical cost-based method,

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[217] Joint Shippers Surreply Comments at 17.

[218] *Id.* at 48-53.

[219] *See supra* note 200.

[220] The Commission has also explained that ADIT is not a true-up or tracker of money owed to shippers. *Lakehead Pipe Line Co. L.P.,* Opinion No. 397-A*,* 75 FERC ¶ 61,181, at 61,594 (1996).

[221] Revised Policy Statement Rehearing, 164 FERC ¶ 61,030 at P 16.

whereas SFPP continues to have cost-based rates. There, as here, the basis for tax normalization no longer applied because the pipeline no longer recovered an income tax allowance.[222] The Commission was confronted with the issue of how to treat the ADIT funds that had accumulated during the previous period for that prior period's service when the pipeline had both an income tax allowance and corresponding adjustment for deferred taxes in rates. Customers unsuccessfully argued that allowing the pipeline to retain the ADIT fund or its earnings would result in an inequitable windfall.[223] The D.C. Circuit found that requiring the pipeline to flow-back the previously-accumulated ADIT balance or to credit the earnings on such balance in rates would run afoul of the rule against retroactive ratemaking.[224] As the D.C. Circuit explained, ADIT "is composed entirely of rate revenue that [the pipeline] has already collected. Refund of such property, or its earnings, would effectively force [the pipeline] to return a portion of rates approved by FERC, and collected by [the pipeline]."[225] Likewise, SFPP's income tax allowance has been eliminated as a result of Opinion No. 511-C. Flowing the previously accumulated ADIT balance to shippers going-forward would amount to little more than returning revenues collected for providing prior-period service, which is retroactive ratemaking.

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[222] *Public Utilities*, 894 F.2d at1379 (the switch "wiped out the premise of tax normalization" and hence the matching principle "ceased to operate as an explicit guide"); *id.* at 1382 ("Tax normalization sought to 'match' the timing of a customer's contribution toward a cost with enjoyment of any offsetting tax benefit." …. "Enactment of the NGPA, however, mooted the whole question to which normalization was an answer."); *see also Public Systems*, 709 F.2d at 8 (the Commission's primary justification for its decision to adopt tax normalization was "the matching principle: as a matter of fairness, customers who pay an expense should get the tax benefit that accompanies the expense.... To do otherwise would subsidize present customers at the expense of future ones.").

[223] *Id.* at 1381 (rejecting argument premised on "the notion that under normalization accounting customers enjoy an equitable interest in a utility's deferred tax account"); *id.* at 1382 (rejecting the argument that the pipeline would receive a "windfall" regarding the deferred tax reserve).

[224] *Id.* at 1383-1384 ("The Commission had no legal right to reduce [the pipeline's going-forward] rates … below levels found to be just and reasonable" as "the Commission's adjustments of those rates were in substance a retroactive adjustment of prior rates based on normalization.").

[225] *Id.* at 1383.

103. For the same reasons, we reject the shippers' claim that their proposed remedy to amortize ADIT to shippers does not constitute retroactive ratemaking because it only applies to SFPP's prospective rates.[226] SFPP's ADIT balance prior to the commencement of this proceeding was lawfully collected for the tax costs associated with prior-period service, and was consistent with the Commission's then-existing policy to allow MLP pipelines to recover an income tax allowance and accordingly also account for deferred taxes under the Commission's normalization policy.[227] The shippers' proposal to amortize the previously-accumulated ADIT balance in SFPP's prospective rates rests on an impermissible finding that SFPP's past rates were "in retrospect too high"[228] or "unjust and unreasonable."[229] The D.C. Circuit in *Public Utilities* found that "[t]his kind of post hoc tinkering would undermine the predictability which the [retroactive ratemaking] doctrine seeks to protect."[230]

104. We also reject the shippers' argument that the Commission's normalization policy provides notice to participants that SFPP is required to adjust rates to reconcile excess ADIT sufficient to satisfy the bar on retroactive ratemaking. As explained above, the Commission's normalization policy does not apply in the context of a complete elimination of a pipeline's income tax allowance. The cases cited by the shippers involve situations where the income tax allowance remains in the entity's cost of service and

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[226] The shippers argue that in a recent decision, the Commission distinguished *Public Utilities* and found that accounting for DR&R collections was not retroactive ratemaking because the remedy only concerned prospective rates. Joint Shippers Surreply Comments at 48 (citing *BP Pipelines (Alaska) Inc.*, 123 FERC ¶ 61,287, at P 163 (2007)). In the cited case, the DR&R continued to be recoverable in rates, but had merely been over-collected. In contrast, here both the tax allowance and ADIT have been removed from SFPP's cost of service, and therefore, as in *Public Utilities*, the basis for income tax normalization in rates no longer applies.

[227] *See* 2005 Income Tax Policy Statement, 111 FERC ¶ 61,139.

[228] *Public Utilities*, 894 F.2d at 1380.

[229] *Id.* at 1382; *see also id.* at 1383-1384 ("The Commission had no legal right to reduce [the pipeline's going-forward] rates … below levels found to be just and reasonable" as "the Commission's adjustments of those rates were in substance a retroactive adjustment of prior rates based on normalization.").

[230] *Id*; *see also Old Dominion Electric Coop. v. FERC*, 892 F.3d 1223, 1230 (D.C. Cir. 2018) ("The filed rate doctrine and the rule against retroactive ratemaking leave the Commission no discretion to waive the operation of a filed rate or to retroactively change or adjust a rate for good cause or for any other equitable considerations.").

there is excess ADIT, such as a reduction in tax rates, and do not raise the same retroactive ratemaking concerns.[231]

105. Moreover, the Commission's normalization principles undermine, rather than support, the shippers' argument that SFPP's ADIT balance is overfunded and must be amortized to ratepayers to prevent a windfall. As explained above, under normalization, the shippers that paid past rates for service on SFPP under which the ADIT balance was accumulated paid their properly allocated share of the pipeline's costs for the transportation service they received. Thus, to order SFPP to amortize the ADIT balance to shippers would retroactively apply Opinion No. 511-C's holding to SFPP's past rates for prior-period service. The shippers' argument that the ADIT accumulated under the past rates was prepayment for a future anticipated cost that will never become due is misplaced.[232] As the D.C. Circuit stated, "just because [the pipeline] may draw on these

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[231] For example, Joint Shippers argue that in *Town of Norwood, Mass. v. FERC*, 53 F.3d 377, the D.C. Circuit found that the Commission's switch to tax normalization accounting did not violate the rule against retroactive ratemaking. Joint Shippers Surreply Comments at 29-30. However, in that case the D.C. Circuit found that "the transition obligation does not run afoul of the retroactive ratemaking proscription, because [the entity] has not shifted any costs that it tried but failed to collect in the past: it *always* planned to collect these costs from future ratepayers, the only shift is timing within the future." *Town of Norwood*, 53 F.3d at 381; *see also id.* at 313 ("because the transition provision only shifts the timing of collection of [post-retirement benefits other than pension] costs among future ratepayers, it does not constitute retroactive ratemaking"). In contrast, if the Commission ordered SFPP to amortize the ADIT balance, it would not merely be shifting the timing of an adjustment that would have refunded the sums to future ratepayers, but instead "correct[ing] for errors in earlier approximates of actual costs" (namely, the error of permitting MLP Pipelines an income tax allowance), which is "impermissible retroactive ratemaking." *Id.* at 312.

[232] Joint Shippers point out that in Order No. 144-A, the Commission compared the rate treatment for deferred tax costs to the rate treatment for dismantlement (DR&R) costs in explaining that neither constitutes a loan from shippers. They quote the Commission's statement that "[j]ust as the prepayment of plant removal costs over a plant's operating life (rather than during the period of dismantlement when the costs are incurred) does not constitute a loan . . . , so too, the prepayment of taxes (through deferred taxes) does not constitute a loan." Shippers' Surreply Comments at 14-15 (quoting Order No. 144-A). The Commission's use of the term "prepayment" in Opinion No. 144-A may have been imprecise. Both deferred taxes and DR&R provide accounting for current costs although those costs are to be paid in the future. Moreover, the analogy to DR&R does not support the shippers' position regarding SFPP's ADIT. Although over-collected DR&R may need to be refunded to shippers, in this scenario DR&R

funds to pay future costs does not mean that the funds should be treated as having been collected in the period in which they are spent."[233] In other words, the "'windfall argument' overlooks the reality that every [prior ratepayer] received the full tax benefit associated with every expense that it bore."[234]

106. We reject Tesoro's argument that amortizing SFPP's ADIT balance would not constitute retroactive ratemaking in this proceeding because SFPP's rates are subject to a refund obligation. Tesoro's argument misses the mark. First, under *United Airlines* and Opinion No. 511-C, SFPP is not entitled to recover an income tax allowance in the first place, and as a result the ADIT balance and any normalization principles associated with it are terminated. Because the Commission has eliminated the income tax allowance from SFPP's cost of service effective for 2008 (when the rate proceeding commenced), no ADIT balance has accumulated since 2008 (during the refund period). Second, regarding the previously-accumulated ADIT prior to 2008, the Commission is precluded from returning those funds to shippers by the retroactive ratemaking doctrine and other concerns as explained above.

107. The Compliance Filing removes the income tax allowance for the refund period, such that shippers are placed in the same position as if SFPP had not collected any income tax allowance (or made corresponding ADIT adjustments) during the refund period. Therefore, the Compliance Filing does not reflect any excess ADIT balance generated during the refund period. As such, we find that the Compliance Filing's removal of the ADIT balances complies with Opinion No. 511-C.

108. As we find that it is not appropriate to amortize SFPP's ADIT balance to shippers, we need not address the shippers' challenges to SFPP's argument that settlements bar their proposed remedy.

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remains recognized in cost of service to cover dismantling and removal costs to the extent such costs exist. That is not the case with SFPP's ADIT. The removal of the income tax allowance removes the basis for any income tax normalization via ADIT. As a result, refunding ADIT to shippers is impermissible and, among other issues, violates the prohibition against retroactive ratemaking as discussed in this order.

[233] *Public Utilities*, 894 F.2d at 1381.

[234] *Id.* at 1382.

B. Litigation Surcharge

1. Background

109. SFPP reflects an updated calculation of the litigation surcharge approved in Opinion Nos. 511 and 511-A to account for additional litigation costs incurred since the Opinion No. 511-B Compliance Filing.

110. SFPP also asserts that in the event it is unable to recover, in Docket No. IS11-444-002, the litigation expenses attributed to SFPP's West Line rate index in that docket, SFPP reserves the right to recover those expenses as an additional component of the litigation surcharge in the instant docket. SFPP argues that the two proceedings are inextricably intertwined because the Commission's ultimate determination regarding the appropriate indexing increase for SFPP's West Line rates in Docket No. IS11-444 will have a direct and substantial impact on the refunds SFPP will pay in the present docket.[235]

2. Protests and Comments

111. Joint Shippers and Tesoro oppose SFPP's litigation surcharge. Joint Shippers oppose SFPP's proposal to recover $8,587,491 in litigation expenses through a surcharged levied over a three-year period. Joint Shippers argue that the factual underpinning for the three-year surcharge in this case no longer exists, given that the litigation has extended well beyond three years. Joint Shippers assert that although all shippers will benefit from the lower rates, only the August 2008 through July 2011 shippers will pay the expenses SFPP has incurred litigating this case. They argue that the litigation expenses should be recovered over the entire litigation and refund period, rather than an arbitrary three-year period.[236]

112. Tesoro challenges SFPP's proposal to recover certain litigation expenses incurred subsequent to its compliance filing in Opinion No. 511-B, arguing that SFPP has not shown that the additional expenses are just and reasonable. Tesoro also argues that SFPP should not be permitted to reserve the right to allocate costs from other proceedings to the litigation surcharge in this proceeding.[237]

113. Joint Shippers argue that the Commission should reexamine its policy of allowing oil pipelines to recover all litigation expenses without considering whether those

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[235] Compliance Filing at 5-7.

[236] *Id.* at 23-25; *see also id.* at Ex. C.

[237] Tesoro Protest at 9.

expenses are excessive or were prudently incurred, and reject SFPP's recovery of a litigation surcharge. Joint Shippers assert that under the Commission's policy, a pipeline has no incentive to limit its costs. Joint Shippers claim that SFPP incurred over $8.5 million in legal costs and the end result has been not just a denial of its proposed rate increase, but a rate decrease. Joint Shippers assert that the only way SFPP can show a rate increase is by tacking on the litigation surcharge to recover the litigation expenses spent in its failed pursuit of a rate increase. Joint Shippers state that where a pipeline's rate increase proposal is rejected, the Commission should not force ratepayers to fund the pipeline's costs of litigating the unfounded rate increase.[238]

3. SFPP's Reply Comments

114. SFPP argues that the litigation surcharge calculation is consistent with Opinion No. 511-A.[239] SFPP states that the Docket No. IS08-390 litigation surcharge was updated to account for additional litigation costs incurred since the Opinion No. 511-B compliance filing, including actual costs through March 31, 2018 and estimated costs through May 14, 2018 regarding preparing the Opinion No. 511-C Compliance Filing. SFPP argues that the factual underpinnings of the three-year surcharge are largely unchanged from when the surcharge was affirmed in Opinion No. 511-A and unchallenged in Opinion No. 511-B.[240]

115. SFPP argues that the Commission has previously accepted recovery of litigation expenses from other proceedings when doing so is reasonable.[241] SFPP asserts that it is entitled to reserve its right to recover litigation expenses attributable to Docket No. IS11-444-002 as an additional component of the litigation surcharge in the instant proceeding in Docket No. IS08-390, *et al* because Docket No. IS11-444-002 is inextricably intertwined with the instant proceeding.

116. SFPP argues that the Commission may not shift its policy regarding the recovery of litigation costs in oil pipeline rate litigation because to do so would be arbitrary and capricious. SFPP argues that the most recent litigation expenses are the result of Joint

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[238] Joint Shippers Protest at 25-27.

[239] SFPP Reply at 42 (citing Opinion No. 511-A, 137 FERC ¶ 61,220 at P 35).

[240] *Id.* at 42-44.

[241] *Id.* at 46 (citing *Texaco Refining and Marketing, Inc. v. SFPP*, 117 FERC ¶ 61,285, at PP 72-74 (2006)).

Shippers' success in overturning the Commission's policy on the income tax allowance, which required SFPP to recalculate its cost of service.[242]

4. Commission Determination

117. We reject the shippers' arguments challenging the litigation surcharge. The shippers primarily repeat the same arguments that the Commission rejected in Opinion Nos. 511 and 511-A.[243] In particular, the shippers reassert the argument that the Commission should not permit pipelines to recover litigation expenses because pipelines will have no incentive to limit litigation costs.[244] As the Commission explained in Opinion No. 511-A, pipelines are entitled to recover their reasonably incurred rate litigation costs.[245] The shippers have not provided any grounds for finding that the expenses SFPP includes in its Compliance Filing are not just and reasonable. As the Commission stated in Opinion No. 511 and Opinion No. 511-A, "[w]here significant litigation costs have been incurred and it is uncertain whether those litigation costs will continue into future years, a surcharge based upon actual litigation costs provides an appropriate means to avoid both over-recovery and under-recovery."[246] As the Commission pointed out in Opinion No. 511-A, SFPP does not control the degree to which shippers have litigated the issues raised in this proceeding.[247]

118. We also reject the shippers' proposal to recover the litigation expenses over the entire litigation and refund period. The three-year period for recovering the litigation

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[242] *Id.* at 45.

[243] *See SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121 at PP 31-37; Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 35-51.

[244] *See e.g.* Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 37, 41.

[245] Opinion No. 511-A, 137 FERC ¶ 61,220 at P 39 (quoting *SFPP, L.P.*, Opinion No. 435-A, 91 FERC ¶ 61,135, at 61,512 (2000) ("Litigation related to the pipeline's cost of service and the structure of its tariff are part of its normal, ongoing operations, and such costs are recoverable as part of the pipeline's cost of service.")); *Iroquois Gas Transmission Sys. v. FERC*, 145 F.3d 398 (D.C. Cir. 1998); *see also* Opinion No. 511, 134 FERC ¶ 61,121 at P 37 (finding that SFPP "may include a limited three-year surcharge to recover reasonable legal costs of the proceeding in Docket No. IS08-390-000 et al. that have been incurred by SFPP").

[246] *Id.* (quoting Opinion No. 511, 134 FERC ¶ 61,121 at P 35 (citations omitted)).

[247] *Id.* P 41.

expenses was approved in Opinion No. 511 and affirmed in Opinion No. 511-A.[248] The shippers provide no support for their proposal to recover the expenses over the entire litigation and refund period, whereas using a shorter period is consistent with both Commission and court precedent.[249] The use of a three-year surcharge remains appropriate because, although the litigation remains ongoing, the majority of the litigation expenses (85.9 percent) were incurred in the earlier stages prior to August 2011.[250] Thus, the three-year recovery period from August 1, 2008 through July 31, 2011 reflects the costliest phase of the litigation.

119. We agree with shippers that SFPP should not be permitted, as part of the Compliance Filing in this proceeding, to reserve the right to include litigation expenses attributable to the litigation in Docket No. IS11-444 in the litigation surcharge. SFPP states that "if SFPP is unable to recover its litigation expenses attributable to Docket No. IS11-444 in that docket, SFPP reserves the right to seek recovery of such litigation expenses as a component of the litigation surcharge the Commission has already ordered in this one."[251] Whether SFPP can recover litigation expenses associated with the pending case in Docket No. IS11-444 is beyond the scope of this proceeding.

C. Overpaid Refunds and Under-Collected Revenues Reserve

1. Background

120. SFPP states that for the periods July 2011 and February 1, 2012 through June 13, 2018, the Opinion No. 511-C refund rate is higher than the Opinion No. 527 refund rates (for July 2011 and from February 1, 2012 through July 2, 2013) or the rates paid (for the period July 3, 2013 through June 13, 2018). Hence, SFPP asserts that refunds paid per Opinion No. 527 for July 2011 and from February 1, 2012 through July 2, 2013 (in Docket No. IS11-444), were greater than what is required based on the rulings in Opinion No. 511-C. SFPP further claims that the rates West Line shippers paid for the period July 3, 2013 through June 13, 2018 were lower than the rates West Line shippers should have

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[248] Opinion No. 511, 134 FERC ¶ 61,121 at P 35; Opinion No. 511-A, 137 FERC ¶ 61,220 at P 42.

[249] *SFPP, L.P.*, Opinion No. 435-A, 91 FERC ¶ 61,135 at 61,512 (approving 5-year surcharge to recover litigation expenses), *order on reh'g*, Opinion No. 435-B, 96 FERC ¶ 61,281, at 62,074 (2001), *order on reh'g*, 100 FERC ¶ 61,353 (2002), *aff'd in relevant part*, *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263, 1293-1294 (D.C. Cir. 2004).

[250] Compliance Filing, Tab A, Schedule 24, Page 1.

[251] Compliance Filing at 6-7.

paid for West Line transportation service based on Opinion No. 511-C. SFPP explains that to return SFPP to the same position it would have been in had it not paid the now-excessive refunds per Opinion No. 527 (Overpaid Refunds), or established the now-insufficient rates per Opinion Nos. 527 and 511-B as indexed forward (Under-Collected Revenues), SFPP offset the Overpaid Refunds and Under-Collected Revenues against other refunds in developing total estimated refunds. SFPP claims that while it still owes refunds, the Overpaid Refunds and Under-Collected Revenues exceed other refunds for 25 shippers, totaling $3.3 million.

121. SFPP claims that the ability to recover the $3.3 million from such shippers is uncertain, and proposes to create an Overpaid Refunds/Under-Collected Revenues Reserve that would be funded by a uniform pro rata withholding of $3.3 million from the refund amounts owed to all shippers to mitigate its exposure. SFPP proposes to assess after a certain period how much of the amount has been recovered and distribute to the applicable shippers a corresponding amount following SFPP's initial distribution of the total refunds. At the end of the period, SFPP would determine if any refunds have not been claimed by SFPP's shippers and credit that amount to the reserve, distributing pro rata to the applicable shippers an equivalent amount. SFPP proposes that after the reserve has been reduced by the amount of unclaimed refunds, the shippers that failed to claim their refunds after 180 days have elapsed would be foreclosed from doing so and SFPP would retain any remainder to compensate it for the amounts of Overpaid Refunds and Under-Collected Revenues it was unable to recoup.[252]

2. Protests and Comments

122. Joint Shippers argue that shippers that do not owe negative refunds should not be required to subsidize the subset of shippers that have the financial obligation, particularly where SFPP has not attempted to recover the negative refunds from such subset of shippers. Joint Shippers argue that SFPP should be required to first seek recovery from the individual shippers with the negative refund obligation, and if that fails, seek recovery through a tariff filing and non-discriminatory mechanism.[253] Similarly, Tesoro challenges SFPP's proposal to retain amounts from shippers that are owed refunds, rather than collecting the $3.3 million from the actual shippers that allegedly owe the negative refunds.[254]

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[252] *Id.* at 7-9.

[253] Joint Shippers Protest at 28-34; *see also id.* at Ex. C.

[254] Tesoro Protest at 10-11.

123. Joint Shippers and Tesoro challenge SFPP's reliance on a 2011 settlement order.[255] They argue that a settlement does not constitute Commission precedent.[256] Joint Shippers assert that unlike the 2011 order, SFPP has not demonstrated that it is sharing the burden of mitigation, nor that it will be unable to recover the overpaid refunds from the shippers that owe them.[257] Joint Shippers and Tesoro also argue that once SFPP's erroneous treatment of ADIT is corrected, no West Line shipper will owe negative refunds and the reserve mechanism will be unnecessary.[258]

3. SFPP's Reply Comments

124. SFPP argues that the Overpaid Refunds/Under-Collected Revenues Reserve is reasonable to place SFPP in the same position it would have been had it not paid excessive refunds per Opinion No. 527 or established insufficient rates per Opinion Nos. 527 and 511-B.[259] SFPP argues that the Commission has previously approved the use of a similar Overpaid Refunds/Under-Collected Revenues Reserve by SFPP.[260] SFPP asserts that SFPP's ability to recover the $3.3 million from the applicable 25 shippers is uncertain and thus, SFPP proposes the Overpaid Refunds/Under-Collected Revenues Reserve to mitigate this risk.

125. SFPP states that it will fund the $3.3 million based on a uniform pro rata withholding of refunds owed to all shippers, but will then attempt to collect the $3.3 million from the 25 specific shippers that owe such amount. To the extent successful, SFPP states that it will release and distribute the amount from the reserve to the applicable shippers that are still owed refunds. SFPP states that it will only retain the portion of the $3.3 million in the reserve to the extent it is not able to collect revenues from the 25 shippers that owe this amount.[261]

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[255] *SFPP, L.P.*, 134 FERC ¶ 61,202 (2011).

[256] Joint Shippers Protest at 31-33; Tesoro Protest at 11.

[257] Joint Shippers Protest at 31-33.

[258] *Id.* at 30; Tesoro Protest at 11 (citing Ex. B at P 12).

[259] *Id.* at 37-42.

[260] *Id.* at 40 (citing *SFPP, L.P.*, 134 FERC ¶ 61,202).

[261] *Id.* at 41-42.

4. Commission Determination

126. We reject SFPP's proposal to implement the Overpaid Refunds/Under-Collected Revenues Reserve. SFPP proposes to withhold $3.3 million in refunds that it owes to all shippers in order to mitigate its risk that SFPP will be unable to collect such amount from 25 specific shippers to which SFPP overpaid refunds as a result of the Commission's orders. As a general principle, it is inappropriate to require shippers to bear the cost of the unrecovered amounts that are owed by other shippers.[262] The fact that the Commission has the authority to correct its errors, as SFPP argues, does not support SFPP's proposal to withhold refunds from shippers that do not have any negative refund obligation.[263]

127. SFPP's proposal is also unsupported. SFPP does not state whether it made any attempts to collect the negative refunds from the subset of shippers that owe such refunds or their successors-in-interest. Based on the record, it is unclear why SFPP would be unable to recover the overpayments from entities that owe negative refunds.[264] The Commission's role is to determine a just and reasonable rate for SFPP, not to mitigate SFPP's risk in pursuing collections.[265]

128. SFPP's attempt to rely on a 2011 Letter Order[266] is also unavailing. In that proceeding, the Commission permitted an overpaid refunds reserve that was

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[262] *See, e.g.*, *Williston Basin Interstate Pipeline Co.*, 67 FERC ¶ 61,137, at 61,360 (1994) (ratepayers should not shoulder the burden of subsidizing amounts owed by certain ratepayers and "Bad debts are a risk of doing business that is compensated through the pipeline's rate of return"), *on reh'g*, 71 FERC ¶ 61,019, at 61,075 (1995) ("allowing this uncollected amount to be borne by its other, paying customers is an improper cross-subsidy").

[263] *See e.g.* SFPP Reply Comments at 39-40 (citing *United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223, 229 (1965); *PUC of California v. FERC*, 988 F.2d 154, 163 (D.C. Cir. 1993)); *see also Natural Gas Clearinghouse v. FERC*, 965 F.2d 1066, 1073-1075 (D.C. Cir. 1992).

[264] *Williston Basin Interstate Pipeline Co.*, 71 FERC at 61,075 ("Shifting the responsibility for costs of amounts uncollected as a result of management's discretion in not seeking to collect those costs from those who are responsible is not appropriate.").

[265] *Transcontinental Gas Pipe Line Corp.*, 78 FERC ¶ 61,198, at 61,856 (1997), *reh'g denied*, 79 FERC ¶ 61,224 (1997).

[266] *SFPP*, 134 FERC ¶ 61,202.

unchallenged in connection with an uncontested offer of settlement, among other distinguishing factors.[267] Here, SFPP's proposal has been challenged by the shippers whose refunds SFPP proposes to withhold. On review of SFPP's Compliance Filing in this proceeding, we see no basis for permitting SFPP to withhold refunds owed to shippers.[268]

The Commission orders:

(A) SFPP's compliance filing is accepted subject to the conditions described herein, as discussed in the body of this order.

(B) Rehearing is denied, as discussed in the body of this order.

(C) SFPP's Motion to Reopen the Record is denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[267] SFPP's proposed reserve in the 2011 proceeding only covered specifically identified circumstances where SFPP explained it was likely unable to collect the previously overpaid refunds from certain shippers, as opposed to SFPP's proposal here which applies to SFPP's entire net refund exposure. *See* Report of SFPP, L.P. on Pending Compliance Filings and Request for Order to Pay Refunds and Recover Overpaid Refunds, Docket No. OR92-8-033, *et al.* (February 10, 2011).

[268] It is unclear from SFPP's Compliance Filing whether any refunds were withheld in order to implement the proposed reserve. To the extent SFPP withheld any refunds owed to shippers, SFPP shall provide the full amount of refunds due to shippers consistent with this order within 30 days.