

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

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| Petition for Expedited Action |) | |
| Addressing the Impact of Federal |) | Docket No. OR18-16-000 |
| Income Tax Changes on Indexed |) | |
| Rate Increases for Oil Pipelines |) | |

REPLY COMMENTS OF THE ASSOCIATION OF OIL PIPE LINES

Pursuant to the March 12, 2018 notice of the Federal Energy Regulatory Commission (“FERC” or “Commission”), the Association of Oil Pipe Lines (“AOPL”)¹ submits its reply to the initial comments regarding the Liquids Shippers Group petition, which asked the Commission to (1) require oil pipelines to calculate their 2017 calendar year page 700 cost of service as if the 2018 federal income tax rates had applied in 2017,² and (2) restrict the ability of oil pipelines to increase their indexed rates when the costs reported on page 700 exceed revenues by five percent or more. Other than the Liquids Shippers Group, which commented in support of its own petition, no comments were filed in support of the requests herein. AOPL’s comments opposing the petition were

¹ AOPL is a nonprofit trade association that represents the interests of oil pipelines regulated by the Commission. AOPL members transport approximately 96 percent of the crude oil and refined petroleum products shipped through pipelines in the United States.

² The recent changes in federal income tax rates became effective January 1, 2018. *See* An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (“Tax Cuts and Jobs Act” or “Tax Act”).

supported by separate filings made by Shell Pipeline Company, L.P. and Marathon Pipe Line LLC.

As explained by AOPL and the other pipeline commenters, there is no justification for granting the petition. The Liquids Shippers Group's first request is moot, because the Commission has already instructed oil pipelines entitled to an income tax allowance to reflect the new federal income tax rates in the 2018 calendar year cost of service to be reported on page 700 in 2019.³ The Liquids Shippers Group's proposal would also result in inaccurate 2017 calendar year data, contrary to the Commission's page 700 requirements, and would be manifestly unfair by changing actual 2017 data for only one item that reduces the cost of service, while ignoring other post-2017 cost changes that could increase the cost of service (*e.g.*, increased steel prices resulting from new tariffs, and spending on pipeline safety and integrity, fuel, power, labor, and the cost of capital). The Liquid Shippers Group's second request should also be rejected, because it is pending in Docket No. RM17-1-000, *see Revisions to Indexing Policies and Page 700 of FERC Form No. 6*, 157 FERC ¶ 61,047 (2016), and is substantively without merit for the reasons explained by AOPL in that proceeding.

The Liquids Shippers Group's comments provide no valid ground to grant the petition. The Liquids Shippers Group appears to acknowledge that its request regarding

³ *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, 162 FERC ¶ 61,227, at P 46 n.84 (2018) ("Policy Statement"). The Policy Statement further indicated that master limited partnership ("MLP") pipelines are not entitled to an income tax allowance and should not report an income tax allowance in the 2016 or 2017 calendar year cost of service reported on page 700. *Id.* at P 46 n.83.

page 700 reporting is moot, and it makes no real effort to defend it. Instead, the Liquids Shippers Group focuses its comments on its request that oil pipelines be denied an indexing rate increase where page 700 shows an “over recovery” of five percent or more. But the arguments in the Liquids Shippers Group comments have little connection to the relief requested and fail to justify that proposal.

DISCUSSION

I. The Liquids Shippers Group Comments Fail to Support its Proposal to Require Pipelines to Report 2018 Tax Costs in the 2017 Calendar Year Page 700 Cost of Service.

Notably absent from the Liquids Shippers Group comments is any meaningful attempt to defend its prior request that pipelines be directed to report 2018 tax costs in the 2017 calendar year page 700 cost of service. Instead, the Liquids Shippers Group acknowledges that the Commission has already ruled on that issue, *see* LSG Comments at 9 n.12, and turns its focus to its proposal to restrict the ability of pipelines to increase their rates pursuant to indexing. *Id.* at 11.

The only reference in the Liquids Shippers Group comments to its prior request regarding page 700 reporting attempts to reframe the petition as seeking “essentially ... a pro forma filing, which would enable a comparison to demonstrate the difference in tax costs prior to, and after, the new Tax Act and the Commission’s revised MLP tax policy changes.” LSG Comments at 3 n.5. But as the Liquids Shippers Group acknowledges the Commission has already required oil pipelines to reflect the MLP income tax allowance Policy Statement in their 2016 and 2017 calendar year page 700 cost of service. *Id.* at 9 n.12. With respect to the changes in federal income tax rates, a revision

to the 2017 calendar year cost of service would not accurately show the “difference in tax costs prior to, and after, the new Tax Act,” because the new tax rates did not take effect until January 1, 2018. In any event, the Commission has already ruled on that issue, and the Liquids Shippers Group does not appear to challenge that decision. Nor does the Liquids Shippers Group explain why it would be accurate, fair, or consistent with the page 700 reporting instructions and the purpose of page 700 in reporting accurate historical data, to include 2018 tax costs in a 2017 calendar year cost of service.

II. The Liquids Shippers Group Comments Fail to Support its Proposed Change to the Commission’s Rules Regarding Indexing Rate Increases.

The Liquids Shippers Group comments fail to justify its attempted end-run around the Commission’s established procedures by seeking expedited action here on a proposal that is pending in Docket No. RM17-1-000. Nor does the Liquids Shippers Group make any effort to address the comments made by AOPL and the other oil pipeline commenters in that proceeding, which explained that the various cost-of-service restrictions on rate indexing, such as proposed by the Liquids Shippers Group, would destroy the efficiency-enhancing benefits of the indexing methodology and effectively ensure that oil pipeline rates fail to keep pace with inflation.

Instead, the Liquids Shippers Group comments essentially make two claims: (1) existing oil pipeline rates are too high as a result of the new tax changes and the Policy Statement, and (2) the Commission’s five-year review of the index will not adequately address alleged “over-earning.” Both arguments are fundamentally flawed and misconstrue the purpose of the Commission’s established ratemaking regime for oil

pipelines. They also fail to provide a rational basis for the Liquids Shippers Group's proposal to deny annual indexed rate increases based on a five percent over-earning test.

The Liquids Shippers Group's main contention is that existing oil pipeline rates are unjust and unreasonable as a result of the new reduced federal income tax rates and the Policy Statement regarding MLP income tax allowances. *See* LSG Comments at 6; *see also id.* at 7-8. But that allegation is entirely unsupported, because, as the Commission has explained, most oil pipeline rates are not set on a cost-of-service basis. *Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates*, 162 FERC ¶ 61,223, at P 8 (2018). Many pipelines have market-based rates or contract rates, which are just and reasonable and in effect without reference to costs. *See* 18 C.F.R. §§ 342.4(c), 348.1 (2017).⁴ Moreover, most pipeline rates are set under the indexing methodology, which permits annual rate changes to keep pace with inflation regardless of whether the underlying rate is cost-based (*e.g.*, initial rates may be cost-based, and are then commonly adjusted annually pursuant to the rate index). *See* Policy Statement at P 46 n.85. In fact, many pipelines have grandfathered rates which were

⁴ Moreover, the annual page 700 cost of service is rate screening information comprising data from pipelines that in most instances do not charge cost-of-service rates. Page 700 does not provide the information that "in itself, either forms the basis of a Commission decision on the merits of a pipeline [rate] filing, or demonstrates that the pipeline's proposed or existing rates are just and reasonable." *Cost-of-Service Reporting and Filing Requirements for Oil Pipelines*, 59 Fed. Reg. 59,137 (Nov. 16, 1994), FERC Stats. & Regs., Regs. Preambles, 1991 – 1996, ¶ 31,006 at 31,168 (1994) ("Order No. 571"), *order on reh'g.*, FERC Stats. & Regs., Regs. Preambles 1991-1996, ¶ 31,012 (1994).

deemed just and reasonable as a matter of law in the Energy Policy Act of 1992, and which have been adjusted in accordance with the Commission's indexing regulations. Further, even if a pipeline's rates were originally established under the Commission's cost-of-service methodology, a reduction in one cost element does not mean that the pipeline's rates are unjust and reasonable, because other costs may have increased.

In any event, the Liquids Shippers Group fails to explain the connection between its allegations of current pipeline over-earning and its proposed changes to the Commission's indexing rules. Indeed, the Liquids Shippers Group acknowledges that its proposal "would not address existing oil pipeline rate over-recoveries." LSG Comments at 9. If shippers wish to challenge a pipeline's existing base rates, they may file a complaint and, if successful, obtain reparations going back two years prior to the date of the complaint. 49 U.S.C. §§ 13(1), 16(3)(b); 18 C.F.R. § 341.3.

Similarly without merit is the Liquids Shippers Group's argument that the Commission's five-year review of the index is somehow flawed because it "does not address current cost over-recoveries." LSG Comments at 6; *id.* at 7 (five-year review "will not address cost over-recoveries in the interim"). But the purpose of the five-year review is to ensure that the index accurately reflects the relationship between economy-wide inflation and actual cost changes in the oil pipeline industry. It is not intended to address how individual pipeline rates compare to the Commission's cost-of-service methodology. *See Flying J v. FERC*, 363 F.3d 495, 498 (D.C. Cir. 2004) ("The relevant question for the price-cap index" is not the overall level of the pipelines' costs, but rather the "changes in their costs"); *Five-Year Review of Oil Pipeline Pricing Index*, 133 FERC

¶ 61,228, at P 112 (2010) (the “purpose of the index is to track cost changes using a generally applicable and simple method, and does not involve an assessment of whether each of the various pipelines are over- or under-recovering their costs”).

Finally, the Liquids Shippers Group argues that the index that will be established in the upcoming five-year review period will be “skewed,” because it will reflect the average cost changes for both corporation-owned pipelines and MLP pipelines. LSG Comments at 8-9. That argument has nothing to do with the Liquids Shippers Group’s proposed change to the Commission’s rules for reviewing annual indexed rate increases. To the extent the Liquids Shippers Group seeks to take that issue up with the Commission, it should raise it in the next five-year review process.

CONCLUSION

For the reasons discussed above and in AOPL's initial comments, the Commission should reject the petition.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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

Dated at Washington, D.C. this 27th day of April 2018.

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