ORIGINAL

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates	)))	**Docket No. RM18-12-000**

COMMENTS OF THE ASSOCIATION OF OIL PIPE LINES

On March 15, 2018, the Federal Energy Regulatory Commission ("FERC" or "Commission"), issued a Notice of Inquiry ("NOI") in the above-referenced docket. *Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates*, 162 FERC ¶ 61,223 (2018). The Association of Oil Pipe Lines ("AOPL") hereby submits its comments in response to the NOI.[1]

The Tax Cuts and Jobs Act made various changes to the tax code, including reducing the federal corporate income tax rate from 35 percent to 21 percent.[2] The NOI seeks comment on issues primarily related to accumulated deferred income taxes

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[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] 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").

("ADIT"), to ensure that "the current balance of ADIT" for regulated entities "accurately reflect[s] the current income tax liability." NOI at P 2. The NOI also seeks comment on certain issues related to bonus depreciation provided for by the Tax Act. *Id.* at PP 26-28.

The same day that it issued the NOI, the Commission announced its Revised Policy Statement on Treatment of Income Taxes, indicating that master limited partnership ("MLP") pipelines are not entitled to an income tax allowance. *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, 162 FERC ¶ 61,227 (2018) ("Policy Statement"). The Policy Statement held that because "including an income tax allowance in the cost of service leads to a double-recovery, there is no basis for an MLP pipeline to claim an income tax allowance" in its FERC-regulated cost of service. *Id.* at P 46 n.83. The Commission applied the Policy Statement in several pending cases involving the rates of SFPP, L.P., an oil pipeline owned by an MLP during the applicable periods. *See SFPP, L.P.*, 162 FERC ¶ 61,228, at PP 10, 21-32 (2018) ("Opinion No. 511-C"); *SFPP, L.P.*, 162 FERC ¶ 61,229, at P 8 (2018) ("Opinion No. 522-B"); *SFPP, L.P.*, 162 FERC ¶ 61,230, at PP 17 n.34 (2018) ("Opinion No. 527-A"); *ConocoPhillips Company v. SFPP, L.P.*, 162 FERC ¶ 61,231 at P 9 (2018) ("2011 SFPP Complaint Order").[3]

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[3] AOPL and various other parties sought rehearing and clarification of the Policy Statement. SFPP also sought rehearing of the Commission's application of the Policy Statement in its proceedings. AOPL and its members reserve all rights to further challenge the Policy Statement, including as it is applied in individual proceedings;

(Continued ...)

Also on March 15, 2018, the Commission took certain actions to provide for near-term changes to the cost-of-service rates of electric utilities and natural gas pipelines in response to the reduced corporate income tax rates. NOI a PP 4-7. The Commission recognized, however, that oil pipelines are differently situated from electric utilities and natural gas pipelines, because "[u]nlike public utilities and interstate natural gas pipelines, the majority of oil pipelines set their rates using indexing, not cost-of-service ratemaking using an oil pipeline's particular costs." NOI at P 8. Although it did not take "industry-wide action regarding oil pipeline rates," the Commission explained that, when oil pipelines submit their page 700, "they must report an income tax allowance and cost of service consistent with the Revised Policy Statement and the Tax Cuts and Jobs Act." *Id.* The Commission further stated that it would review the overall index during its next five-year review beginning in 2020. *Id.*

The Commission appropriately declined to take extraordinary action regarding oil pipeline rates as a result of the Tax Cuts and Jobs Act and the Policy Statement. As the Commission correctly explained, most oil pipelines do not set their rates on a cost-of-service basis. Where an oil pipeline's rates are subject to a cost-of-service challenge or are established on a cost-of-service basis, the Commission's Policy Statement will apply if the pipeline is an MLP; otherwise, the new lower income tax rates provided for in the Tax Cuts and Jobs Act will apply in calculating the pipeline's income tax allowance.

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however, AOPL recognizes that it remains FERC policy unless and until reversed by the Commission or a reviewing court.

Nor are any changes to the Commission's cost-of-service ratemaking or accounting rules required with respect to the issue of ADIT, which is the focus of the NOI. As discussed below, the Commission's existing cost-of-service precedent governs the treatment of ADIT for oil pipelines entitled to an income tax allowance, including how ADIT should be adjusted when income tax rates change.[4] Under existing Commission oil pipeline cost-of-service ratemaking precedent, if income tax rates are reduced, the amount of "overfunded" ADIT is deducted from the cost of service over time using the so-called "Reverse South Georgia Method." *See SFPP, L.P.*, 86 FERC ¶ 61,022, at 61,092-93 (1999) ("Opinion No. 435"); *see also* NOI at P 17. For MLP pipelines, there is no basis to include any ADIT in the pipeline's cost of service or to adjust ADIT for changes in tax rates, because under the Policy Statement MLP pipelines do not pay taxes and are not entitled to a tax allowance.

I. EXECUTIVE SUMMARY

- No action is required by the Commission with respect to oil pipelines as a result of the recent tax changes. Changes in federal income tax rates have occurred before, and the Commission's existing cost-of-service ratemaking and accounting rules have governed how oil pipelines entitled to an income tax

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[4] As the NOI noted, the Tax Cuts and Jobs Act is not the first change in income tax rates during the period oil pipelines have been regulated by FERC. NOI at P 2 n.2 (noting major tax law changes in 1986).

allowance should adjust ADIT. There is no reason to change the Commission's existing rules.

- Under existing Commission oil pipeline cost-of-service ratemaking precedent, ADIT balances are deducted from rate base. If income tax rates are reduced, the amount of "overfunded" ADIT is removed from the cost of service over time using the Reverse South Georgia Method. All else being equal, the "flow-back" of overfunded ADIT reduces the ratemaking cost of service for oil pipelines.
- For regulatory accounting purposes, when income tax rates are reduced, oil pipelines reduce their ADIT balances immediately by the full overfunded amount. This accounting treatment is required by the Uniform System of Accounts for Oil Pipelines ("USoA"). It is intended to be consistent with Generally Accepted Accounting Principles ("GAAP") and does not govern ratemaking.
- When assets are sold or retired, the ADIT balance associated with those assets is extinguished. The ADIT balance that existed prior to the sale or retirement is therefore no longer deducted from rate base.
- There is no reason to require additional reporting for oil pipelines beyond the Commission's current requirements. Oil pipelines filing new cost-of-service rates are required to provide support for their ADIT calculations, including "underfunded or overfunded ADIT amortization." 18 C.F.R. § 346.2(c)(4)-(5). For page 700 purposes, no additional reporting requirements are necessary.

since page 700 is a "preliminary screening tool" rather than the information that demonstrates a pipeline's rates are just and reasonable.

- For MLP pipelines, there is no basis to include any ADIT in the pipeline's cost of service or to adjust ADIT for changes in tax rates, because under the Policy Statement MLP pipelines do not pay taxes and are not entitled to an income tax allowance.

II. COMMUNICATIONS

AOPL requests that the following persons be placed on the Commission's service list for this proceeding:

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III. RESPONSES TO COMMISSION REQUESTS FOR COMMENT

A. Accumulated Deferred Income Taxes[5]

1. Effect on Rate Base

Request for Comment: "The Commission seeks comment on whether ... oil pipelines should make adjustments so that rate base may be appropriately adjusted by excess ADIT and deficient ADIT." *Id.* at P 15. "Oil pipelines should discuss how these issues pertain to Form No. 6, page 700 reporting practices and, as relevant, to cost-of-service ratemaking." *Id.* at P 15.

AOPL Response: As discussed below, ADIT is treated differently in certain respects under the Commission's oil pipeline cost-of-service ratemaking precedent and the rules governing oil pipeline regulatory accounting under the USoA. The cost-of-service and accounting issues are therefore discussed separately below.[6]

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[5] As discussed in Section 7, below, because the Policy Statement provided that MLP pipelines do not pay income taxes and are not entitled to an income tax allowance, there is no basis for MLP pipelines to accumulate deferred income taxes or adjust ADIT for changes in tax rates. Therefore, with the exception of Section 7 of these comments, AOPL's responses regarding the treatment of, and accounting for, ADIT, apply only to those entities not organized as an MLP.

[6] Unlike electric utilities and natural gas pipelines, oil pipelines are not subject to specific Internal Revenue Code requirements regarding ADIT. NOI at PP 17-18. Instead, for oil pipelines, ADIT is a matter of FERC cost-of-service ratemaking and accounting.

a. *Cost-of-Service Treatment of ADIT*

In the cost of service context, Commission precedent governs how rate base should be adjusted for excess and deficient ADIT for oil pipelines entitled to an income tax allowance. AOPL submits that oil pipelines should be able to rely on existing Commission precedent for purposes of calculating the page 700 cost of service (*see* 18 C.F.R. § 357.2), filing initial and changed cost-of-service rates (*see* 18 C.F.R. §§ 342.2(a), 342.4(a) and part 346), and defending against cost-based rate challenges. There is no need for industry-wide changes to the Commission's cost-of-service rules regarding ADIT.

For purposes of calculating a cost of service under the Commission's governing "Opinion No. 154-B" methodology, oil pipelines are required to use the normalization method for addressing timing differences between federal income taxation and Commission ratemaking. *Williams Pipe Line Company*, 31 FERC ¶ 61,377, at 61,837-38 (1985). In setting cost-based rates, oil pipelines are therefore required to deduct ADIT from rate base so that no return is earned on the accumulated deferred tax amount. *See* Opinion No. 154-B, 31 FERC ¶ 61,337 at 61,839 n.55; *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055, at 61,237–38 (1990), *aff'd on reh'g*, 53 FERC ¶ 61,398, at 62,390 (1990).[7]

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[7] Negative deferred income taxes can also result "when the pipeline incurs an expense in its cost of service that is not afforded contemporaneous expense treatment by the IRS. This means that the pipeline's tax allowance contains no sum for paying the taxes owed by virtue of the IRS' denial of the expense. The pipeline must pay the taxes out of its own capital and is, therefore, entitled to ... decreas[e] its deferred tax account."
(Continued ...)

With the reduction in income tax rates that took effect January 1, 2018, oil pipelines entitled to an income tax allowance will be required to calculate their tax allowance for 2018 and subsequent years using the new lower tax rates.[8] Under existing Commission cost-of-service ratemaking precedent, oil pipelines are required to adjust their ADIT balance to reflect changes in income tax rates using the Reverse South Georgia Method. *SFPP, L.P.*, 86 FERC ¶ 61,022, at 61,092-93 (1999) ("Opinion No. 435"); *see also* NOI at P 17.

Under the Reverse South Georgia Method, oil pipelines are required "to flow back excess plant-based ADIT over the remaining regulatory life of the property." NOI at P 17. This "flow back" is accomplished through two mechanisms in calculating the cost of service. First, the portion of the ADIT balance that is now "overfunded" (*i.e.*, the "excess tax reserve") is amortized over the remaining regulatory life of each applicable category of property, with the annual amortization deducted from the cost of service. *See, e.g., SFPP, L.P.*, 80 FERC ¶ 63,014, at 65,136-39 (1997) (Initial Decision), *aff'd*, Opinion No.

ARCO Pipe Line Co., 52 FERC ¶ 61,055 at 61,240. Costs for dismantling, removal and restoration ("DR&R") are "a prime example of this situation," because the DR&R allowance is taxed when received but is not deductible for tax purpose until the DR&R work is actually done. *Id.*

[8] For page 700 purposes, the Commission has held that oil pipelines must incorporate the new tax rates into their income tax allowance for purposes of calculating the 2018 calendar year page 700 cost of service, which is due to be filed in April 2019. Policy Statement at P 46 & n.84.

435, at 61,092-93.[9] Second, as the excess tax reserve is amortized, it is removed from the overall ADIT balance, with the remaining unamortized portion of the ADIT balance deducted from rate base. *Id.*

Since the new tax rates take effect January 1, 2018, and will first be reflected for page 700 purposes in the 2018 calendar year cost of service to be filed in April 2019, Policy Statement at P 46 n.84, the adjustment to ADIT using the Reverse South Georgia method should also be reflected for page 700 purposes beginning with the 2018 calendar year cost of service. All else being equal, the "flow-back" of the excess tax reserve under the Reverse South Georgia Method will tend to reduce the FERC ratemaking cost of service for oil pipelines. This reduction to the allowed cost of service, in addition to the reduced income tax allowance resulting from the new lower income tax rates, will tend to reduce the page 700 cost of service for oil pipelines as well as the cost of service that an oil pipeline would be permitted to use to justify new or changed cost-based rates. The overall level of the reduction for any individual pipeline depends on various factors, including the amount of rate base remaining and the current ADIT balance.

[9] The reduction to cost of service is generally performed as part of the income tax allowance by deducting the annual amortization of the excess tax reserve from the allowed return prior to grossing up the return for income taxes. *See, e.g.*, Prepared Direct Testimony of George R. Ganz on Behalf of SFPP, L.P., Docket No. IS08-390, Exhibit No. SFP-57 at Statement D (October 16, 2008).

b. *USoA Accounting Treatment for ADIT*

For regulatory accounting purposes, the USoA governs how oil pipelines record ADIT on their FERC books. The USoA provides that the "interperiod tax allocation method" (*i.e.*, normalization) "shall be applied to all material temporary differences ... between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years." 18 C.F.R. part 352, Instruction I-12(a). Accumulated deferred income tax liabilities are recorded in USoA Account 64. Any accumulated deferred income tax assets are recorded in USoA Account 45. Further instructions regarding accounting for ADIT are contained on page 230 of the Form No. 6.

The primary difference between oil pipeline cost-of-service ratemaking and USoA accounting with respect to ADIT relates to the treatment of excess tax reserves resulting from a change in tax laws. The USoA provides that a "carrier shall adjust its deferred tax liabilities and assets for the effect of the change in tax law or rates *in the period that the change is enacted*." *Id.* at Instruction I-12(b) (emphasis added). The USoA instructions regarding deferred tax liabilities were established with the express purpose of conforming to GAAP accounting, which requires the immediate recognition of changes in future tax liabilities. *See Revisions to and Electronic Filing of the FERC Form No. 6 and Related Uniform System of Accounts*, FERC Stats. & Regs. ¶ 32,553, at 33,954 (2000) (Notice of Proposed Rulemaking to change the USoA instructions regarding deferred tax liabilities "to make them consistent with the SFAS 109 liability method of accounting for income taxes"), *adopted in*, 93 FERC ¶ 61,262 (2000) ("Order No. 620"), *aff'd on reh'g*, 94

FERC ¶ 61,130 (2001). Thus, for regulatory accounting purposes, when income taxes are reduced, oil pipelines reduce their ADIT balance immediately by the full amount of the excess tax reserve consistent with GAAP.[10]

AOPL submits that it is not necessary to make any adjustments to the USoA rules or existing pipeline accounting practices. Although differences exist between FERC's accounting and ratemaking standards for oil pipelines, FERC oil pipeline accounting is not intended to mirror ratemaking, but is intended instead to conform to GAAP. The difference between FERC oil pipeline accounting and ratemaking has always existed and does not cause undue difficulties, since it is well-established that "accounting does not control ratemaking." *Entergy Services, Inc.*, 130 FERC ¶ 61,026, at P 89 (2010) (citing *Southern Co. Services, Inc.*, 116 FERC ¶ 61,247, at P 23 (2006)).

2. Flow-Back or Recovery of Plant-Based ADIT

Request for Comment: The Commission seeks comment on how "the amortization of excess plant-based ADIT ... may affect oil pipeline cost-of-service ratemaking." NOI at P 18.

AOPL Response: As discussed above, for cost-of-service ratemaking, oil pipelines are required to use the Reverse South Georgia Method to amortize any excess

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[10] It is AOPL's understanding that certain oil pipelines that derive a significant portion of their revenue from cost-of-service rates have elected to amortize excess tax reserves for accounting purposes consistent with the cost-of-service ratemaking treatment. As noted, however, most oil pipeline rates are not set on a cost-of-service basis.

ADIT over the remaining regulatory life of the applicable property. This will tend to reduce the allowed cost of service for oil pipelines, all else being equal.

3. Flow-back or Recovery of Non-Plant Based ADIT

Request for Comment: "Oil pipeline commenters should ... address how quickly any excess non-plant based ADIT should be flowed back in the data reported on Form No. 6, page 700 and in any cost-of-service proceeding as the issue arises." NOI at P 19.

AOPL Response: AOPL is not aware of the issue of non-plant based ADIT ever arising in an oil pipeline rate case and is therefore not aware of any FERC oil pipeline ratemaking precedent on the issue. AOPL respectfully submits that the issue is best left for application in individual cost-of-service rate cases to the extent it arises.

Non-plant based ADIT is generally small relative to plant-based ADIT and a pipeline's overall cost of service. It is also hard to formulate general rules regarding non-plant based ADIT in the abstract, because each individual type of non-plant based ADIT may present different considerations.

Moreover, while timing differences may exist between IRS rules and FERC accounting with respect to non-plant accounts, such timing differences appear less likely to occur in the ratemaking context. Oil pipeline regulatory accounting is based on the *accrual* method (*see* USoA, Instruction 1-4(a)), while oil pipeline cost-of-service ratemaking generally relies on a base period of *actual* data adjusted for known and measurable changes. 18 C.F.R. § 346.2(a)(1). Thus, for example, if a pipeline accrues expenses for unused employee vacation time on its FERC books, that may result in a timing difference with its tax books to the extent the IRS does not permit the deduction of that anticipated expense. But the timing difference would not likely arise in the ratemaking context, because cost-of-service rates are generally based on actual costs incurred, consistent with the tax treatment.

4. Assets Sold or Retired After December 31, 2017

Request for Comment: The Commission seeks comment on whether, and if so how, it should address excess ADIT that is removed from the books of public utilities, oil pipelines and interstate natural gas pipelines after December 31, 2017, as a result of assets being sold or retired." NOI at P 20.

AOPL Response: Commission precedent provides that when assets are sold or transferred as part of a taxable event, the ADIT balance associated with those assets is extinguished. *Enbridge Pipeline (KPC)*, 102 FERC ¶ 61,310, at 62,031-33 (2003); *Koch Gateway Pipeline Company*, 74 FERC ¶ 61,088 (1996); *see also Chevron Products Co. v. SFPP, L.P.*, 160 FERC ¶ 63,006, at PP 721-26 (2017) (Initial Decision finding that the portion of the ADIT balance associated with Kinder Morgan Energy Partners' publicly held units should be extinguished due to the acquisition of those units by Kinder Morgan, Inc., since no party opposed it and there "being no compelling arguments to the contrary").[11] As the Commission has explained, "ADIT balances consist of deferred

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[11] If regulated assets are transferred through a partnership contribution rather than a sale, the pipeline acquiring the assets may be required to deduct the accumulated ADIT from the carryover rate base value of the transferred property. *Kuparuk Transportation*
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taxes that are intended to be paid at a future time – when the taxes become due. When a taxable event occurs such as the sale of assets …, taxes are due and the ADIT balances are reduced to zero." *Enbridge Pipeline (KPC)*, 102 FERC ¶ 61,310 at P 68. Thus, the "ADIT balances that existed prior to the sale no longer exist and are no longer an offset against rate base." *Id.* at P 5. As the NOI explains, any ADIT associated with assets that are sold are removed from the regulated entity's "books because any previously deferred tax effects related to the assets are now triggered as part of the computation of gains or losses associated with the sale … (*i.e.*, the deferred taxes are now payable to the IRS)." NOI at P 20.

ADIT balances are also extinguished when assets are retired. NOI at P 20. When pipeline assets are retired, the assets are removed from the pipeline's rate base. There is thus no longer any depreciation, return or tax allowance associated with the asset and no basis for continuing to record ADIT (or amortizing any excess or deficient ADIT) with respect to that asset. As noted above, under the Reverse South Georgia Method, excess ADIT is amortized over the life of the applicable category of property. Any deficiency (*e.g.*, resulting from a tax increase) would be similarly added to ADIT over the regulatory life of the asset. When the asset is taken out of service, there is no basis to continue amortizing any excess or deficiency.

Co., 55 FERC ¶ 61,122 at 61,369.

5. Amortization of Excess and Deficient ADIT

Request for Comment: The Commission seeks comment on how the income tax allowance should be adjusted by the amortization of excess and deficient ADIT in the context of oil pipeline cost-of-service ratemaking and in the cost-of-service summary on Form No. 6, page 700. NOI at P 21. The Commission further seeks comment on whether oil pipelines should record the amortization of excess and deficient ADIT "in Account 665 (Unusual or Infrequent Items (Debit)) or Account 645 (Unusual or Infrequent Items (Credit))." NOI at P 22.

AOPL Response: As noted above, in the oil pipeline cost-of-service context, excess ADIT is amortized and removed from the cost of service by reducing the allowed return before it is grossed up for income taxes. AOPL submits there is no reason to change this existing practice unless a need arises in the context of a future cost-of-service rate case.

With respect to regulatory accounting under the USoA, as noted above, any excess ADIT is eliminated when tax rates change consistent with GAAP, rather than being reduced over time through amortization. AOPL does not believe there is any reason to change either the Commission's accounting rules or current oil pipeline accounting practices, since, as noted, FERC's ratemaking precedent controls rather than accounting rules for purposes of setting cost-of-service rates. AOPL takes no position on the account in which oil pipelines should record the amortization of excess and deficient ADIT if they were to record it.

6. Supporting Worksheets

Request for Comment: "The Commission seeks comment on whether it should require public utilities, interstate natural gas pipelines, and oil pipelines to provide to the Commission, on a one-time basis, additional information, such as supporting worksheets, to show the computation of excess or deficient ADIT and the corresponding flow-back of excess ADIT to customers or recovery of deficient ADIT from customers. Commenters should address what types of information public utilities, interstate natural gas pipelines, and oil pipelines already record for ADIT-related accounting and whether balances and amortization of regulatory liability and asset accounts, computation of excess and deficient ADIT, delineation between plant assets and non-plant assets, and a description of the allocation method used to determine the transmission-related portion of excess or deficient ADIT would be appropriate to include in a supporting worksheet." NOI at P 23.

AOPL Response: AOPL submits that it is not necessary to require additional reporting for oil pipelines beyond the Commission's current requirements.

When oil pipelines file initial or changed cost-of-service rates, they are required to include information regarding ADIT, including "underfunded or overfunded ADIT amortization." 18 C.F.R. § 346.2(c)(4)-(5). Shippers therefore have sufficient detail regarding the ADIT calculations underlying a pipeline's proposed rates in order to determine whether to challenge the rate filing.

The current information reported on page 700 is also sufficient for the purpose of that form. The Commission's page 700 requirements were established pursuant to Congress's mandate in EPAct to "streamline" its oil pipeline procedures "in order to avoid unnecessary regulatory costs and delays." EPAct at § 1802(a). The Commission has made clear that page 700 is a "preliminary screening tool" for pipeline rate filings, not 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 31,168-69 (1994) ("Order No. 571"), *order on reh'g.*, FERC Stats. & Regs., Regs. Preambles 1991-1996, ¶ 31,012 (1994) ("Order No. 571-A").

Pipelines are therefore required to calculate page 700 pursuant to the Commission's Opinion No. 154-B methodology using consistent approaches over time (or noting any changes), but are not required to report on page 700 all of the various individual elements that would be required for a full-blown cost-of-service rate filing. *See* Page 700 Instructions 2, 6. The specific cost-of-service line items that oil pipelines are required to report on page 700 do not include ADIT, but instead include summary data such as "Rate Base – Original Cost," which reports the original cost rate base after deduction of any ADIT balance. There is no reason to impose additional reporting requirements. Since the Commission has determined that it is not necessary to report ADIT on page 700, there is no reason to require detailed back-up for changes to ADIT balances for page 700 purposes.

As discussed above, for accounting purposes, oil pipelines do not amortize excess ADIT, but instead immediately remove any excess ADIT from their books when the tax change becomes known consistent with GAAP. There is no basis to require additional reporting requirements related to recordation of ADIT for accounting purposes.

7. Treatment of ADIT for Partnerships

Request for Comment: "The Commission seeks comment on the effect of the elimination of the income tax allowance for MLPs on ADIT. Likewise the Commission seeks comment regarding the treatment of ADIT to the extent the income tax allowance is eliminated for other non-MLP pass-through entities. For such MLPs and pass-through entities, commenters should address whether previously accumulated sums in ADIT should be eliminated altogether from the cost of service or whether those previously accumulated sums should be placed in a regulatory liability account and returned to ratepayers. Commenters should address specifically how their approach would be applied in the MLP's or other pass-through entity's cost of service." NOI at P 25.

AOPL Response: The Commission's recent Policy Statement provides that "granting an MLP an income tax allowance results in an impermissible double recovery." Policy Statement at P 45. That same day, the Commission applied the Policy Statement in the context of the pending proceeding involving SFPP's 2008 West Line rates of SFPP, L.P., holding that "in order to avoid a double recovery of investor-level tax costs, SFPP should not receive an income tax allowance." Opinion No. 511-C at P 10.[12] The

[12] As noted, the Policy Statement "does not address other, non-MLP partnership or other pass-through business forms." Policy Statement at P 45. The Commission stated

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Commission also applied the Policy Statement in other pending cases involving SFPP's rates going back to 2010 and 2011. *See* Opinion No. 522-B, at P 8 (2018); Opinion No. 527-A, at PP 17 n.34; 2011 SFPP Complaint Order, at P 9.

As noted, AOPL and various other parties filed requests for rehearing of the Policy Statement, and SFPP sought rehearing of the orders applicable to it. Those requests are pending before the Commission. Absent rehearing, however, to the extent the Commission continues to deem it "impermissible" for MLP pipelines to recover an income tax allowance, there is no basis for continuing to accumulate ADIT for MLP pipelines. Under the theory of the Policy Statement, MLP pipelines do not pay income taxes, and MLP unitholders are compensated for their income taxes through the equity rate of return. *See* Policy Statement at P 9. Thus, consistent with the Policy Statement, MLP pipelines should no longer include an income tax allowance or continue to accumulate deferred income taxes in calculating their cost of service.

The rationale for recognizing ADIT is inherently linked with and inseparable from the recovery of an income tax allowance. ADIT is an adjustment that accounts for timing differences between how federal income taxes are calculated by the IRS and how the Commission calculates the pipeline's income tax allowance for ratemaking purposes. See NOI at P 11. As noted, "ADIT balances consist of deferred taxes that are intended to be paid at a future time – when the taxes become due." *Enbridge Pipelines (KPC)*, 102

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that it would determine whether non-MLP pass-through entities are entitled to an income tax allowance "as those issues arise in subsequent proceedings." Policy Statement at P 3.

FERC ¶ 61,130, at 68. In the meantime, the "ADIT balances are removed from rate base to prevent the pipeline from earning a return on these balances." *Id.* at P 69. Since MLPs are deemed not to pay taxes and are denied the ability to recover an income tax allowance under the Policy Statement, there is no basis for continuing to require an ADIT adjustment. For the same reasons, since MLP pipelines do not benefit from the deferral of income taxes, there is no basis to deduct any amount of assumed ADIT from rate base.

Moreover, in calculating the pipeline's ADIT balance, oil pipelines should eliminate any adjustments to ADIT for past periods in which the pipeline was organized as an MLP, since there is no basis in those years to record a difference between IRS tax rules and a FERC income tax allowance. The Commission has made clear that a pipeline's current ADIT balance should be based on accurate data for historical periods given currently-known information regardless of how past rates may have been calculated. *SFPP, L.P.*, 150 FERC ¶ 61,096, at PP 6-21 (2015) ("Opinion No. 511-B").[13]

In order to calculate annual adjustments to ADIT for past periods, various inputs are required such as "annual changes to rate base, depreciation rates, and other factors which influence the size of tax deferrals." *Id.* at P 18. For example, with respect to the appropriate income tax rate to use for past periods, the Commission has held that the pipeline should use the tax rate "applicable to the year in which each tax deferral

[13] In Opinion No. 511-C, the Commission required SFPP to revise its compliance filing consistent with its holding that MLP pipelines are not entitled to an income tax allowance. Opinion No. 511-C did not change its prior holding that ADIT balances should be based on accurate data for past years.

occurred," reversing its prior holding that the pipeline should use the tax rates that were "embedded" in its most recent prior fully-litigated cost-of-service rates. *Id.* at PP 6, 21. In so holding, the Commission explained that "ADIT is not based on the difference between taxes actually paid and the dollar amount of the pipeline's income tax allowance as calculated in the most recent rate case," because the assumptions used in the last rate case may "provide an inaccurate calculation of tax deferrals" in subsequent years as circumstances may change. PP 18-19.

Consistent with Opinion No. 511-B, it would not be accurate to accumulate deferred income taxes for past years when a pipeline was organized as an MLP, since under Commission policy MLP pipelines do not pay taxes and are not entitled to an income tax allowance. Nor is there any basis for assuming that an income tax allowance was "embedded" in past rates and that some portion of it must now be "returned." As the Commission has recognized, most oil pipelines do not set rates on a cost-of-service basis, but instead use indexing to change existing rates. NOI at P 8. Moreover, the rates subject to indexing may not have been filed initially on a cost-of-service basis, but instead may have been the product of agreement among shippers or grandfathering under EPAct. Even in the rare case of a pipeline that has been subject to prior cost-of-service rate proceedings, it is not appropriate to assume that the pipeline's historical rates contained any particular level of income tax allowance or tax deferral. As the Commission explained in Opinion No. 511-B, "because SFPP's rates have changed pursuant to the Commission's indexing policies and settlements, it would be unreasonable to view SFPP's rates as embedding a dollar amount of the income tax allowance from its last fully litigated cost-of-service rate case." *Id.*

The recalculation of ADIT for past periods may also affect the calculation of deferred return. Under the Commission's trended original cost methodology for oil pipelines, ADIT is deducted from rate base before the inflation component of equity return is included (*i.e.*, trended). *See ARCO Pipe Line Co.*, 52 FERC at 61,238–39; *Kuparuk Transp. Co.*, 55 FERC ¶ 61,122, at 61,371 (1991). In other words, the inflation portion of the return on rate base that has been deferred is smaller than it would have been had no ADIT been deducted. Since MLP pipelines were not entitled to an income tax allowance and should not have accumulated deferred income taxes, their deferred return should be recalculated to reflect the appropriate level of inflation-related rate base trending.

In sum, pipelines organized as MLPs should no longer accumulate deferred income taxes in calculating their cost of service, because the Policy Statement assumes they do not pay income taxes and denies them an income tax allowance. For the same reason, and consistent with the precedent established by the Commission's Opinion 511-B, historical ADIT balances should be eliminated for prior years in which the pipeline was organized as an MLP with no portion of the eliminated ADIT balances being included in the pipeline's cost of service.

B. Bonus Depreciation

Request for Comment: "The Commission seeks comment on the effect of the bonus depreciation change under the Tax Cuts and Jobs Act. The Commission also seeks comment on whether, and if so how, the Commission should take action to address bonus depreciation-related issues. Commenters should address the practical application of their proposals, including, among other things, what type of action the Commission should take and whom the Commission should target with its action." NOI at P 28.

AOPL Response: No extraordinary Commission action is required to address bonus depreciation. To the extent an oil pipeline is entitled to an income tax allowance, the bonus depreciation permitted in the Tax Cuts and Jobs Act will apply to the 2018 tax year and subsequent years.[14] To the extent an oil pipeline elects to take bonus depreciation, that will affect its ADIT balance beginning in 2018, by increasing the timing difference between depreciation used for federal income tax purposes and depreciation used for FERC book and ratemaking purposes. If specific issues arise in the context of a cost-of-service rate case, they can be dealt with based on the facts and circumstances in that case.

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[14] Pipelines that are not entitled to a tax allowance will not be affected by the bonus depreciation provisions in the Tax Cuts and Jobs Act.

C. <u>Additional Inquiries</u>

Request for Comment: "In addition, the Commission seeks comment on whether, and if so how, it should take further action to address the change in the federal corporate income tax rate" or "any other effects of the Tax Cuts and Jobs Act." NOI at P 29.

AOPL Response: AOPL submits that no further action is necessary from the Commission with respect to oil pipelines to address the Tax Cuts and Jobs Act. As discussed above, the Commission's existing rules and policies regarding oil pipeline ratemaking will factor in the new tax rates appropriately without any need for extraordinary action on behalf of the Commission.

Respectfully submitted,

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May 21, 2018

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