ORAL ARGUMENT IS NOT YET SCHEDULED

Nos. 18-1252 & 18-1254 (consolidated)

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Enable Mississippi River Transmission, LLC
and Enable Gas Transmission LLC, *et al.*,
Petitioners,

v.

Federal Energy Regulatory Commission
and the United States of America,
Respondents.

On Petition for Review of Orders of the
Federal Energy Regulatory Commission

BRIEF OF THE ASSOCIATION OF OIL PIPE LINES AS INTERVENOR IN SUPPORT OF PETITIONERS

Steven M. Kramer
Senior Vice President, General Counsel and Corporate Secretary
Association of Oil Pipe Lines
900 17th Street, NW, Suite 600
Washington, DC 20006
(202) 292-4502

Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
(202) 429-6233

Counsel for Association of Oil Pipe Lines

July 29, 2019

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

A. Parties and Amici

All parties, intervenors and amici appearing before the Federal Energy Regulatory Commission and this court are listed in Petitioners' brief.

B. Rulings Under Review

The rulings under review are identified in Petitioners' brief.

C. Related Cases

The related cases are identified in Petitioners' brief.

Respectfully submitted,

_*/s/ Daniel J. Poynor*________

Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, D.C. 20036-1795
(202) 429-6233

Counsel for Association of Oil Pipe Lines

July 29, 2019

IN THE
UNITED STATES COURT OF APPEALS FOR
THE DISTRICT OF COLUMBIA CIRCUIT

ENABLE MISSISSIPPI RIVER TRANSMISSION, LLC AND ENABLE GAS TRANSMISSION, LLC, *et al.*, Petitioners, v. FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA, Respondents.	)	Nos. 18-1252 & 18-1254 (consolidated)

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rules 28 and 26.1 of the Federal Rules of Appellate Procedure and the Rules of this court, the Association of Oil Pipe Lines ("AOPL") respectfully submits this Corporate Disclosure Statement. AOPL is an incorporated, non-profit trade association that represents the interests of oil pipeline owners and operators before the U.S. Congress, regulatory agencies, and the courts. AOPL's membership includes pipelines that carry approximately 96 percent of the crude oil and petroleum products moved by pipeline in the United

States. AOPL has no parent companies, and no publicly held company owns a ten percent or greater interest in AOPL.

Respectfully submitted,

Daniel J. Poynor

Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
(202 429-6233

Counsel for Association of Oil Pipe Lines

Of Counsel:

Steven M. Kramer
Senior Vice President, General Counsel and Corporate Secretary
Association of Oil Pipe Lines
900 17th Street, NW, Suite 300
Washington, DC 20006
(202) 292-4502

July 29, 2019

TABLE OF CONTENTS

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

GLOSSARY v

STATEMENT REGARDING JURISDICTION 1

STATEMENT OF ISSUES 1

STATEMENT REGARDING STATUTES AND REGULATIONS 2

STATEMENT OF THE CASE AND FACTS 2

SUMMARY OF ARGUMENT 5

STANDING 8

ARGUMENT 12

- **I. FERC Erred by Adopting as Fact the Double-Recovery Theory that It was Charged with Investigating Instead of Conducting an Independent Review of the Relevant Issues** 12
- **II. FERC Failed to Provide a Reasoned Explanation for Abandoning the Policies Underpinning Its Prior Income Tax Allowance Methodology** 14
- **III. FERC Erred by Failing to Grapple with Crucial Empirical Evidence that Undermined Its "Double Recovery" Theory** 21
- **IV. FERC Erred by Ignoring Evidence that Removal of the Income Tax Allowance for MLP Pipelines Could Have Significant Adverse Effects on MLP Pipelines and Their Ability to Attract Capital** 24

CONCLUSION 29

STATUTORY AND REGULATORY ADDENDUM

TABLE OF AUTHORITIES

Page(s)

CASES

ANR Pipeline Co. v. FERC, 71 F.3d 897 (D.C. Cir. 1995) 14

Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679 (1923)...24

BP West Coast Products, LLC v. FERC, 374 F.3d 1263 (D.C. Cir. 2004) 19

City of Charlottesville, Va. v. FERC, 774 F.2d 1205 (D.C. Cir. 1985)...................20

ExxonMobil Oil Corp. v. FERC, 487 F.3d 945 (D.C. Cir. 2007)................. 3, 14, 17

Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944) 6, 7, 21, 24, 25

Fed. Power Comm'n v. Texaco, 417 U.S. 380 (1974) 28

Great Lakes Gas Transmission Ltd. P'ship v. FERC, 984 F.2d 426 (D.C. Cir. 1993) 10

Greater Boston Television Corp. v. F.C.C., 444 F.2d 841 (D.C. Cir. 1970)...........15

Hunt v. Wash. State Apple Advert. Comm'n, 432 U.S. 333 (1977) 9

Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992) 8, 12

Memphis Light, Gas and Water Division v. Fed. Power Comm'n, 411 U.S. 458 (1973)...25

Motor Vehicle Mfrs. Ass'n of US, Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983).. 24, 27

Papago Tribal Utility Authority v. FERC, 776 F.2d 828 (9th Cir. 1985)................20

Permian Basin Area Rate Cases, 390 U.S. 747 (1968)..15

Petro Star Inc. v. FERC, 835 F.3d 97 (D.C. Cir. 2016) 28

Public Systems v. FERC, 606 F.2d 973 (D.C. Cir. 1979)..................... 15, 24, 27, 28

SEC v. Chenery Corp., 318 U.S. 80 (1943) 13

SEC v. Chenery Corp., 332 U.S. 194 (1947) 13

Tesoro Alaska Petroleum Co. v. FERC, 234 F.3d 1286, 1288 (D.C. Cir. 2000) 28

United Airlines v. FERC, 827 F.3d 122 (D.C. Cir. 2016) 2, 5, 13, 14

STATUTES

BP West Coast Prods. LLC v. SFPP, L.P., 118 FERC ¶ 61,261 (2007) 11

BP West Coast Prods. LLC v. SFPP, L.P., 121 FERC ¶ 61,141 (2007) 11

Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity, 123 FERC ¶ 61,048 (2008) 16

Enbridge Energy, Limited Partnership, 166 FERC ¶ 61,237 (2019) 9

Inquiry Regarding Income Tax Allowances, 111 FERC ¶ 61,139 (2005). 14, 15, 16, 17, 18, 19, 20

Inquiry Regarding the Commission's Policy for Recovery of Income Tax Cost, 157 FERC ¶ 61,210 (2016) 2, 3

Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs, 162 FERC ¶ 61,227 (2018) 4, 5, 7, 8, 9, 11, 13, 18, 19, 21, 23, 24, 26

Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs, 164 FERC ¶ 61,030 (2018) 4, 9, 27

Interstate and Intrastate Natural Gas Pipelines, 164 FERC ¶ 61,031 (2018) 9

ONEOK Elk Creek Pipeline, L.L.C., 167 FERC ¶ 61,277 (2019) 11

SFPP, L.P., 134 FERC ¶ 61,121 (2011) 19

Targa NGL Pipeline Company LLC, 166 FERC ¶ 61,179 (2019) 10

OTHER AUTHORITIES

28 U.S.C. § 2344 8

IRC § 7704(d)(1)(E)....................18

Pub. L. 100-203, 101 Stat. 1330-403 (1987) (codified at IRC § 7704)....................18

RULES

18 C.F.R. § 342.2 (2018) 9, 10

18 C.F.R. § 342.3 (2018) 9

18 C.F.R. § 342.4 (2018) 9, 10

18 C.F.R. § 343.1 (2018) 10

18 C.F.R. § 343.2 (2018) 10

18 C.F.R. § 357.2 (2018) 11

GLOSSARY

SHORT FORM	DEFINITION
AOPL	Association of Oil Pipe Lines
FERC	Federal Energy Regulatory Commission
MLP	Master Limited Partnership

STATEMENT REGARDING JURISDICTION

This court has jurisdiction for the reasons discussed in Petitioners' brief.

STATEMENT OF ISSUES

1. Whether FERC erred by failing to engage in reasoned decision-making by adopting as fact the double-recovery theory that FERC was charged by *United Airlines* with investigating instead of conducting an independent review of the relevant issues.

2. Whether FERC erred in failing to provide a reasoned explanation for abandoning the policies underpinning its prior income tax allowance methodology.

3. Whether FERC erred by ignoring an important aspect of the problem and reaching a decision contrary to the facts when it failed to grapple with crucial empirical evidence that undermines its "double recovery" theory.

4. Whether FERC erred by failing to consider an important aspect of the problem and reaching a decision contrary to the facts when it ignored evidence that removal of the income tax allowance for master limited partnership ("MLP") pipelines could have significant adverse effects on the financial integrity of MLP pipelines and their ability to attract capital.

STATEMENT REGARDING STATUTES AND REGULATIONS

Except as included in the addendum attached hereto, all applicable statutes and regulations are set forth in the addendum to Petitioners' brief.

STATEMENT OF THE CASE AND FACTS

On December 15, 2016, FERC issued a notice of inquiry regarding its income tax allowance policies. *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Cost*, 157 FERC ¶ 61,210 (2016) ("Notice of Inquiry"). The Notice of Inquiry was issued in response to the decision of this court in *United Airlines v. FERC*, 827 F.3d 122 (D.C. Cir. 2016). The petitioners in *United Airlines* argued that the discounted cash flow rate of return methodology that FERC uses to set cost-of-service rates provides MLP pipeline investors a return on equity sufficient to pay their taxes, and that giving MLP-owned pipelines an income tax allowance in addition to the pre-investor-tax rate of return constitutes "double recovery" of income taxes. The court concluded that FERC had "not provided sufficient justification for its conclusion that there is no double recovery of taxes for partnership pipelines receiving a tax allowance in addition to the discounted cash flow return on equity" and remanded the issue to FERC for further explanation. *Id*. at 136-37.

The Notice of Inquiry sought comments regarding the "concerns presented by *United Airlines*" with respect to any potential double-recovery of income tax

costs as well as "the practical application" of any proposals made by commenters. Notice of Inquiry at PP 18, 20. Numerous parties, including the Association of Oil Pipe Lines ("AOPL"), filed comments urging FERC to maintain its prior income tax allowance and rate of return policies.

AOPL's comments explained that FERC's prior, established income tax allowance policy was consistent with legal precedent regarding the recovery of income tax costs and was upheld by this court. AOPL Comments at 2, R.23 (JA ___) (citing *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007) ("*ExxonMobil*")). As AOPL discussed, FERC's previous longstanding income tax allowance policy appropriately recognized that income taxes are a cost of operating a pipeline that regulated entities are entitled to recover regardless of whether they are structured as a corporation or a partnership. AOPL Comments at 2, R.23 (JA ___).

AOPL further explained that FERC's rate of return policy is reasonable both on its own and in conjunction with the income tax allowance policy, and does not result in any impermissible "double-recovery" of income taxes for MLP pipelines. On the contrary, empirical data included in the record comparing the market-based returns of comparable natural gas pipelines owned by both MLPs and corporations showed that the market-based returns observed for MLP pipelines are not

systematically higher than those for corporate pipelines. AOPL Comments at 3, R.23 (JA ___).

As AOPL discussed, when FERC's existing rate of return and income tax allowance policies are used, they result in comparable rates for MLP pipelines and corporate pipelines. Theoretical concerns regarding the pre-tax nature of the MLP return should not be the basis for departing from FERC's established policies, particularly where there has been no showing of any difference in the resulting rates for corporate and MLP pipelines and given the important policy considerations underlying FERC's approach. AOPL Comments at 3, R.23 (JA ___).

On March 15, 2018, FERC rejected AOPL's arguments and concluded that 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) ("Revised Statement"). On July 18, 2018, FERC denied rehearing of the Revised Statement. *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, 164 FERC ¶ 61,030 (2018) ("Rehearing Order").

SUMMARY OF ARGUMENT

FERC's fundamental error was to assume the answer to the question it was charged with investigating. In *United Airlines*, this court held that FERC had not "provided sufficient justification" for permitting MLP pipelines to include an income tax allowance in their cost of service and remanded the issue to FERC for further review and explanation. 827 F.3d at 136, 137. The court did not dictate the outcome and made clear that "to the extent FERC has a reasoned basis for granting a tax allowance to partnership pipelines, it may do so." *Id.* at 135. But instead of taking a fresh look at the issue and performing an independent review, FERC wrongly adopted as a fact "the fundamental premise of *United Airlines* that an income tax allowance for MLP pipelines leads to a double-recovery." Revised Statement at P 23, R.70 (JA ___). FERC's failure to conduct its own inquiry was arbitrary and capricious and requires FERC's decision to be remanded.

This threshold error infected all of FERC's decision, and, because of it, FERC's ruling fell short of the requirements of reasoned decisionmaking in numerous ways. Certain of these issues were discussed in Petitioners' brief. AOPL focuses on two additional deficiencies not addressed by Petitioners and elaborates briefly on a third issue that was also raised by Petitioners.

First, FERC failed to provide an adequate explanation for abandoning the policy goals that underpinned its prior income tax allowance methodology.

FERC's prior approach of permitting an income tax allowance for all regulated oil pipelines regardless of ownership structure was the result of careful consideration of the applicable policy issues, including (1) ensuring comparability in rates between MLP pipelines and corporate pipelines, and (2) encouraging investment in pipeline infrastructure through the use of the MLP organizational form. Because FERC assumed that *United Airlines* dictated the result, it glossed over these prior policy goals and failed to justify its abandonment of them.

Second, FERC failed to investigate key evidence that undercut its "double recovery" theory. The record in this proceeding showed that the returns for MLP pipelines are not systematically higher than those of corporate pipelines. Thus, FERC's assumption that MLP pipelines do not need an income tax allowance because they already recover their income taxes through a (presumably higher) rate of return on equity does not square with market reality. The Supreme Court has made clear that in ratemaking it "is not theory but the impact of the rate order which counts." *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) ("*Hope*"). But here FERC rejected the facts when they did not fit its chosen theory. FERC erred by failing to grapple with the record evidence regarding the practical effect of abandoning its existing income tax allowance policy.

Third, FERC erred by disregarding the record evidence regarding the likely – and then actual – adverse effect of its decision on MLP pipelines. It is a bedrock

principle of ratemaking that FERC's decisions must "assure confidence in the financial integrity of the [regulated entity], so as to maintain its credit and attract capital." *Hope,* 320 U.S. at 603. FERC must therefore engage in a "pragmatic assessment" of the issues to establish rates where the "end result" is just and reasonable, since ultimately it "is not theory but the impact of the rate order which counts." *Id.* at 602-603.

Contrary to these fundamental requirements, FERC simply denied the real-world consequences of its actions. Prior to the issuance of the Revised Statement, AOPL and others submitted evidence predicting that eliminating the income tax allowance for MLP pipelines would risk causing financial harm to MLP pipelines in contravention of FERC's obligations under *Hope*. The sum total of FERC's response to that evidence was to state: "This is not the case." Revised Statement at P 44, R.70 (JA ___).

Unfortunately, the aftermath of the Revised Statement showed that FERC was incorrect. In the days following the issuance of FERC's decision, MLPs lost over $30 billion in market capitalization. Petitioners Br. at 34. Even when presented with evidence of what had actually occurred, FERC refused to revisit its decision.

Most FERC decisions have some effect on regulated entities, either positive or negative (although rarely this dramatic). That in itself is not error. Here,

however, FERC abandoned its prior policy without acknowledging the potential for adversely affecting MLP pipeline finances, let alone investigating the issue or providing a reasoned basis why its new policy was justified in light of it. Instead, FERC shifted responsibility to the court, claiming the outcome was determined by *United Airlines* regardless of the consequences for the industry. Revised Statement at P 44, R.70 (JA ___). FERC abdicated its basic duties as an administrative agency by failing to consider the evidence and show a rational connection between the facts and the decision reached.

Each of the above errors, standing alone, compels vacating and remanding FERC's decision. Taken together, they reveal a fundamentally flawed and inadequate decisionmaking process that requires FERC to revisit the issue unshackled from its mistaken assumption that *United Airlines* dictated the result, to conduct a proper investigation of the evidence, and to provide an adequate explanation for the ultimate decision made.

STANDING

AOPL is aggrieved by FERC's decisions under 28 U.S.C. § 2344 and has standing to seek review before this court. Article III standing requires a showing of an injury in fact, causation, and redressability. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992). Here, FERC held that it "will no longer permit MLPs to recover an income tax allowance in their cost of service." Revised

Statement at P 2, R.70 (JA ___). Although FERC attempted to characterize its decision as merely an "expression of general policy intent," Rehearing Order, at P 6, R.91 (JA ___), FERC has treated it as "binding precedent" in setting rates for oil and gas pipelines. *See, e.g., Interstate and Intrastate Natural Gas Pipelines*, 164 FERC ¶ 61,031, at PP 50, 54, 59 (2018). The resulting harm to AOPL's members is redressible by vacating and remanding FERC's decisions.

AOPL has standing because its members have standing, the interests AOPL seeks to protect are germane to its purpose, and neither the claim nor the relief requested requires the participation of the individual members. *Hunt v. Wash. State Apple Advert. Comm'n*, 432 U.S. 333, 342-343 (1977). AOPL has MLP pipeline members, and they are directly harmed by FERC's new policy, which reduces their FERC-regulated cost of service and thus the rates they are permitted to charge on a cost-of-service basis.

The oil pipeline industry operates under a combination of indexed rates, settlement rates, market-based rates, and cost-of-service rates. *See* 18 C.F.R. §§ 342.2, 342.3 and 342.4 (2018). For oil pipelines with cost-of-service rates, FERC's new income tax allowance rule causes an obvious immediate injury. *See, e.g.*, *Enbridge Energy, Limited Partnership*, 166 FERC ¶ 61,237, at PP 2-6 (2019) (rate reduction reflecting FERC's income tax allowance rule filed by pipeline subject to annual cost-based rates pursuant to a settlement agreement). A reduction

in the allowed cost of service also has an immediate injurious effect on pipelines that do not currently set their rates on a cost-of-service basis. In part, this is because cost-based rates form the backdrop against which other types of rates are set. By limiting the cost-based rates (and potentially the indexed rates and settlement rates) that pipelines are able to charge in the future, FERC's decisions cause immediate injury to pipeline market values and their ability to obtain adequate financing. As this court has explained, a FERC decision that puts a regulated entity at "risk of lower future earnings" has a "present injurious effect" by lowering its "creditworthiness [and] affecting its ability to raise capital." *Great Lakes Gas Transmission Ltd. P'ship v. FERC*, 984 F.2d 426, 431 (D.C. Cir. 1993).

For example, a lower cost of service restricts a pipeline's ability to increase its existing rates using a cost-of-service justification. 18 C.F.R. § 342.4(a) (2018). It also makes the pipeline's existing rates more vulnerable to challenge by complaint, 18 C.F.R. §§ 343.1(a) and 343.2, and thus gives its shippers increased leverage to negotiate discounts or other benefits even if no complaint is filed.

Initial rates for new services must also be justified on a cost-of-service basis if challenged. 18 C.F.R. § 342.2 (2018). In fact, the Commission has recently indicated that at least in certain circumstances even initial negotiated rates must be cost-justified, including potentially over the life of the agreement. *See, e.g.*, *Targa NGL Pipeline Company LLC*, 166 FERC ¶ 61,179, at PP 18-22 (2019); *ONEOK*

Elk Creek Pipeline, L.L.C., 167 FERC ¶ 61,277, at PP 3-4 (2019). A lower allowed cost of service therefore limits the rates pipelines can charge for new services and may make potential new offerings less economic.

A lower cost of service can also affect a pipeline's ability to increase its rates under FERC's indexing methodology. Oil pipelines are required to report an annual company-wide cost of service on the page 700 of their FERC Form No. 6. *See* 18 C.F.R. § 357.2 (2018). In light of its new policy, FERC has required oil pipelines owned by MLPs to remove the income tax allowance from their page 700 cost of service. *See* Revised Statement, at P 46 n.83, R.70 (JA ___). FERC uses the information reported on the page 700 to evaluate challenges to indexed rates. *See, e.g.*, *BP West Coast Prods. LLC v. SFPP, L.P.*, 121 FERC ¶ 61,141, at P 6 (2007). Thus, for example, a pipeline that reports revenues significantly in excess of its page 700 cost of service may be denied an indexed rate increase in certain circumstances. *See, e.g.*, *BP West Coast Prods. LLC v. SFPP, L.P.*, 121 FERC ¶ 61,141, at PP 6-10 (2007). By the same token, a pipeline that reports under-recovery on its page 700 may increase its rates under the indexing methodology regardless of how its costs changed in a given year. *See, e.g.*, *BP West Coast Prods. LLC v. SFPP, L.P.*, 118 FERC ¶ 61,261, at P 8 n.10 (2007), *aff'd on reh'g*, 121 FERC ¶ 61,195, at P 4 (2007). FERC's new income tax allowance rule may cause some pipelines to appear to be significantly over-recovering their cost of

service reported on page 700 or eliminate the safe-harbor of page 700 under-recovery thus making it more difficult for pipelines to adjust their rates pursuant to indexing.

In sum, AOPL's members have suffered "concrete," "actual" harms as a result of the challenged FERC orders that are not "conjectural or hypothetical." *Lujan*, 504 U.S. at 560. The challenged orders directly caused these harms, and the harms would be redressed if the court were to reverse FERC's decision. *Id.* AOPL's members therefore have standing, and AOPL has standing to intervene on its members' behalf.

ARGUMENT

I. FERC Erred by Adopting as Fact the Double-Recovery Theory that It was Charged with Investigating Instead of Conducting an Independent Review of the Relevant Issues

FERC's threshold error in this proceeding was its failure to conduct an independent review of the relevant issues, instead treating as a settled fact the fundamental question it was required to answer. Since this issue was also raised by Petitioners (Br. at 48-55), AOPL elaborates on it only briefly here.

In *United Airlines*, this court held that FERC had not "provided sufficient justification for its conclusion that there is no double recovery of taxes for partnership pipelines receiving a tax allowance in addition to the discounted cash flow return on equity," and remanded the issue to FERC for further review and

explanation. 827 F.3d at 136, 137. Instead of engaging in independent review, however, FERC simply adopted as a fact "the fundamental premise of *United Airlines* that an income tax allowance for MLP pipelines leads to a double-recovery." Revised Statement at P 23, R.70 (JA ___). But that "premise" was what FERC was required to "demonstrate" and justify, *United Airlines*, 827 F.3d at 134, 136, not accept as a given. Indeed, the court made clear that "to the extent FERC has a reasoned basis for granting a tax allowance to partnership pipelines, it may do so." *Id.* at 135.

A judicial decision "cannot be made to do service for an administrative judgment" that "the agency alone is authorized to make." *SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943) ("*Chenery I*"). Where agency action is remanded for lack of adequate explanation, the agency has the authority and indeed *the duty* to "deal with the problem afresh" on remand. *SEC v. Chenery Corp.*, 332 U.S. 194, 200-201 (1947) ("*Chenery II*"). Here, FERC failed to take a fresh look at the problem or provide a reasoned basis for its decision. By simply adopting as fact the theoretical question posed by *United Airlines*, FERC failed to "appreciat[e] the complexities of the problem," respect the "statutory policies" at issue, or engage in responsible consideration of the facts, as it was required to do. *Chenery II*, 332 U.S. at 209. In short, FERC's new income tax allowance policy is not the product of reasoned decisionmaking and must be vacated and remand.

II. FERC Failed to Provide a Reasoned Explanation for Abandoning the Policies Underpinning Its Prior Income Tax Allowance Methodology

FERC's prior policy of permitting an income tax allowance for all regulated oil pipelines, including both corporations and partnerships, was the result of careful consideration of the applicable policy issues. *See Inquiry Regarding Income Tax Allowances*, 111 FERC ¶ 61,139, at P 1 (2005) ("2005 Policy Statement"). This court upheld the 2005 Policy Statement, *ExxonMobil*, 487 F.3d at 951, and *United Airlines* expressly did not overrule *ExxonMobil*. 827 F.3d at 137. Thus, FERC's 2005 Policy Statement remained in place after *United Airlines* and FERC was required to justify its departure from that policy, not treat it as if it no longer applied. Instead, FERC erred by reversing course without grappling with the important goals that underlay the prior policy, including (1) ensuring comparability in rates between MLP pipelines and corporate pipelines, and (2) encouraging investment in pipeline infrastructure through use of the MLP organizational form.

"[W]here an agency departs from established precedent without a reasoned explanation, its decision will be vacated as arbitrary and capricious." *ANR Pipeline Co. v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995). "An agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion it may cross the

line from the tolerably terse to the intolerably mute." *Greater Boston Television Corp. v. F.C.C.,* 444 F.2d 841, 852 (D.C. Cir. 1970).

Moreover, FERC has a fundamental obligation to consider how its rulings affect important Congressional and FERC policies. As the Supreme Court has explained, the Commission "cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead *obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress*." *Permian Basin Area Rate Cases*, 390 U.S. 747, 791 (1968) (emphasis added). FERC must also "assess the consequences of its actions for the industry" and "indicate fully and carefully the purposes behind" its decision. *Public Systems v. FERC*, 606 F.2d 973, 980 (D.C. Cir. 1979) (internal quotation marks omitted).

FERC's 2005 Policy Statement was supported by important policy concerns. *See* 111 FERC ¶ 61,139, at P 1. For example, the 2005 Policy Statement cited the importance of maintaining comparable treatment of MLP pipelines and corporate pipelines with respect to ratemaking and observed the incongruity in denying an income tax allowance to a partnership pipeline when the same assets held by a

corporation would be entitled to an income tax allowance. *Id.* at PP 33-36, 38 & n.33.[1]

FERC further explained that the MLP form was important for encouraging investment in energy infrastructure and held that "termination of the allowance would clearly act as a disincentive for the use of the partnership format." *Id.* at PP 26, 30, 36. FERC noted the "substantial amount of existing investment" affected by the income tax allowance policy. *Id.* at P 33 n.30. For example, the record on which the prior income tax allowance policy was based indicated that "75 percent of $14.4 billion in energy infrastructure invested for the years 2001 through 2003 [was] in pass-through entities," and that the market capitalization of MLP pipelines was approximately $38.5 billion at the time of the policy statement. *Id.*[2] FERC noted that use of the MLP form helped to facilitate large infrastructure

[1] The 2005 Policy Statement's decision to permit an income tax allowance for all regulated entities, was consistent with FERC's practice of using the same proxy group of publicly-traded oil pipelines to set the rate of return on equity for all oil pipelines. *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at PP 2, 7, 57-66 (2008) (citing FERC's longstanding presumption that all oil pipelines "fall within a broad range of average risk").

[2] The record showed that those numbers have significantly increased. MLPs invested approximately $177 billion in capital in energy infrastructure between 2007 and 2016, and are expected to invest another $60 billion through 2020. The market capitalization of MLPs involved in oil and gas pipeline operations was approximately $350 billion as of the end of 2016. Master Limited Partnership Association Comments at 6-7, R.33 (JA ___).

projects in part because it permits risk sharing among various parties, including municipalities and public power entities that may be prohibited from owning corporate stock, and permits "greater flexibility in making contributions in-kind" and distributing earnings. *Id.* at PP 29, 36. FERC also cited Congress's intent to encourage investment through the use of the MLP form. *Id.*

In upholding the 2005 Policy Statement, this court concluded that FERC's "explanation in support of this policy choice is reasonable" and was not inconsistent with prior court rulings on the issue. *ExxonMobil*, 487 F.3d at 951. In holding that FERC had "weigh[ed] the relevant policy concerns," the court specifically noted FERC's findings that termination of the income tax allowance would create a disincentive for regulated entities to use the partnership form and that pipelines "operating as limited partnerships should receive a full income tax allowance in order to maintain parity with pipelines that operate as corporations." *Id.* at 950, 953. As noted, *United Airlines* did not reverse either *ExxonMobil* or the 2005 Policy Statement. FERC, however, summarily abandoned the 2005 Policy Statement without giving adequate consideration to the goals underlying the prior policy.

There can be no dispute that if an MLP pipeline is denied an income tax allowance, it will (all else equal) not be able to justify rates at the same level as a corporate-owned pipeline with comparable operations. FERC acknowledged that

fact, stating that denying MLP pipelines an income tax allowance will "enabl[e]" them "to provide lower tariff rates to shippers." Revised Statement at P 41, R.70 (JA ___). But what FERC euphemistically referred to as "enabling" lower rates, is in fact the forced reduction of MLP pipeline rates below those of comparable corporation-owned pipelines. FERC failed to explain how such a reduction in rates for MLP pipelines was consistent with its prior policy of ensuring that corporate and MLP pipelines charge comparable rates for similar services or why that goal was no longer important. Instead, FERC simply dismissed the argument, claiming its hands were tied by *United Airlines*. Revised Statement at P 43, R.70 (JA ___) (the "court in *United Airlines* reached the opposite conclusion").

FERC further failed to explain its departure from its longstanding policy to facilitate investment in energy infrastructure consistent with Congressional tax policy. *See* 2005 Policy Statement at P 1 & P 33 n.30. In 1987, Congress withdrew incentives for most enterprises to be publicly-traded partnerships by taxing them as corporations. Pub. L. 100-203, 101 Stat. 1330-403 (1987) (codified at IRC § 7704). However, Congress permitted certain specific industries, including "pipelines transporting gas, oil, or products thereof," to use that form and be taxed as partnerships." IRC § 7704(d)(1)(E) (2008). In singling out this narrow category of companies, Congress intended to facilitate investment in those sectors by providing a tax-efficient means to raise capital. *See SFPP, L.P.*, 134 FERC

¶ 61,121, at PP 253-256 (2011) (discussing legislative history). FERC's denial of an income tax allowance for MLP pipelines reduces the allowable tariff rates for MLP pipelines below those permissible for otherwise identical corporation-owned pipelines, which plainly undercuts Congress's goal of facilitating investment in oil pipeline and other energy infrastructure by encouraging the use of the MLP form. 2005 Policy Statement at P 36.

FERC stated that Congress "did not provide explicit instructions" regarding how to implement the 1987 tax legislation in the ratemaking context. Revised Statement at P 39 & n.72, R.70 (JA ___). FERC relied on *BP West Coast*, which stated that "[t]he mandate of Congress in the tax amendment was exhausted when the pipeline limited partnership was exempted from corporate taxation." *Id.* at P 38 & n.70 (citing *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263, 1293 (D.C. Cir. 2004)). But the holding in *BP West Coast* responded to the argument that the Congressional mandate *required* FERC to permit a full tax allowance. *BP West Coast*, 374 F.3d at 1292 ("no precedent for the proposition that we should compel the Commission … to adopt a rate structure bringing it into line with the perceived intent of Congress to achieve objectives in general"). While Congress's action did not mandate any specific ratemaking approach, FERC plainly has the discretion to take Congressional tax policy into account in setting rates and to structure its ratemaking policies to align with tax incentives created by Congress.

FERC previously considered this to be an important goal, but here failed to explain why that is no longer the case. *See* 2005 Policy Statement at PP 30, 33, 36.

The 2005 Policy Statement was also consistent with FERC's longstanding practice of accommodating tax benefits conferred by Congress through ratemaking, which the courts have upheld as a permissible exercise of FERC's ratemaking expertise. *See, e.g.*, *City of Charlottesville, Va. v. FERC*, 774 F.2d 1205,1207-1216 (D.C. Cir. 1985) (upholding FERC's calculation of pipeline income tax allowance on a "stand-alone" basis without reducing it to reflect tax savings resulting from use of a consolidated corporate return); *Papago Tribal Utility Authority v. FERC*, 776 F.2d 828, 832 (9th Cir. 1985) (holding in the case of investment tax credits that FERC's "normalization" approach is permissible because it "serves the public interest" and "accommodates the utility's need for investment capital by permitting the utility to generate more capital internally").

In short, Congress's policy of encouraging pipeline infrastructure development through the use of the MLP form was also *FERC's* policy. FERC's observation that it was not required to adopt this policy is not sufficient justification for abandoning it.

FERC further attempted to support its policy shift by stating that "[e]ven in the absence of an income tax allowance, the energy sector will benefit from the MLP business form," because MLPs will provide "lower tariff rates to shippers,

including those engaged in production, marketing and refining." Revised Statement at P 41, R.70 (JA ___). FERC failed to explain how a forced reduction in MLP pipeline tariff rates is consistent with its prior policy of accommodating Congressional tax benefits in ratemaking in order to encourage investment in pipeline infrastructure through the MLP form. Nor does FERC address how the energy sector will benefit if there is insufficient rate recovery to support needed new pipeline capacity as a result of policies that do not provide adequate returns to MLP pipelines. In any event, FERC made no attempt to conduct the type of searching inquiry required to justify its policy reversal.

In sum, FERC failed to adequately explain its departure from its longstanding policies. FERC failed to explain why those important policy goals were no longer important or why its new income tax allowance approach better served those goals. Again, because FERC erroneously interpreted *United Airlines* as dictating the result, it failed to perform the type of investigation that would be necessary to justify abandoning its prior polices. FERC's decision is therefore arbitrary and capricious and must be remanded for further review.

III. FERC Erred by Failing to Grapple with Crucial Empirical Evidence that Undermined Its "Double Recovery" Theory

The Supreme Court has made clear that in ratemaking it "is not theory but the impact of the rate order which counts." *Hope*, 320 U.S. at 602. But here

FERC relied solely on theoretical concerns while turning a blind eye to evidence showing that the rate of return for MLP pipelines is not systematically higher than those for corporate pipelines, which undercuts the assumption that MLP pipelines are somehow "double recovering" their income tax allowance through their FERC-regulated return. FERC's failure to understand and grapple with the record evidence regarding the practical effect of abandoning its existing income tax allowance policy was error.

The record evidence in this proceeding includes a study conducted on behalf of the Interstate Natural Gas Association of America. Interstate Natural Gas Association of America Comments at 31-35, R.24 (JA ___). The study was based on three different analyses of historical returns for various corporate and MLP natural gas pipelines using FERC's established rate of return methodology. The study demonstrated that the returns for MLP pipelines are not systematically higher than those of corporate pipelines.

The results of this study are significant, because they undercut the assumption (which FERC improperly adopted as fact without independently investigating) that MLP pipelines do not need an income tax allowance because they already recover their income taxes through the rate of return on equity. In other words, since the theory that MLP returns include investor expectations regarding income taxes appears to make little difference in the actual market-based

returns of corporate and MLP pipelines, the "double recovery" theory does not apply in reality and fails to justify the radical change mandated by FERC on remand, *i.e.*, the complete elimination of the income tax allowance for MLP pipelines.

FERC disputed the significance of the empirical studies, claiming they fail to account for differences in risk among the various entities reviewed and were based on a relatively small sample size. Revised Statement at P 33, R.70 (JA ___). But FERC did not fundamentally dispute the accuracy of the studies. Nor did FERC grapple with the complete lack of evidence in the record that MLP pipelines have higher returns than corporate pipelines, as would be expected if the "double recovery" theory were correct. FERC acknowledged that "[i]t is true that the *United Airlines* double-recovery theory would predict that, assuming all other factors are exactly equal, investor-level tax differences would create a differential between MLP and corporate pipeline [discounted cash flow] returns." Revised Statement at P 33, R.70 (JA ___). But when faced with evidence that cast doubt on its theory, FERC stuck with the theory and rejected the facts without conducting the requisite searching inquiry.

Ultimately, FERC dismissed the empirical studies as "irrelevant," stating that the "holding in *United Airlines* would not change [even] if the pipeline commenters were to conclusively establish that … corporate pipeline [discounted

cash flow] returns exceeded MLP pipeline [discounted cash flow] returns." Revised Statement at P 30, R.70 (JA ___). According to FERC, *United Airlines* compelled the result, regardless of the record evidence. But *United Airlines* did not hold that FERC's prior policy resulted in "double recovery" for MLP pipelines or require FERC to change its policy to eliminate the income tax allowance for MLPs. Again, FERC erred by accepting as fact the question it was charged with investigating and by glossing over empirical studies that did not fit with its preordained conclusion. FERC's decision thus "runs counter to the evidence" and lacks a reasoned basis. *Motor Vehicle Mfrs. Ass'n of US, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

IV. FERC Erred by Ignoring Evidence that Removal of the Income Tax Allowance for MLP Pipelines Could Have Significant Adverse Effects on MLP Pipelines and Their Ability to Attract Capital

In establishing ratemaking policies, FERC is required to "assess the consequences of its actions for the industry" and "indicate fully and carefully the purposes behind" its decision. *Public Systems v. FERC*, 606 F.2d 973, 980 (D.C. Cir. 1979) (internal quotation marks omitted). FERC's decisions regarding pipeline returns must be "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." *Hope*, 320 U.S. at 603; *see also Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 693 (1923). FERC ratemaking rulings must also

ensure that "the financial health of the pipeline in our economic system remains strong." *Memphis Light, Gas and Water Division v. Fed. Power Comm'n*, 411 U.S. 458, 474 (1973). In complying with these standards, FERC is required to engage in a "pragmatic assessment" that ensures the "end result" is reasonable, since ultimately it "is not theory but the impact of the rate order which counts." *Hope*, 320 U.S. at 602-603.

Here, FERC erred by ignoring the evidence presented by AOPL and other commenters that abandoning the Commission's prior income tax allowance policies could have significant adverse effects on the financial integrity of MLP pipelines. As AOPL's witness Dr. John Graham explained, if the income tax allowance were removed, the result was likely to be an immediate drop in the price for MLP units. Graham Decl. at 11, R.23 (JA ___). Dr. Graham based his conclusion both on economic theory as well as empirical evidence, citing the dramatic drop in MLP unit prices in 1995 when FERC held (in a precursor to the 2005 Policy Statement) that MLP pipelines would no longer be allowed an income tax allowance on income attributable to the partnership interests held by individuals. *Id.* at 12 (JA ___).

In addition, as Dr. Graham explained, if the tax allowance were removed, "the financial condition of MLP pipelines could become more tenuous." *Id.* at 13 (JA ___). Removing the income tax allowance for MLP pipelines would also put

them at a permanent competitive disadvantage against corporate pipelines, because the cost-of-service tariff rates that MLP pipelines would be permitted to charge would be capped at levels materially below those of corporate pipelines for the same services. *See* Graham Decl. at 13, R.23 (JA ___). That could "make it more difficult for MLP pipelines to compete for capital against corporation-owned pipelines, since lenders might view an MLP pipeline as less creditworthy and equity investors might view the MLP pipeline as a less attractive investment." *Id.* Petitioners provided similar evidence of the likely effect of removing the income tax allowance for MLP pipelines in their comments to FERC. *See* Petitioners Br. at 35.

FERC's response to this evidence was entirely inadequate and failed to meet the minimum requirements of reasoned decisionmaking. The following is FERC's complete discussion of the issue:

> Pipelines claim that removal of the income tax allowance for MLPs will deny pipelines adequate recovery under *Hope* and deter investment. *This is not the case.* Notwithstanding the absence of an income tax allowance, MLP pipelines will continue to recover their costs and a reasonable return for investors. *United Airlines* … merely [denies] MLP pipelines the double recovery of their income tax costs.

Revised Statement at P 44 (emphasis added), R.70 (JA ___). In other words, FERC simply denied that there would be a negative effect on MLP pipelines' ability to raise capital, without reference to any proof or consideration of the actual evidence in the record. Again, FERC cited *United Airlines* and the "double

recovery" theory as compelling a particular result, while failing to perform even a cursory investigation of what effect its new policy would have on the finances of the industry it regulates.

Contrary to FERC's sanguine view, the prices of publicly-traded MLP units dropped dramatically after the issuance of FERC's new policy. As Petitioners describe, approximately $30 billion of market value was lost as a direct result of the Revised Statement. Petitioners Br. at 34. The collapse of MLP unit prices undermined market confidence in the MLP structure, making it more challenging for MLP pipelines to raise capital and causing several MLPs to convert their ownership structures. *Id.* The evidence of the immediate effect of FERC's order was presented to the Commission on rehearing (Petitioners Br. at 34-35), but FERC ignored it and denied rehearing without comment. Rehearing Order at PP 7-8, R.91 (JA ___).

FERC's casual disregard for the evidence in the record and the practical consequences of its new policy is contrary to *Hope* and the basic obligation to provide a reasoned decision for agency action. *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43. This court has reversed FERC orders that "provide no indication of the impact" on the regulated entity. *Public Systems v. FERC*, 606 F.2d 973, 980 (D.C. Cir. 1979). Instead, FERC is required to demonstrate that it "has given reasoned consideration to each of the pertinent factors," which includes assessing "the

consequences of its action for the industry." *Id*. "Generalities do not supply the requisite clarity" to permit a court to sustain a Commission order. *Fed. Power Comm'n v. Texaco*, 417 U.S. 380, 397 (1974).

While FERC erred in ignoring the evidence of the likely effect of its actions on MLP pipelines, FERC's failure to confront the evidence of market turmoil following the issuance of the Revised Statement or to reconsider its approach in light of that evidence is particularly egregious. Where a party "'offer[s] evidence that is new in relation to what [wa]s before the Commission in its earlier determinations and sufficiently compelling to require reconsideration of the earlier resolution,'" FERC's "'failure to respond meaningfully to the evidence renders its decision[] arbitrary and capricious.'" *Petro Star Inc. v. FERC*, 835 F.3d 97, 102 (D.C. Cir. 2016) (citing *Tesoro Alaska Petroleum Co. v. FERC*, 234 F.3d 1286, 1288, 1294 (D.C. Cir. 2000)).

In sum, FERC's refusal to consider market realities in departing from its prior policy is an abdication of its responsibility to protect the financial integrity of the entities it regulates and does not constitute reasoned decisionmaking. FERC's decision must therefore be remanded for further investigation.

CONCLUSION

For the foregoing reasons, FERC's decision should be vacated and remanded.

Respectfully submitted,

/s/ Daniel J. Poynor
Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
(202) 429-6233

Counsel for Association of Oil Pipe Lines

Of Counsel:

Steven M. Kramer
Senior Vice President, General Counsel and Corporate Secretary
Association of Oil Pipe Lines
900 17th Street, NW, Suite 600
Washington, DC 20006
(202) 292-4502

July 29, 2019

Certificate of Compliance with Type-Volume Limitation,
Typeface Requirements and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,507 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2019 in Times New Roman 14-point typeface.

/s/ Daniel J. Poynor

Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, D.C. 20036-1796

Counsel for Association of Oil Pipe Lines

Dated: July 29, 2019

CERTIFICATE OF SERVICE

Pursuant to Fed. R. App. P. 25(d) and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have this 29th day of July, 2019, caused to be served copies of the foregoing Brief of the Association of Oil Pipe Lines as Intervenor in Support of Petitioners upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system.

/s/ Daniel J. Poynor
Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, NW
Washington, D.C. 20036-1796

Counsel for Association of Oil Pipe Lines

STATUTORY AND REGULATORY ADDENDUM

TABLE OF CONTENTS

Internal Revenue Code, § 7704 (2008) A-1

18 C.F.R. § 342.2 .... A-7

18 C.F.R. § 342.3 .... A-8

18 C.F.R. § 342.4 .... A-11

18 C.F.R. § 343.1 .... A-12

18 C.F.R. § 343.2 .... A-13

18 C.F.R. § 357.2 .... A-15

Internal Revenue Code, § 7704 (2008)

§ 7704. Certain publicly traded partnerships treated as corporations

(a) General rule.--For purposes of this title, except as provided in subsection (c), a publicly traded partnership shall be treated as a corporation.

(b) Publicly traded partnership.--For purposes of this section, the term "publicly traded partnership" means any partnership if--

> **(1)** interests in such partnership are traded on an established securities market, or
>
> **(2)** interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

(c) Exception for partnerships with passive-type income.--

> **(1) In general.**--Subsection (a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of paragraph (2) for such taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence. For purposes of the preceding sentence, a partnership shall not be treated as being in existence during any period before the 1st taxable year in which such partnership (or a predecessor) was a publicly traded partnership.
>
> **(2) Gross income requirements.**--A partnership meets the gross income requirements of this paragraph for any taxable year if 90 percent or more of the gross income of such partnership for such taxable year consists of qualifying income.
>
> **(3) Exception not to apply to certain partnerships which could qualify as regulated investment companies.**--This subsection shall not apply to any partnership which would be described in section 851(a) if such partnership were a domestic corporation. To the extent provided in regulations, the preceding sentence shall not apply to any partnership a principal activity of which is the buying and selling of

commodities (not described in section 1221(a)(1)), or options, futures, or forwards with respect to commodities.

(d) Qualifying income.--For purposes of this section--

(1) In general.--Except as otherwise provided in this subsection, the term "qualifying income" means--

(A) interest,

(B) dividends,

(C) real property rents,

(D) gain from the sale or other disposition of real property (including property described in section 1221(a)(1)),

(E) income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of any fuel described in subsection (b), (c), (d), or (e) of section 6426, or any alcohol fuel defined in section 6426(b)(4)(A) or any biodiesel fuel as defined in section 40A(d)(1),

(F) any gain from the sale or disposition of a capital asset (or property described in section 1231(b)) held for the production of income described in any of the foregoing subparagraphs of this paragraph, and

(G) in the case of a partnership described in the second sentence of subsection (c)(3), income and gains from commodities (not described in section 1221(a)(1)) or futures, forwards, and options with respect to commodities.

For purposes of subparagraph (E), the term "mineral or natural resource" means any product of a character with respect to which a deduction for depletion is allowable under section 611;

except that such term shall not include any product described in subparagraph (A) or (B) of section 613(b)(7).

(2) Certain interest not qualified.--Interest shall not be treated as qualifying income if--

(A) such interest is derived in the conduct of a financial or insurance business, or

(B) such interest would be excluded from the term "interest" under section 856(f).

(3) Real property rent.--The term "real property rent" means amounts which would qualify as rent from real property under section 856(d)if--

(A) such section were applied without regard to paragraph (2)(C) thereof (relating to independent contractor requirements), and

(B) stock owned, directly or indirectly, by or for a partner would not be considered as owned under section 318(a)(3)(A) by the partnership unless 5 percent or more (by value) of the interests in such partnership are owned, directly or indirectly, by or for such partner.

(4) Certain income qualifying under regulated investment company or real estate trust provisions.--The term "qualifying income" also includes any income which would qualify under section 851(b)(2)(A) or 856(c)(2).

(5) Special rule for determining gross income from certain real property sales.--In the case of the sale or other disposition of real property described in section 1221(a)(1), gross income shall not be reduced by inventory costs.

(e) Inadvertent terminations.--If--

(1) a partnership fails to meet the gross income requirements of subsection (c)(2),

(2) the Secretary determines that such failure was inadvertent,

(3) no later than a reasonable time after the discovery of such failure, steps are taken so that such partnership once more meets such gross income requirements, and

(4) such partnership agrees to make such adjustments (including adjustments with respect to the partners) or to pay such amounts as may be required by the Secretary with respect to such period,

then, notwithstanding such failure, such entity shall be treated as continuing to meet such gross income requirements for such period.

(f) Effect of becoming corporation.--As of the 1st day that a partnership is treated as a corporation under this section, for purposes of this title, such partnership shall be treated as--

(1) transferring all of its assets (subject to its liabilities) to a newly formed corporation in exchange for the stock of the corporation, and

(2) distributing such stock to its partners in liquidation of their interests in the partnership.

(g) Exception for electing 1987 partnerships.--

(1) In general.--Subsection (a) shall not apply to an electing 1987 partnership.

(2) Electing 1987 partnership.--For purposes of this subsection, the term "electing 1987 partnership" means any publicly traded partnership if--

(A) such partnership is an existing partnership (as defined in section 10211(c)(2) of the Revenue Reconciliation Act of 1987),

(B) subsection (a) has not applied (and without regard to subsection (c)(1) would not have applied) to such partnership

for all prior taxable years beginning after December 31, 1987, and before January 1, 1998, and

(C) such partnership elects the application of this subsection, and consents to the application of the tax imposed by paragraph (3), for its first taxable year beginning after December 31, 1997.

A partnership which, but for this sentence, would be treated as an electing 1987 partnership shall cease to be so treated (and the election under subparagraph (C) shall cease to be in effect) as of the 1st day after December 31, 1997, on which there has been an addition of a substantial new line of business with respect to such partnership.

(3) Additional tax on electing partnerships.--

(A) Imposition of tax.--There is hereby imposed for each taxable year on the income of each electing 1987 partnership a tax equal to 3.5 percent of such partnership's gross income for the taxable year from the active conduct of trades and businesses by the partnership.

(B) Adjustments in the case of tiered partnerships.--For purposes of this paragraph, in the case of a partnership which is a partner in another partnership, the gross income referred to in subparagraph (A) shall include the partnership's distributive share of the gross income of such other partnership from the active conduct of trades and businesses of such other partnership. A similar rule shall apply in the case of lower-tiered partnerships.

(C) Treatment of tax.--For purposes of this title, the tax imposed by this paragraph shall be treated as imposed by chapter 1 other than for purposes of determining the amount of any credit allowable under chapter 1 and shall be paid by the partnership. Section 6655 shall be applied to such partnership with respect to such tax in the same manner as if the partnership were a corporation, such tax were imposed by section 11, and references in such section to taxable income were references to the gross income referred to in subparagraph (A).

(4) Election.--An election and consent under this subsection shall apply to the taxable year for which made and all subsequent taxable years unless revoked by the partnership. Such revocation may be made without the consent of the Secretary, but, once so revoked, may not be reinstated.

18 C.F.R. § 342.2

§342.2. Establishing initial rates

A carrier must justify an initial rate for new service by:

(a) Filing cost, revenue, and throughput data supporting such rate as required by part 346 of this chapter; or

(b) Filing a sworn affidavit that the rate is agreed to by at least one non-affiliated person who intends to use the service in question, provided that if a protest to the initial rate is filed, the carrier must comply with paragraph (a) of this section.

18 C.F.R. § 342.3

§ 342.3 Indexing

(a) Rate changes. A rate charged by a carrier may be changed, at any time, to a level which does not exceed the ceiling level established by paragraph (d) of this section, upon compliance with the applicable filing and notice requirements and with paragraph (b) of this section. A filing under this section proposing to change a rate that is under investigation and subject to refund, must take effect subject to refund.

(b) Information required to be filed with rate changes. The carrier must comply with Part 341 of this title. Carriers must specify in their letters of transmittal required in § 341.2(c) of this chapter the rate schedule to be changed, the proposed new rate, the prior rate, the prior ceiling level, and the applicable ceiling level for the movement. No other rate information is required to accompany the proposed rate change.

(c) Index year. The index year is the period from July 1 to June 30.

(d) Derivation of the ceiling level.

(1) A carrier must compute the ceiling level for each index year by multiplying the previous index year's ceiling level by the most recent index published by the Commission. The index will be published by the Commission prior to June 1 of each year.

(2) The index published by the Commission will be based on the change in the final Producer Price Index for Finished Goods (PPI–FG), seasonally adjusted, as published by the U.S. Department of Labor, Bureau of Labor Statistics, for the two calendar years immediately preceding the index year. The index will be calculated by

dividing the PPI–FG for the calendar year immediately preceding the index year, by the previous calendar year's PPI–FG.

(3) A carrier must compute the ceiling level each index year without regard to the actual rates filed pursuant to this section. All carriers must round their ceiling levels each index year to the nearest hundredth of a cent.

(4) For purposes of computing the ceiling level for the period January 1, 1995 through June 30, 1995, a carrier must use the rate in effect on December 31, 1994 as the previous index year's ceiling level in the computation in paragraph (d)(1) of this section. If the rate in effect on December 31, 1994 is subsequently lowered by Commission order pursuant to the Interstate Commerce Act, the ceiling level based on such rate must be recomputed, in accordance with paragraph (d)(1) of this section, using the rate established by such Commission order in lieu of the rate in effect on December 31, 1994.

(5) When an initial rate, or rate changed by a method other than indexing, takes effect during the index year, such rate will constitute the applicable ceiling level for that index year. If such rate is subsequently lowered by Commission order pursuant to the Interstate Commerce Act, the ceiling level based on such rate must be recomputed, in accordance with paragraph (d)(1) of this section, using the rate established by such Commission order as the ceiling level for the index year which includes the effective date of the rate established by such Commission order.

(e) Rate decreases. If the ceiling level computed pursuant to § 342.3(d) is below the filed rate of a carrier, that rate must be reduced to bring it into compliance with the new ceiling level; provided, however, that a carrier is

not required to reduce a rate below the level deemed just and reasonable under section 1803(a) of the Energy Policy Act of 1992, if such section applies to such rate or to any prior rate. The rate decrease must be accomplished by filing a revised tariff publication with the Commission to be effective July 1 of the index year to which the reduced ceiling level applies.

18 C.F.R. § 342.4

§ 342.4. Other rate changing methodologies

(a) Cost-of-service rates. A carrier may change a rate pursuant to this section if it shows that there is a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index such that the rate at the ceiling level would preclude the carrier from being able to charge a just and reasonable rate within the meaning of the Interstate Commerce Act. A carrier must substantiate the costs incurred by filing the data required by part 346 of this chapter. A carrier that makes such a showing may change the rate in question, based upon the cost of providing the service covered by the rate, without regard to the applicable ceiling level under § 342.3.

(b) Market-based rates. A carrier may attempt to show that it lacks significant market power in the market in which it proposes to charge market-based rates. Until the carrier establishes that it lacks market power, these rates will be subject to the applicable ceiling level under § 342.3.

(c) Settlement rates. A carrier may change a rate without regard to the ceiling level under § 342.3 if the proposed change has been agreed to, in writing, by each person who, on the day of the filing of the proposed rate change, is using the service covered by the rate. A filing pursuant to this section must contain a verified statement by the carrier that the proposed rate change has been agreed to by all current shippers.

18 C.F.R. § 343.1

§ 343.1. Definitions.

For purposes of this part, the following definitions apply:

(a) Complaint means a filing challenging an existing rate or practice under section 13(1) of the Interstate Commerce Act.
(b) Protest means a filing, under section 15(7) of the Interstate Commerce Act, challenging a tariff publication.

18 C.F.R. § 343.2

§ 343.2. Requirements for filing interventions, protests and complaints.

(a) Interventions. Section 385.214 of this chapter applies to oil pipeline proceedings.

(b) Standing to file protest. Only persons with a substantial economic interest in the tariff filing may file a protest to a tariff filing pursuant to the Interstate Commerce Act. Along with the protest, a verified statement that the protestor has a substantial economic interest in the tariff filing in question must be filed.

(c) Other requirements for filing protests or complaints—

(1) Rates established under § 342.3 of this chapter. A protest or complaint filed against a rate proposed or established pursuant to § 342.3 of this chapter must allege reasonable grounds for asserting that the rate violates the applicable ceiling level, or that the rate increase is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable, or that the rate decrease is so substantially less than the actual cost decrease incurred by the carrier that the rate is unjust and unreasonable. In addition to meeting the requirements of the section, a complaint must also comply with all the requirements of § 385.206, except § 385.206(b)(1) and (2).

(2) Rates established under § 342.4(c) of this chapter. A protest or complaint filed against a rate proposed or established under § 342.4(c) of this chapter must allege reasonable grounds for asserting that the rate is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable. In addition to meeting the requirements of the section, a complaint must also comply with all the requirements of § 385.206, except § 385.206(b)(1) and (2).

(3) Non-rate matters. A protest or complaint filed against a carrier's operations or practices, other than rates, must allege reasonable grounds for asserting that the operations or practices violate a provision of the Interstate Commerce Act, or of the Commission's regulations. In addition to meeting the requirements of this section, a complaint must also comply with the requirements of § 385.206.

(4) A protest or complaint that does not meet the requirements of paragraphs (c)(1), (c)(2), or (c)(3) of this section, whichever is applicable, will be dismissed.

18 C.F.R. § 357.2

§ 357.2. FERC Form No. 6, Annual Report of Oil Pipeline Companies.

(a) Who must file.

(1) Each pipeline carrier subject to the provisions of section 20 of the Interstate Commerce Act whose annual jurisdictional operating revenues has been $500,000 or more for each of the three previous calendar years must prepare and file with the Commission copies of FERC Form No. 6, "Annual Report of Oil Pipeline Companies," pursuant to the General Instructions set out in that form. Newly established entities must use projected data to determine whether FERC Form No. 6 must be filed.

(2) Oil pipeline carriers exempt from filing Form No. 6 whose annual jurisdictional operating revenues have been more than $350,000 but less than $500,000 for each of the three previous calendar years must prepare and file pages 301, "Operating Revenue Accounts (Account 600)," and 700, "Annual Cost of Service Based Analysis Schedule," of FERC Form No. 6. When submitting pages 301 and 700, each exempt oil pipeline carrier must include page 1 of Form No. 6, the Identification and Attestation schedules.

(3) Oil pipeline carriers exempt from filing Form No. 6 and pages 301 and whose annual jurisdictional operating revenues were $350,000 or less for each of the three previous calendar years must prepare and file page 700, "Annual Cost of Service Based Analysis Schedule," of FERC Form No. 6. When submitting page 700, each exempt oil pipeline carrier must include page 1 of Form No. 6, the Identification and Attestation schedules.

(b) When to file.

(1) The annual report for the year ending December 31, 2004, must be filed on April 25, 2005.

(2) The annual report for each year thereafter must be filed on April 18 of the subsequent year.

(c) What to submit.

(1) This report form must be filed as prescribed in § 385.2011 of this chapter and as indicated in the General Instructions set out in the report form, and must be properly completed and verified.

(2) A copy of the report must be retained by the pipeline carrier in its files. The conformed copies may be produced by any legible means of reproduction.
(3) The form must be filed in electronic format only pursuant to § 385.2011 of this chapter, beginning with report year 2002, due on or before March 31, 2003.