UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs	)))	Docket Nos. PL17-1

MOTION FOR CLARIFICATION, OR IN THE ALTERNATIVE RECONSIDERATION, OF THE MASTER LIMITED PARTNERSHIP ASSOCIATION

Pursuant to Rule 212 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission" or "FERC"),[1] the Master Limited Partnership Association ("MLPA") hereby respectfully submits this motion for clarification or, in the alternative, reconsideration, of the Commission's July 18, 2018 Order on Rehearing of its "Revised Policy Statement on Treatment of Income Taxes."[2] The Order on Rehearing addressed requests for rehearing and clarification of the Revised Policy Statement and emphasized "that when applied in specific cases, opportunity will be afforded to affected parties to challenge or support" the Commission's revised policy on income taxes "through factual or legal presentation and to present any issues and arguments regarding the application of these policies to the entities at issue as may be appropriate in the circumstances presented."[3] Recent Commission orders have cast doubt on the meaning of the Commission's language in the Order on Rehearing and clarification is needed.

[1] 18 C.F.R. § 385.212 (2018).

[2] *Revised Policy Statement on Treatment of Income Taxes*, 162 FERC ¶ 61,227 ("Revised Policy Statement") (2018), *order on reh'g*, 164 FERC ¶ 61,030 ("Order on Rehearing") (2018).

[3] Order on Rehearing at P 6.

MLPA respectfully requests the Commission clarify that, in a Section 4 or Section 5 rate proceeding, any entity, including a master limited partnership ("MLP"), may present facts and arguments that the Commission's reversal of its prior income tax cost recovery policy in the Revised Policy Statement, and the general application of that Revised Policy Statement, result in disparate treatment of pipelines and their owners or otherwise contradict the requirements of the Natural Gas Act and related precedent, and that entities may raise all arguments in opposition to the Revised Policy Statement and are not confined to arguing whether the circumstances of their case comply with the double recovery theory and revised income tax allowance policy itself. As further set forth below, if applied to all MLPs (and entities owned by MLPs) as a blanket policy, the Commission's revised policy results in disparate treatment of MLPs and C-corporations, contrary to the Supreme Court's requirement in *FPC v. Hope Natural Gas Co.* (hereafter "*Hope*")[4] and the Commission's regulatory obligations as summarized in *United Airlines, Inc. v. FERC* (hereafter "*United Airlines*").[5] If the Revised Policy Statement is not "establish[ing] a binding rule," MLPs and entities owned by MLPs should be allowed to demonstrate that the application of the Revised Policy Statement results in such disparate treatment and is inconsistent with Congressional intent and should therefore be further revised.

In support hereof, MLPA states as follows:

[4] *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944).
[5] *United Airlines, Inc. v. FERC,* 827 F.3d 122, 137 (D.C. Cir. 2016).

I. BACKGROUND

On March 15, 2018, the Commission issued the Revised Policy Statement, which reversed the Commission's prior policy on income tax cost recovery established in 2005.[6] MLPA and others submitted requests for clarification of the Revised Policy Statement seeking clarification that the facts underlying the Revised Policy Statement and the Commission's concurrently issued Opinion 511-C were specific to one discrete MLP and its circumstances, and that disparate treatment of all MLPs relative to non-MLPs was neither intended nor supported by the Revised Policy Statement or the record in that proceeding. Indeed, MLPA and others submitted evidence and arguments demonstrating that applying the revised income tax cost recovery policy to all entities owned by MLPs is contrary to court precedent and Congressional intent. In light of these concerns, MLPA requested that the Commission clarify that MLPs may address the question of income tax recovery on a case-by-case basis in individual proceedings. The focus of MLPA and others was that pipelines receive an equal opportunity to recover the costs of operating Commission-jurisdictional pipelines – a result required by the Natural Gas Act as interpreted by the Supreme Court in *Hope*.

The Order on Rehearing appears, in part, to grant the clarification MLPA requested. As explained by the Commission, "no entities are aggrieved by the Revised Policy Statement," and the Revised Policy Statement "does not, in and of itself, finally determine the rights and duties of any entities."[7] However, in the very next paragraph of the Order on Rehearing the Commission appears to narrow the scope of arguments available to MLPs,

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[6] *See Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139, at P 33 (2005) ("2005 Tax Policy Statement").
[7] Order on Rehearing at P 7.

stating that the Commission "declines to reconsider the policy announced in the Revised Policy Statement."[8] An entity "such as an MLP pipeline" is simultaneously subject to a revised policy yet permitted to argue that it is "entitled to an income tax allowance" and that "its recovery of an income tax allowance does not result in a double recovery of investors' income tax costs."[9]

Two recent orders from the Commission highlight the need for clarification of the Order on Rehearing. On July 31, 2018, in *Enable Mississippi River Transmission, LLC*,[10] the Commission granted summary disposition denying a pipeline the ability to recover an income tax allowance for that portion of the income tax liability incurred by its MLP-parent's corporate unitholders. The same day, in *Trailblazer Pipeline Company, LLC*,[11] the Commission accepted and suspended, subject to refund, tariff records filed by a pipeline that is a pass-through entity indirectly owned by private equity owners and a C-corporation and established a paper hearing to examine the extent to which the pipeline "is entitled to an income tax allowance."[12] One pass-through entity was permitted the opportunity, although in the form of a paper hearing rather than a full evidentiary hearing, to support an income tax allowance, while another pass-through entity was denied that opportunity on summary disposition. In light of the uncertainty resulting from the orders summarized above, MLPA

[8] *Id.* at P 8. On the same day the Commission issued the Order on Rehearing, the Commission also issued a Final Rule in Docket No. RM18-11-000 that sowed further doubt into the ability of MLPs to fully argue in individual proceedings that they should recover an income tax allowance. *See Interstate and Intrastate Natural Gas Pipelines; Rate Changes Relating to Federal Income Tax Rate*, 164 FERC ¶ 61,031 (2018) (stating that the Commission "is not, in this rulemaking proceeding, addressing the merits" of the income tax allowance issue, but further stating: "However, the binding precedent of United Airlines and Opinion No. 511-C may be considered by the Commission or any shipper when initiating any subsequent section 5 action, and we encourage pipelines to consider the guidance provided by the Revised Policy Statement.").
[9] *Id.*
[10] 164 FERC ¶ 61,075 (2018) ("*Enable*").
[11] 164 FERC ¶ 61,074 (2018) ("*Trailblazer*").
[12] *Id.* at P 30.

respectfully requests clarification or, in the alternative reconsideration, of the Order on Rehearing.

II. MOTION FOR CLARIFICATION, OR IN THE ALTERNATIVE RECONSIDERATION

As explained by both the Supreme Court in *Hope* and the D.C. Circuit in *United Airlines*, the Commission, under the Natural Gas Act, is obligated to provide pipelines with a reasonable opportunity to recover costs of providing jurisdictional service[13] and to provide "parity between equity owners in partnership and corporate pipelines."[14] In order to avoid unduly discriminatory treatment among Commission-regulated pipelines, at a minimum the Commission must provide each pipeline the opportunity to argue for and receive an income tax allowance on a case-by-case basis, and that opportunity must be more than illusory. In addition, as the Commission stated in the Order on Rehearing, the "Commission will have to fully support and justify the application" of the Revised Policy Statement in individual cases.[15] Thus, an opportunity for a full evidentiary hearing is needed to allow entities to argue that the Commission has failed to fully support the application of the Revised Policy Statement. The Commission should clarify that, as set out in the Order on Rehearing, entities owned by MLPs will be permitted, in each case, to submit and fully support all arguments related to the Revised Policy Statement and will be granted a bona fide opportunity to demonstrate their eligibility for an income tax allowance.

In addition, the Commission should clarify that implementation of the Revised Policy Statement is intended, as required by *Hope*, to ensure that all regulated pipelines are given

[13] *Hope Nat. Gas Co.*, 320 U.S. at 603.
[14] *United Airlines, Inc.*, 827 F.3d at 137.
[15] Order on Rehearing at P 6.

the opportunity to recover the full cost of service and maintain parity between pipelines with different corporate forms. Consistent treatment is necessary in order to "assure confidence in the financial integrity" of the pipelines regardless of their corporate form.[16] While this goal may be achieved in a number of ways, MLPA provides one proposal to ensure that parity, and requests clarification that pipelines are and will be permitted to put forth this and similar proposals and to fully support such proposals in future proceedings. Failure to grant the clarifications requested would signal the Commission's Revised Policy Statement is, in fact, a binding rule denying MLPs an income tax allowance, with all MLP pipelines "aggrieved by" the Revised Policy Statement.[17] The result would be a Commission policy directly contrary to Congressional intent and resulting in disparate treatment of MLPs, other pass-through entities, and C-corporations.

A. The Commission's policies must "ensure parity between equity owners in partnership and corporate pipelines" and allow pipelines a return "sufficient to assure confidence in the financial integrity of the enterprise."

The Commission's regulatory charge under the Natural Gas Act is to ensure just and reasonable rates, which "involves a balancing of the investor and consumer interests."[18] While such balancing does not mean that pipelines are guaranteed net revenues, pipelines must be allowed the opportunity to recover their costs and earn a return "commensurate with returns on investments in other enterprises having corresponding risks."[19] The pipeline's return should be "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[20] A policy that fails to ensure parity

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[16] *Hope Nat. Gas Co.*, 320 U.S. at 603.
[17] *See* Order on Rehearing at P 7.
[18] *Hope Nat. Gas Co.*, 320 U.S. at 603.
[19] *Id.*
[20] *Id.*

between owners of partnership and corporate pipelines would undermine the "confidence in the financial integrity" of the disparately treated enterprise and inhibit the ability of the pipeline to "maintain its credit and to attract capital."

The starting point for the *United Airlines* decision that triggered the Commission's Revised Policy Statement was the Supreme Court's "instruct[ion] that 'the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.'"[21] The court stated that, while the Commission may have a justifiable basis for its ratemaking policy, the Commission nevertheless has an "obligation to ensure 'commensurate . . . returns on investments' for 'equity owner[s]' as required under *Hope Natural Gas*," and "must still ensure parity between equity owners in partnership and corporate pipelines."[22] Citing the Supreme Court's *Hope* precedent, the court in *United Airlines* identified the potential for "inequitable returns for partners in those [partnership] pipelines as compared to shareholders in corporate pipelines" and found that since the Commission's income tax cost recovery policy potentially resulted in such inequitable returns, the Commission had "not shown that the resulting rates under FERC's current policy are 'just and reasonable.'"[23] The court therefore remanded to the Commission to consider mechanisms for which it could demonstrate that partnership pipelines do not "double recover" income taxes[24] and therefore receive a return disparate from other Commission-regulated pipelines.

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[21] *United Airlines, Inc.*, 827 F.3d at 128 (citing *Hope Nat. Gas Co.*, 320 U.S. at 603).
[22] *United Airlines, Inc.*, 827 F.3d at 137.
[23] *United Airlines, Inc.*, 827 F.3d at 136 (citing *Hope Nat. Gas Co.*, 320 U.S. at 603).
[24] *Id.* at 137.

B. Absent clarification and a bona fide opportunity to recover an income tax allowance, the Revised Policy Statement itself results in disparate treatment based purely on choice of corporate form.

The Revised Policy Statement, as the Commission appears to be implementing it in recent orders, creates disparity between pipelines owned by MLPs and C-corporations based purely on choice of legal form.[25] Unless clarified as requested herein, the Revised Policy Statement establishes a binding rule that no MLP will be allowed to receive an income tax allowance. Evidence of the disparity resulting from the Commission's application of the Revised Policy Statement is immediately visible in the market's reaction to the Commission's orders[26] as well as decisions being implemented by pipelines themselves. The Revised Policy Statement has set in motion a process by which all pipelines with FERC cost-of-service rates, regardless of their current tax classification, could eventually receive an equivalent income tax recovery by pursuing a conversion to corporate form. Multiple MLPs that own FERC-regulated pipelines with cost-of-service rates have announced or completed plans to elect to be taxed as C-corporations for U.S. federal income tax purposes in order to recover a corporation-equivalent income tax allowance in their cost of service. Additional announcements of such restructurings are likely absent relief or guidance from the FERC on this issue. If the discounted cash flow methodology ("DCF") for calculating a return on equity ("ROE") for MLPs did in fact recover income tax costs (i.e., if there was a "double recovery" from the combination of the DCF-based return and an income tax allowance), these conversions to C-corporations would not be necessary. The conversions

[25] The Commission's articulation in *Enable* and *Trailblazer* that only MLPs that wholly consolidate with their tax paying parent can recover an income tax allowance represents a misunderstanding of the MLP structure as, to be an MLP, a firm must be publicly traded and thus, by definition cannot be 100% consolidated with a parent.

[26] *See, e.g.*, Request for Clarification of the Master Limited Partnership Assoc., Docket No. PL17-1-000, at p. 11-16 (filed Apr. 13, 2018).

are necessary precisely because the Revised Policy Statement created a disparity that the market itself is attempting to address, but as discussed below this Commission-induced shift toward C-corporations is contrary to Congressional intent and circumvents Congress' tax policy. Thus, the Commission is effectively mandating that cost of service pipelines become C-corporations by economically *penalizing* the choice of partnership form, as demonstrated below.

The Commission should clarify that MLPs will have the opportunity to propose cost-of-service rates that ensure parity with other corporate forms and that the Commission will provide a bona fide opportunity for MLPs to support an income tax allowance, or to otherwise provide such parity between MLPs, other pass-through entities, and C-corporations. Failure to ensure this parity is likely to result in a change of corporate form with no benefit to ratepayers or pipelines. The election by MLPs to be taxed as C-corporations will not lead to any permanent reduction in tariff rates for shippers. On the contrary, when an MLP pipeline becomes a C-corporation pipeline, its income tax allowance will reset in the next rate case to be equal to that of a C-corporation pipeline, and tariff rates will adjust accordingly. Furthermore, if MLPs convert to C-corporations in order to get a corporate-equivalent income tax allowance, costs to investors are likely to be extensive, which will have deleterious effects on infrastructure investment and development. When an investor surrenders an MLP unit for a share of common stock, it typically triggers taxable gain to the investor. Moreover, these conversions undermine the generally held belief that energy infrastructure is a safe place to invest retirement savings. By fundamentally reshaping the image of energy investment, these taxable conversions of MLPs to C-corporations will increase the cost of capital for infrastructure projects in general.

Accordingly, without clarification that MLPs will be permitted to support an income tax allowance and other means to provide parity with C-corporation pipelines, the Revised Policy Statement will fail "to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[27]

C. Absent clarification, the Revised Policy Statement will undermine Congress' intent to maintain the tax benefits of the partnership structure for natural-resource businesses in the Tax Cuts and Jobs Act.

The Commission's Order on Rehearing, to the extent it precludes any effort by MLPs to recover income tax costs or obtain parity with pipelines organized in other corporate forms, eliminates the tax benefit of the partnership structure for cost of service assets and thereby contravenes the clear desire of Congress expressed last year in the Tax Cuts and Jobs Act to continue to utilize the MLP structure to foster infrastructure development in the energy sector.

As an initial matter, the tax benefit Congress affords to partnerships does not mean that income earned by partnership pipelines does not incur an income tax liability. Income taxes are paid by the partners in a partnership pipeline, and MLPs generally require that all MLP unitholders must themselves be U.S. taxpaying entities. Rather, the tax benefit afforded MLPs is a policy choice by Congress to allow pipelines and other companies structured as natural-resource MLPs to avoid double taxation—the pipeline's income is taxed once when allocated to partners rather than being taxed twice through C-corporations (once when allocated to a C-corporation and again when passed to the C-corporation's shareholders). It is what happens after the pipeline's income is taxed, and the rate at which it is taxed, that provides the incentive intended by Congress. Congress made the policy

[27] *Hope Nat. Gas Co.*, 320 U.S. at 603.

choice to forgo the additional tax revenue to the U.S. Treasury in order to encourage investors to invest in natural resource infrastructure, including pipelines, through the MLP structure.

As previously explained by MLPA and others, and as emphasized below, Congressional intent to encourage the use of the MLP structure was recently reaffirmed. This recent emphasis on the value of MLPs is of critical importance and should be considered when evaluating the disparate effects of the Commission's Order on Rehearing. Unless clarified to allow MLPs to propose a cost-of-service that allows for income tax cost recovery and parity with C-corporations, the Revised Policy Statement will upend Congress' intended policy by removing the tax-based benefit to the MLP structure for cost of service assets, resulting either in the conversion of MLPs to C-corporations, effectively frustrating the MLP incentive, or passing the effect of lower U.S. Treasury revenue on to shippers via lower pipeline transportation rates with MLPs left paying taxes not otherwise recovered.[28] In either case, the effect of the Revised Policy Statement would be to undermine Congressional intent.

1. Congress recently reaffirmed its MLP policy.

Under U.S. federal income tax rules, partnerships are not subject to entity-level tax. Instead, the partners pay tax on items of income or gain recognized by the partnership as if such items had been realized by the partners directly. In contrast, corporations are subject to entity-level taxation, and corporate shareholders generally are subject to a second level of tax on dividends paid by the corporation. Prior to tax reform in 2017 (the Tax Cuts and Jobs

[28] As noted above, the idea that "double recovery" occurs through the DCF-based ROE is undermined by the conversion of MLPs to C-corporations, and may be further rebutted, if allowed by the Commission, in individual proceedings where pipelines can demonstrate that no double recovery occurs.

Act, or "TCJA"), because of this corporate "double tax," a taxable U.S. individual was often better off investing in an asset through a partnership, rather than through a corporation.

For example, under the federal income tax rates in effect in 2017, if a taxable individual owned 10 percent of a partnership that owned an asset that generated $1,000 of net income, the individual would have paid tax at a maximum rate of 39.6 percent on his $100 share of such income ($39.60). If the same individual owned 10 percent of a corporation that owned an asset that generated $1,000 of net income, the corporation would have paid tax at a maximum rate of 35 percent ($350). If the corporation made a pro rata distribution of the remaining $650, the investor receiving $65 generally would have paid tax at a 20-percent rate ($13). Total taxes on the corporate shareholder's $100 share of the income would have been $48. Thus, owning the asset through the partnership rather than a corporation resulted in a Congressionally intended tax break of $8.40 – an infrastructure incentive policy paid for by Congress through reduced U.S. Treasury tax revenue.

In 1987, in order to protect the corporate tax base, Congress strictly limited the ability of publicly traded entities to be treated as partnerships for tax purposes. In fact, as a general rule a publicly traded partnership is taxed as a corporation and subject to two levels of tax.[29] However, Congress permitted certain publicly traded partnerships to continue to be taxed on a pass-through basis, provided at least 90 percent of the partnership's annual gross income is from qualifying sources. In general, the only active business income that is from a qualifying source is income attributable to natural-resource businesses, i.e., "income and gains derived from the exploration, development, mining or production, processing, refining,

[29] *See* I.R.C. § 7704(a) (2012) (providing as a general rule that a "publicly traded partnership shall be taxed as a corporation").

transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource."[30] The purpose of this narrow carve-out was clear at the time and remains relevant today. As the Assistant Secretary for Tax Policy stated in testimony before the House Ways and Means and Senate Finance Committees in 1987, "[g]iven the importance of natural resource development to the nation's security, Congress should consider carefully whether such traditionally non-corporate activities should be subjected to corporate level tax."[31] Following that advice, Congress carefully considered the nation's energy security and allowed natural-resource MLPs, including pipeline MLPs, to benefit from a narrow tax incentive, which was denied to virtually every other type of business.

For the 30 years between 1987 and 2017, MLPs have been a critical financing vehicle for the nation's energy infrastructure. By fine-tuning the definition of qualifying income in section 7704, Congress and the Department of the Treasury have been able to adjust and target the investment incentive it provides. In connection with the recently passed TCJA, Congress again took affirmative steps to preserve a tax benefit for MLPs even as other significant tax expenditures, such as the mortgage interest deduction and the deduction for State and local income taxes, were curtailed or eliminated to manage the cost of reform.

In general, the TCJA reduced the top corporate rate from 35 percent to 21 percent and the top individual rate from 39.6 percent to 37 percent, exclusive of the Affordable Care Act surcharge. This change in the rates generally eliminated the tax rate benefit previously

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[30] I.R.C. § 7704(d)(1)(E) (2012).

[31] *See* Written Statement of the National Association of Publicly Traded Partnerships, Submitted for the Senate Committee on Finance Hearing on Tax Reform, August 1, 2012, available at: http://www.mlpassociation.org/wp-content/uploads/2015/07/NAPTP_Taxation_of_-Business_Entities_FINAL-1.pdf

enjoyed by a business operating as a partnership. Consider again the example set forth above. Under the new rates, the 10-percent partner in a partnership that earns $1,000 pays $37 of tax on his 10-percent share of the income. In the case of a corporation that earns the same $1,000 of income, the corporate tax is now $210, which leaves $790 to be paid to shareholders as a dividend. A shareholder receiving a $79 dividend still generally pays tax at a 20-percent rate on the dividend (i.e., $15.80), meaning that the shareholder's total tax on $100 earned through the corporation is $36.80 (i.e., $0.20 less than what is paid on the same income earned directly or through a partnership).

In order to preserve some tax benefit for partnerships, Congress created a new provision, section 199A, which allows persons other than corporations to deduct 20 percent of their combined qualified business income.[32] For partners in partnerships that earn income that is eligible for the section 199A deduction, the provision preserves much of the benefit that was enjoyed prior to TCJA. For example, a 10-percent partner in a partnership that earns $1,000 of qualified business income is entitled to deduct 20 percent of their $100 share of the income. After taking the deduction of $20, the partner then pays tax on the remaining $80 at normal rates. Assuming the partner pays tax at the highest marginal rate (37 percent), total tax of $29.60 is due. The difference between the $29.60 of tax paid by the partner eligible for the section 199A deduction and the $36.80 of tax paid by the similarly situated corporate shareholder is $7.20 (i.e., most of the $8.40 of relative benefit enjoyed by the partner in the partnership pre-TCJA is preserved as a result of the 199A deduction).[33]

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[32] Unless extended, section 199A will not apply to taxable years beginning after December 31, 2025.

[33] MLPs are not the only taxpayers that benefit from federal spending in the form of tax incentives. The staff of the Joint Committee on Taxation produces an annual list of "tax expenditures," i.e., special income tax provisions that "may be analogous to direct outlay programs and may be considered alternative means of accomplishing similar budget policy objectives." See Joint Committee on Taxation, Estimates of Federal Tax

In order to limit the revenue cost of section 199A, Congress enacted several restrictions on the deduction, most notably in the case of a partnership, limiting it to 50 percent of the partner's allocable share of wages paid to employees of the partnership.[34] Simultaneously, Congress took steps to ensure that MLPs could get the benefit of the 199A deduction, regardless of their employee wage base.[35] In the case of an MLP, 20 percent of "qualified publicly traded partnership income" is deductible even if the MLP pays no employee wages.[36] The steps taken to preserve a tax benefit for MLPs are a clear reaffirmation of the policy enacted in 1987 to foster energy security and infrastructure development.[37] The effects of rate changes enacted as part of TCJA and section 199A on the relative benefit of the MLP structure are illustrated in Exhibit A, attached hereto. The Commission's Revised Policy Statement and Order on Rehearing ignore this reaffirmation of Congressional intent which postdates the court's *United Airlines* decision.

Expenditures for Fiscal Years 2017-2021 (JCX-34-18), May 25, 2018, at 2. Over 50 expenditures are listed for energy alone. *Id.* at 35-36.

[34] *See* I.R.C. § 199A(b)(2)(B)(i) (2012).

[35] The same benefit was given to real estate investment trusts (REITs), which facilitate investment in another capital-intensive sector of the economy.

[36] I.R.C. § 199A(b)(1)(B) (2012).

[37] As an aide to Sen. John Cornyn stated in the run-up to passage of the TCJA, with regard to the Senate amendments to section 199A, "[u]nder current law, publicly-traded Master Limited Partnerships (MLPs) are taxed as pass-through entities, and this amendment simply preserves that status in the new bill." Ben White, What's in the Tax Deal, Politico (Dec. 14, 1017), available at https://www.politico.com/newsletters/morning-money/2017/12/14/whats-in-the-tax-deal-052458. In addition to indicating that the changes to section 199A were a reaffirmation of the prior-law benefit for MLPs, Sen. Cornyn's aide also noted another goal of the amendments, namely to "help enable MLPs to remain an affordable investment option for retail investors who are close to retirement or are retired." *Id.* As further discussed *supra*, taxable conversions of MLPs are a costly and unwelcome surprise, particularly for an investor population that supported infrastructure development in exchange for a predictable yield on its retirement savings.

2. Disparate treatment of MLPs by denying an income tax allowance is contrary to Congressional intent.

The Commission's policy of not allowing MLPs to recover an income tax allowance, or even support recovery of an income tax allowance or other means to ensure parity with C-corporation pipelines, reverses the policy decision made by Congress in 1987 and reaffirmed in 2017 to provide a tax incentive to MLPs. The Commission should remain open to proposals that maintain parity between MLPs, other pass-through entities, and C-corporations, such as the MLPA proposal below, because such proposals comply with the Natural Gas Act as interpreted in *Hope* as well as with the intent of Congress in its establishment and support of MLPs as a critical infrastructure development vehicle for the energy sector.

The effect of the Order on Rehearing, if not clarified, and the impact of the uniform denial of an income tax allowance to all MLPs can be illustrated based on the facts of the simple example discussed above. While the example has assumed that the MLP and corporation have the same pre-tax net income, the results are amplified if the corporation is able to increase its pre-tax income to include an income tax allowance equal to the additional pre-tax income the corporation would need in order to be left with $1,000 after taxes. The corporation's net income would be grossed up to $1,265.82. After paying taxes of $265.82, the corporation would pay the 10-percent shareholder a dividend of $100. After taxes ($20), the shareholder would be left with $80. In comparison, the 10-percent owner of an MLP (the cash flow of which would not recognize income tax liability under the Revised Policy Statement) is left with only $70.40 after taxes. In short, even with the benefit of the new 199A deduction, *the same pre-tax-allowance net income leaves the owner of the MLP with a materially lower return than a similarly situated corporate shareholder*. Most critically,

the benefit for the MLP structure enacted in 1987 and reaffirmed thirty years later in TCJA is not just eliminated, it is completely reversed. As a result, the Revised Policy Statement makes MLPs an inferior vehicle as compared to corporations for owning cost-of-service-regulated pipelines. Moreover, the return earned by the MLP unitholder is not sufficient to cover the unitholder's income tax expense.

There are at least three unwelcome consequences to a policy that upsets the parity between MLPs and C-corporations at FERC and therefore causes MLPs to be less attractive than corporations as financing vehicles for cost of service pipelines. First, if MLPs are not the ownership vehicle of choice for cost of service pipelines, the incentive Congress passed for infrastructure financing in the form of section 7704 will not be used. Thus, the cost of financing for these pipelines will increase, and critical infrastructure development will slow. The benefit of the tax expenditure for MLPs—an incentive for infrastructure development supported and defended by Congress for over thirty years—will ironically be lost for the cost-of-service-based pipelines previously considered to be the most suitable to be held by MLPs. Although cost of service pipelines held by MLPs have felt the most immediate impact of the Revised Policy Statement, the damage to MLPs has been considerably broader and could spread further into other segments of the energy sector. The damage and related policy uncertainty come at a time when the benefits of the MLP structure continue to be the focus of Senate and Congressional attention. In addition to Congress' recent reaffirmation of their commitment to the MLP structure in the 2017 TCJA, there is growing bipartisan support among members in both the House and Senate for expanding the MLP structure to include renewables. Many members of Congress support such expansion precisely because

the MLP structure has been successful in attracting billions of dollars of lower cost capital to the build out our nation's energy infrastructure.

Second, MLPs owning these assets are incentivized to convert into corporations; such transactions are often taxable, meaning that the conversions themselves would take potentially billions of dollars of capital out of the energy infrastructure sector in the form of taxes paid by investors as a result of such conversions. Finally, continued marketplace and investor disruption increases the investment risk in the sector, further driving up capital costs and stifling infrastructure development.

While denial of an income tax allowance to MLPs has been characterized as a simple elimination of the "double recovery" of income taxes, as indeed was stated in the Revised Policy Statement itself, the Commission's orders have in fact so tipped the scales in favor of the corporate form—upsetting parity between pipelines based purely on organizational structure—that it is causing many MLPs holding cost of service pipelines to convert to C-corporations in order to retain an income tax allowance and ensure treatment commensurate with other pipelines. The examples discussed so far in this pleading ignore the fact that all types of entities, not just individuals, invest in MLPs. Often MLPs are sponsored by corporations that contribute assets to a partnership and retain ownership of the general partner and a material portion of the MLP's outstanding units. In these MLP structures, there is at least one level of tax before dividends are made to the corporate owner's investors. Failing to account for the intermediate taxes that must be paid results in systematic underestimation of the cost of service.

A corporate sponsor of an MLP that is developing a pipeline has the choice of owning the asset directly or through an MLP. Following the Commission's recent actions, the

pipeline owned through the MLP will generate lower returns. Nevertheless, tax at the same rate will still be owed on the corporate sponsor's reduced return from the investment. Thus, investors (as well as corporate sponsors of MLPs) will prefer future investments be made by corporations. As a result, the Congressional tax incentive directed at the energy sector will have effectively been nullified for cost of service assets. In this respect, FERC has inadvertently thwarted the intent of Congress. Similarly, any MLP holding these assets that currently has a corporate sponsor is likely to view converting to a C-corporation as a rational economic choice. If the corporations holding partnership units were sufficiently compensated for income tax expense using the DCF ROE methodology, such conversions would not be occurring.

It is estimated that over 44 percent of MLP investors are corporations that under the new FERC policy will no longer receive the same benefit for investing in the country's infrastructure;[38] Exhibit B, attached hereto, provides further information regarding the demographics of MLP investors. If these same corporations invested directly, cost-of-service rates would be adjusted to take their income taxes into account. If they invested through other corporations, the dividends received deduction would at least partially (though perhaps not fully) reduce the additional tax burden on the end investors.[39] But no relief would be provided for investments by corporations through MLPs.[40]

The corporate conversions completed and announced to date demonstrate that the Revised Policy Statement and its application fails to allow MLPs a meaningful opportunity

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[38] *See* Exhibit B.

[39] Section 243 of the Internal Revenue Code permits a corporation to deduct between 50 and 100 percent of the amount received as dividends from a taxable domestic corporation. *See* I.R.C. § 243 (2012).

[40] While the Commission in *Enable* appears to summarily dismiss this disparity in benefits, it cannot so easily dismiss the empirical evidence of disparity provided by the market's responses to the Revised Policy Statement and Order on Rehearing.

to seek recovery of an income tax allowance. In the wake of the Revised Policy Statement, a growing list of MLPs, including Enbridge Energy Partners LP, Boardwalk Pipeline Partners LP, Dominion Energy Midstream Partners LP, TC Pipelines, LP, Williams Partners LP, and Spectra Energy Partners LP have initiated or have indicated plans to change their tax classification to taxable corporations. Many of these MLPs stated publicly that the Revised Policy Statement is a material factor in their deliberations regarding a change to entity classification for tax purposes and their strategy going forward.[41] By electing to be taxed as a corporation, an MLP can obtain the same income tax allowance as other pipeline companies classified as corporations.[42] Although the motivations for the conversion of each

[41] *See, e.g.,* TC PipeLines, LP, Quarterly Report (Form 10-Q) (May 2, 2018) ("TransCanada has stated that the Partnership is not seen as a viable funding lever in the absence of changes to the 2018 FERC Actions and as a result, it does not anticipate further asset dropdowns to the Partnership at this time. This traditional source of growth will not be accessible under the current circumstances, and options for further growth are significantly limited. Accordingly, many longer-term implications must be re-evaluated. Various strategic options are being considered currently, including a reorganization of the Partnership's legal structure to partially mitigate the effects of the 2018 FERC Actions."); Enbridge Energy Partners, L.P., Quarterly Report (Form 10-Q) (May 10, 2018) ("Both the direct consequences of the change in FERC policy, as well as the adverse market effect may negatively impact the longer-term availability of capital to us at attractive terms."); Boardwalk Pipeline Partners, LP, Quarterly Report (Form 10-Q) (Apr. 30, 2018) ("Any decision by our general partner to exercise [its] purchase right will be made by Boardwalk Pipelines Holding Corp. (BPHC), the sole member of Boardwalk GP, LLC (BGL) and a wholly-owned subsidiary of Loews, rather than by our Board. We have been informed by BPHC that it is analyzing the FERC's recent actions and seriously considering its purchase right under our partnership agreement in connection therewith.").

[42] For example, Jim Simpson, a sector analyst, recently explained the reasoning behind Williams Partners' conversion as follows:

> "So let's look at [Williams Partners' Transcontinental Gas Pipe Line Co. LLC], a major pipeline in the Northeast," Simpson said. "What does this [FERC policy change] mean for a pipe like Transco?"
>
> Before the changes to tax policy, Transco's income before taxes was about $567 million, Simpson said. Transco's income tax burden was about 37.5%, with a federal rate of 35% and a state rate of roughly 2.5%. Its composite tax was about $212 million, which lowered its net income to $354 million. "That makes my ROE 10%," comfortably within the allowable 10% to 14% range. "Life is good."
>
> With Transco in an MLP structure, the tax allowance is zero, Simpson said. "My ROE is now 16%," above the allowable range. "My max tariff rate is at risk."
>
> If Transco is rolled into the C-corp with Williams Partners, its tax allowance is 23.5%, with a federal tax rate of 21% plus about 2.5% for the state rate, Simpson said. Transco's composite tax is about

individual company may be complex, the sheer number of conversions contemplated demonstrates clearly that the FERC's policy change has had a dramatic effect and indicates that unless the Revised Policy Statement is altered or the clarification requested is granted, MLPs holding predominantly cost of service pipelines may cease to exist.

Ironically, these pipelines had heretofore been considered among the most appropriately suited for the MLP structure and comparatively the safest of such MLP investments. The benefit of the tax expenditure for MLPs—an incentive for infrastructure development supported and defended by Congress for over thirty years—will be lost for the pipelines previously considered to be the most suitable to be held by MLPs. Although cost-of-service-based pipelines held by MLPs have felt the most immediate impact of the Revised Policy Statement and lack of clarity regarding the ability of MLPs to argue for an income tax allowance or other mechanisms to ensure parity, the damage to MLPs has been considerably broader and could spread further into other segments of the energy sector.

Of equal concern is that transactions that change the entity classification of an MLP to a corporation are not typically tax-free to MLP unitholders. For example, if the corporate sponsor of an MLP acquires all of the outstanding units of the MLP for its stock, the MLP becomes disregarded as an entity separate from the sponsor (and would be taxed as a

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> $133 million and net income is about $433 million. Its ROE is 12%. "I'm in my allowable range of 10% to 14%, and I'm probably OK."
>
> "One driver for the Williams LP — not the only driver — to roll up to a C-corp is to lower the ROE on a pipe like Transco," Simpson said.
>
> There could be similar effects on other pipeline companies, depending on their corporate structures and their tariff arrangements. "So from the FERC tax standpoint, essentially that risk to an MLP can be mitigated by rolling up to a C-corp," Simpson said. He observed that the equity market was pleased with the Williams corporation and its general partner after it announced that it would absorb the partnership.

Sean Sullivan, *MLP Roll-ups Can Protect Pipeline Rates after FERC Tax Changes, Researcher Says*, SNL Financial Extra (June 15, 2018).

C-corporation); most unitholders would recognize immediate gain upon receipt of the sponsor's stock and generally would not receive cash to pay the required taxes. In the aggregate, the taxes paid on MLP conversions could amount to billions of dollars. Tax dollars paid to the government are no longer invested in the energy sector.

Finally, taxable conversions of MLPs compound the injury to those investors who already suffered a significant drop in the value of their investments when the Revised Policy Statement was issued. At a minimum, investors who sought safe, steady yields from MLPs and investments in energy infrastructure will think twice before investing in that industry again.

A reduction in investment in pipeline infrastructure—due to lack of parity between MLPs and other corporate forms, because the Congressional incentive for MLPs will not be claimed, because taxable conversions may squeeze billions of investment dollars from the sector, and because investors who got burned will be slow to come back--will ultimately work to the disadvantage of shippers, who will face higher tariffs reflecting a higher overall cost of service. The Commission's failure to allow pipelines owned by MLPs to reflect liability on income they earn, to ensure parity, will ultimately harm the Commission's and Congress' overarching goal of maintaining a reliable, safe, energy infrastructure system. Further, failure to allow for parity among corporate forms reflects an incomplete understanding of the intent of Congress in passing the TCJA, the tax benefits of the partnership structure, and the legal requirement of *Hope* and *United Airlines*. The Commission must re-evaluate the Order on Rehearing and the application of the Revised Policy Statement uniformly across MLPs. To aid in this evaluation, the MLPA provides a different approach to income tax allowance for partnerships.

D. The Commission should allow MLPs to propose an entity-indifferent approach to the treatment of the income tax allowance to ensure parity among regulated pipelines.

While the MLPA and others[43] have provided alternative approaches to the treatment of income tax in prior submissions in this docket, given the Commission's orders it is unclear whether MLPs will be permitted to propose such alternatives. The Commission should clarify that pipelines owned by MLPs are permitted to file and support proposals for an income tax allowance that better aligns with Congressional intent by maintaining the benefits of the MLP structure and providing the proper incentives to continue investment in infrastructure development, while also ensuring parity between pipelines regulated by the Commission.

While a number of options may exist to achieve these goals, MLPA respectfully submits one example of an approach that pipelines owned by MLPs should be permitted to propose to solve the income tax allowance issues created by the Revised Policy Statement. The Commission would satisfy its obligations under the Natural Gas Act and ensure parity among regulated entities by allowing pipelines owned by MLPs and corporations to recover the same federal income taxes (i.e., 21 percent) in their cost of service. This approach results in the two ownership models being placed on equal footing vis-à-vis shippers, preserving Congress' long-held and recently reaffirmed policy of incentivizing energy development through the MLP structure. Importantly, it would also remove the Commission from economically dictating the choice of form of legal ownership (corporation versus partnership). This approach assumes that the DCF ROE component of the cost of service calculation, which MLPA understands to be based on empirical market data and not any

[43] Comments of OFI SteelPath, Inc. on the Revised Policy Statement on the Treatment of Income Tax, Docket No. PL17-1 (filed June 21, 2018).

component of tax liability or MLP sponsor's tax liability, would be left unchanged. By allowing all entities the option, regardless of their tax classification, to recover the same income tax allowance in their cost of service based on the same rate, taxes are taken out of the equation in terms of choice of entity.[44]

III. CONCLUSION

For the reasons stated herein, the MLPA respectfully requests that the Commission accept this Motion for Clarification, or in the Alternative Reconsideration, and grant the clarifications requested herein. Given the demonstrated market reaction to the potential for disparate treatment of pipelines owned by MLPs through case-by-case application of the Revised Policy Statement, failure to grant these clarifications will have a similar effect as an affirmative policy choice to uniformly deny an income tax allowance to pipelines owned by MLPs. Lack of clarity on these points will stand as a choice by the Commission to eliminate a material sector of the MLP universe, the benefit of the MLP incentive to the development of cost-of-service-based infrastructure, and a material portion of the dollars invested by current MLP unitholders. Inaction will adversely impact a financing model that has delivered proven benefits for over thirty years and undermine the usefulness of that financing model for other sectors of the energy industry. Ensuring parity among organizational forms, whether by setting the income tax allowance for all pipeline owners at the same level, or through other means, should stabilize the market and demonstrate the Commission's commitment to providing the parity required under *Hope*. MLPA respectfully requests the

[44] While MLPA does not have clarity regarding FERC's approach to any adjustment to index-based rates as a result of the Revised Policy Statement, MLPA strongly encourages the Commission to ensure that any such adjustment also provide parity with respect to the choice of business form in order to preserve Congressional intent.

Commission consider the arguments set forth above, and grant the clarification, or in the alternative reconsideration, requested herein.

Respectfully submitted,

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Dated: August 17, 2018

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Houston, Texas this 17th day of August, 2018.

/s/ Melan A. Patel

EXHIBIT A

Exhibit A

TCJA: Comparison of MLPs to C Corporations and Parity with REITs

Before Tax Reform:

- Highest marginal individual tax rate of 39.6%
- Corporate tax rate of 35%
- State and local income tax rate of 5%
- Qualified dividend rate of 20%
- Net investment income tax of 3.8%

House Bill:

- Highest marginal individual tax rate of 39.6%
- Qualified passthrough income tax rate of 25%
- Corporate tax rate of 20%
- State and local income tax rate of 5%
- Limitation on deduction of state and local income taxes for individuals
- Qualified dividend rate of 20%
- Net investment income tax of 3.8%

Senate Bill (as originally proposed):

- Highest marginal individual tax rate of 38.5%
- 23% deduction on qualified passthrough income (publicly traded partnerships subject to wage/property limitations)
- Corporate tax rate of 20%
- State and local income tax rate of 5%
- Limitation on deduction of state and local income taxes for individuals
- Qualified dividend rate of 20%
- Net investment income tax of 3.8%

Senate Bill (as amended):

- Same as originally proposed Senate Bill
- Amendment for 23% deduction on qualified passthrough income to apply to publicly traded partnerships without applying wage/property limitations

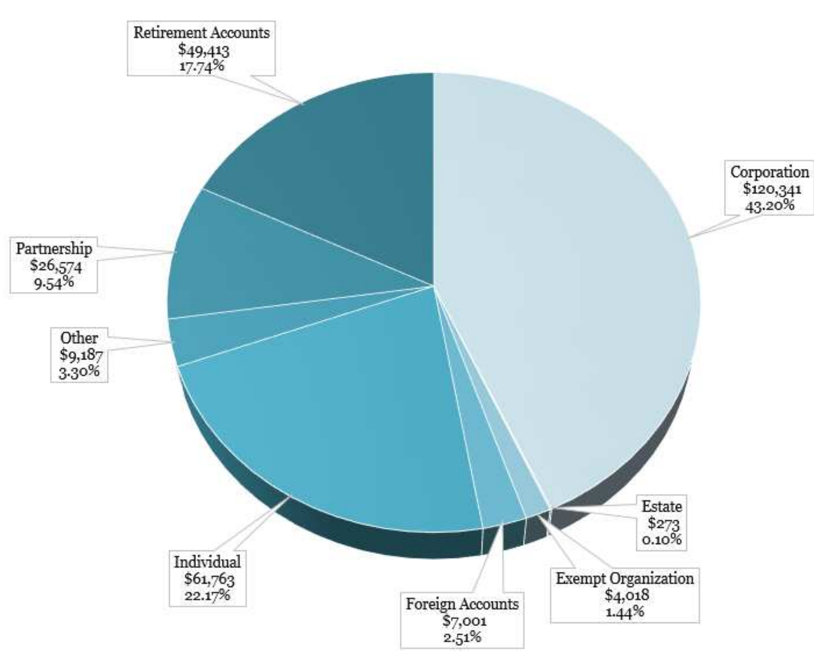
After Tax Reform:

- Highest marginal individual tax rate of 37%
- 20% deduction on qualified passthrough income
- Corporate tax rate of 21%
- State and local income tax rate of 5%
- Limitation on deduction of state and local income taxes for individuals
- Qualified dividend rate of 20%
- Net investment income tax of 3.8%

EXHIBIT B

Exhibit B

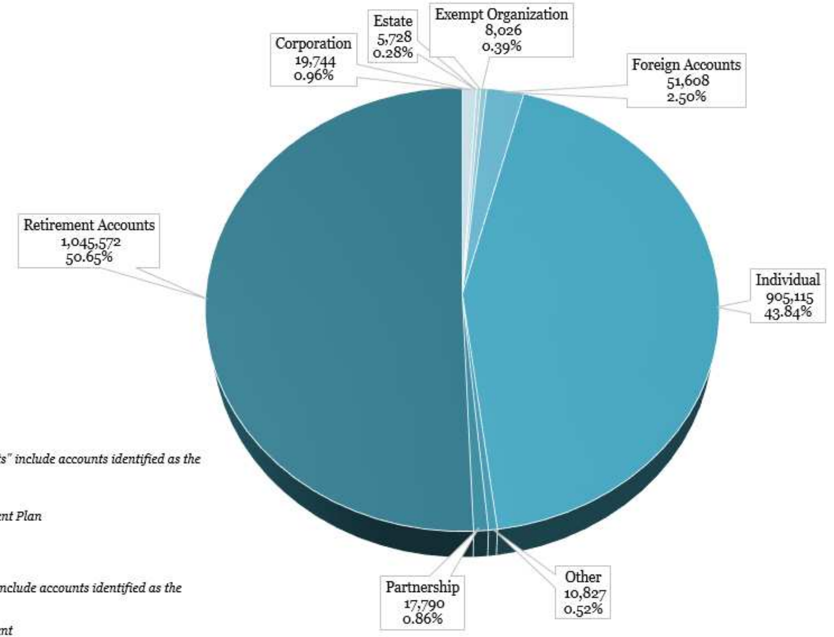
Value of MLP Equity Owned by Entity Type



MLP equity value of $278.6 million across a sample of 60 MLPs as of December 31, 2017

Data provided by PwC (in $m)

Number of MLP Investors by Entity Type



"Retirement Accounts" include accounts identified as the following:
- *IRA/Sep/Koegh*
- *Pension Plan*
- *Qualified Retirement Plan*
- *Educational IRA*
- *Roth IRA*
- *Trust*

"Foreign Accounts" include accounts identified as the following:
- *Foreign Entity*
- *Foregin Government*

3.65 million investments made by over 2 million investors across a sample of 60 MLPs as of December 31, 2017

Data provided by PwC