

162 FERC ¶ 61,228
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Kevin J. McIntyre, Chairman;
Cheryl A. LaFleur, Neil Chatterjee,
Robert F. Powelson, and Richard Glick.

SFPP, L.P.

Docket Nos. IS08-390-008
IS08-390-009

OPINION NO. 511-C

ORDER ON REMAND AND COMPLIANCE FILING

(Issued March 15, 2018)

1. This order addresses the United States Court of Appeals for the District of Columbia Circuit's (D.C. Circuit) remand in *United Airlines*¹ which vacated in part and remanded Commission Opinion Nos. 511, 511-A and 511-B addressing SFPP, L.P.'s (SFPP) 2008 West Line cost-of-service rate case.² This order also addresses an April 6, 2015 compliance filing by SFPP, L.P., pursuant to Opinion No. 511-B.
2. In *United Airlines*, the D.C. Circuit remanded to the Commission holdings concerning (a) the decision to grant SFPP an income tax allowance and a return on equity (ROE) determined by the discounted cash flow (DCF) methodology and (b) the data period for assessing SFPP's real ROE. As to the first issue, the D.C. Circuit determined the Commission failed to demonstrate that a double recovery does not result from granting a partnership pipeline both an income tax allowance and a DCF ROE.³ As to the second issue, the D.C. Circuit held that the Commission failed to provide a reasoned explanation for determining the real ROE based upon data for the six-month period ending September 2008.⁴ In this order, the Commission reconsiders both issues and

¹ *United Airlines, Inc. v. FERC*, 827 F.3d 122 (2016).

² *SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121 (2011), *order on reh'g*, Opinion No. 511-A, 137 FERC ¶ 61,220 (2011), *order on reh'g*, Opinion No. 511-B, 150 FERC ¶ 61,096 (2015).

³ *United Airlines*, 827 F.3d 122 at 134.

⁴ *Id.* at 131.

(a) denies SFPP an income tax allowance, and (b) determines a real ROE of 10.24 percent for SFPP based on an inflationary component of 2.39 percent.

3. On April 6, 2015, SFPP submitted a compliance filing pursuant to Opinion No. 511-B.⁵ Certain shippers challenge the application of certain indexed rate increases for calculating refunds. As discussed below, the Commission accepts in part SFPP's compliance filing and orders SFPP to make a further compliance filing within 60 days that (a) implements the Commission's holdings on the remanded issues and (b) calculates refunds and going forward rates based upon the timing and the level of the index increases actually filed by SFPP and accepted by the Commission consistent with section 342.3 of the Commission's regulations.⁶

I. Procedural History

4. In June 2008, SFPP filed a cost-of-service rate increase pursuant to section 342.4(a) of the Commission's regulations to increase the rates for its West Line between Watson Station, Los Angeles County, California and Phoenix, Arizona.⁷ The rates were protested by shippers, raising numerous issues of material fact regarding SFPP's costs and proposed rates.⁸ The Commission accepted and suspended SFPP's proposed West Line rates to become effective August 1, 2008, subject to refund and set the issues surrounding the proposed rates for hearing.⁹ The hearing was held in June 2009.¹⁰

5. The Administrative Law Judge's December 2009 Initial Decision resolved numerous rate-setting issues.¹¹ The Commission addressed briefs on exceptions in Opinion No. 511 and rehearing in Opinion Nos. 511-A and 511-B. Opinion Nos. 511, 511-A, and 511-B collectively reduced SFPP's proposed West Line rate increase. On

⁵ Opinion No. 511-B, 150 FERC ¶ 61,096.

⁶ 18 C.F.R. § 342.3 (2017).

⁷ 18 C.F.R. § 342.4(a) (2017).

⁸ Opinion No. 511, 134 FERC ¶ 61,121 at P 2.

⁹ *SFPP, L.P.*, 124 FERC ¶ 61,103 (2008).

¹⁰ Opinion No. 511, 134 FERC ¶ 61,121 at P 5.

¹¹ *SFPP, L.P.*, 129 FERC ¶ 63,020 (2009) (Initial Decision).

April 6, 2015, SFPP submitted its compliance filing to Opinion No. 511-B.¹² The parties subsequently submitted comments and reply comments.

6. In September 2015, SFPP and Shippers¹³ filed petitions with the D.C. Circuit regarding, as relevant here, the income tax allowance issue and data period for determining SFPP's DCF ROE. On July 1, 2016, the D.C. Circuit granted the petitions for review and in *United Airlines* remanded those issues to the Commission.¹⁴

7. SFPP subsequently filed comments and supplemental comments.¹⁵ Shippers filed reply comments.¹⁶

II. Income Tax Allowance

8. In the SFPP rate case issues arose involving the interaction between (a) the Commission's policy permitting an income tax allowance policy for partnership business forms (such as SFPP) and (b) the Commission's DCF methodology used to determine a cost-of-service rate of return.

9. At the time of SFPP's 2008 West Line rate case addressed in Opinion Nos. 511, 511-A, and 511-B, SFPP was a wholly owned subsidiary of a master limited partnership

¹² SFPP filed tariff records to implement its April 6, 2016 compliance filing in Docket No. IS15-238. That filing was accepted subject to the outcome of this and other ongoing SFPP proceedings. *SFPP, L.P.*, 151 FERC ¶ 61,101 (2015).

¹³ For purposes of this order, Shippers generally refers to the shipper parties that petitioned the D.C. Circuit challenging the Commission's Opinion No. 511 orders, including United Airlines, Inc., Delta Air Lines, Inc., Southwest Airlines Co., US Airways, Inc., BP West Coast Products LLC, Chevron Products Co., ExxonMobil Oil Corporation, Valero Marketing and Supply Company, and Tesoro Refining and Marketing Company LLC. The same parties except for US Airways, Inc. filed comments on remand with the Commission.

¹⁴ *United Airlines*, 827 F.3d 122.

¹⁵ SFPP Comments on Remand (August 25, 2016); SFPP Supplemental Comments on Remand (November 30, 2016).

¹⁶ Shippers Comments on Remand (September 13, 2016).

(MLP),¹⁷ a partnership form in which units are traded on exchanges much like corporate stock. In order to be treated as an MLP for Federal income tax purposes, an MLP must receive at least 90 percent of its income from certain qualifying sources, including natural gas and oil transportation.¹⁸ Unlike corporations, MLP pipelines are pass-through entities, which means that MLPs are not taxed at the pipeline level. Rather, for tax purposes, the partnership agreement allocates to each partner a share of the partnership's taxable income, and each partner is personally responsible for paying income taxes on the partnership's net taxable income.¹⁹

10. In *United Airlines*, the D.C. Circuit held that because both the partnership income tax allowance and the DCF ROE may include investors' tax costs, permitting both may result in a double recovery. In light of the *United Airlines* findings and the discussion below, the Commission determines that, in order to avoid a double recovery of investor-level tax costs, SFPP should not receive an income tax allowance.

A. Background

1. The DCF Methodology

11. The Commission's cost-of-service ratemaking methodology uses the DCF model to determine the ROE that a regulated entity may recover in rates. The DCF methodology estimates the return required by investors in order to invest in the pipeline whose rates are at issue.²⁰ The DCF model considers the range of returns that the market provides investors in a proxy group of publicly-traded entities with similar risk profiles.²¹ For each member of the proxy group, the required rate of return is estimated to equal investors' current dividend yield – dividends (or in the case of MLPs, distributions) divided by stock (or unit) price – plus the projected future growth rate of dividends (or distributions), such that $k = D/P + g$. In the DCF formula, P is the six-month average price of the stock (or units) over the relevant test period, D is the current dividend (or

¹⁷ At the time of SFPP's rate filing, Kinder Morgan Energy Partners (KMEP) indirectly owned a 99 percent general partner interest in SFPP. Initial Decision, 129 FERC ¶ 63,020 at PP 28 n. 13, 39, 82; Opinion No. 511, 134 FERC ¶ 61,121 at P 74.

¹⁸ 26 U.S.C. § 7704.

¹⁹ *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at P 14 (2008).

²⁰ *Coakley, Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, at P 14 (2014).

²¹ See *Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 293-294 (D.C. Cir. 2001).

distribution), k is the investors' required rate of return, and g is the expected growth rate in dividends (or distributions). Based typically upon the median of the range of returns in the proxy group, the Commission determines the regulated entity's allowed ROE.

2. The Commission's 2005 Income Tax Allowance Policy

12. The Commission's 2005 Income Tax Policy Statement²² adopted a policy allowing partnerships, including MLP pipelines, to recover an income tax allowance for the partners' income tax costs²³ much like a corporation receives an income tax allowance for its corporate income tax costs. The 2005 Income Tax Policy Statement reasoned that while partnerships do not pay income taxes, the partners incur an income tax liability on the partnership income. Accordingly, the Commission determined that those investor-level income tax costs should be attributed to the regulated entity and included in a pipeline's cost of service.²⁴ In *ExxonMobil*,²⁵ the D.C. Circuit held that the Commission provided a sufficient rationale for affording partnership pipelines an income tax allowance.²⁶

3. Commission Proceedings

13. In SFPP's 2008 West Line rate case, the Initial Decision applied the 2005 Income Tax Policy Statement to permit SFPP to include an income tax allowance in its rates.²⁷ In briefs on exceptions and requests for rehearing, shipper-parties argued that a double recovery results from granting SFPP both a DCF ROE and an income tax allowance. Shippers emphasized that whereas a corporation pays the corporate income tax prior to the distribution of dividends to investors, an MLP is a pass-through entity and the MLP's

²² *Policy Statement Income Tax Allowances*, 111 FERC ¶ 61,139 (2005) (2005 Income Tax Policy Statement). The 2005 Income Tax Policy Statement issued in response to a D.C. Circuit remand regarding the Commission's then-existing policy of affording regulated partnership entities an income tax allowance for income attributable to interests held by corporations, but not for income attributable to interests held by individuals. *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (2004).

²³ The Commission's policy permits an income tax allowance, provided that the owners can show an actual or potential income tax liability to be paid on income from the regulated assets. 2005 Income Tax Policy Statement, 111 FERC ¶ 61,139 at P 32.

²⁴ *Id.* P 34.

²⁵ *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007).

²⁶ *Id.* at 952-954.

²⁷ Initial Decision, 129 FERC ¶ 63,020 at PP 662-666, 670.

only income tax liability is paid directly by the partners themselves. Because the MLP partners must pay the income taxes themselves, the shippers explained that in order to attract capital in the market, an MLP must provide a market return (i.e., a DCF return) that allows investors (a) to earn their required after-tax rate of return and (b) to pay the investors' income tax liability. The shippers asserted that because the DCF return must include sufficient funds to pay investor income taxes, permitting SFPP to recover both a DCF ROE and an income tax allowance in its cost of service results in a double recovery.

14. In Opinion Nos. 511 and 511-A, the Commission rejected the shippers' double recovery argument. The Commission stated that because Commission policy imputes the partners' income taxes to the partnership entity, the partners' income taxes are not investor-level taxes. Accordingly, the Commission explained that the DCF ROE determines an after-tax return.²⁸ The Commission further asserted that the Commission's rate design methodology does not "gross up" the after-tax DCF ROE to achieve a pre-tax ROE that would include investor income taxes.²⁹

4. United Airlines

15. Shippers appealed the Commission's decision. As an initial matter, the D.C. Circuit rejected the Commission's argument that Shippers' challenge was an impermissible collateral attack on the D.C. Circuit's prior affirmation in *ExxonMobil* of the income tax policy. The D.C. Circuit found that *ExxonMobil* "reserved the issue of whether the combination of the [DCF ROE] and the tax allowance results in double recovery of taxes for partnership pipelines."³⁰

16. As to the merits, the D.C. Circuit agreed with Shippers and held that the Commission failed to demonstrate that there is no double recovery of taxes for partnership pipelines that receive both an income tax allowance and the DCF ROE.³¹ Due to the double recovery, the D.C. Circuit also concluded that the Commission was not providing parity between returns to corporate owners (which do not include such a double recovery) and returns to partnership owners (which include the double recovery). In support of these findings, the D.C. Circuit found that, "unlike a corporate pipeline, a partnership pipeline incurs no taxes, except those imputed from its partners, at the entity level," and "the [DCF ROE] determines the pre-tax investor return required to attract

²⁸ Opinion No. 511, 134 FERC ¶ 61,121 at PP 228, 240, 250; Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 280, 339-340.

²⁹ Opinion No. 511-A, 137 FERC ¶ 61,220 at P 295.

³⁰ *United Airlines*, 827 F.3d at 134.

³¹ *Id.* at 136.

investment, irrespective of whether the regulated entity is a partnership or a corporate pipeline.”³²

17. The D.C. Circuit also rejected the Commission’s arguments that for a partnership pipeline no double recovery exists because the Commission does not adjust, or “gross-up,” partnership ROE to cover the income taxes that must be paid to obtain its after-tax return.³³ Even without such a gross-up, a double recovery remained given the *United Airlines* finding that the DCF ROE is a “pre-tax investor return.”³⁴ The D.C. Circuit also rejected the Commission’s argument that any disparity in returns is justified by the Internal Revenue Code.³⁵

18. The D.C. Circuit remanded the decisions to the Commission to consider “mechanisms for which the Commission can demonstrate that there is no double recovery.”³⁶ The D.C. Circuit further explained that “[e]ven if FERC elects to impute

³² *Id.* The D.C. Circuit relied on Opinion No. 511, 134 FERC ¶ 61,121 at PP 243-244, which included the following example:

The investor desires a 6 percent after-tax return and has a 25 percent marginal tax rate. Thus, the security must have an ROE of 8 percent to achieve an after-tax yield of 6 percent. Assume that the distribution or dividend is \$8. The investor will price the security at \$100. Conversely, if the security price is \$100 and the yield is \$8, the Commission determines that the required return is 8 percent. If the dollar distribution increases to \$10, the investor will price the security at \$125 because \$10 is 8 percent of \$125. The Commission would note that the security price is \$125 and that the yield is \$10, or a return of 8 percent. If the distribution is \$6, the security price will drop to \$75, a return of 8 percent. The Commission would observe a \$75 dollar security price, a \$6 yield, and a return of 8 percent. In all cases the ROE is 8 percent and the after-tax return is 6 percent based on the market-established return.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 137. The D.C. Circuit also noted that the Commission “might be able to remove any duplicative tax recovery for partnership pipelines directly from the [DCF ROE]” and that the Commission had in the past considered “eliminating all income tax allowances and setting rates based on pre-tax returns.” *Id.*

partner taxes to the partnership pipeline entity, it must still ensure parity between equity owners in partnership and corporate pipelines.”³⁷

5. Pleadings on Remand

19. In comments on remand, SFPP asserts that “the Court erred” when holding that a double recovery results from including both a DCF ROE and an income tax allowance in SFPP’s cost of service.³⁸ SFPP further argues that the Commission’s current policy of affording MLPs an income tax allowance preserves the investment incentive created by Congress in the tax code.³⁹ While SFPP argues for the preservation of an income tax allowance for partnership pipelines, SFPP requests a paper hearing regarding whether any adjustment is appropriate to the ROE of a tax pass-through entity that includes an income tax allowance in its cost of service.⁴⁰

20. Shippers’ comments defend *United Airlines*’ holdings and argue that on remand the Commission should eliminate the income tax allowance from SFPP’s cost of service.⁴¹

B. Discussion

21. The Commission implements the *United Airlines* remand by removing the income tax allowance from SFPP’s cost of service. This action (a) remedies the double recovery identified by the court in its *United Airlines* remand, (b) restores parity between SFPP (an MLP partnership) and corporate investment forms, (c) is consistent with Congressional intent, and (d) provides SFPP with a sufficient return via the DCF ROE. SFPP’s request for additional paper hearing procedures is rejected as discussed below.

³⁷ *Id.*

³⁸ SFPP Comments on Remand at 5.

³⁹ SFPP Supplemental Comments on Remand at 8-12.

⁴⁰ SFPP Comments on Remand at 12.

⁴¹ Shippers Comments on Remand at 8-10.

1. **Granting the SFPP Partnership an Income Tax Allowance Results in a Double Recovery**

22. Consistent with *United Airlines*, the Commission finds that a double recovery results from granting an MLP such as SFPP an income tax allowance and a DCF ROE.⁴² This finding is based upon the following:

- MLPs and similar pass-through entities do not incur income taxes at the entity level.⁴³ Instead, the partners are individually responsible for paying taxes on their allocated share of the partnership's taxable income.⁴⁴
- The DCF methodology estimates the returns a regulated entity must provide to investors in order to attract capital.⁴⁵
- To attract capital, entities in the market must provide investors a pre-tax return, i.e., a return that covers investor-level taxes and leaves sufficient remaining income to earn investors' required after-tax return.⁴⁶ In other words, because investors must pay taxes from any earnings received from the partnership, the DCF return must be sufficient both to cover the investor's tax costs and to provide the investor a sufficient after-tax ROE.

⁴² The D.C. Circuit discussed these issues in terms of partnerships generally. While all partnerships seeking an income tax allowance will need to address *United Airlines'* double recovery concerns, this holding pertains to SFPP, which was organized as an MLP at the time of this litigation.

⁴³ *United Airlines*, 827 F.3d at 136.

⁴⁴ 2005 Income Tax Policy Statement, 111 FERC ¶ 61,139 at P 33; *see also ExxonMobil*, 487 F.3d at 954 (noting that "investors in a limited partnership are required to pay tax on their distributive shares of the partnership income, even if they do not receive a cash distribution"). In contrast, corporations pay entity-level income taxes, and corporate dividends are second tier income to a common stock investor, not analogous to partnership distributions.

⁴⁵ *See supra* P 11.

⁴⁶ *Kern River Transmission Co.*, Opinion No. 486-B, 126 FERC ¶ 61,034, at P 114 (2009) ("investors invest on the basis of after-tax returns and price an instrument accordingly").

- The DCF methodology “determines the *pre-tax* investor return required to attract investment.”⁴⁷

Given that the DCF return is a “pre-tax investor return,” permitting SFPP to recover both an income tax allowance and a DCF ROE would lead to a double recovery of its income tax costs.⁴⁸

23. SFPP’s arguments to the contrary are unavailing. The Commission rejects SFPP’s argument that the D.C. Circuit “erred” in finding a double recovery. SFPP specifically challenges the D.C. Circuit’s statement that “with a tax allowance, a partner in a partnership pipeline will receive a higher after-tax return than a shareholder in a corporate pipeline, at least in the short term before adjustments can occur in the investment market.”⁴⁹ SFPP essentially argues that there is no “short term” because (pursuant to the efficient market hypothesis) the market immediately increases the price of partnership units in response to the cash flow from an income tax allowance, thereby maintaining the same rate of return as if there was no income tax allowance.⁵⁰

24. The Commission rejects such claims. As an initial matter, this argument is a direct challenge to a finding by the D.C. Circuit notwithstanding the fact that SFPP failed to appeal the *United Airlines* decision. Second, SFPP’s argument distracts from the fundamental concern. This proceeding involves whether an income tax allowance should be included in SFPP’s cost of service, not the post-rate case effects upon the unit price of SFPP’s parent MLP. Regarding SFPP’s cost of service, SFPP’s DCF ROE is based upon a proxy group of other MLPs, all of which must provide investors with sufficient pre-tax investor returns to attract capital.⁵¹ Permitting SFPP to recover both the DCF pre-

⁴⁷ *United Airlines*, 827 F.3d at 136 (emphasis added).

⁴⁸ SFPP’s DCF ROE is based upon a proxy group of 7 MLPs. Initial Decision, 129 FERC ¶ 63,020 at PP 365, 651-657; Opinion No. 511, 134 FERC ¶ 61,121 at PP 199, 203. For the reasons discussed above, each of these MLPs must provide a return that covers investor-level taxes and leaves sufficient remaining income to earn investors’ required after-tax return. If, in addition to this DCF ROE SFPP receives an income tax allowance, it will double-recover its tax costs.

⁴⁹ SFPP Comments on Remand at 6 (quoting *United Airlines*, 827 F.3d at 136). In other words, the D.C. Circuit found that while unit prices rose to account for the increased cash flows and distributions resulting from the income tax allowance, the pipeline would earn a higher percentage return.

⁵⁰ SFPP Comments on Remand at 5-7; SFPP Supplemental Comments on Remand at 11.

⁵¹ SFPP appears to concede as much on remand. SFPP Supplemental Comments on Remand, Table 1, Column C shows that an MLP recovering both an income tax

investor tax return and an income tax allowance for the investor-level tax costs leads to a double recovery. Whether or not the double recovery manifests itself in a “short term” higher percentage return or an “instantaneously” inflated unit price, the impermissible double recovery in SFPP’s cost of service remains.⁵²

2. Eliminating the Duplicative Income Tax Allowance for SFPP Restores Parity between Corporations and Partnerships

25. Denying SFPP a duplicative income tax allowance also restores the parity between the rate treatment of MLPs (such as SFPP) and corporations by ensuring that neither double-recover tax costs. As discussed above, permitting SFPP to recover an income tax allowance leads to a double recovery. In contrast, no double recovery results when a corporation’s cost of service includes an income tax allowance. Because the corporate income tax is not an investor-level tax, the corporate income tax is not reflected in the investor’s DCF return.⁵³

3. Congressional Intent Does Not Justify Permitting SFPP to Maintain This Double Recovery

26. While SFPP denies the existence of a double recovery, SFPP also concedes that MLPs with an income tax allowance receive greater cash flows than corporations.⁵⁴

allowance and a DCF ROE earns the same 6.5 percent investor after-tax return as an MLP without an income tax allowance in Column D. While the table does not show the investors’ pre-tax returns, since both pipelines were subject to a 35 percent investor-level tax, both must have earned a 10 percent pre-tax investor return. Thus, in SFPP’s own example, the cost-of-service double recovery of income tax costs of the pipeline in Column C inflated the unit price until it earned the same pre-tax return as the pipeline without an income tax allowance in Column D.

⁵² While an inflated cost of service will likely increase distributions to investors and potentially cause a pipeline’s unit price to rise, such benefits to a pipeline’s unitholders do not render the double recovery permissible. Under SFPP’s theory, the Commission could increase SFPP’s cost of service by allowing SFPP to incorporate duplicative costs, yet SFPP appears to claim that because its parent’s unit price would subsequently rise, the inclusion of duplicative costs in SFPP’s cost of service is not unjust or unreasonable. This argument is without merit.

⁵³ No double recovery results when a corporate pipeline’s cost of service includes an income tax allowance because this so-called “first tier” corporate income tax is paid directly by the corporation, rather than by shareholders from the dividends used in the DCF methodology.

⁵⁴ SFPP Supplemental Comments on Remand at 8.

SFPP claims that denying partnerships an income tax allowance would eliminate the tax benefit Congress intended to provide to pass-through entities in section 7704 of the Internal Revenue Code (IRC).⁵⁵ As the D.C. Circuit observed, such arguments engage “in a form of Orwellian doublethink” that simultaneously denies that a double recovery exists (see SFPP’s argument above) while attributing this disparity in returns to the IRC.⁵⁶ Moreover, the D.C. Circuit has twice rejected the argument that Congress’ intent in section 7704 provides an independent basis for upholding a full income tax allowance for partnerships. Prior to *United Airlines*, the D.C. Circuit stated that “[t]he mandate of Congress in the tax amendment was exhausted when the pipeline limited partnership was exempted from corporate taxation. It did not empower FERC to do anything....”⁵⁷ Likewise, in *United Airlines* the D.C. Circuit rejected the argument that “any disparate treatment between partners in partnership pipelines and shareholders in corporate pipelines is the result of the [IRC], not FERC’s tax allowance policy.”⁵⁸

27. In addition to being contrary to two previous D.C. Circuit holdings, SFPP’s argument is unsubstantiated. Contrary to SFPP’s arguments on remand,⁵⁹ when the D.C. Circuit issued these decisions, it was fully aware that Congress designed the MLP business form to reduce the tax burden on energy related activities (including transportation via an oil pipeline such as SFPP).⁶⁰ Moreover, SFPP provides no evidence that Congress intended the Commission’s income tax allowance policy to provide a necessary component of the advantages conferred in section 7704. Congress did not

⁵⁵ 26 U.S.C. § 7704.

⁵⁶ The Commission further emphasizes that the D.C. Circuit on remand has instructed the Commission to consider “mechanisms for which the Commission can demonstrate that there is no double recovery.” *United Airlines*, 827 F.3d at 137. SFPP’s attempt to justify affording an income tax allowance on the basis that the Commission is implementing Congress’ intent does not address the remand’s mandate to resolve the double recovery issue.

⁵⁷ *BP West Coast*, 374 F.3d at 1293.

⁵⁸ *United Airlines*, 827 F.3d at 136; see also Opinion No. 511, 134 FERC ¶ 61,121 at PP 253-258, 262; Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 342-353; Federal Energy Regulatory Commission and United States of America, Brief for Respondents, Case No. 11-1479, at 29-30 (D.C. Cir., filed Feb. 5, 2016).

⁵⁹ SFPP Supplemental Comments on Remand at 8.

⁶⁰ Federal Energy Regulatory Commission and United States of America, Brief for Respondents, Case No. 11-1479, at 30 (D.C. Cir., filed Feb. 5, 2016).

provide explicit instructions to federal agencies regarding how to address section 7704's tax treatment in setting regulated entity rates as, for instance, it did in the Revenue Act of 1964.⁶¹ Instead, the statutory language is silent.⁶² As the D.C. Circuit has twice already concluded, there is no basis for SFPP's argument that Congress implicitly intended to limit the Commission's discretion in carrying out its statutory rate setting obligations.⁶³

4. The tax costs of partnership investors are not properly attributed to the regulated partnership entity

28. Accordingly, the Commission denies SFPP's income tax allowance and denies SFPP's request for further paper hearing procedures. Removing the income tax allowance eliminates the double recovery identified by the court in *United Airlines*. In light of the Commission's finding that the DCF methodology determines ROE based on the before-tax return demanded by market investors, there is no basis for imputing the partners' income tax costs to SFPP's cost of service.⁶⁴ In light of these findings, and

⁶¹ The Revenue Act of 1964 established an investment tax credit and explicitly provided in the statute that federal agencies could not use the credit as a basis to reduce a regulated entity's income taxes for its cost of service and rates. *See Alabama-Tennessee Natural Gas Co. v. FPC*, 359 F.2d 318, 333 (5th Cir. 1966) ("In the Revenue Acts of 1962 and 1964 Congress demonstrated that when it desires a tax statute to restrict the ratemaking authority of federal regulatory agencies it does so in precise language.").

⁶² Moreover, contrary to SFPP's arguments on remand, when the D.C. Circuit issued its decisions in *BP West Coast* and *United Airlines*, it was fully aware that Congress designed the MLP business form to reduce the tax burden on energy related activities (including transportation via an oil pipeline such as SFPP). Federal Energy Regulatory Commission and United States of America, Brief for Respondents, Case No. 11-1479, at 30 (D.C. Cir., filed Feb. 5, 2016).

⁶³ *See Alabama-Tennessee Natural Gas Co. v. FPC*, 359 F.2d at 335 ("It is unlikely to suppose that Congress amended the Natural Gas Act by a reference in the [IRC]; it is unreasonable to read Section 167 [of the IRC] as a mandate reducing the Commission's responsibility to fix fair rates according to its usual ratemaking policies in favor of the consumer"); *see also Cheney R. Co., Inc. v. ICC*, 902 F.2d 66, 69 (D.C. Cir. 1990) ("in an administrative setting, ... Congress is presumed to have left to reasonable agency discretion questions that it has not directly resolved").

⁶⁴ As discussed above, the *United Airlines* opinion spoke generally in terms of partnerships, not just an MLP such as SFPP. While all partnerships seeking an income tax allowance in a cost-of-service rate case will need to address the *United Airlines* double recovery concerns, this holding addresses the circumstances of an MLP such as SFPP. *United Airlines* expressly did not overturn *ExxonMobil*, meaning that there may be circumstances in which a partnership could justify imputing an income tax allowance

consistent with the D.C. Circuit's remand, the Commission revises its prior policy⁶⁵ that an income tax allowance may be recovered in the rates of an MLP such as SFPP.

29. There is no evidence that the pre-investor tax DCF ROE will fail to provide SFPP with sufficient returns. The DCF ROE by itself provides the pipeline with a return commensurate with investments of corresponding risk and sufficient to attract capital, thereby satisfying the Supreme Court's standard in *Hope*.⁶⁶ SFPP's proxy group (a) consists solely of entities of like risk selected pursuant to Commission policy and (b) contains other MLPs whose investors also incur partner-level tax costs. As discussed above, this return addresses investor tax costs while providing sufficient after-tax investor earnings to attract investment.⁶⁷

30. The Commission also denies SFPP's request for a paper hearing. Because the Commission is eliminating the income tax allowance, there is no need to consider offsetting adjustments to the DCF ROE as proposed by SFPP. This proceeding has included an exhaustive record developed in nearly a decade of litigation, and the Commission has considered two separate filings by SFPP following the remand. There is no reason for further delay.

III. ROE Data Period

31. In *United Airlines*, the D.C. Circuit also remanded issues related to the determination of SFPP's ROE. Specifically, the D.C. Circuit determined that while Opinion Nos. 511 and 511-A may have selected a reasonable nominal ROE of 12.63

to its cost of service. *United Airlines*, 827 F.3d at 134. However, those circumstances (whatever they may be), do not exist for an MLP such as SFPP.

⁶⁵ 2005 Income Tax Policy Statement, 111 FERC ¶ 61,139.

⁶⁶ *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (“[T]he return to the equity owner should be commensurate with the return on investments in other enterprises having corresponding risks.”).

⁶⁷ While investor-level costs affect investment decisions, such costs are not included in a line item in the cost of service. For example, SFPP's ultimate investors incur bookkeeping costs associated with any investment and the Commission does not include these bookkeeping costs in the cost of service. It is not clear why SFPP's investors' tax costs should be treated differently. *See BP West Coast*, 374 F.3d at 1291. Based upon the *United Airlines* reasoning, all of these costs should be adequately addressed by the DCF ROE – an investor will not make an investment unless the returns are sufficient to (a) cover the investor's costs and (b) allow the investor to retain a sufficient return notwithstanding those costs.

percent, those orders failed to justify selecting an inflationary component of ROE of 4.64 percent and a resulting real ROE of 7.69 percent.⁶⁸

32. On remand, as discussed below, the Commission will permit SFPP's cost of service to reflect a nominal ROE of 12.63 percent, an inflationary component of 2.39 percent, and a real ROE of 10.24 percent.

A. Background

1. Trended Original Cost Methodology

33. Using the methodology described above, the Commission's DCF ROE methodology determines a nominal ROE.⁶⁹ Under the Commission's oil pipeline trended original cost methodology, the nominal ROE is then divided into (a) an inflationary component and (b) a real ROE (calculated by subtracting the inflationary component from the nominal ROE). The real ROE times the equity share of the rate base yields the pipeline's yearly allowed equity return in dollars. The inflation factor times the equity rate base yields the equity rate base write-up, which is written-off or amortized over the life of the property.⁷⁰

2. Data Period for Determining the ROE

34. The Commission's DCF methodology for determining a pipeline's ROE provides an exception to the Commission's typical test year approach. In general, the Commission uses a test period methodology for cost-of-service ratemaking. The test period consists of a 12-month base period of actual experience "adjusted for changes in revenues and costs which are known and measurable with reasonable accuracy at the time of filing and which will become effective within nine months after the last month" of the base

⁶⁸ *United Airlines*, 827 F.3d at 130-131.

⁶⁹ As described in the prior section, the DCF estimates the investor's required return based upon a proxy group of entities with similar risks. The investor's return is then used to determine the pipeline's required return. For each member of the proxy group, the DCF estimates the required return based upon the current dividend yield – dividends (or in the case of MLPs, distributions) divided by stock (or unit) price – plus the projected future growth rate of dividends, such that $k = D/P + g$.

⁷⁰ *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,834 (1985).

period.⁷¹ In this proceeding, the base period consists of the calendar year 2007 (January 1, 2007 to December 31, 2007) and an adjustment period of the first nine months of 2008 (January 1, 2008 through September 30, 2008).⁷²

35. However, in contrast, the Commission's ROE (including the nominal ROE, inflation factor and real ROE) determinations generally use the most recent data in the record, even if such data is outside the test period "because the market is always changing and later figures more accurately reflect current investor needs."⁷³ Commission policy also provides that "updates are not permitted once the record has been closed and the hearing has concluded."⁷⁴ In this case, the record closed on June 26, 2009.⁷⁵

3. Commission Proceedings

36. SFPP presented the following ROE studies into the record:

Data Period	Nominal ROE	Real ROE	Inflation prior 12 months
Six-month period ending September 2008 (April – September 2008) ⁷⁶	12.63	7.69	4.94

⁷¹ 18 C.F.R. § 346.2(a) (2017).

⁷² *United Airlines*, 827 F.3d 122 at 129 (citing Opinion No. 511, 134 FERC ¶ 61,121 at P 8).

⁷³ *Portland Natural Gas Transmission System*, Opinion No. 510, 134 FERC ¶ 61,129, at P 242 (2011) (quoting *Trunkline Gas Co.*, 90 FERC ¶ 61,017, at 61,117 (2000) (citing *Panhandle Eastern Pipe Line Co.*, 74 FERC ¶ 61,109, at 61,363 (1996) (citing *Boston Edison Co. v. FERC*, 885 F.2d 962, 966 (1st Cir. 1989))).

⁷⁴ *Portland Natural Gas Transmission System*, Opinion No. 510, 134 FERC ¶ 61,129 at P 242 (citing *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at PP 379-386 (2002), *reh'g denied*, 102 FERC ¶ 61,310 (2003)); *Portland Natural Gas Transmission System*, Opinion No. 510-A, 142 FERC ¶ 61,198, at 62,063 (2013) (the Commission's longstanding policy is "to use the most current record data available but to exclude post-hearing data").

⁷⁵ Initial Decision, 129 FERC ¶ 63,020 at P 579.

⁷⁶ For purposes of this order, this period is referred to as the September 2008 data period. The direct testimony submitted by SFPP's expert, Dr. J. Peter Williamson, determined a nominal ROE of 13.01 percent with 5.37 percent inflation and a real ROE of 7.64 percent. Ex. SFP-1; SFP-5 at 9. On April 25, 2011, SFPP filed its compliance filing implementing Opinion No. 511, which recalculated the ROE figures for the

Six-month period ending January 2009 (August 2008 – January 2009) ⁷⁷	14.33	14.30	0.03
Six-month period ending April 2009 (November 2008 – April 2009) ⁷⁸	14.09	14.83	-0.74

37. In Opinion No. 511, the Commission upheld the Initial Decision’s determination to adopt the September 2008 nominal ROE, inflation factor, and real ROE. The Commission rejected SFPP’s proposed use of April 2009 data for all three ROE components. The Commission acknowledged that its general policy is to use the most recent data, which in this case would be the April 2009 data. However, the Commission held that the April 2009 data was not representative of SFPP’s long-term equity cost of capital. The Commission explained that the increase in the real ROE from October 2008 to January and April 2009 “reflects the collapse of the stock market in late 2008 and early 2009 and the use of a negative inflation rate in calculating SFPP’s ROE.”⁷⁹ The Commission elaborated that “SFPP’s proposed West Line rates in this proceeding will be in effect indefinitely into the future” and “[n]either the collapse of the stock prices (which increased the dividend yield used in the DCF calculation) nor the minimal or negative inflation rate (which establishes the real rather than the nominal cost of capital) would have so continued.”⁸⁰ For comparison purposes,⁸¹ the Commission also considered

September 2008 period consistent with the Commission’s rulings. SFPP Compliance Filing Implementing Opinion No. 511 at 4 and Schedule 10 (April 25, 2011); *see also*, SFPP Compliance Filing Implementing Opinion No. 511-B at Schedule 10, page 6 (April 6, 2015).

⁷⁷ For purposes of this order, this period is referred to as the January 2009 data period. Exs. SFP-75; SFP-76. If the January 2009 ROE figures were recalculated consistent with the Commission’s ruling to remove Enterprise Products Partners, L.P. from the proxy group (Opinion No. 511, 134 FERC ¶ 61,121 at P 199), the nominal ROE would be 14.14 and real ROE would be 14.11.

⁷⁸ For purposes of this order, this period is referred to as the April 2009 data period. Ex. SFP-323. If the January 2009 ROE figures were recalculated consistent with the Commission’s ruling to remove Enterprise Products Partners, L.P. from the proxy group, the nominal ROE would be 13.94 and real ROE would be 14.68.

⁷⁹ Opinion No. 511, 134 FERC ¶ 61,121 at P 209.

⁸⁰ *Id.*

⁸¹ Because this data was not available at the time the hearing record closed in June 2009, it was not used by Opinion No. 511 to determine the DCF ROE. Rather, Opinion No. 511 used this data for comparison purposes only.

subsequent DCF ROE data developed in a separate rate case involving SFPP's East Line:⁸²

Data Period	Nominal ROE	Real ROE	Inflation prior 12 months
Six-month period ending February 2010 (September 2009 – February 2010) ⁸³	11.24	9.09	2.14
Six-month period ending March 2010 (October 2009 – March 2010) ⁸⁴	11.03	8.72	2.31

The Commission observed that elevated January 2009 and April 2009 real ROEs did not persist into 2010.

38. On April 11, 2011, SFPP requested rehearing of Opinion No. 511, arguing that the Commission erred in rejecting the most recent data in the record, the April 2009 ROE. While SFPP continued to advocate for the April 2009 nominal ROE, SFPP acknowledged that the nominal ROE for the September 2008 period was itself consistent with historical patterns.⁸⁵ SFPP objected to the relatively high September 2008 data period's inflation factor of 4.94 percent and the resulting real ROE of 7.69.⁸⁶ Whether or not the Commission used the April 2009 nominal ROE or the September 2008 nominal ROE, SFPP urged the Commission to calculate the inflation factor and the real ROE based upon an average inflation factor based on the approximately two and a half year period during which the rates in this proceeding had been in effect (August 2008 through February 2011), which is 1.11 percent.⁸⁷

⁸² *Id.* P 209, n. 339 (referring to FERC Docket No. IS09-437-000, Ex. SPE-108).

⁸³ For purposes of this order, this period is referred to as the February 2010 data period.

⁸⁴ For purposes of this order, this period is referred to as the March 2010 data period.

⁸⁵ SFPP, Request for Rehearing at 11-12 (April 11, 2011).

⁸⁶ *Id.*

⁸⁷ *Id.* at 14-15.

39. In Opinion No. 511-A, the Commission denied rehearing and continued to determine the real ROE based upon the September 2008 period nominal ROE and the September 2008 period inflation factor of 4.94 percent.⁸⁸

4. United Airlines

40. On appeal, SFPP argued that the Commission acted arbitrarily and capriciously in departing from its policy to use the most recent ROE data in the record (here, April 2009 data) and adopting the September 2008 data without providing any basis for finding that such data represents a reasonable forecast of SFPP's future cost of service.⁸⁹ In its reply brief, SFPP clarified that it did not dispute that the nominal ROE for the September 2008 period reasonably represents SFPP's cost of capital.⁹⁰ However, SFPP argued that the inflation component and thus the real ROE for the September 2008 period are not representative.⁹¹

41. The D.C. Circuit concluded that the Commission did not justify determining the ROE based upon September 2008 data. The D.C. Circuit explained that "there may be evidence to support the conclusion that the *nominal* [ROE] for September 2008 was in line with historical trends."⁹² However, the D.C. Circuit held that the Commission did not provide a reasoned explanation for adopting the *real* ROE of 7.69 from the September 2008 period (i.e., the September 2008 nominal ROE minus the September 2008 inflation of 4.94 percent).⁹³ The D.C. Circuit stated that the Commission "provides only a cursory comparison of real [ROEs] from the September 2008 through the March

⁸⁸ Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 256-259.

⁸⁹ SFPP, Brief of Petitioner, Case No. 11-1479, at 19-20, 22-25 (D.C. Cir., filed Feb. 5, 2016).

⁹⁰ SFPP, Reply Brief of Petitioner, Case No. 11-1479, at 4-5 (D.C. Cir., filed Feb. 5, 2016) (citing Exs. SFP-4 and SFP-5).

⁹¹ *Id.*

⁹² *United Airlines*, 827 F.3d at 130.

⁹³ *Id.* at 131 ("FERC engaged in arbitrary-or-capricious decision-making by adopting the September 2008 real return on equity without reasoned explanation"); *see also id.* at 130 (the Commission's "evidence does not show that the *real* return on equity for [the September 2008] time period was representative of SFPP's costs").

2010 time periods, and otherwise appears to have chosen the smallest real [ROE] from the data available.”⁹⁴

42. While remanding the use of September 2008 data back to the Commission, the D.C. Circuit also concluded that “it was reasonable for FERC to conclude that the April 2009 data was not representative of SFPP’s long-term cost of capital.”⁹⁵ The D.C. Circuit rejected SFPP’s argument that the Commission has a bright-line policy of relying on the most recent data to determine ROE, explaining that “the Commission ‘seeks to find the *most representative figures* on which to base rates.’”⁹⁶

5. Pleadings on Remand

43. SFPP argues in its comments on remand that the Commission can evaluate data on inflation and real ROE from both before and after SFPP filed its transportation rates to arrive at a representative return.⁹⁷ SFPP requests a paper hearing on the issue of “the just and reasonable real [ROE] to be provided to SFPP.”⁹⁸

44. Shippers oppose additional proceedings, arguing that the existing record provides ample information for the Commission to reach a decision.⁹⁹ Shippers continue to argue that the September 2008 nominal ROE, inflation, and real ROE should be used to calculate SFPP’s rates, given the more recent data has been found to be anomalous.¹⁰⁰

45. In supplemental post remand comments, SFPP newly proposes to determine the real ROE based upon the 12.63 percent September 2008 nominal ROE minus an inflation factor calculated using the annual 12-month inflation factors for 2007 and 2008. SFPP explains that 2007 and 2008 incorporate the full January 1, 2007 – September 30, 2008

⁹⁴ *Id.* at 130-131. The D.C. Circuit found it need not reach SFPP’s alternative argument regarding its proposed average inflation factor for determining real ROE. *Id.* at 131.

⁹⁵ *Id.* at 130.

⁹⁶ *Id.* (quoting *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017, at 61,049 (2000) (emphasis added by the D.C. Circuit)).

⁹⁷ SFPP Comments on Remand at 2, 11.

⁹⁸ *Id.* at 12.

⁹⁹ Shippers Comments on Remand at 11-12.

¹⁰⁰ *Id.* at 13-14.

test period. This would lead to an inflation factor of 2.09 percent and a real ROE of 10.54 percent.¹⁰¹

B. Discussion

46. As discussed below, the Commission will continue to determine SFPP's cost of service using the September 2008 nominal ROE of 12.63 percent. However, following *United Airlines*, the Commission will use an inflation factor of 2.39 percent, calculated using an annualized average of monthly inflation from January 2007 through April 2009. Subtracting the 2.39 percent inflation factor from the nominal ROE of 12.63 leads to a real ROE of 10.24 percent.

47. The Commission affirms the inclusion in SFPP's cost of service of the 12.63 percent nominal ROE from September 2008. The D.C. Circuit did not dispute that the 12.63 percent nominal ROE was generally consistent with historical trends, and, on remand, neither SFPP nor Shippers challenge the reasonableness of the 12.63 percent nominal ROE.¹⁰² The Commission also notes that the court affirmed the Commission's prior rejection of the only two alternative nominal ROEs in the record (January 2009 and April 2009).¹⁰³ The Commission continues to find that the 12.63 September 2008 nominal ROE figure is a representative figure on which to determine SFPP's rates.¹⁰⁴

48. However, on remand, the Commission also concludes that the September 2008 4.94 percent inflation and the resulting 7.69 real ROE¹⁰⁵ are not "representative of the conditions likely to happen while the rate is in effect."¹⁰⁶ Immediately after September

¹⁰¹ SFPP Supplemental Comments on Remand at 16-17.

¹⁰² SFPP Supplemental Comments on Remand at 14-18; Shippers Comments on Remand at 12-14; *see also* SFPP, Request for Rehearing at 11-12 (April 11, 2011). As discussed extensively in Opinion Nos. 511 and 511-A, the decision to use the September 2008 data resulted from extraordinary economic circumstances. The Commission emphasizes that its general policy remains to use the most recent nominal ROE data in the record.

¹⁰³ *United Airlines*, 827 F.3d 122 at 128.

¹⁰⁴ *See* Opinion No. 511, 134 FERC ¶ 61,121 at P 209.

¹⁰⁵ This is the nominal ROE of 12.63 minus inflation of 4.94.

¹⁰⁶ Opinion No. 511-A, 137 FERC ¶ 61,220 at P 258.

2008, inflation decreased significantly,¹⁰⁷ and, as the D.C. Circuit observed, remained between 2.14 and 2.31 percent in early 2010.¹⁰⁸ Particularly given that the September 2008 4.94 percent inflation was high by historical standards,¹⁰⁹ there is no basis to conclude that the September 2008 4.94 percent inflation represents future inflation conditions. The 4.94 percent inflation factor skews the real ROE downwards to, as the D.C. Circuit noted, “the smallest real [ROE] from the data available.”¹¹⁰ While the Commission generally uses coinciding data periods¹¹¹ for determining the inflation factor and the nominal ROE, an exception must be applied here where (a) all parties concede the reasonableness of the September 2008 nominal ROE,¹¹² and (b) the September 2008 inflation levels (and hence the real ROE) are not representative of future conditions.

49. In these highly unusual circumstances, while continuing to use the September 2008 nominal ROE, the Commission will adopt an inflation factor of 2.39 percent based upon an annualized average of the monthly inflation for January 2007 to April 2009¹¹³

¹⁰⁷ Annualized monthly inflation dropped by 9.82 percent from September to October 2008 to negative 11.47, and dropped again by 9.24 percent to negative 20.71 percent in November 2008. Ex. SFP-323 at 42.

¹⁰⁸ For comparison purposes, the DCF ROE 2010 data from SFPP’s East Line rate case in Docket No. IS09-437 that the Commission considered in Opinion No. 511 reflects inflation figures of 2.14 and 2.31 for the six-month periods ending in February and March, respectively. Opinion No. 511, 134 FERC ¶ 61,121 at P 209 n. 339 (citing Docket No. IS09-437-000, Ex. SPE-108).

¹⁰⁹ While not the highest on record, the September 2008 inflation figure is on the high end of the historical inflation data in the record for 1984 to 2007. The inflation data in the record shows that between January 1984 and January 2009 the 12-month inflation factor was equal to or higher than 4.94 percent in only approximately 20 months out of 301 months. In every month from January 1992 to May 2008 the 12-month inflation factor was lower than 4.94 percent. See Ex. SFP-84.

¹¹⁰ *United Airlines*, 827 F.3d 122 at 130-131.

¹¹¹ The data periods are not exactly the same as the ROE is generally based upon the most recent six months of data while the inflation factor is typically based upon the most recent twelve months.

¹¹² SFPP, Request for Rehearing at 11-12 (April 11, 2011); SFPP Supplemental Comments on Remand at 14-18; Shippers Comments on Remand at 12-14.

¹¹³ The Commission measured the change in the consumer price index (CPI) between January 1, 2007 (201.8) (which is the CPI for the end of December 2006) and April 30, 2009 (213.240). Exs. SFP-6 at 7; SFP-323 at 42. The Commission calculated

and the resulting 10.24 percent real ROE.¹¹⁴ Given the abnormal inflation volatility in the 2007-2009 period¹¹⁵ and the difficulty of predicting future inflation levels in those uncertain conditions, adopting an average inflation factor for the entire period, from January 1, 2007 (the start of the base period) through April 30, 2009 (the most recent data submitted prior to the hearing), will offset the outlying high and low inflationary periods and stabilize the extreme fluctuations.¹¹⁶

50. Moreover, the annualized average of the monthly inflation for January 2007 to April 2009 addresses the concerns raised by the court in *United Airlines*. The resulting 2.39 percent inflation is neither the highest nor the lowest inflation level considered by the Commission,¹¹⁷ and it reflects the entire record used at hearing to set SFPP's rates. The 2.39 percent inflation level is also generally consistent with the 2.14 and 2.31 inflation levels recorded for February and March 2010. Likewise, the resulting real ROE of 10.24 (the September 2008 nominal ROE minus the January 2007 to April 2009

the mean for the monthly changes by taking the 28th root, and then annualized it by taking this mean to the 12th power. Expressed as a formula, the average monthly inflation over the 28-month period = $\sqrt[28]{\frac{213.24}{201.8}} = 1.001971$. The annualized average monthly inflation = $1.001971^{12} = 1.0239$.

¹¹⁴ This is the nominal ROE of 12.63 minus inflation of 2.39 percent.

¹¹⁵ During this period, the highest 12-month inflation figure was 5.6 percent for July 2008, and the lowest 12-month inflation figure was negative 0.74 percent for April 2009. Ex. SFP-323 at 42. In essence, inflation increased to the upper bound of historical experience and then plummeted during the financial crisis to atypically low levels. *Id*; see also Ex. SFP-6; Ex. SFP-84. See also Opinion No. 511-A, 137 FERC ¶ 61,220 at P 256 (“All parties have recognized in this proceeding that the period of time in question was a volatile economic period.”).

¹¹⁶ As noted previously, the Commission typically determines the nominal ROE, the inflation factor, and the real ROE based upon the most recent data in the record. In this case, that would be the April 2009 data. However, this case presents unique circumstances where the most recent data encompasses a period of financial turmoil and a minimal or negative inflation rate that was unlikely to continue, and thus does not reflect SFPP's long-term cost of equity. Opinion No. 511, 134 FERC ¶ 61,121 at P 209; Opinion No. 511-A, 137 FERC ¶ 61,220 at PP 256-258; *United Airlines*, 827 F.3d 122 at 130.

¹¹⁷ The 2.39 percent inflation level is between the higher September 2008 inflation level (4.94 percent) and the lower January 2009 inflation (0.03) and April 2009 (-0.74) levels.

inflation factor) addresses the D.C. Circuit's concerns that Opinion Nos. 511 and 511-A selected the lowest real ROE in the record. Specifically, while higher than the September 2008 (7.69 percent), February 2010 (9.09 percent), and March 2010 (8.72 percent) real ROEs, the 10.24 percent real ROE is lower than the real ROEs recorded for January 2009 (14.30 percent) and April 2009 (14.83 percent).

51. The Commission declines to adopt three alternative proposals advanced by SFPP. First, the Commission rejects SFPP's proposal in its supplemental comments on remand to adopt an average inflation factor of 2.09 percent based on the average inflation for the calendar years 2007 and 2008.¹¹⁸ While SFPP justifies using this data on the basis that it coincides with the base and test period, SFPP's calculation actually includes the last three months of 2008 that (a) are not in the base and test period and (b) include anomalously low inflation levels.¹¹⁹ The Commission's proposed methodology is superior because it considers the full record available for determining SFPP's return as opposed to only 2007 and 2008 data. Moreover, while there was considerable negative monthly inflation in late 2008, the data from early 2009 moderates those swings in the inflation level.¹²⁰ As discussed above, the annualized average of the monthly inflation figures using a longer period counter-balances the impact of both the high and low outliers and results in more reasonable and representative figures on which to base SFPP's rates.¹²¹

52. Second, the Commission continues to reject SFPP's alternative proposal advanced on rehearing of Opinion No. 511 to use the inflation factor of 1.11 percent based upon the

¹¹⁸ SFPP Supplemental Comments on Remand at 16-17 (proposing an inflation factor of 2.09 percent based on the annual 12-month inflation factors for 2007 (4.08 percent) and 2008 (0.09 percent)).

¹¹⁹ On an annualized basis, October 2008 monthly inflation was negative 11.47 percent, November 2008 monthly inflation was negative 20.71 percent, and December 2008 monthly inflation was negative 11.73 percent. Ex. SFP-323 at 42.

¹²⁰ The last three months of 2008 showed abnormal deflation, such as negative 20.71 percent monthly inflation on an annualized basis for November 2008. Ex. SFP-323 at 42. By April 2009, monthly annualized inflation levels had moderated, but the 12-month inflation factors remained skewed downward by the last months of 2008. *Id.* Thus, while the Commission appropriately rejects using the negative 0.74 inflation based upon the 12-months preceding April 2009, it is not inappropriate for the Commission to include the stable monthly inflation levels for January, February, March, and April 2009. *Id.*

¹²¹ Tr. 350-351 (SFPP's expert explained that some are of the view that capturing a longer period for averaging the high and low unit prices may reduce the impact of aberrations in the most recent six months of data).

average inflation from August 2008 to February 2011.¹²² While the Commission's ROE policies permit consideration of some information beyond the last month of the test period, longstanding Commission policy generally prohibits determining a pipeline's return using data that emerges "once the record has been closed and the hearing has concluded."¹²³ As the Commission explained in Opinion No. 511-A, "the goal is to set a future, lawful rate by predicating it upon reliable information that will be representative of the conditions likely to happen while the rate is in effect, *but without being so open-ended as to time that the test year is obscured.*"¹²⁴ In this case, the February 2011 data became available well after the June 2009 close of the record. Continually updating the record for new ROE and inflation data could encourage perpetual litigation, and the return data should not become too attenuated from the test period used to calculate other elements in SFPP's cost of service.¹²⁵ While market returns may change more rapidly (thus justifying the Commission's consideration of more recent ROE data), other cost-of-service elements can also shift. The solution to these changes is for the pipeline to file a new rate case,¹²⁶ not to continually reinsert new data into a closed record. Accordingly, the Commission rejects incorporating return data through February 2011, which is far removed from the 2007 and 2008 data used to determine all other elements of SFPP's cost-of-service rates and the June 2009 close of the record.

¹²² SFPP, Request for Rehearing at 10, 14-15 (April 11, 2011).

¹²³ Opinion No. 511, 134 FERC ¶ 61,121 at P 208. While the Commission considered February and March 2010 data from another SFPP rate case, this was for comparison purposes only.

¹²⁴ Opinion No. 511-A, 137 FERC ¶ 61,220 at P 258 (emphasis added) (citing *Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 56-57 (D.C. Cir. 1999), *Indiana & Michigan Mun. Distrib. Ass'n v. FERC*, 659 F.2d 1193, 1197-98 (D.C. Cir. 1981)).

¹²⁵ Opinion No. 511-A, 137 FERC ¶ 61,220 at P 258. SFPP's own ROE expert, Dr. Williamson also stated "the longer the Commission waits beyond the present time to do the DCF, the greater the likelihood that it will be inconsistent with . . . other parts of the cost of service conclusion." Tr. 353; *see also id.* at 352, 355. Dr. Williamson further stated that using 2010 data to determine the rate of return would be "quite inconsistent with other parts of the cost of service." Tr. 353. Dr. Williamson's statements apply with even more force to the later 2011 data SFPP seeks to use.

¹²⁶ We emphasize that neither SFPP nor shippers are without a remedy to the extent return levels and other costs have changed since 2009. SFPP may refile its cost-of-service rates at any time, using the most recent data available, and shippers can file a complaint at any time.

53. Third, for the same reasons, the Commission rejects SFPP's proposal on remand to re-open the record. At some point, this proceeding must reach finality, and there is no need to consider any data that became available nearly a decade after the close of the record. To the extent market returns have changed since 2009, SFPP may file a new cost-of-service rate change.

IV. Compliance Filing

A. Background

54. On April 6, 2015, SFPP submitted its compliance filing to Opinion No. 511-B calculating refunds for the August 1, 2008 - May 10, 2015 period and going forward rates. The calculation of refunds owed to shippers and going forward rates both involve (a) the final cost-of-service rate for SFPP's West Line established by this proceeding to be effective August 1, 2008, and (b) the subsequent indexing changes affecting SFPP's West Line rates.

55. On April 20, 2015, Joint Shippers¹²⁷ filed comments, and, on April 21, 2015, Tesoro Refining & Marketing Company LLC (Tesoro) filed late comments.¹²⁸ Joint Shippers and Tesoro object to the index increases that SFPP applied to calculate refunds and going forward rates. While SFPP's compliance filing includes an index increase of 5.98 percent effective July 1, 2011, Joint Shippers and Tesoro emphasize that the Commission previously rejected SFPP's proposed July 1, 2011 index rate increase in Docket No. IS11-444.¹²⁹ Thus, they assert that SFPP should not be allowed to apply this index increase effective July 1, 2011, to calculate refunds. They also object that SFPP's compliance filing included a 5.52 percent increase effective July 1, 2012, as opposed to the 5.40 percent increase previously filed by SFPP.¹³⁰ Likewise, they oppose the compliance filing's inclusion of an 8.50 percent index filing to be effective on July 1, 2013, which exceeds the 7.77 percent index increase previously filed by SFPP. Tesoro also seeks to challenge index increases that were previously accepted by the Commission for 2012, 2013, and 2014, and Tesoro asserts that the Commission should consider these

¹²⁷ BP West Coast Products LLC, Chevron Products Company, United Airlines, Inc., Delta Air Lines, Inc., ExxonMobil Oil Corporation, Southwest Airlines Co., US Airways, Inc., and Valero Marketing and Supply Company.

¹²⁸ We grant Tesoro's unopposed request to file late comments because it will not disrupt the proceeding.

¹²⁹ Joint Shippers Protest at 7 (citing *SFPP, L.P.*, Opinion No. 527, 143 FERC ¶ 61,213, *as modified by* 144 FERC ¶ 61,002 (2013)).

¹³⁰ The 5.40 percent increase became effective August 5, 2012. SFPP had withdrawn the prior index increase it had proposed to make effective July 1, 2012.

index increases in light of (i) ongoing litigation against those rates in separate complaint proceedings and (ii) West Line specific cost changes during those years.

56. On May 5, 2015, SFPP filed reply comments defending the refund calculations in its compliance filing. SFPP states that its filing is consistent with Opinion No. 522-A, which allowed SFPP in its East Line rate case (Docket No. IS09-437) to apply index increases that exceeded the index increases SFPP had previously filed.¹³¹ SFPP also states that its compliance filing is consistent with the precedent established in a prior SFPP complaint proceeding in Docket No. OR92-8, *et al.*

B. Discussion

57. The Commission directs SFPP to recalculate its refunds and going forward rates to remove index increases that (a) were not previously filed by SFPP or (b) were previously rejected by the Commission. In Opinion No. 522-B,¹³² which reverses Opinion No. 522-A, the Commission explains why it will not permit a pipeline to calculate refunds following a cost-of-service rate case using different index increases than those previously filed by the pipeline and accepted by the Commission. Opinion No. 522-B also addresses SFPP's reliance upon the Docket No. OR92-8 proceedings, explaining that, among other things, neither the Commission nor the appellate court in that proceeding "directly rule[d] upon a challenge to the permissibility of retroactive indexing increases that had not previously been sought by the pipeline."¹³³ Likewise, contrary to Tesoro's arguments, as the Commission explains in Opinion No. 522-B, a compliance filing is not an appropriate forum for re-litigating index filings previously accepted by the Commission.

58. Accordingly, SFPP must make a further compliance filing within 60 days that calculates refunds and going forward rates based upon the timing and the level of the index increases actually filed by SFPP and accepted by the Commission consistent with section 342.3 of the Commission's regulations.¹³⁴ In addition, the compliance filing must

¹³¹ SFPP Reply Comments at 4 (citing *SFPP, L.P.*, Opinion No. 522-A, 150 FERC ¶ 61,097, at PP 69-70 (2015)).

¹³² *SFPP, L.P.*, Opinion No. 522-B, 162 FERC ¶ 61,229 (2018).

¹³³ *Id.* P 21.

¹³⁴ 18 C.F.R. § 342.3 (2017). The Commission recognizes that there is ongoing rate litigation in Docket No. IS11-444 regarding SFPP's 2011 West Line indexed rate increase. Concurrently with the issuance of this order, the Commission has granted rehearing of Order No. 527 in Docket No. IS11-444 and has sent it back to hearing. *SFPP, L.P.*, Opinion No. 527-A, 162 FERC ¶ 61,230 (2018). Consistent with that decision, SFPP's calculation of refunds in this 2008 West Line rate proceeding may include the full index increase. The Commission will address subsequent issues related to the 2011 West Line Index increase, including any changes to the refunds owed by

implement the Commission's rulings discussed above in Sections II and III that deny SFPP an income tax allowance in its cost of service and determine a real ROE of 10.24 percent based on an inflationary component of 2.39 percent.

The Commission orders:

(A) SFPP's compliance filing is accepted subject to the conditions described herein.

(B) SFPP shall file revised West Line rates and refunds consistent with this order within 60 days after this order issues, including supporting workpapers, explanatory statements, and any other necessary documentation.

(C) Comments on the compliance filing directed in Ordering Paragraph (B) are due 75 days after this order issues and reply comments are due 90 days after the date this order issues.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

SFPP, in that proceeding. Likewise, the Commission will address any issues involving ongoing complaints against SFPP's rates in those complaint proceedings. *See* Docket Nos. OR11-13, OR11-16, OR11-18, OR14-35 and OR14-36.