KIRKLAND & ELLIS
Energy Blog

# FERC Issues Order Revising Downward the Five-Year Oil and Liquids Pipeline Rate Index, Estimated to Save Customers $3.7 Billion Through 2026

27 January 2022

On January 20, 2022, the Federal Energy Regulatory Commission ("FERC" or the "Commission") issued an order on rehearing revising downward the index level used in determining interstate oil and liquids pipeline (collectively, "oil pipelines") rate ceilings ("Order on Rehearing"). As a result of this order, oil pipelines that have adjusted their transportation rates on an indexed basis since July 2021 will be required to decrease those rates, effective March 1, 2022, to the new, lower index ceiling, and indexed rate increases through June 2026 will be smaller than they would have been under the prior order.

The Order on Rehearing granted in part and denied in part requests for rehearing of the Commission's December 17, 2020 Order Establishing Index Level ("December 2020 Order"). The December 2020 Order concluded the Commission's five-year review to establish the oil pipeline index level for the July 1, 2021 to June 30, 2026 time period. The Order on Rehearing revised the index level established in the December 2020 Order, from an index level of Producer Price Index for Finished Goods plus 0.78% ("PPI-FG+0.78%") to an index level of Producer Price Index for Finished Goods minus 0.21% ("PPI-FG-0.21%").

In so doing, the Commission incorporated the effects of its 2018 Revised Policy Statement on Treatment of Income Taxes on Master Limited Partnership ("MLP") pipelines ("Income Tax Policy Change") in its calculation of the index.

FERC Chairman Glick estimated that the ruling would save customers $3.7 billion

through 2026.

This post discusses the specific changes FERC adopted in its Order on Rehearing and the implications for oil pipelines and investors.

## Background

Pursuant to the Interstate Commerce Act ("ICA"), FERC regulates interstate oil pipeline rates to ensure they are "just and reasonable." In furtherance of this objective, and in response to the Energy Policy Act of 1992's directive to establish a simplified and generally applicable ratemaking methodology, FERC adopted an indexed ratemaking methodology in Order No. 561.

As its index, FERC uses the change in the Producer Price Index for Finished Goods ("PPI-FG") established by the U.S. Department of Labor as a baseline measure for inflation, and then adjusts as appropriate to reflect the actual cost changes experienced by the oil pipeline industry. FERC reviews this benchmark index every five years to ensure it adequately reflects changes to industry costs.

Using this benchmark, FERC publishes an inflation index each year that oil pipelines use to establish ceiling level rates for the following year. Oil pipelines calculate adjustments to their rate ceiling levels by multiplying the previous index year's ceiling level by the most recent index published by FERC. Oil pipelines may adjust their existing transportation rates to the new ceiling level without the need to justify the rates in a cost-of-service filing. The majority of oil pipelines subject to FERC's jurisdiction under the ICA use this index to demonstrate that their rates are just and reasonable.

## Order on Rehearing

As part of its five-year review of the oil pipeline index level, FERC issued the December 2020 Order and adopted an index level of PPI-FG+0.78% for the July 1, 2021 to June 30, 2026 time period. However, on January 19, 2021, certain shipper and pipeline industry participants filed requests for rehearing on the Commission's December 2020 Order.

In response, on January 20, 2022, FERC issued its Order on Rehearing revising the

oil pipeline index level as described above.

As explained below, the Commission identified three reasons for revising the December 2020 index level. First, it reviewed a narrower data set to calculate the index level, reviewing the middle 50% of oil pipelines to determine cost changes in the industry instead of the middle 80%. Second, the Commission incorporated the effects of its Income Tax Policy Change for MLP pipelines in its calculation of the index. Third, the Commission relied on updated page 700 data to correct its index calculation.[1]

### 1. Using the Middle 50% Instead of the Middle 80% to Calculate the Index

In their requests for rehearing, shippers argued that FERC erred in its December 2020 Order by departing from its prior practice of using the middle 50% of cost changes as a data set to calculate the index level. During its five-year review of the oil pipeline index level, the Commission performs certain calculations based upon oil pipeline data collected over the prior five-year period from Form No. 6, page 700 to determine an appropriate adjustment to the PPI-FG. In reviewing this data, FERC assesses each pipeline's cost change on a per-barrel mile basis. To remove statistical outliers, FERC has previously trimmed the data set to only include those oil pipelines in the middle 50% of cost changes. However, in its December 2020 Order, FERC had expanded the data set to include the middle 80% on the basis that using a broader data set would lead to a more accurate calculation of industry-wide cost changes.

In its Order on Rehearing, FERC agreed with shippers and concluded that it should have calculated the oil pipeline index level during its five-year review based upon a data set consisting of the middle 50%, and that it had not provided adequate justification for straying from its established practice.

### 2. Incorporating the Income Tax Policy Change into the Index Calculation

In 2018, FERC implemented the Income Tax Policy Change in response to a decision by the U.S. Court of Appeals for the District of Columbia Circuit in *United Airlines, Inc., et al. v. Federal Energy Regulatory Commission*, 827 F.3d 122 (D.C. Cir. 2016). In that decision, the D.C. Circuit found that allowing MLP pipelines to recover both an income tax allowance and a return on equity ("ROE") determined pursuant to FERC's discounted cash flow methodology was an impermissible double recovery of tax costs. The Income Tax Policy Change addressed the issue of potential double counting by no longer permitting oil pipelines owned by MLPs to recover an income

tax allowance in their cost of service.

At the time, the Commission noted it would defer action regarding rates of oil pipelines and instead incorporate the effects of the Income Tax Policy Change in the 2020 five-year review of the oil pipeline index level. However, in a reversal, in the December 2020 Order, FERC declined to incorporate the effects of the Income Tax Policy Change when calculating the index level. The Commission reasoned that the index was not meant to act as a remedy to true-up over- or under-recoveries resulting from cost-of-service policy changes, and that it was also unclear that the double recovery of MLP pipelines' income tax costs was ever incorporated into the index.

Shippers, in their requests for rehearing, argued that the Commission should have incorporated the effects of the Income Tax Policy Change in the December 2020 Order calculating the index level. The Commission agreed, noting that both it and the D.C. Circuit concluded that the ability of MLP pipelines' rates to recover investor-level tax costs twice — once in an income tax allowance and again in an ROE — led to impermissible double recovery and produced unjust and unreasonable rates. FERC found that, by not incorporating the effects of the Income Tax Policy Change, the December 2020 Order allowed oil pipeline rates to continue to reflect this impermissible double recovery. Thus, the Commission concluded in the Order on Rehearing that the index must reflect the Income Tax Policy Change.

### 3. Using Updated Page 700 Data for Index Calculations

In their requests for rehearing, pipeline industry participants argued that the December 2020 Order erred in using outdated page 700 data. As part of its five-year review of the oil pipeline index, FERC analyzes data listed on page 700 of FERC Form No. 6 over the prior five-year period (in this case, 2014-2019). Page 700 includes columns for reporting both current-year and previous-year cost-of-service data. The more recently filed page 700 often updates the previous year's data. In calculating the index for the December 2020 Order, FERC relied on the page 700 data originally reported for the year 2014 rather than using the updated 2014 data that was reported in the next year's filing. The Commission agreed that it had erred in using outdated data when analyzing page 700 data for the year 2014, and concluded that it is the Commission's policy to use updated data provided by a pipeline in its page 700 filing in calculating the index level.

## Concurrences and Dissents

Commissioner Danly concurred in part and dissented in part with the Order on Rehearing. First, he dissented from the Commission's decision to trim the data used to calculate the oil pipeline index to the middle 50% because he agreed with the December 2020 Order's conclusion that the broader sample set of the middle 80% would enhance the Commission's understanding of the industry cost experience. Second, Commissioner Danly dissented from the Commission's decision to incorporate the effects of the Income Tax Policy Change because he does not believe incorporation is necessary to ensure just and reasonable rates. Third, Commissioner Danly concurred with the Commission's decision to grant rehearing to use updated page 700 cost data for 2014 in calculating the index.

Commissioner Christie also concurred in part and dissented in part, noting that he concurred with most of the Order on Rehearing, but dissented on the portion that reversed the December 2020 Order in declining to incorporate the effects of the Income Tax Policy Change in the index calculation. Commissioner Christie also argued that the Commission that issued the December 2020 Order weighed the evidence on the record to reach its decision, and the principle of regulatory certainty should compel FERC to leave that "one-off" decision on a tax issue alone.

## What's Next, and What Are the Implications for Oil Pipelines, Shippers and Investors?

Oil pipelines that use the indexing methodology to demonstrate their rates are just and reasonable must now re-compute their ceiling levels and rates to be effective March 1, 2022. Oil pipelines must revise their ceiling levels for July 1, 2021–June 30, 2022 to instead reflect an index level of PPI-FG-0.21%.

Oil pipelines with filed rates that exceed their recomputed ceiling levels must file with the Commission to reduce that rate, effective March 1, 2022. Oil pipelines unable to submit such filings 30 days in advance of the March 1, 2022 effective date may seek a waiver of the 30-day notice requirement.

Oil pipeline owners said the decision ignores that costs for maintenance and safety operations are rising faster than inflation, and that the lower index puts some pipelines at risk of curtailing services in newly uneconomic locations.

Midstream investors likely remember March 2018 when FERC announced its Income Tax Policy Change for MLP pipelines that caused concern in the midstream space. FERC noted at that time that it would defer action regarding rates of oil pipelines and instead incorporate the effects of the Income Tax Policy Change in the 2020 five-year review of the oil pipeline index level. That shoe has now dropped.

It has been reported that oil pipelines might still be able to increase their rates despite the lower ceiling, given that inflation has climbed so high and the PPI-FG is at its highest level since FERC adopted the indexing method in 1993.

If an oil pipeline ultimately determines that the new index level is not providing a reasonable return, it could file for cost-of-service rates with the FERC to seek a higher rate. In addition, some oil pipelines have market-based or negotiated rates that would not be directly impacted.

**Associate Alexandra Calabro also assisted in the drafting of this post.*

---

1. Oil pipelines regulated by FERC must file a FERC Form No. 6 each year, which is an annual report designed to collect financial and operational information from oil pipeline companies. Page 700 of Form No. 6 requires regulated oil pipelines to provide information related to their annual cost of service.↩

---

- Read all insights from the Energy & Infrastructure Blog.
- Read more Energy Regulatory and Oil & Gas insights.
- Subscribe to receive future updates.

## Authors


### Brooksany Barrowes

Partner / Washington, D.C.

### Robert S. Fleishman

Partner / Washington, D.C.


## Related Services

## Practices

- Energy & Infrastructure
- Energy Regulatory
- Transactional

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.

This publication may cite to published materials from third parties that have already been placed on the public record. The citation to such previously published material, including by use of “hyperlinks,” is not, in any way, an endorsement or adoption of these third-party statements by Kirkland & Ellis LLP.
© 2022 Kirkland & Ellis LLP.