

Initial views on FERC tax cut ruling on March 15, 2018

The Federal Energy Regulatory Commission (the “FERC”) announced Thursday that regulated natural gas and liquids pipelines in an MLP structure would no longer be able to recover an income tax allowance in their cost of service rates; and that allowing MLPs to do so would amount to a “double recovery.” The FERC also initiated a process for natural gas pipelines to provide financial information on the implications of tax reform on pipeline rates. For now, this affects natural gas pipelines all liquids rates will be reviewed in 2020—and go into effect into 2021.

The immediate market reaction was swift to the downside. The Alerian MLP Index (“Index”) declined more than 10% on an intraday basis and energy infrastructure C-corps declined as well.

In general, we believe the impact on company cash flows will be modest, for two primary reasons:

- At present, this only applies to FERC-regulated natural gas pipelines (not every midstream asset).
- Many companies operate their pipelines under a negotiated-rate framework, which falls outside of FERC-mandated returns or regulations.

Importantly, a number of companies have released statements indicating the decision will have little impact on their underlying results. We therefore believe that overall this is an overreaction to the downside, especially for C-corps, upstream sponsored MLPs that predominantly have non-FERC-regulated gathering and processing, LNG or crude export facilities, and NGL fractionation.

In general, this should only impact those that have cost of service rate agreements with their customers on FERC-regulated long-haul lines. Most lines today operate under negotiated rate agreements, so again, we believe that the overall impact should be limited.

Despite the outsized price movement within energy infrastructure on Thursday, we are encouraged by the rebound in the latter half of the day, which continued on Friday (when the Index was up nearly 2%). We maintain our view that the fundamental picture for the North American energy infrastructure sector continues to be strong and that market sentiment has the potential to catch up with a strong fundamental backdrop.

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Definitions

The Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships ("MLPs") calculated by Standard & Poor's using a float-adjusted market-capitalization methodology. The index is disseminated by the New York Stock Exchange real-time on a price return basis (NYSE: AMZ) and on a total-return basis.