Comments on FERC Rate Policy Changes

MARCH 15, 2018

On March 15, 2018, the Federal Energy Regulatory Commission (FERC):

- Announced that MLPs will no longer be allowed to recover an income tax allowance in their cost of service contracts on interstate pipelines, and
- Formalized a process for C-Corp pipeline operators to address the impact of a lower corporate tax rate on their interstate pipeline cost of service tariffs due to the C-Corp tax rate being cut from 35% to 21% by the Tax Cuts and Jobs Act of 2017.

The Alerian MLP Index promptly traded lower and closed down 4.6% on the day.

Today's FERC response affects a subset of midstream assets:

1. Interstate gas and oil pipelines, with
2. Cost of service rates.

We estimate minimal portfolio cash flow impact assuming the full elimination of the tax allowance based on the most recent FERC filings.

Background

FERC responded with today's MLP related action to the recent U.S. Court of Appeals ruling on the United Airlines, Inc. v. FERC case with a Notice of Proposed Rulemaking (NOPR). In the case, the court found the FERC failed to demonstrate there was no double recovery of income tax costs given MLPs are not subject to taxes at the LP level. Historically, MLPs were allowed to collect the tax allowance as unitholders are still subject to income taxes.

Natural Gas Pipelines

The industry uses cost of service, negotiated, and market (discounted) rate types. Many contracts are negotiated between operator and customer and are outside of the FERC's purview as decided in the U.S. Supreme Court's decision in the 1956 Sierra-Mobile case. The change in the corporate tax rate to 21% for C-Corps and 0% for MLPs will only impact cost of service contracts. With the NOPR, both C-Corps and MLPs with cost of service rates will be required to file their estimated return on equity (ROE) reflecting the lower tax rate for C-Corps and the removal of tax allowances for MLPs.

Pipeline operators have 4 options:

- Initiate a limited Section 4 review and reduce their respective tariffs by the change in taxes immediately.
- File an uncontested rate settlement or negotiated rate agreement.

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- File an explanation with the FERC for why no change in rate is required.
- Do nothing and wait for the FERC to initiate a Section 5 review if over earning. Typically the FERC has chosen to section 5 the top 3-5 over earning pipelines each year.

The FERC is also requesting comments on how to address deferred tax assets and liabilities, which are included in a pipeline's rate base and could potentially further impact (positively or negatively) the rate changes from the new corporate tax rate or elimination thereof. Additionally, any reduction in deferred asset obligations could require a retroactive payback of excess tax allowances collected, though the FERC has yet to issue guidance on how this process would work.

Crude Oil (Liquids Pipelines)

Cost of service rates are one of four contract types used by liquids pipelines. Most interstate liquids pipelines operate under market based, negotiated rates, or use an indexed rate methodology whereby indexed rates change annually based on PPI + a spread. FERC reviews the Index formula every 5 years and adjusts the spread calculation by considering the change in industry costs over that time period. The reduction in corporate tax rates for C-Corps and the elimination of tax allowances at MLPs will likely reduce average industry costs and potentially lower the PPI + index. The next revision is scheduled for 2020 and any change would not apply until 2021. The FERC has requested comments for a future NOPR that will address the index calculation methodology. We do not anticipate a near term cash flow impact to operators of liquids pipelines.

Public Commentary by Midstream Entities

Below we highlight public commentary by several midstream entities addressing the expected impact of the revised FERC policy statement to disallow income tax allowance cost recovery by MLPs. The comments broadly imply that most of the entities below expect no material impact from the proposed policy.

Andeavor (ANDX/ANDZ)

- Andeavor Logistics (ANDX) operates some FERC regulated pipelines but anticipates that the ruling may only have a possible annual negative impact to Andeavor Logistics' net earnings and EBITDA of less than $10 million, which reflects the entire potential impact of changes in FERC corporate tax allowance.
- Andeavor (ANDV) is a party to the cases involving SFPP, L.P. and anticipates receiving refunds that will have a positive impact upon future cash flows, which the company is in the process of estimating.

Buckeye Partners (BPL)

- Buckeye Partners does not expect material impact from recent FERC income tax allowance ruling.
- A significant portion of Buckeye's rates on file with FERC have not been set on a cost-of-service basis and therefore are not impacted by yesterday's order.
- For Buckeye's rates established by application of FERC's indexation methodology, wherein the underlying base rates could be required to be justified by a cost of service if challenged, Buckeye believes any potential impact would not be material to Buckeye's aggregate financial results.

DCP Midstream (DCP)

- No significant impacts to the company's financials are expected.
- Our analysis shows that these FERC policy revisions will have de minimis impact to DCP Midstream's financial performance, as the majority of our revenues and earnings are derived from assets not regulated by FERC.
- Where our assets are subject to FERC's jurisdiction, we expect no significant financial impacts, as our negotiated and incentive rates are below the cost of service rates established by FERC.

Enbridge Inc./Enbridge Energy Partners (ENB/EEP)

- Enbridge Inc. does not expect a material consolidated financial impact as a result of FERC Revised Policy Statements.
- Enbridge Energy Partners derives a portion of its revenue from a Facility Surcharge Mechanism that applies cost of service tariffs which would be impacted by this policy change. As a result of lower tax rates under US Tax Reform, EEP previously guided to a decrease in distributable cash flow (DCF) of $55 million for 2018. This new FERC policy would cause a further decrease to DCF of roughly $80 million on an annual basis, or roughly $60 million on a prorated basis in 2018.
- The combined impact at both EEP and ENF are offsetting for Enbridge on a consolidated basis.

Enterprise Products Partners (EPD)

- Revisions are not expected to have a material impact to the earnings and cash flow of Enterprise.
- The cost-based tariff rates that are in effect for all of our interstate pipelines are based on a cost of service for those pipelines whereby the disallowance for the recovery of an income tax allowance will not have a material effect, if any, to the posted tariffs.

EnLink Midstream (ENLK/ENLC)

- EnLink will be virtually unaffected by the FERC policy shift. The vast majority of our pipelines operate under negotiated rates, and thus there is no direct tax amount calculated in our cost of service.
- We do have a few small pipelines with FERC regulated rates in our portfolio, but they represent an insignificant piece of our business.

Energy Transfer (ETP)

- These revisions are not expected to have a material impact to ETP's earnings and cash flow.
- Many of ETP's rates are set pursuant to negotiated rate arrangements or rate settlements that it believes would not be subject to adjustment, or would be limited in terms of adjustments.
- Many of its current transportation services are provided at discounted rates that are below maximum tariff rates, many of which it believes would not be impacted by a change in the maximum tariff rate.

Genesis Energy (GEL)

- Less than 5% of GEL's total segment margin was derived from assets and operations subject to regulation and/or oversight of the FERC.
- Less than 1% of its total segment margin was derived from assets which rates are derived from or determined in accordance with FERC cost of service ratemaking methodologies.

Kinder Morgan (KMI)

- Kinder Morgan notes that the rule issued by the FERC is a proposed rule and that it is neither final nor immediate and will be subject to a public comment process.
- Kinder Morgan plans to provide comments during the FERC process, both as an individual company and through its trade associations.
- KMI is pleased by FERC's inclusion of an option for companies to file a statement with the FERC explaining why an adjustment to rates to reflect the Tax Act impact is not necessary.
- The competitive environment in which interstate natural gas transmission companies operate is vastly different from a historic "franchised utility service territory" that is still prevalent for traditional utilities. Many of our rates are set pursuant to negotiated rate arrangements that we believe should not be subject to adjustment due to changes in tax law.
- Many of our current transactions are provided at discounted rates that are below maximum tariff rates.
- Many of our pipelines operate under rate settlements that limit changes to their terms during the life of the settlement.
- Any action by FERC should not affect negotiated rate contracts and will not significantly impact assets that are currently cash taxpayers.
- The timing and impact of any future rate adjustments are not expected to be material to KMI's distributable cash flow.
- KMI has been organized as a C-Corporation since 2014.

Magellan Midstream (MMP)

- Magellan does not expect a material impact from today's revised policy statement by the FERC to disallow income tax allowance cost recovery by MLPs.
- MMP does not have cost-of-service rates that would be directly impacted by this policy change.
- The rates on ~40% of the shipments on Magellan's refined products pipeline system are regulated by FERC primarily through index methodology.
- As an alternative to cost-of-service or index-based rates, interstate pipeline companies may establish rates by obtaining authority to charge market-based rates in competitive markets or by negotiation with unaffiliated shippers.
- Approximately 60% of Magellan's refined products pipeline systems are either subject to state regulation or approved for market-based rates by the FERC.

MPLX LP (MPLX)

- The partnership expects the FERC revisions to have a de minimis effect on its earnings and cash flow.

Plains All American (PAA/PAGP)

- We do not believe this change will have any near-term impact on Plains.
- This change does not impact intra-state or Canadian tariffs.
- Plains has no FERC cost of service tariff rates.
- It is too early to assess the impact this change may have on the calculation of the FERC's allowable index increases, which are reviewed every five years. The next review in 2020 would apply in mid-year of 2021.

SemGroup Corporation (SEMG)

- SemGroup does not expect any impact from today's revised policy statement by the FERC to disallow income tax allowance cost recovery in rates charged by pipeline companies organized as master limited partnerships.
- SemGroup is structured as a C-Corp and does not have any pipelines subject to FERC jurisdiction other than its interest in one joint venture oil pipeline (White Cliffs) that utilized negotiated rate tariffs and is not impacted by the revised policy statement.

Spectra Energy Partners LP (SEP)

- Spectra Energy Partners does not expect any material impact to its financial guidance from the FERC policy actions.
- SEP anticipates no immediate impact to its current gas pipeline cost of service rates as a result of the revised policy, and therefore, no impact is expected to its previously provided 2018 financial guidance.
- Any future impacts would only take effect upon the execution and settlement of a rate case. In the event of a rate case, all cost of service framework components would be taken into consideration, which is expected to offset a significant portion of any impacts related to the new FERC policy. Any unmitigated impacts are not anticipated to materially change SEP's distributable cash flow outlook beyond 2018.
- The liquids assets within SEP are predominantly negotiated tariffs and also not materially affected by the policy revisions.

Summit Midstream Partners (SMLP)

- Summit Midstream Partners confirms that it does not currently provide services pursuant to FERC jurisdictional cost of service-based rates, and as such, SMLP does not expect to be adversely impacted by yesterday's announcement from the FERC.

Tallgrass Energy Partners (TEP/TEGP)

- Tallgrass does not expect policy revisions governing recovery of income taxes released today from the FERC to have a material impact on the company's revenues.
- While we are in the process of reviewing the FERC orders, it's important to note that the bulk of TEP's revenues come from REX and Pony Express. Both REX and Pony Express have negotiated rate contracts, and we expect the ruling would have little to no impact on these revenues.
- While TIGT and Trailblazer both have some recourse rate contracts, we expect the impact to be immaterial to Tallgrass given the relative size of those businesses.

Williams (WMB/WPZ)

- The ruling is not expected to impact previous guidance for WMB and WPZ cash dividends and distributions and related growth rates.
- It is unclear at this point if the corporate ownership of Williams Partners can be considered in the latest FERC order on tax recovery.
- Williams and Williams Partners will continue to evaluate their organizational structure in light of FERC announcements.
- About 34% of WPZ's gross margin came from regulated pipelines in 2017.
- Negotiated rates will make up about 50% of Transco's revenue by year-end and would not be impacted by this ruling.
- Northwest Pipeline settled its rate case with shippers in 2017, with new rates becoming effective in 2018.
- Gulfstream Natural Gas System's rates with its customers, which are all negotiated rates, would not be impacted by this ruling.