Chickasaw Capital Management

Weekly Midstream & Market Pulse

JUNE 28, 2020

There have been some noteworthy regulatory updates since our last newsletter. We believe the three discussed below are positive and could potentially help sentiment continue to improve – both near and long term.

The Supreme Court Steps In

On June 15th, the U.S. Supreme Court decided 7-2 in favor of the owners of the Atlantic Coast Pipeline (ACP), led by Dominion Energy Inc (D, $79.68) and Duke Energy Corp (DUK, $78.93), who successfully argued a lower court's decision that the U.S. Forest Service did not have the authority to grant a special use permit for ACP to construct an underground segment to cross the Appalachian National Scenic Trail in Virginia was unconstitutional[1].

In recent years, energy infrastructure owners have increasingly dealt with activists who have used the court system to cause significant delays and increased costs for projects under construction. Some of the cases have had merit or have at least added additional protections for a wide range of constituents and stakeholders; however, the majority of these have been a delay tactic by organizations seeking the end of the fossil fuel industry. This case was the first recent one to make it all the way to the Supreme Court and decisively upheld the permitting authority of the U.S. Forest Service in this context.

We have highlighted that increased regulatory scrutiny is a risk for this sector and we do not expect it to decrease just because of this ruling. But we do expect that, as companies budget both time and dollars to account for this risk, there is strong legal support at the highest level to uphold previously issued permits. Current litigation related to previously issued permits for the Dakota Access Pipeline developed by Energy Transfer LP (ET, $7.06) and for the Keystone XL Pipeline currently being developed by TC Energy Corp (TRP, $41.78) may provide additional data points should the Supreme Court hear appeals of lower court holdings in those cases. Lastly, it's important to reinforce our viewpoint of the increased value of "pipe in the ground". We've seen an increased reluctance by companies to advance projects in this environment, particularly much needed natural gas pipeline projects which would help lower energy costs for areas of the Northeast, as well as significantly reduce producer flaring and achieve CO_2 reduction targets by replacing coal and fuel oil energy sources. As these assets' contracts renew, which our databases are able to track, it increases the odds of favorable outcomes.

(1) Wall Street Journal, "Supreme Court Removes Hurdle for $8 Billion Atlantic Coast Pipeline", 6/15/2020.

INVESTMENT TEAM

Geoffrey P. Mavar – Principal
Matthew G. Mead – Principal
Robert M.T. Walker – Principal
Bryan F. Bulawa – Principal

Paul R. Jacob – Vice President

Scott B. Warren, CFA – Senior Analyst
Luke B. Davis, CFA – Senior Analyst
Rahil Jiwan – Senior Analyst
Walter P. Frank – Associate Analyst

Refined Products Pipelines Indexation Renewal

At its scheduled meeting on June 18th, the Federal Energy Regulatory Commission (FERC) issued a notice of inquiry (NOI) for the 5-year renewal of the indexation methodology for refined products pipelines (gasoline, diesel, jet fuel, and other distillates). This period of inquiry gives industry participants time to present data encompassing the previous 5 years volumetric and rate data to assist FERC in setting the index rate for non-market-based pipelines (where there is little or no competition) for the following 5 years. The meeting, the NOI, and discussion between FERC and owners all met market expectations and we expect a neutral outcome when the 5-year rate is set later this summer.

We would note this indexation methodology applies only to pipelines with little to no competition. In markets that are deemed to be competitive, the FERC indexation methodology may play a role in discussions, but the final rate is agreed to by both parties and has typically been higher. As an example, Magellan Midstream Partners LP (MMP, $41.15) estimates that 60% of its pipelines are subject to market rate making contracts.

FERC Asserts Its Jurisdictional Authority

On June 22nd, the FERC issued an order concluding that the Commission and the United States Bankruptcy court have concurrent jurisdiction to review and address disposition of natural gas transportation agreements ("FERC-jurisdictional agreements") sought to be rejected in bankruptcy due to FERC's authority under the Natural Gas Act (NGA). According to Vinson & Elkins, "This order is significant in that it affirmatively states the Commission's position that FERC has the right to approve or deny the modification or abrogation of the filed rate that occurs when a party rejects a FERC-jurisdictional agreement in bankruptcy."[2]

In practical terms, FERC is not saying they supersede or are subservient to bankruptcy courts when a shipper files to reject an interstate natural gas contract. Because they set the rate and understand best the components factored into the rate setting, they are asserting they need to be included in the discussion to protect against unforeseen outcomes some of which we surmise as return on equity (ROE) calculations, increased costs to other shippers, and volumetric flow and pressure concerns.

If this order stands, our presumption is that it provides an additional hurdle to shippers wishing to reject interstate natural gas transportation agreements in bankruptcy, which should provide additional protection to owners of those assets.

Capital Markets Update

The debt capital markets continue to improve and we saw two non-investment grade issuances price the past two weeks, the first two for this rating category since January 2020.

- On June 16th, EQM Midstream Partners LP (ETRN, $8.58)[3] placed $700 million of 5-year bonds and $900 million of 7-year bonds at coupons of 6.0% and 6.5%, respectively. The combined $1.6 billion represented an aggregate upsizing of $800 million from the initial launch.
- On June 17th, DCP Midstream LP (DCP, $11.35) placed $500 million of 7-year bonds at a 5.625% coupon. This offering was upsized $100 million from the initial launch.

Geoffrey Mavar   Matt Mead   Robert Walker   Bryan Bulawa

(2) Vinson & Elkins, "FERC Rules It has Concurrent Jurisdiction Over the Rejection of FERC-Regulated Midstream Gas Contracts", 6/22/20. (3) On June 17th, Equitrans Midstream Corp (ETRN) completed its acquisition of EQT Midstream partners LP (EQM), and the combined companies are now under the ticker of ETRN.