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A FERC ruling has driven MLP valuations even lower and sponsors are again left to consider the long-term viability of the structure

Master Limited Partnerships (MLPs) historically benefitted from their tax-efficient structures, strong dividend profiles, and low costs of capital that helped them deliver significant growth as the US oil & gas industry experienced a renaissance in the early half of the decade. With commodity prices still significantly below 2014 highs, interest rates starting to rise, and the relative tax-efficiency of the MLP structure incrementally reduced by tax reform, many have been reevaluating the MLP structure in favor of more common “C-Corp” structures.

On March 15th the Federal Energy Regulatory Commission (FERC) compounded these issues by ruling that MLPs operating interstate gas pipelines based on cost-of-service contracts would no longer be allowed an income tax allowance, in effect lowering the rates these MLPs can charge their customers. Even though this change should only apply to a small number of assets with only certain kinds of rate structures, MLP investors reacted negatively, sending the benchmark Alerian index down 4.6% on the day of the FERC’s announcement and the index remains down 8.1% as of the March 29th close. The general shift away from the MLP structure can be observed more broadly, as well:

- The benchmark Alerian index has seen the number of constituents drop from 50 in 2014 to 41 today
- The ten largest MLPs now represent 69% of the total market cap of the Alerian index, up from 58% in 2014
- In the last two months, at least five MLPs have announced plans to simplify their structure or convert to a C-Corp

Key Takeaways

- A confluence of macroeconomic, fiscal, and commodity-oriented factors have made MLPs less appealing in recent years
- A recent ruling by the FERC may further contribute to the trend of MLPs converting to more traditional C-corporation structures

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