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The Greening of Energy Midstream Infrastructure

Written by: Ben Niedermeyer and Sean Fitzgibbon

Executive Summary

- **The newly enacted Inflation Reduction Act (IRA) is expected to have a profound impact on Midstream MLP and energy infrastructure revenue and valuations.**
- **Outsized tax incentives for carbon capture and sequestration (CCS) will provide meaningful growth to midstream MLPs that can transport and store CO2.**
- **Midstream MLPs are positioned to play an important role in CO2 reduction and the transition to cleaner fuels leading to better air quality worldwide.**

In late May, NBW attended the Energy Infrastructure Council's ("EIC") annual conference. We always learn a great deal at this industry sponsored gathering and 2023's conference did not disappoint. The agenda included updates from a number of individual companies, as well as an overview of the regulatory and tax environment. One main focal point of the conference was the recently enacted Inflation Reduction Act ("IRA"). This infrastructure bill is likely to have a large, favorable and long-lasting impact on Master Limited Partnerships ("MLPs") and energy infrastructure in general.

As seen in the table below, the IRA provides significant tax incentives for large scale carbon dioxide capture out of the air and to permanently store it underground. The Congressional Budget Office estimates the cost of this tax incentive to be $400 billion over 12 years; a figure many believe to be inaccurate. Goldman Sachs has estimated the cost to be $1.3 trillion, while an industry presenter believed $4.7 trillion was more likely. Regardless of the true cost, it will be a very large program. For context, even in the MLP capital spending boom years annual expenditures for the industry rarely topped $60 billion.

Figure 1: 45Q Enhancements

	Prior Scheme	IRA Rules
Eligibility: annual CO_2 capture threshold for a qualified facility	Carbon utilization: 25-500,000 tons Industrial and EOR: 100,000 tons Power generation: 500,000 tons	Industrial and EOR: 12,500 tons Power generation: 18,750 tons Direct Air Capture: 1,000 tons
Credit Value	EOR or use: $35/ton Geological storage: $50/ton	EOR or use: $60/ton Geological storage: $85/ton Direct Air Capture for EOR or use: $130/ton Direct Air Capture for storage: $180/ton
Construction Start	By January 1, 2026	By January 1, 2033
Direct Pay Provisions	N/A	First 5 years for corporate projects All 12 years for non-profits and co-ops

Source: Evercore ISI Research

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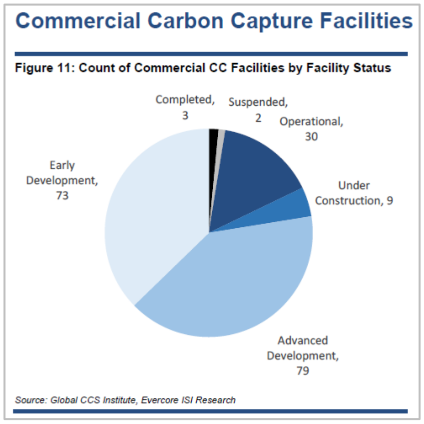
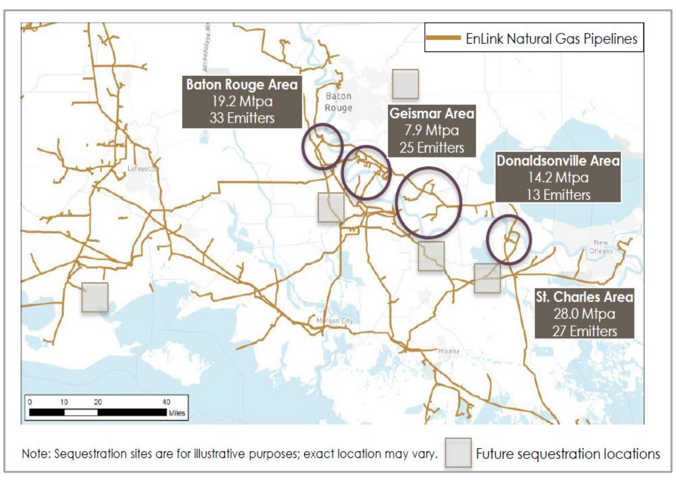


Carbon capture and sequestration ("CCS") is a technology that has been around for quite some time. Historically, it was uneconomic as CO2 pricing was insufficient to provide returns on investment high enough to justify its build out. The passage of the IRA legislation has dramatically changed this. Specifically, emitters of carbon will be incentivized to capture carbon at a rate of $85 per ton. Further, this $85 per ton will be a direct cash payment for the first five years and a tax credit for the last seven years. The bill also lowered the threshold for carbon emissions so that smaller CO2 emitters can qualify for these cash incentives. The two features of cash payment instead of tax credit and lower emission thresholds is driving a dramatic increase in the development of CCS projects, as seen in the chart to the left. In short, you no longer have to be paying taxes to qualify and can participate if you are a small emitter.

CCS is a business opportunity that plays to MLPs core competencies. Nothing is more fundamental to midstream MLPs than transport and storage. As CO2 is captured it will be transported by pipeline to large underground caverns for permanent storage. We expect CCS to be a meaningful growth opportunity for midstream MLPs for the foreseeable future. Their pipelines will transport the CO2, and to a lesser extent, they will be engaged in the long-term storage of CO2.

Key first mover advantages exist for MLPs that have assets geographically located near areas of concentrated CO2 emissions. One area that stands out is the Baton Rouge to New Orleans corridor. As seen in the chart below, there are 98 entities[1] emitting over 69 million tons of CO2 annually in a relatively small area. Existing pipelines are available to send emissions back underground representing a big opportunity for the environment and business.



Source: Enlink Midstream

In conclusion, we are optimistic that CCS will make a meaningful difference in the improvement of air quality. The improved economics from the IRA bill is already driving increased order activity for equipment used in carbon capture. While these are large projects that take time to bring online, we believe it is just a question of when, not if. Importantly, CCS should extend the economic life of oil and gas energy resources in a more environmentally friendly format. As the industry shows that it is providing tangible solutions to the clean air problem, investors will likely be drawn to energy infrastructure.

[1]Includes refineries, fertilizer plants, cement plants, petrochemical facilities, and natural gas processing plants.

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