Master Limited Partnerships (MLPs)

Tim Fenn
January 24, 2008
PRESENTATION OVERVIEW

- Basic Structure
- Formation Issues
- Industry Application and Current Trends
- Canadian Structures
• Limited Partnership or Limited Liability Company
  – tax partnership
• Publicly Traded
• Listed on Major Exchange
PUBLICLY TRADED

• Liquidity
• Float
• Nature of Holders
  – Retail
  – Domestic
  – Institutional
LISTED ON MAJOR EXCHANGE

- New York Stock Exchange (NYSE)
- American Stock Exchange (AMEX)
- NASDAQ National Market
**LEGAL STRUCTURE/OWNERSHIP**

- **Sponsor**
- **Public**
  - G 2%/L/IDRs
  - L
- **LP**
  - 100%
- **LLC**
- **Lenders**

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- = ownership
- = debt
G = general partner
L = limited partner
IDRs = incentive distribution rights
TWO-TIERED STRUCTURE RATIONALE

- Historical
  - Administrative Issues

- Contemporary
  - Holding Company
  - Double Breasted Financing
  - Cash Distribution Support (additional contributions from sponsor to MLP)
• Available Cash
  – Agreement to Distribute
  – Not a Tax Requirement
  – Market Driven
  – Definition
• Available Cash Definition
  – “Available Cash” generally means, for each fiscal quarter, all cash on hand as of the end of the quarter.
• Less the amount of cash reserves established by the General Partner to:
  – Provide for the proper conduct of the MLP’s business;
  – Comply with applicable law, any of the MLP’s debt instruments, or other agreements; or
  – Provide funds for distributions to the MLP’s unitholders and to the General Partner for any one or more of the next four quarters;
• Plus all cash on hand on the date of determination of available cash for the quarter resulting from working capital borrowings made after the end of the quarter.
In the prospectus, the MLP makes a statement as to its intention to distribute a specified minimum level of distributions on a quarterly basis.

- This amount is referred to as the minimum quarterly distribution or MQD when the MLP has subordinated units.
- Sometimes referred to as the initial quarterly distribution or IQD when the MLP does not have subordinated units.
• Cash Distribution Support
  – “Internal” (Subordinated/Common Units)
    • 50/50 subordinated units/common units
    • Minimum quarterly distribution (“MQD”)
    • Five year subordination period generally
    • Early conversion: 25% in year three, 25% in year four
    • Test for conversion: (1) distribute and (2) earn distributions
      • Arrearages
        – “External”
          • Additional partnership interests (“APIs”)
          • Contribution by sponsor
        – Combination
• Incentive Distribution Rights
  – Definition: right to increasing share of cash distributions as benchmarks for limited partners are achieved
  – Tiers (example)
    • 98%/2% (target 10% yield based on MQD)
    • 85%/15% (upon achieving 11% yield)
    • 75%/25% (upon achieving 12.5% yield)
    • 50%/50% (upon achieving 15.0% yield)
  – Rationale
    • Incentive for general partner
    • Compensation for subordination
FORMATION ISSUES
LEGAL ISSUES

- Asset Transfers
- Securities Laws/Governance
- Taxes
• Predicate: all assets in tax pass through /ignored entity
  – Partnership
  – Limited liability company
• Issues
  – Permits/Licenses
  – Consent Requirements
  – Transfer Taxes
• Methods
  – Conveyances
  – Mergers
  – Conversions
SECURITIES LAWS

• Federal
  – Disclosure/Prospectus
  – Securities and Exchange Commission
    • Process
    • Timing
  – Periodic Reporting

• State
  – “Blue Sky” Laws
  – Listing Exemption
GOVERNANCE

• General Partner Control
• No Annual Meetings
• Limited Partners Vote on Strategic Events
  – Sale of substantially all assets
  – Removal of general partner
  – Amendments to partnership agreement
• Fiduciary Duty/Conflicts Committee
  – Business opportunities — acquisitions/dropdowns/sale of GP
  – Omnibus Agreement/Partnership Agreement
• Qualification for Partnership Treatment
  – Qualifying Income Test – 90% of Gross Income
    • Services (including pipeline transportation): gross revenue before costs
    • Products: sales – cost of goods sold (gross margin)
  – Natural Resource Related
    • Minerals or natural resources
      – Naturally occurring
      – Refinery tailgate
      – Gas processing tailgate
• Activity
  – Transportation (including by pipeline)
  – Exploration
  – Development
  – Mining
  – Production
  – Processing
  – Refining
  – Marketing
  – Storage
– Other Qualifying Income
  • Real property income
    – Rents from real property
    – Income from sale of real property (including inventory)
  • Gain from sale of assets generating qualifying income
  • Interest (not from financial/insurance business)
  • Dividends
  • Gain from sale of stock
  • Gain from commodities, futures, forwards and options with respect to commodities
• Organizational Issues
  – Gain to Sponsor
    • Value versus tax basis
    • Non-recognition
      – Contribution to partnership
      – Disguised sale rules
      – Distribution exceeding basis rules
    • Gain deferral/704(c) income
  – Capital Structure
    • Equity proceeds
    • Debt proceeds
Market Issue
  - “Shield”
    • Non-taxable distributions (return of capital)
    • Reciprocal of ratio of taxable income to distributions
  - Built in Gain Recognition
    • 704(c) allocations
    • Effective step-up for public
  - Refreshening of Shield
    • 754 election
    • 743(b) adjustment
• Character of Income
  – Unrelated business taxable income ("UBTI") for tax exempts
  – Effectively connected income ("ECI") and withholding for foreign persons
  – Qualifying income for mutual funds
    • Pre Jobs Creation Act
    • Post Jobs Creation Act

• State Tax Issues

• Tax Accounting
  – Section 754 Election
  – Tax Accounting System
## ACCOUNT NUMBERS AND UNITS BY ENTITY TYPE (2005)

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>Total Accounts*</th>
<th>Percent</th>
<th>Total Units</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>1,222,624</td>
<td>51.71%</td>
<td>651,464,390</td>
<td>46.33%</td>
</tr>
<tr>
<td>Corporation</td>
<td>74,400</td>
<td>3.15%</td>
<td>124,836,299</td>
<td>8.88%</td>
</tr>
<tr>
<td>Partnership</td>
<td>27,123</td>
<td>1.15%</td>
<td>81,017,407</td>
<td>5.76%</td>
</tr>
<tr>
<td>Estate</td>
<td>14,265</td>
<td>0.60%</td>
<td>10,056,326</td>
<td>0.72%</td>
</tr>
<tr>
<td>Trust</td>
<td>393,687</td>
<td>16.65%</td>
<td>268,899,051</td>
<td>19.12%</td>
</tr>
<tr>
<td>Foreign Citizen</td>
<td>13,971</td>
<td>0.59%</td>
<td>24,975,018</td>
<td>1.78%</td>
</tr>
<tr>
<td>Other</td>
<td>36,381</td>
<td>1.54%</td>
<td>86,281,127</td>
<td>6.14%</td>
</tr>
<tr>
<td>Exempt Organization</td>
<td>16,898</td>
<td>0.71%</td>
<td>8,160,407</td>
<td>0.58%</td>
</tr>
<tr>
<td>IRA/SEP/KEOGH</td>
<td>525,593</td>
<td>22.23%</td>
<td>131,541,965</td>
<td>9.36%</td>
</tr>
<tr>
<td>Pension Plan</td>
<td>22,046</td>
<td>0.93%</td>
<td>15,316,198</td>
<td>1.09%</td>
</tr>
<tr>
<td>Qualified Ret. Plan</td>
<td>5,130</td>
<td>0.22%</td>
<td>1,143,207</td>
<td>0.08%</td>
</tr>
<tr>
<td>Clearing Entity</td>
<td>2,023</td>
<td>0.09%</td>
<td>869,240</td>
<td>0.06%</td>
</tr>
<tr>
<td>Roth IRA</td>
<td>10,310</td>
<td>0.44%</td>
<td>1,516,696</td>
<td>0.11%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,364,451</strong></td>
<td><strong>100.00%</strong></td>
<td><strong>1,406,077,331</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

*Total Accounts are the accounts holding a position at some time during the tax year.*
<table>
<thead>
<tr>
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<th>Total Accounts*</th>
<th>Percent</th>
<th>Total Units</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>1,693,500</td>
<td>48.90%</td>
<td>951,008,811</td>
<td>42.91%</td>
</tr>
<tr>
<td>Corporation</td>
<td>117,663</td>
<td>3.40%</td>
<td>255,104,843</td>
<td>11.51%</td>
</tr>
<tr>
<td>Partnership</td>
<td>51,980</td>
<td>1.50%</td>
<td>173,817,743</td>
<td>7.84%</td>
</tr>
<tr>
<td>Estate</td>
<td>19,641</td>
<td>0.57%</td>
<td>32,978,224</td>
<td>1.49%</td>
</tr>
<tr>
<td>Trust</td>
<td>605,571</td>
<td>17.49%</td>
<td>443,881,139</td>
<td>20.03%</td>
</tr>
<tr>
<td>Foreign Citizen</td>
<td>31,514</td>
<td>0.91%</td>
<td>90,498,264</td>
<td>4.08%</td>
</tr>
<tr>
<td>Exempt Organization</td>
<td>25,275</td>
<td>0.73%</td>
<td>22,775,736</td>
<td>1.03%</td>
</tr>
<tr>
<td>IRA/SEP/KEOGH</td>
<td>850,349</td>
<td>24.56%</td>
<td>210,513,189</td>
<td>9.50%</td>
</tr>
<tr>
<td>Pension Plan</td>
<td>37,597</td>
<td>1.09%</td>
<td>26,965,180</td>
<td>1.22%</td>
</tr>
<tr>
<td>Qualified Ret. Plan</td>
<td>7,977</td>
<td>0.23%</td>
<td>2,139,247</td>
<td>0.10%</td>
</tr>
<tr>
<td>Clearing Entity</td>
<td>2,719</td>
<td>0.08%</td>
<td>3,938,867</td>
<td>0.18%</td>
</tr>
<tr>
<td>Roth IRA</td>
<td>19,220</td>
<td>0.56%</td>
<td>2,430,945</td>
<td>0.11%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,463,006</strong></td>
<td><strong>100.00%</strong></td>
<td><strong>2,216,052,187</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

* Total Accounts are the accounts holding a position at some time during the tax year
ACCOUNTING ISSUES

• Gain Recognition
  – No gain recognition if Sponsor owns >50% of MLP
  – If Sponsor owns <20% of MLP, proportionate gain recognition
  – >20% - <50%:

• Consolidation
  – Current state of accounting views: mixed views, but consolidation nearly certain
  – EITF: dictates that ownership of GP of MLP results in 100% consolidation with minority interest

• Financial Statements
  – Audited (carve-out; predecessor)
  – Pro Forma

• Financial Forecast
  – Ability to pay first year’s MQD
INDUSTRY ANALYSIS AND CURRENT TRENDS
Average MLP Initial Public Offering Size

$ Millions

Average MLP Initial Public Offering

Years: 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 00, 01, 02, 03, 04, 05, 06, 07
# INDUSTRY ANALYSIS

<table>
<thead>
<tr>
<th>Year</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>87</td>
<td>PVC resin manufacturing</td>
</tr>
<tr>
<td>88</td>
<td>Liquids pipeline</td>
</tr>
<tr>
<td></td>
<td>Refining</td>
</tr>
<tr>
<td>89</td>
<td>Refining</td>
</tr>
<tr>
<td></td>
<td>Liquids pipelines/terminaling</td>
</tr>
<tr>
<td></td>
<td>Timber</td>
</tr>
<tr>
<td>90</td>
<td>Refining</td>
</tr>
<tr>
<td></td>
<td>Liquids pipeline</td>
</tr>
<tr>
<td>91</td>
<td>Liquids pipeline</td>
</tr>
<tr>
<td></td>
<td>Fertilizer manufacturing</td>
</tr>
<tr>
<td>92</td>
<td>Fertilizer manufacturing</td>
</tr>
<tr>
<td></td>
<td>Liquids pipeline</td>
</tr>
<tr>
<td>93</td>
<td>Gas gathering</td>
</tr>
<tr>
<td></td>
<td>Gas pipeline</td>
</tr>
<tr>
<td>94</td>
<td>Crude gathering/Refining</td>
</tr>
<tr>
<td></td>
<td>Propane</td>
</tr>
<tr>
<td>95</td>
<td>Timber</td>
</tr>
<tr>
<td></td>
<td>Propane</td>
</tr>
<tr>
<td>96</td>
<td>Propane</td>
</tr>
<tr>
<td></td>
<td>Propane</td>
</tr>
<tr>
<td></td>
<td>Crude gathering</td>
</tr>
<tr>
<td></td>
<td>Propane</td>
</tr>
</tbody>
</table>
## INDUSTRY ANALYSIS (cont’d)

<table>
<thead>
<tr>
<th>Year</th>
<th>Industries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>• timber</td>
</tr>
<tr>
<td>1998</td>
<td>• gas processing/distribution</td>
</tr>
<tr>
<td></td>
<td>• crude gathering/pipeline</td>
</tr>
<tr>
<td>1999</td>
<td>• gas pipeline</td>
</tr>
<tr>
<td></td>
<td>• coal mining</td>
</tr>
<tr>
<td>2000</td>
<td>• gas gathering</td>
</tr>
<tr>
<td>2001</td>
<td>• fertilizer pipeline/liquids terminaling</td>
</tr>
<tr>
<td></td>
<td>• liquids pipelines/liquids terminaling</td>
</tr>
<tr>
<td></td>
<td>• liquids processing</td>
</tr>
<tr>
<td></td>
<td>• coal leasing</td>
</tr>
<tr>
<td></td>
<td>• crude pipeline</td>
</tr>
<tr>
<td></td>
<td>• marine transportation, terminaling, logistical services</td>
</tr>
<tr>
<td></td>
<td>• gas gathering/transmission/processing</td>
</tr>
<tr>
<td></td>
<td>• marine transportation, terminaling, logistical services</td>
</tr>
<tr>
<td></td>
<td>• propane</td>
</tr>
<tr>
<td></td>
<td>• coal leasing/timber</td>
</tr>
</tbody>
</table>
• barge business
• refined product pipelines
• cemetery operations
• gas gathering/transmission/processing
• ship transportation

05
• gas gathering/processing
• LNG/crude ship transportation
• refined product terminals/pipelines
• gas gathering/transportation/processing/storage
• refined petroleum products

06
• upstream
• refining
• gas gathering/transportation/processing/storage
• compression services
• upstream
• refined product pipelines
• LNG receiving terminals
• gas gathering/transportation/processing/storage
• crude oil gathering/transportation/terminaling/storage
MLPs AND CANADA
PARTNERSHIP APPROACH: DOUBLE PASSTHROUGH (SIMPLIFIED)

- No entity level taxation in Canada
- U.S. Investors required to file Canadian tax returns (and pay taxes)
  - Canadian individual rates progressive
- U.S. Investors pay tax on Canadian activity reported on U.S. returns
  - U.S. foreign tax credit available, but difficult to use
- Canadian withholding on distributions
  - No withholding if activity involves a sale of a product
  - 15% withholding on gross revenue if providing a service
ABULC/NSULC APPROACH: SINGLE PASSTHROUGH (SIMPLIFIED)

- ABULC = Alberta Unlimited Liability Company
- NSULC = Nova Scotia Unlimited Liability Company
- ABULC/NSULC taxed as a corporation in Canada
  - Canadian assets generate after-tax cash flow
  - Canadian withholding of maximum 15% on distributions (under U.S.-Canada Tax Treaty)
  - Plan to debt finance acquisitions, to the extent possible under Canadian thin capitalization rules, to create interest expense and thereby lower Canadian taxes
- ABULC/NSULC treated as a passthrough in the U.S.
  - U.S. Investors pay tax on Canadian activity reported on U.S. returns
  - U.S. foreign tax credit available (entity tax and withholding), but difficult to use
On September 21, 2007, the fifth Protocol to the U.S.-Canada Tax Treaty signed

Some expected/some unexpected changes

Protocol enters into force on the later of the date the countries exchange notifications of ratification and January 1, 2008

Current rule: 25% withholding tax on interest paid by a Canadian resident to a non-resident lender unless lower treaty rate applies
  – Reduced to 10% under U.S.-Canada Treaty
  – “5/25” Exemption
• Withholding eliminated on interest paid by a resident of one country to an **unrelated** resident of the other country
  – Withholding rate reduction applies on first day of second month after Protocol enters into force (e.g., earliest would be March 1, 2008)

• Withholding eliminated on interest paid by a resident of one country to a **related** resident of the other country
  – Withholding rate reduction phased in over three years (7%/4%/0%)
• Extension of Treaty Benefits — now includes U.S. resident members of LLCs and other fiscally transparent entities where amounts received by the entity is taxed as if received directly by the members
  – With respect to withholding taxes, effective when withholding rate to unrelated persons is eliminated
  – In all other cases, effective for tax years that begin on or after January 1, 2009
• Denial of Treaty Benefits to Hybrid Entities: Protocol denies Treaty benefits to members of LLCs and other fiscally transparent entities if the hybrid nature of the entity allows it to be disregarded for tax purposes in one country but not the other
  – Delayed implementation; expected effective date of January 1, 2010
  – Example: U.S. resident members of Canadian resident unlimited liability corporation (e.g., ABULC or NSULC) not entitled to Treaty benefits in respect of dividend payments from the ULC
  – Consider the “no passthrough” structure?