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AN INTRODUCTION: MASTER LIMITED PARTNERSHIPS

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AN INTRODUCTION: MASTER LIMITED PARTNERSHIPS

Master limited partnerships ("MLPs") are tax-advantaged yield-oriented public vehicles formed for the purpose of owning certain qualifying businesses, typically energy infrastructure assets operating in oil, gas, or other natural resource-related activities. This primer provides an overview of MLPs, including their capitalization and economic structure, typical financial metrics used by MLPs or appearing in their organizational documents, governance and fiduciary-like duties, and certain considerations in preparing for or undertaking an initial public offering.

67%

Our lawyers have advised on **67%** of all natural resource and real estate **MLP IPOs** completed in the last decade.*

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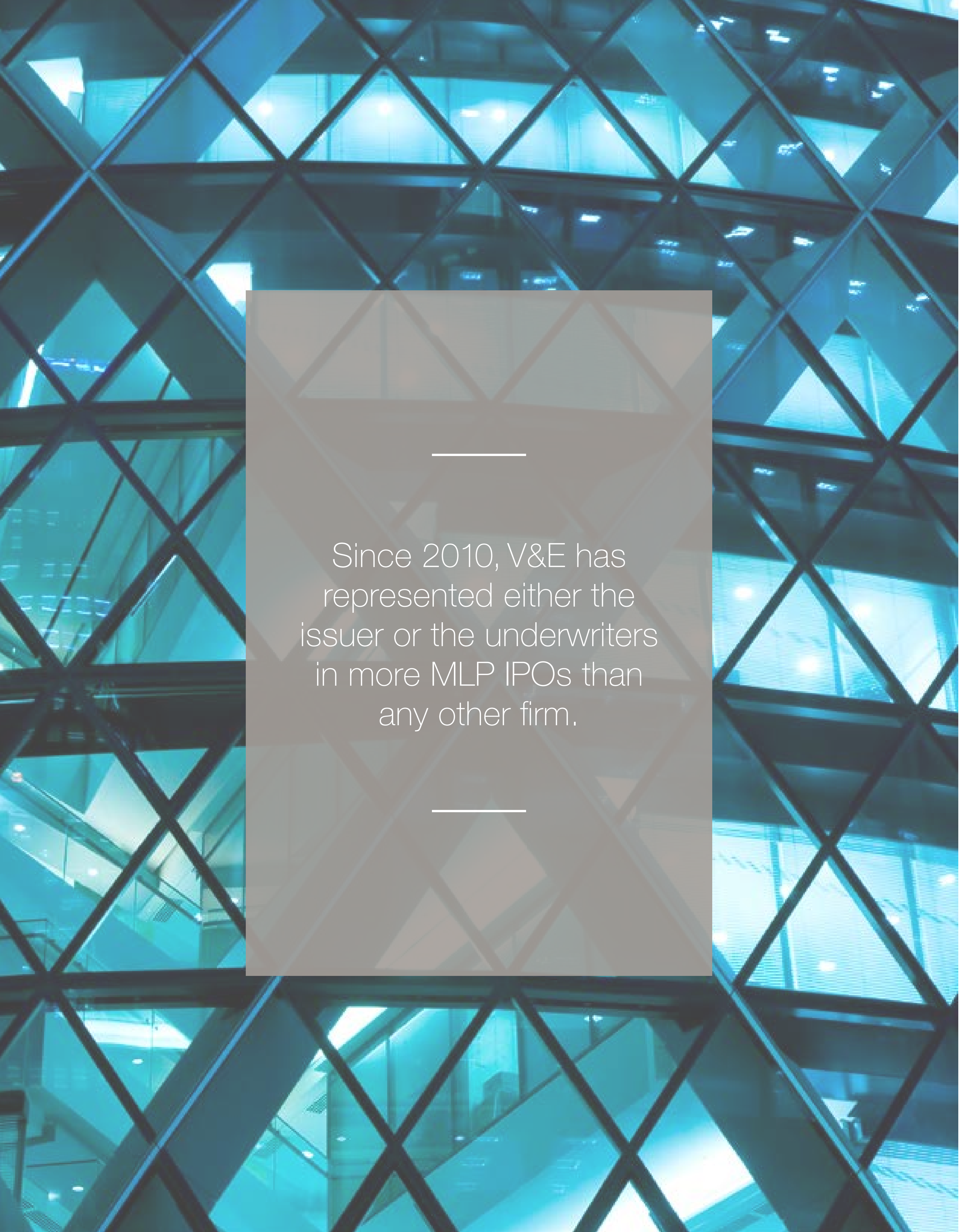
– *Chambers USA* 2017



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MASTER LIMITED PARTNERSHIPS

This primer discusses general aspects of MLPs and is intended to be an introduction to legal, tax and market issues relating to MLPs. As a general overview, this primer describes standard provisions in the most current MLP form and does not purport to describe all MLPs and their structure and governing documents.

MLP: DEFINITION AND CATEGORIZATION

PTP MLPS

Prototypical MLPs are publicly traded entities that are taxed for U.S. federal income tax purposes as partnerships.[1] MLPs of this type are sometimes referred to as "PTPs" (short for "publicly traded partnerships"), specifically referencing their treatment for U.S. federal income tax purposes. This type of MLP will be referred to as "PTP MLPs" in this primer where specificity is required to distinguish them from taxable MLPs,[2] which are described below.

In order for a PTP to be taxed as a partnership for U.S. federal income tax purposes, the PTP must comply with the "qualifying income" exception contained in Section 7704(d)(1)(E) of the Federal Tax Code ("Section 7704").[3] The qualifying income exception in Section 7704 requires that at least 90% of the PTP's gross income be "qualifying income" for each year of the PTP's existence.[4] Failure to meet the qualifying income test results in the entity being taxed as a corporation for U.S. federal income tax purposes.

Among PTP MLPs there are two predominant capitalization structures:

- MLPs with common units, subordinated units and incentive distribution rights ("IDRs"); referred to herein as the "traditional capitalization." These MLPs typically have a distribution policy of generating stable and increasing quarterly per-unit distributions. MLPs with this distribution policy are referred to herein as "Traditional MLPs"; and
- MLPs with only common units; referred to herein as the "common only capitalization." This capitalization structure is commonly used for "Variable Distribution MLPs," which are MLPs that make fluctuating cash distributions, based generally on fluctuations in cash from their operations.[5]

TYPES OF MLPS

PROTOTYPICAL MLP

Traditional MLPs with common units, subordinated units and incentive distribution rights.

Variable Distribution MLPs with only common units, referred to as "common only capitalization."

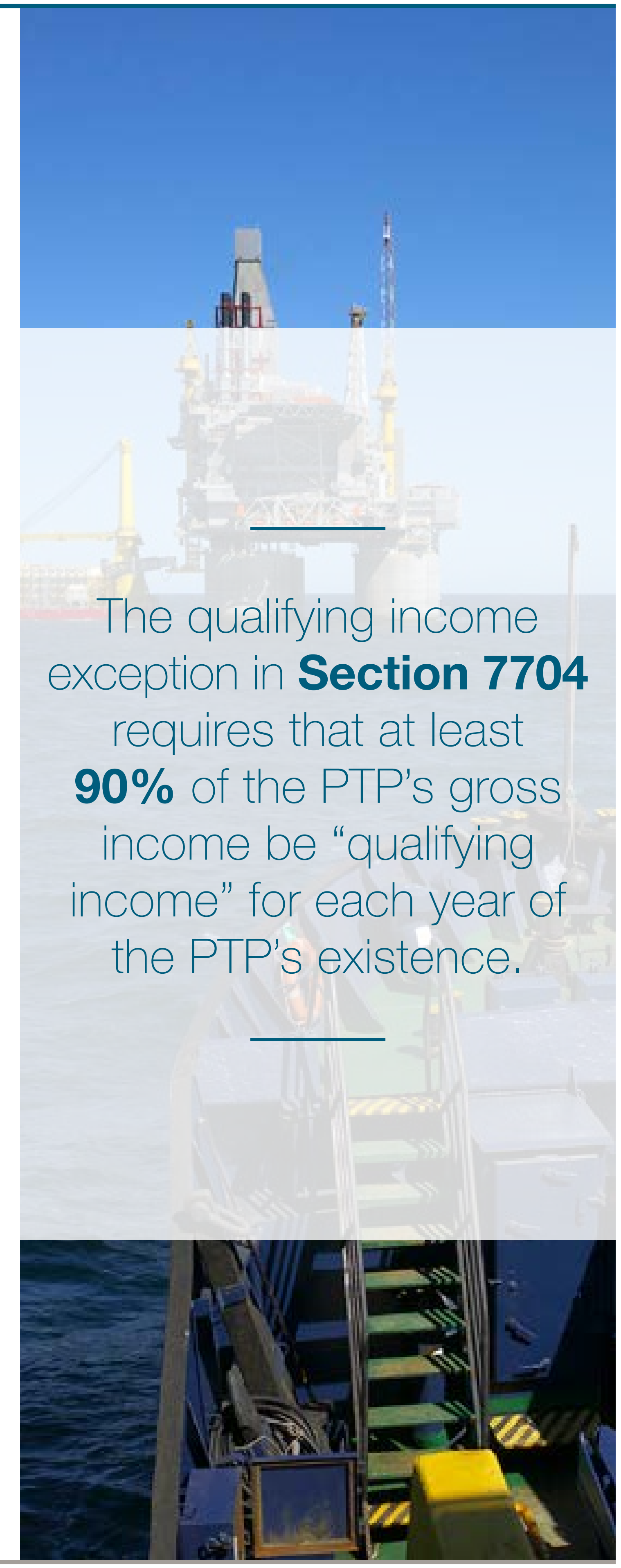
TAXABLE MLPS

This primer also discusses "Taxable MLPs," which are publicly traded entities that have capital structures and distribution policies of Traditional MLPs but are taxed (or their subsidiaries are taxed) as corporations for U.S. federal income tax purposes. Taxable MLPs have been used by entities that could not generate qualifying income (or where being taxable as a corporation has benefits that outweigh pass-through treatment) but where the entity-level U.S. federal income tax is manageable. This has included MLPs in the shipping and offshore drilling industries and more recently includes contracted power "YieldCos."

Where this primer refers to "MLPs," without specifying "PTP" or "Taxable," reference is to both forms.

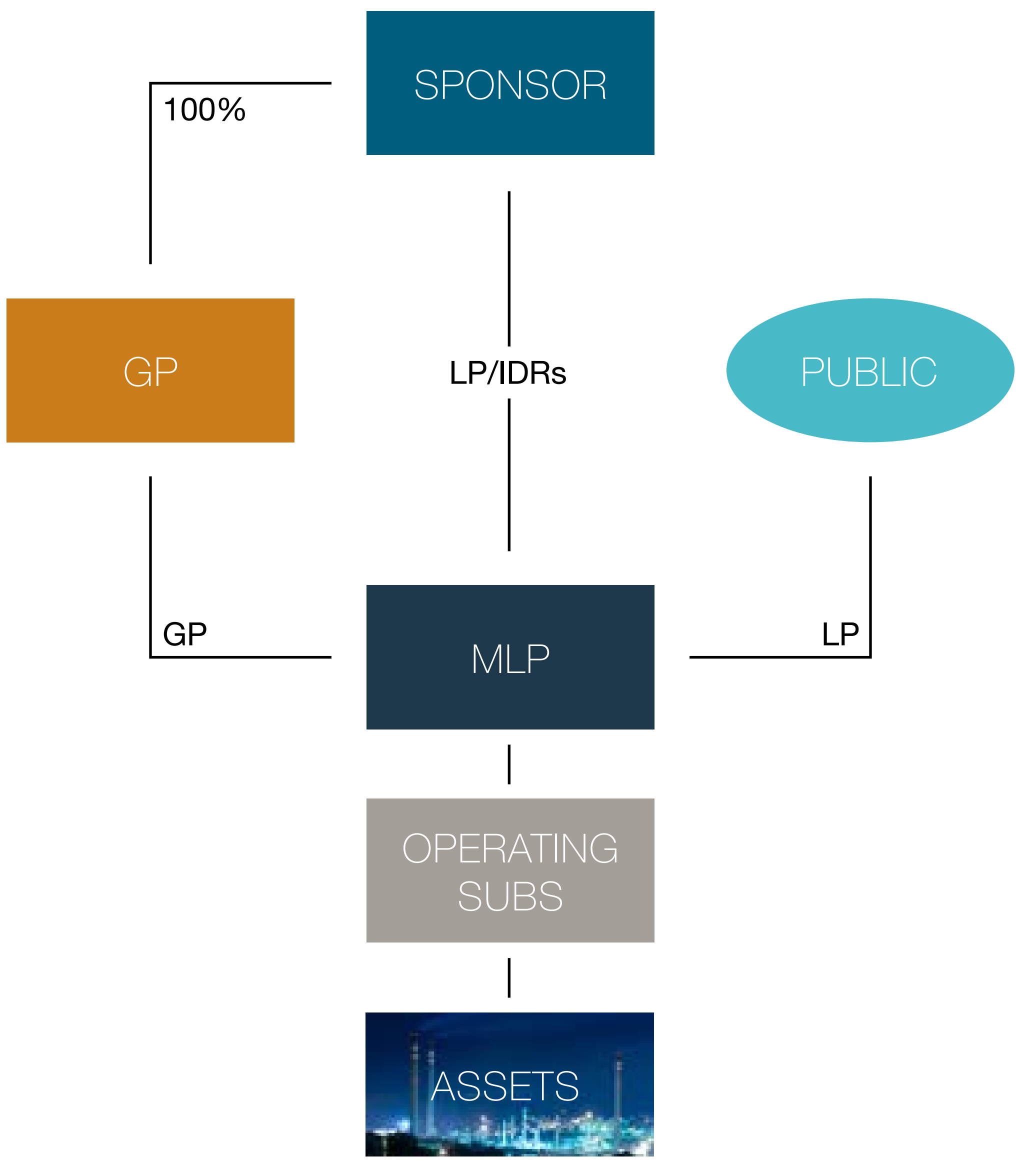
TAXABLE MLP

Taxable MLPs are publicly traded entities that have capital structures and distribution policies of Traditional MLPs but are taxed (or their subsidiaries are taxed) as corporations for U.S. federal income tax purposes.



ORGANIZATIONAL STRUCTURE

MLPs are typically organized as Delaware limited partnerships.[6] Limited partnerships are required to have at least one general partner ("GP") and at least one limited partner. Most MLPs have one GP owned by the Sponsor.[7] In addition to the GP, the Sponsor typically also owns common units (as well as IDRs and subordinated units, assuming the traditional capitalization) and the public owns common units.



ECONOMIC STRUCTURE

There are four key concepts in the economic structure of Traditional MLPs: (i) distribution policy, (ii) a minimum quarterly distribution ("MQD") amount, (iii) common units and subordinated units and (iv) IDRs.

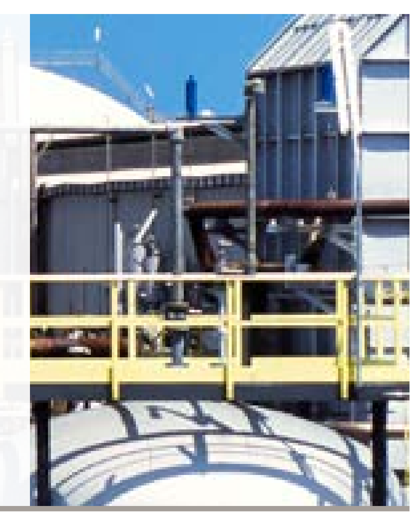
DISTRIBUTION POLICY

The expectation of distributions (or yield[8]) is a critical aspect of the way in which Traditional MLPs are marketed to investors. PTP MLPs are not required to make distributions in order to maintain their exemption from U.S. federal income tax.[9]

Traditional MLPs have a distribution policy of generating stable quarterly[10] per-unit distributions and increasing distributions per unit when sustainable. In order for a business to be suitable for a Traditional MLP, the business needs to generate sufficiently steady and predictable distributable cash flow (or "DCF") to support payment of the MQD, post IPO, and steady and growing distributions thereafter. Successful marketing of the IPO requires a credible path to sustainable distribution growth over time. Traditional MLPs will use cash coverage or short term borrowings to maintain or increase per unit distributions through quarterly or seasonal fluctuations in DCF.

In contrast to Traditional MLPs, Variable Distribution MLPs have a policy of distributing all reasonably distributable cash, without maintaining coverage or borrowing to otherwise smooth the level of distributions. Variable Distribution MLPs are suitable for businesses that are unlikely to generate sufficiently steady and predictable DCF (*i.e.*, their businesses are subject to substantial and unpredictable fluctuations in cash generation) to fit within the Traditional MLP distribution model, at least without undue cost. For Variable Distribution MLPs the business focus is on optimizing business results and maximizing total distributions, not managing for quarterly distribution stability or steady growth in distributions. Roughly speaking, the business strategy of Variable Distribution MLPs is "we'll manage our business to the best of our ability and pay out as much cash as we can each quarter – sometimes it will be a lot, sometimes it will be a lot less (or even none), as our operating results rise and fall." Variable Distribution MLPs do not have an MQD (although their IPO prospectuses will include a four-quarter forecast of DCF, as discussed below) and do not have the structural incentives (subordinated units and IDRs) for steady distributions.

Approximately half of all Variable Distribution MLPs operated in the refining or fertilizer industries at the time of their initial public offering.



MINIMUM QUARTERLY DISTRIBUTION

In an IPO prospectus for a Traditional MLP, common units are offered to the public with a statement that the MLP expects to pay quarterly cash distributions at or above the stated MQD. This statement is supported by a forecast of DCF[11] for at least four quarters,[12] along with GAAP financial statement line items and detailed assumptions. The underwriters typically price the IPO on the basis of, among other things, an implied annual yield based upon the IPO price and the MQD, as supported by the forecast. Since 2010, Traditional MLPs have had yields at IPO ranging from 2.7% to almost 14% (with an average of 7.0%). As described below, the MQD is not merely the MLP's expected initial quarterly distribution rate but also serves as (a) the distribution threshold below which the Sponsor would lose some or all of the distributions on its subordinated units and (b) a baseline distribution for establishing the quarterly distribution thresholds above which the Sponsor would be entitled to distributions on its IDRs.

As stated above, Variable Distribution MLPs do not have an MQD. Similarly, Traditional MLPs with the common only capitalization do not have an MQD either. However, both include a forecast of DCF in their IPO prospectus, with the forecast per unit distribution amount typically described as an "initial quarterly distribution rate."

Prior results do not guarantee a similar outcome.

COMMON UNITS AND SUBORDINATED UNITS

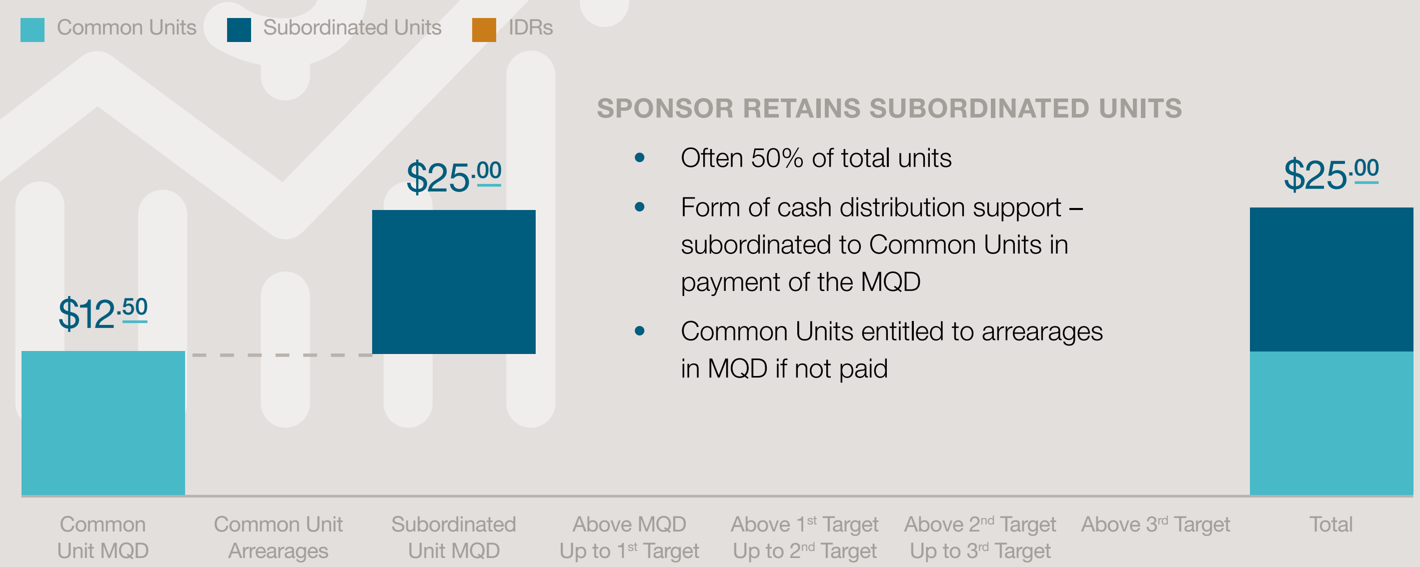
Traditional MLPs issue common units and subordinated units at IPO.[13] Typically, 50% of the units of a Traditional MLP are common units and the remaining 50% are subordinated units.[14][15] Public investors purchase common units. The Sponsor will retain all of the subordinated units, as well as any common units not sold to the public. Subordinated units represent a form of distribution support from the Sponsor to the public investors who purchase common units.[16] (See figure below.)

An MLP's limited partnership agreement (the "LPA") will contain a provision providing for an allocation of quarterly cash distributions among the classes of partners, commonly referred to as the "distribution waterfall." In the distribution waterfall of a Traditional MLP, the common units are entitled to quarterly cash distributions from operating surplus in an amount equal to the MQD before the subordinated units are entitled to any cash distributions from operating surplus. Once the common units have received the full MQD from operating surplus for the quarter, the subordinated units are thereafter entitled to receive cash distributions from operating surplus up to the MQD for that quarter (assuming the MLP has sufficient cash from operating surplus for distribution). Distributions from operating surplus in excess of the MQD are made to common and subordinated units pro rata, subject to any amount payable in respect of the IDRs. During the subordination period, common units accrue arrearages if they are not paid the MQD from operating surplus each quarter.

100 UNIT EXAMPLE

SUBORDINATED UNITS: FORM OF CASH DISTRIBUTION SUPPORT

$25 DISTRIBUTION FOR THE QUARTER



As a simplified example, this primer refers to a "100 unit example," in which there are 50 common units and 50 subordinated units and an MQD of $0.25 per unit ($1.00 annualized). In the 100 unit example, the MLP requires $12.50 per quarter to distribute the full MQD on the common units and another $12.50 per quarter to thereafter distribute the full MQD on the subordinated units, for a total of $25.00 per quarter and $100.00 per year.

THREE-PART SUBORDINATION TEST

In most modern MLPs the test for the end of subordination is a three-part test summarized as follows:

- the MLP must have "paid" at least the MQD on all of its outstanding units for three consecutive, non-overlapping four-quarter periods.[22] "Paying" the MQD means that the MLP must have made aggregate distributions[23] from operating surplus in an amount that equals or exceeds the aggregate MQD on all units;
- the MLP must have "earned" at least the MQD on all of its outstanding[24] units for those same three four-quarter periods. "Earning" the MQD means that the MLP must have generated an amount of adjusted operating surplus during the specified periods in excess of the MQD on all of the common and subordinated units; and
- there must be no existing arrearages in payment of the MQD on the common units.

Any such arrearages must be paid to the common units[17] before any further distributions from operating surplus are made to the subordinated units.[18] Subordinated units are not entitled to arrearages if they do not receive the MQD in respect of any quarter.[19] The basic economic bargain can be described as the Sponsor putting its money (or at least its distributions on its subordinated units) where its mouth is – in the IPO prospectus the Sponsor (or technically the MLP, as the IPO registrant) forecasts that the MLP can generate DCF[20] at least sufficient[21] to pay the MQD for the four-quarter forecast. If the forecast is wrong, the subordinated units will lose part or all of their distribution in order to support payment of the MQD on the common units. With a 50/50 split of common and subordinated units, the forecast needs to be off by at least 50% before there is insufficient cash to pay the full MQD on the common units.

The subordination period ends when a three-part test is satisfied. When the subordination period ends the subordinated units convert into an equal number of common units. The basic theory is that once the MLP has proven that it can consistently generate sufficient cash to pay the MQD on *all* units (common and subordinated) the Sponsor no longer needs to support the common units through the mechanism of subordination.

The subordination period may end approximately three years after the MLP's IPO.[25] If all three parts of the test are satisfied, the subordination period will end. If not, the test can be re-run and met in respect of any future quarter based on the three non-overlapping four-quarter periods rolled forward to include the new quarter(s).

In most Traditional MLPs there is also a possibility for "early conversion" of subordinated units, which may be better described as a "four-quarter bullet conversion" test.[26] The early conversion test is similar to the regular test to end subordination, but tested for a single four-quarter period[27] and the amount that must be "earned" and "paid" is 150% of the MQD on all units together with the resulting amounts payable on the IDRs (as described below). The basic theory is that if the MLP earns and pays at this significantly elevated level of distributions for a four-quarter period, it will have proven sufficient ability to continue to pay at least the MQD such that the downside protection through the mechanism of subordination is no longer required.

Prior results do not guarantee a similar outcome.

INCENTIVE DISTRIBUTION RIGHTS

In the capitalization of a Traditional MLP, the GP (or another Sponsor affiliate) is issued a class of equity denominated as IDRs. IDRs typically do not appear in Variable Distribution MLPs.

Under the Traditional MLP distribution waterfall, the owner of the IDRs is entitled to increasing percentages of incremental amounts of quarterly cash distributions from operating surplus above specified thresholds (often referred to as "target distribution levels"). The thresholds are expressed as a per unit quarterly distribution amount paid in respect of each of the units. The typical quarterly thresholds are 115%, 125% and 150% of the MQD. Above each threshold, the owner of the IDRs receives a percentage of incremental cash distributed until the next threshold is exceeded. The typical formulation is shown in the chart below.

The incremental nature of the calculation can be thought of as comparable to a graduated tax system, with only incremental amounts in excess of the thresholds being distributed to the IDRs at the specified marginal percentage interest. (See figure on page 12.)

Two theories are commonly advanced as justification for the IDR structure. Most frequently, and consistent with the name, it is suggested that IDRs provide the GP an incentive to cause the MLP to increase quarterly cash distributions per unit. Alternatively (or additionally), IDRs are sometimes justified as compensation to the Sponsor for agreeing to subordination.

The IDRs provide strong incentives for the Sponsor to grow the MLP. First, the distribution waterfall incents the Sponsor to grow distributions per unit, in order that the quarterly distributions exceed the specified thresholds and the IDRs begin to participate (or participate at a higher percentage) in incremental cash distributions. Second, once the IDRs are "in the money" (*i.e.*, the first distribution threshold is exceeded such that the IDRs are entitled to cash distributions) and assuming the per unit quarterly distribution amount is constant, IDR distributions grow in linear correlation to growth in the number of outstanding units. Thus, the IDRs benefit from both increases in the quarterly distribution per unit and increases in the total number of outstanding units. (See figures on pages 13 and 14.)

TYPICAL IDR DISTRIBUTION WATERFALL

Quarterly Distribution Amount (per Unit)	Marginal Percentage Interest in Distributions: Unitholders	IDRs
Up to 1st Target (115% of MQD)	100%	0%
Above 1st Target, Up to 2nd Target (125% of MQD)	85%	15%
Above 2nd Target, Up to 3rd Target (150% of MQD)	75%	25%
Above 3rd Target	50%	50%

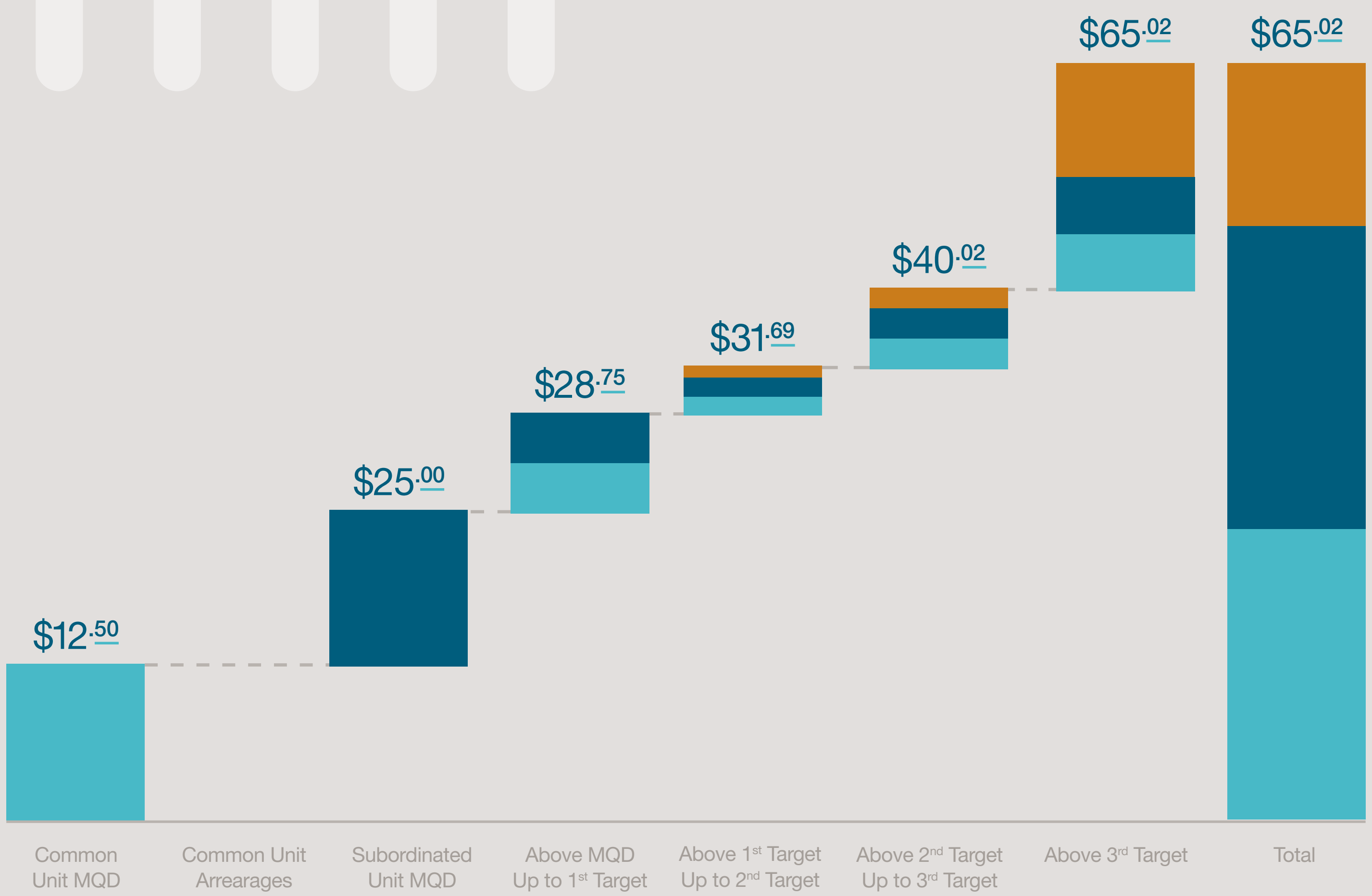
The 0% up to the 1st Target reflects a recent trend of having a noneconomic (0.0%) interest for the GP and IDR marginal percentage interests of 15%, 25% and 50%. Prior to 2011, the GP typically had either a fixed 2% interest at every distribution level, with IDR marginal interests of 13%, 23% and 48%, or IDRs that were embedded in (*i.e.*, part of) the GP interest, with marginal percentage interests of 2%, 15%, 25% and 50%.

100 UNIT EXAMPLE

DISTRIBUTION WATERFALL

Common Units · Subordinated Units · IDRs

- 1 quarter distribution
- Illustrative $0.50 per unit



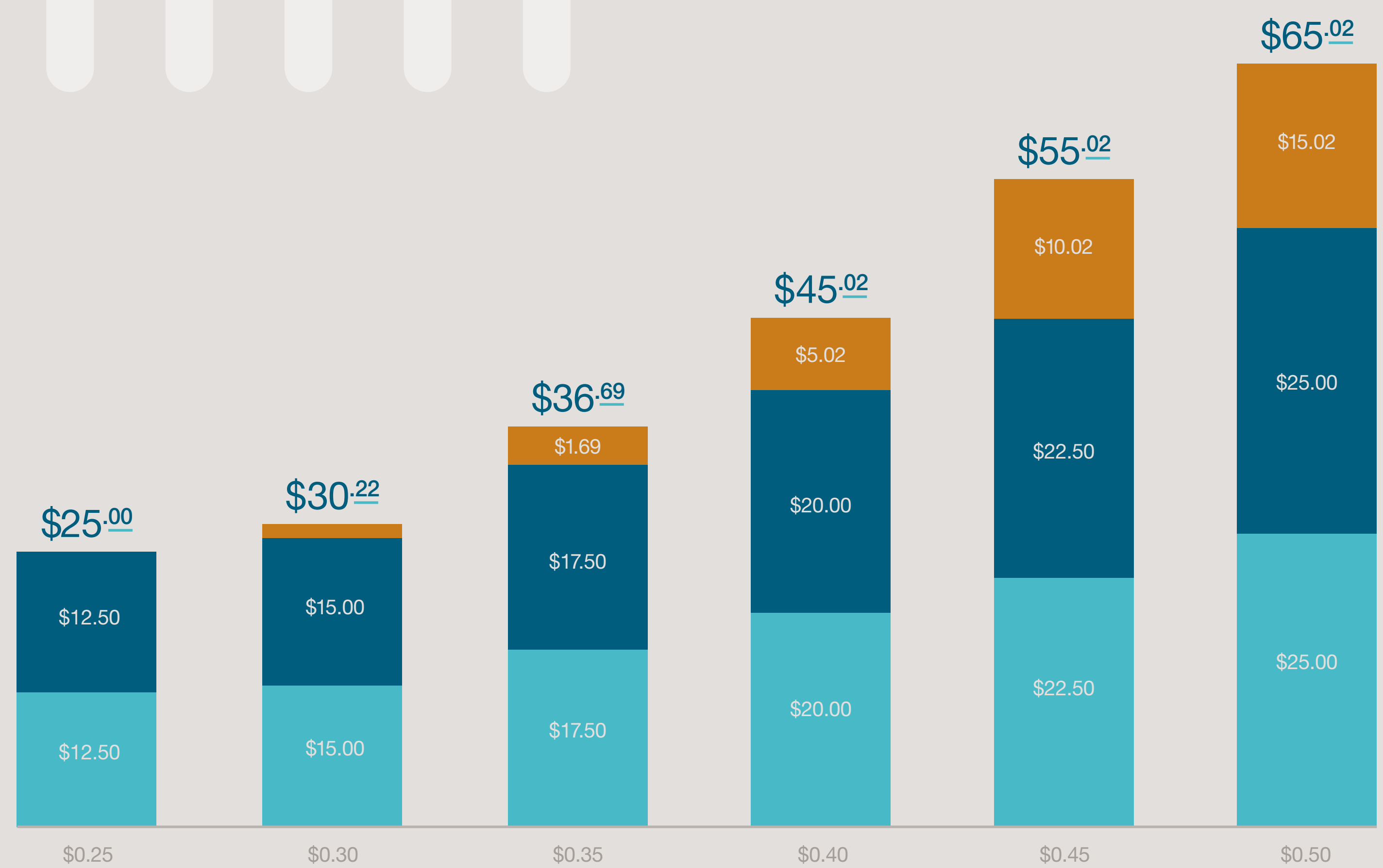
In the 100 unit example, the 1st target would be $0.2875 per unit (115% of the $0.25 MQD), the 2nd target would be $0.3125 per unit (125%) and the 3rd target would be $0.3750 per unit (150%). For each quarter, it would take a total distribution of $28.75 to reach the 1st target (up to which point the IDRs would receive no distributions), an incremental $2.94 to reach the 2nd target ($2.50 to the unitholders, or $0.025 per unit, and $0.44 to the IDRs (or 15% of the incremental distribution)), and another incremental $8.33 to reach the 3rd target ($6.25 to the unitholders, or $0.0625 per unit, and $2.08 to the IDRs (or 25% of the incremental distribution)).

100 UNIT EXAMPLE

IDR THEORY

Common Units · Subordinated Units · IDRs

- IDRs benefit from increases in quarterly distributions
- Provides incentive for the Sponsor to grow distributions
- Illustrative $0.05 per unit quarterly distribution increases

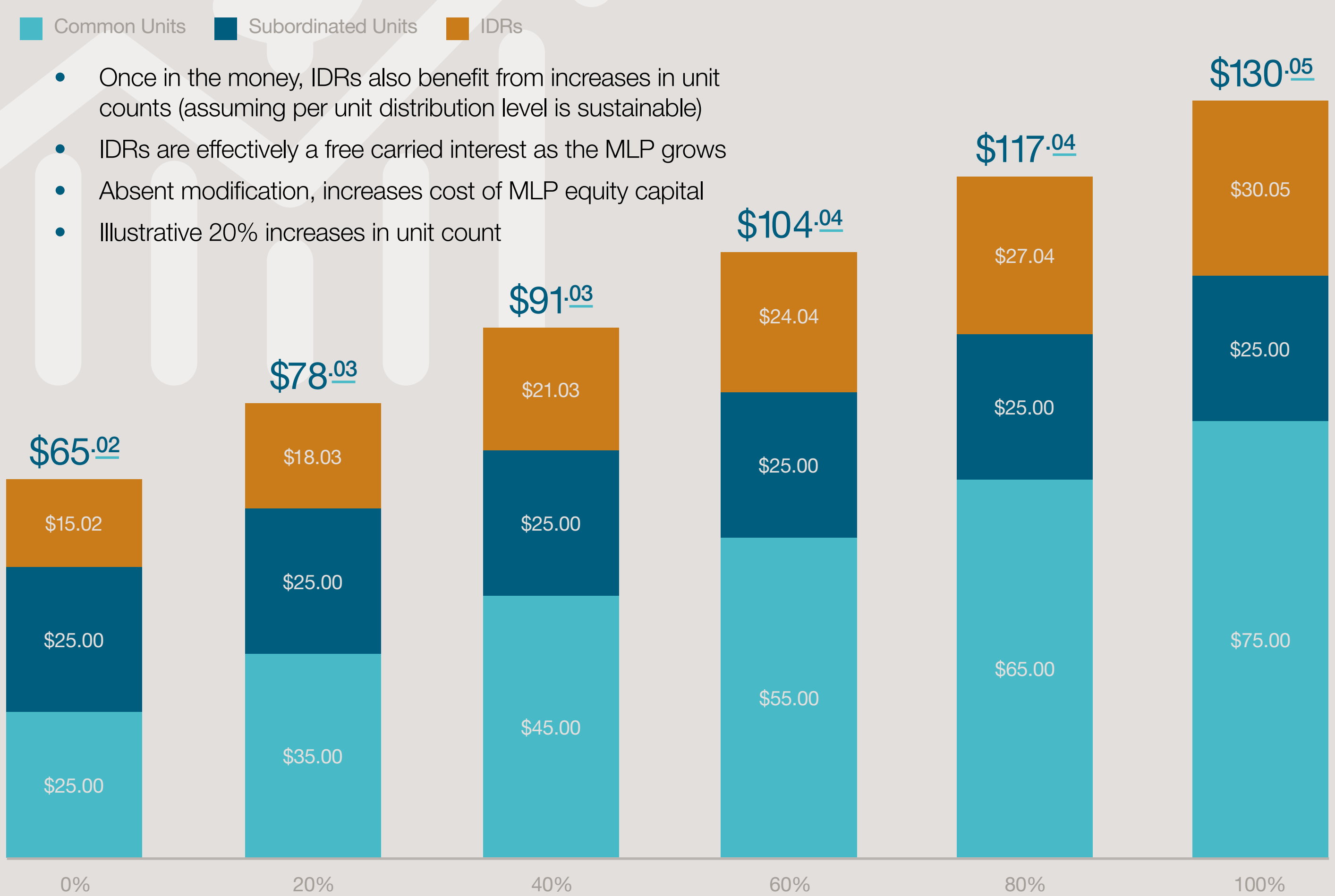


Prior results do not guarantee a similar outcome.

100 UNIT EXAMPLE

IDR GROWTH THROUGH EQUITY ISSUANCES

- Once in the money, IDRs also benefit from increases in unit counts (assuming per unit distribution level is sustainable)
- IDRs are effectively a free carried interest as the MLP grows
- Absent modification, increases cost of MLP equity capital
- Illustrative 20% increases in unit count



Using the 100 unit example, assume the MLP units are each paid $0.50 per unit in quarterly distributions (*i.e.*, the MLP has increased its per unit distribution amount to two times the $0.25 MQD). Under the typical MLP waterfall this would require $50.00 to pay the distribution on the units and result in $15.02 being distributed to the IDRs – each unit is entitled to $0.50 quarterly, but is accompanied by a $0.1502 quarterly payment on the IDRs. To express this in yield and cost of equity capital, if the MLP units were trading at $40.00, the yield on the units would be 5% ($2.00/$40.00) but the cost of equity capital would be ~6.5% (~$2.60/$40.00).

However, the IDRs also present a cost of capital issue because the IDRs are effectively a carried interest on the MLP units, including units issued after the IPO. (See figure above.) While IDRs benefit from an increase in the total number of outstanding units, the incremental cost of capital (absent modification of the IDRs) may result in the MLP being unable to complete acquisitions because the cost of capital prevents it from bidding the highest price. To ameliorate the problem, the IDRs may be modified or waived in specified amounts for specified time periods or the holder of the IDRs may agree to alternative transactions or structures. Since the beginning of 2007, most Traditional MLPs have included a provision in their LPAs permitting the holder of the IDRs to "reset" the IDRs. Substantively, in a reset the IDR holder exchanges the IDRs for a combination of new out-of-the-money IDRs and new common units. The new IDRs are similar to the old IDRs in terms of the marginal IDR percentage interest and the framework of the specified quarterly distribution thresholds but the distribution thresholds are reset at 115%, 125% and 150% of the MLP's recent distribution amounts (the "reset MQD"). The number of common units issued is set at the amount that will give the IDR holder roughly equivalent total cash distributions, at the reset MQD, to the most recent distributions on the old IDRs.[28]

Prior results do not guarantee a similar outcome.

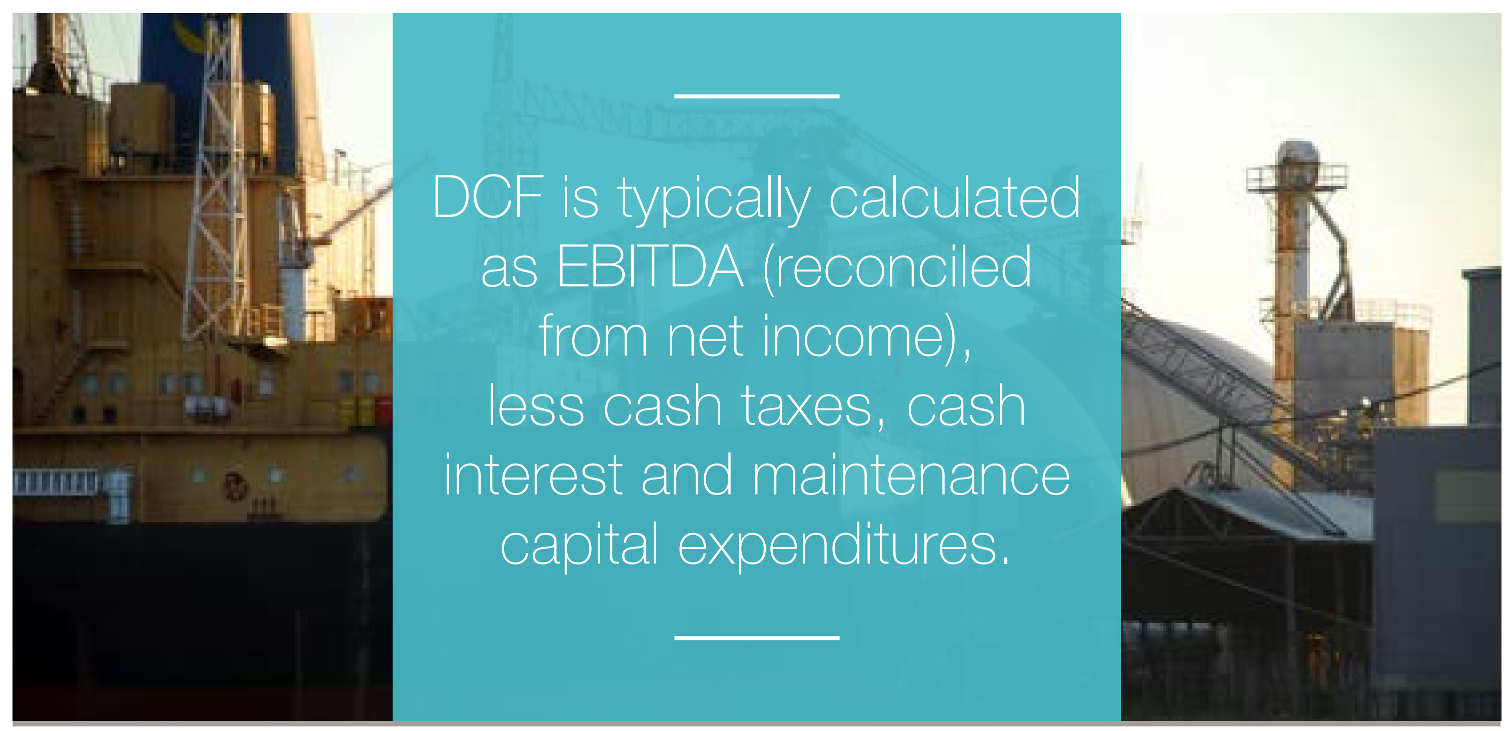
MLP FINANCIAL MEASURES

DISTRIBUTABLE CASH FLOW

DCF is a non-GAAP financial measure used by most MLPs and MLP investors and analysts as an indicator of the amount of operating income an MLP has generated in a particular period that, when rendered to cash, will be distributable. DCF is typically calculated as EBITDA (reconciled from net income), less cash taxes, cash interest and maintenance capital expenditures.[29] MLPs occasionally explain DCF as the amount of cash that is distributable, which ignores the timing of accruals and income recognition and changes in working capital and reflects an assumption that the MLP will externally finance expansion capital expenditures and debt repayment. DCF is used as a proxy for the amount of cash an MLP could distribute (once the cash is received) based on its results for a particular period. DCF is not a measure that appears in most MLP LPAs, but is a measure commonly used within the MLP industry.

OPERATING SURPLUS, CAPITAL SURPLUS AND ADJUSTED OPERATING SURPLUS

Distributions made by an MLP are typically characterized as made from "operating surplus" or "capital surplus." Distributions from operating surplus are made differently than cash distributions from capital surplus. Distributions from operating surplus are made through the distribution waterfall. Distributions from capital surplus are made pro rata to all unitholders, and the IDRs generally do not participate in any capital surplus distributions. Any distribution from capital surplus results in a reduction of the MQD and target distribution levels and, if the MQD is reduced to zero and any unpaid arrearages are eliminated, thereafter distributions from



capital surplus would be distributed as if they were distributions from operating surplus and the IDRs would thereafter be entitled to participate in such distributions. Capital surplus distributions are rare (if not unprecedented), and there is a negative perception around the concept of an MLP making a distribution that is, in essence, a return of capital.

"Operating surplus" is the measure used in an LPA to distinguish between distributions from earnings and distributions from capital. "Adjusted operating surplus" is the measure used in an LPA to measure whether the MLP has "earned" the distributions on all units, to pass the earn test for the end of the subordination period. Both "operating surplus" and "adjusted operating surplus" are specified in the LPA as calculated based on the MLP's cash receipts and cash expenditures. Roughly speaking, operating surplus is calculated as (a) a starting basket (2x-4x the MQD on all units), plus (b) all cash receipts, including working capital borrowings but excluding specified types of cash received from "interim capital transactions" (such as non-ordinary course sales of assets, equity issuances, and long-term debt incurrence), minus (c) all operating expenditures (as defined in the LPA), minus (d) cash reserves for future operating expenditures.

Operating surplus is compared to aggregate distributions the MLP has made since the IPO to determine whether a distribution is from cash earned in the MLP's business (a return on capital) or from cash that represents a return of capital (typically long-term debt or proceeds from asset sales). Cash receipts are not traced to the source of the cash, but an aggregate amount of operating surplus is calculated, and all distributions are deemed to be operating surplus so long as the total amount of distributions does not exceed the total amount of operating surplus calculated through the distribution date. Operating surplus is calculated on a cumulative basis from the MLP's IPO, and can be thought of as comparable to an MLP's cumulative cash flow from operations on an aggregate basis since the IPO.

Adjusted operating surplus, for any period, is roughly the operating surplus generated for the period, excluding (i) the starting basket, (ii) cash receipts from working capital borrowings, and (iii) changes in cash reserves that are not used to fund the originally intended purpose of the reserve. Adjusted operating surplus can be thought of as comparable to the amount of operating cash flow during particular periods. The inclusion of working capital borrowings and cash from reserves in operating surplus allows the GP to smooth operating surplus notwithstanding non-recurring or seasonal changes in cash receipts or cash expenditures, but are backed out of adjusted operating surplus in order to arrive at a metric that is closer to true earned operating surplus for the period.

OPERATING SURPLUS CALCULATION

A — A Starting Basket (2x-4x the MQD on All Units)

+B — All Cash Receipts, Including Working Capital Borrowings

−C — All Operating Expenditures (As Defined in the LPA)

−D — Cash Reserves for Future Operating Expenditures

SOMETHING TO CONSIDER

The calculation of adjusted operating surplus and operating surplus for a specific business should be carefully considered early in IPO evaluation.[30]

Prior results do not guarantee a similar outcome.

GOVERNANCE

BASIC GOVERNANCE STRUCTURE

MLPs formed as limited partnerships are typically governed by their GPs which are owned solely by the Sponsors. The GP has the authority to make most decisions regarding the conduct of the MLP's business and operations, including the amount of cash the MLP will distribute.[31] The LPA specifies certain actions for which the GP is required to obtain limited partner approval (or sometimes approval from a subset of the limited partners), providing a small measure of negative control to the limited partners.[32] For example, limited partners generally have an approval right with respect to the sale of all or substantially all of the MLP's assets or certain material amendments to the MLP's LPA. Notably, the limited partners do not have an approval right on the issuance of additional equity or have a vote on election of directors. The LPA sets the percentage of limited partner vote necessary for any required approval and whether the GP or its affiliates can vote units they control, which varies between types of actions being approved (*e.g.*, the GP and its affiliates can vote their units in votes to remove the GP but not in votes to approve conflicts of interest).

At the GP level, the manner in which decisions are made is determined by the Sponsor. In the most common structure, the GP is a limited liability company with directors and executive officers who have authority and functions roughly equivalent to those of directors and officers of Delaware corporations. For purposes of federal securities laws, the directors and officers of the GP perform the function of the directors and officers of the MLP[33] and are thus functionally the directors and officers of the MLP.[34] Unlike shareholders in a corporation, limited partners generally do not engage in the periodic election of directors of the GP.[35] No annual meeting of unitholders is held and no vote for that purpose is solicited.[36] Instead, the Sponsor appoints all of the directors of the GP, including independent directors necessary under stock exchange listing requirements and federal securities laws for service on audit committees. The directors of the GP appoint the officers of the GP, who manage the day-to-day operation of the MLP at the direction of the board. It is often the case that the directors and executive officers of the GP are also directors and executive officers of the Sponsor.

INDEPENDENT DIRECTORS AND BOARD COMMITTEES

Under stock exchange listing requirements, MLPs formed as limited partnerships are exempt from the requirement to have a majority of independent directors that is applicable for most publicly traded corporations. MLPs formed as limited liability companies may benefit from a similar exemption if they qualify as "controlled companies." The stock exchanges, as well as the Sarbanes-Oxley Act of 2002 and federal securities regulations adopted pursuant thereto, require at least three independent directors to serve as an audit committee, subject to a phase-in provision for entities listing in connection with their IPOs. Unlike many publicly traded corporations, limited partnerships are not required to have corporate governance committees or compensation committees and are exempt from the requirement that such committees be independent to the extent such committees are nonetheless appointed.

The typical MLP LPA contemplates that the GP may have a conflicts committee composed entirely of independent directors. The independence standard specified for service on the conflicts committee is more strict than the stock exchange and Securities Exchange Act of 1934 requirement for audit committees — notably it prohibits the conflicts committee members from being directors of the Sponsor or owning a material[37] amount of equity of the Sponsor or any of the GP's affiliates (other than certain interests in the MLP). The board of directors of the GP may, but is not required to, submit conflicts of interest for review and approval by the conflicts committee.

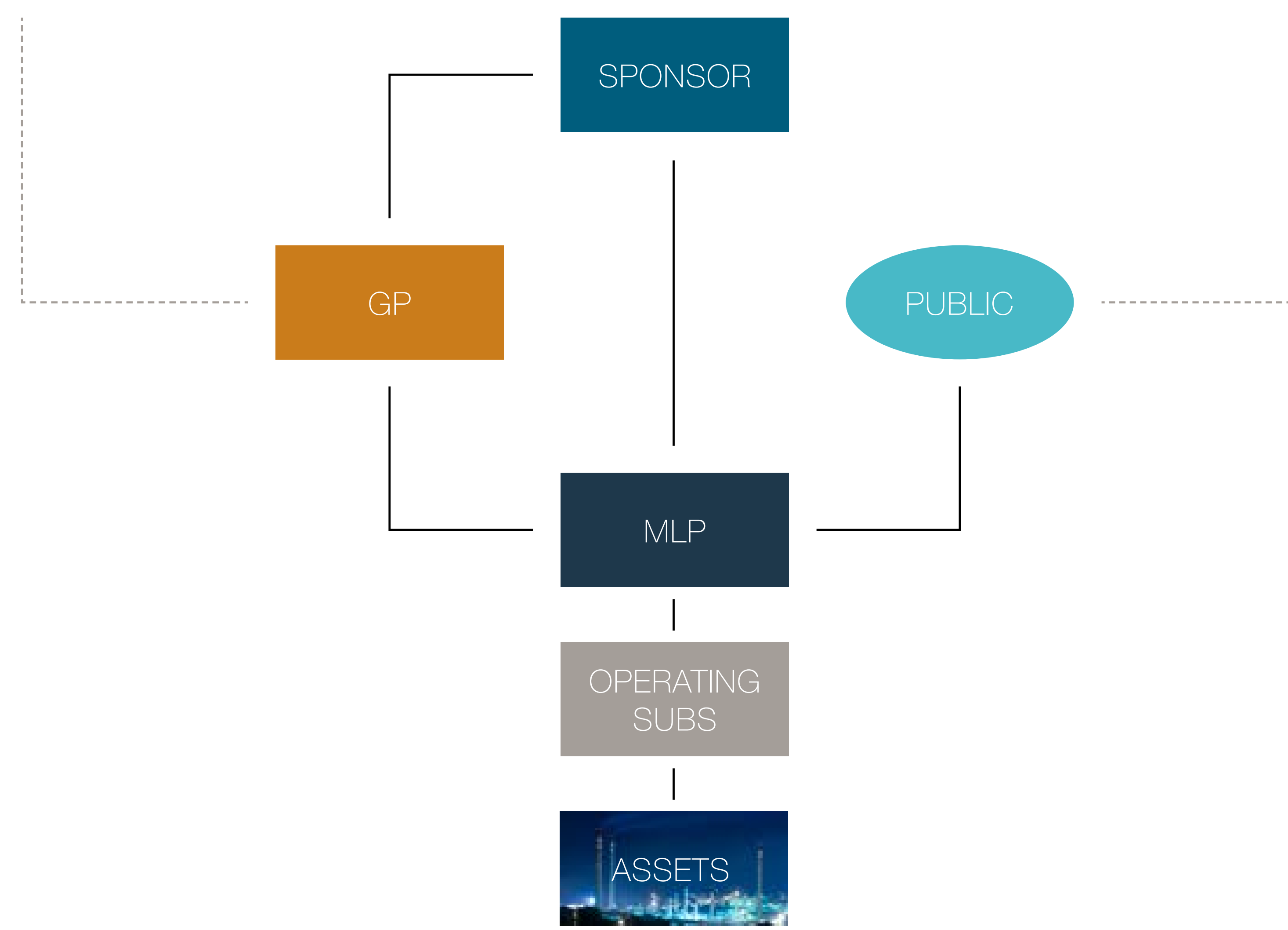
SUMMARY OF GOVERNANCE STRUCTURE

GP

- GP Controls the MLP
- GP is 100% Owned by Sponsor
- GP Board of Directors Appointed by Sponsor (Not Required to be Majority Independent)
- GP Officers Will Likely Overlap with Sponsor Officers
- 3-Member Independent Audit Committee Required (May Include Independent Directors from Sponsor's Board)

PUBLIC

- Limited Partners Do Not Elect Directors
- No Annual Meeting Required (No Proxy Statement)
- Limited Partners Vote Only on Limited Items



Of the last 100 MLPs to go public, more than **85%** have been domiciled in **Delaware**.

"FIDUCIARY-LIKE" DUTIES

Under Delaware law, in the absence of a contractual modification, the GP of a limited partnership, as well as the directors of the GP, owe corporate fiduciary duties (*i.e.*, the duty of care and the duty of loyalty) to the limited partners and the partnership.[38] The Delaware Revised Uniform Limited Partnership Act provides that Delaware limited partnerships may, in their partnership agreements, expand, restrict or eliminate the fiduciary duties otherwise owed by the GP to the limited partners and the partnership.[39] MLP LPAs eliminate fiduciary duties and replace those duties with contractual standards specified in the LPA. While these contractual standards are technically not "fiduciary duties" under Delaware law, they are comparable in many respects and described herein as "fiduciary-like."

MLP LPAs specify a default contractual standard requiring the GP to act in "good faith" (or sometimes to not act in "bad faith"), meaning that the GP (or persons or entities causing the GP to act, including the officers and directors) believes that the action or decision is in the best interests of (or not opposed to the interests of) the MLP. This default standard applies to most actions and decisions by the GP under the LPA, and no higher standard applies. Where the GP is acting in its individual capacity (*i.e.*, not on behalf of the MLP), or for actions where the LPA specifies that the GP may act in its "sole discretion,"[40] the GP may take such actions free of any duties to the MLP or the limited partners. This entitles the GP (or the Sponsor or the GP's officers or directors, depending on who has authority to control the GP's action) to consider only the interests and factors that it desires and relieves it of any duty to give any consideration to any interest of, or factors affecting, the MLP or the limited partners.

CONFLICTS OF INTEREST

Conflicts of interest may arise between the MLP or the public unitholders, on the one hand, and the GP, the Sponsor and the other affiliates of the GP, on the other hand. Typical examples of such potential conflicts of interest are provided in the diagram below. By virtue of the relative rights of common units, subordinated units and IDRs in the traditional capitalization, relatively commonplace decisions, like the decision to raise the quarterly distribution or to incur indebtedness or to issue equity, can also present conflicts of interest between the Sponsor and the unitholders.

For certain conflicted decisions, the MLP LPA will specify that the GP may act in its "sole discretion" or "individual capacity," meaning the GP need not consider the interests of the MLP or the unitholders, and may make the determination as it sees fit, free of any duty. For decisions or actions to which the sole discretion/individual capacity standard does not apply, the default "good faith" standard will apply to the GP and its board of directors or officers causing it to make the decision. However, the directors and officers also have fiduciary[41] duties to manage the GP in the best interest of the Sponsor, as the owner of the GP. Recognizing the inherent conflicts between duties owed to the MLP and duties owed to owners of the GP, the MLP LPA contains specific conflict of interest resolution procedures that should be thought of as "safe harbors." If the conflict of interest resolution procedures are utilized properly, the GP will not be in breach of any duties to the MLP or its unitholders based on the action taken with respect to the conflict. Specifically, the MLP LPA permits, but does not require, the GP to refer a decision to the conflicts committee for approval. If the conflicts committee determines the transaction or decision is in the best interests of the MLP (or meets the other applicable standard provided for in the specific LPA) and approves the conflicted transaction or decision, it will be *conclusively* presumed that the transaction or decision is not a breach of the GP's duties. Alternatively, the GP can seek approval from a majority of the unitholders not affiliated with the GP. The GP is never required to seek approval from the conflicts committee or a vote of the unaffiliated unitholders, but if such approval is sought and granted, the conclusive presumption specified in the LPA makes it more difficult for plaintiffs to prevail in a lawsuit challenging the conflicted transaction.

POTENTIAL CONFLICTS OF INTEREST

- The allocation of business opportunities, such as potential acquisitions, that could logically be pursued by either the MLP or the Sponsor
- Direct dealings between the MLP and the Sponsor, such as the acquisition by the MLP of assets from the Sponsor (a "drop-down" transaction) or the entry into or modification of contracts between the MLP and the Sponsor
- The allocation of general and administrative expenses from the Sponsor to the MLP and the reimbursement by the MLP thereof
- The decision to enforce agreements between the Sponsor and the MLP

TYPICAL MLP CONTRACTS

There is a standard set of contracts between the Sponsor or GP and the MLP entered into at IPO, as well as a handful of contracts that are less standard but not infrequent. All of the MLP's material agreements will be described in the IPO registration statement and filed as exhibits thereto. The terms of the contracts entered into with the Sponsor or GP in connection with the IPO need not reflect arms-length terms, but non-market terms require clear disclosure and may raise marketing or accounting considerations.

LIMITED PARTNERSHIP AGREEMENT

Each MLP will have an LPA or equivalent governing document.[42] The LPA sets forth the relative rights, preferences, powers and duties of, as well as the relationship between, the limited partners (or classes of limited partners) and the GP. The LPA will also set out the distribution waterfall, the voting rights of the limited partners, certain restrictions on actions by the GP, the contractual duties of care applicable to the GP, the ability of the GP to amend the LPA and tax allocation provisions. Deviations from the typical LPA may be necessary or appropriate depending on the capitalization structure or specific circumstances of the assets or businesses the MLP is to own or in response to specific requests of Sponsors. LPAs have evolved substantially over the three-decade plus history of MLPs, resulting in fairly substantial variation among those of MLPs currently in existence.

CONTRIBUTION AGREEMENT

Most MLPs are formed as shell entities for purposes of registering the IPO, and operating assets are contributed to the MLP around the time of, and often contingent upon the closing of, the IPO.[43] The contribution of assets by the Sponsor, usually accomplished through a contribution of entities or interests in entities, is effected pursuant to a contribution agreement. Under the contribution agreement, the Sponsor contributes the business, assets, operations and related contracts to the MLP and in exchange receives equity in the MLP (common units, subordinated units and IDRs in the traditional capitalization) as well as, in most cases, some or all of the net cash proceeds from the IPO. The contribution agreement typically contains very few, if any, representations, warranties or indemnification provisions that one would typically see in an asset or stock purchase agreement.

REGISTRATION RIGHTS AGREEMENT

The MLP and the Sponsor will generally enter into a registration rights agreement, giving the Sponsor broad registration rights for the common units and other equity it receives from the MLP. Historically, the registration rights were contained in a short section of the LPA, and that section continues to appear in most MLP LPAs. This section provided the GP and its affiliates fairly broad rights but omitted many of the customary provisions that appear in modern registration rights agreements. Recently, it has become somewhat more common to supplement that short LPA section with a separate registration rights agreement that contains the customary provisions one would see in an arms-length registration rights agreement[44] but with terms more favorable to the Sponsor (*e.g.*, strong demand underwriting rights and a long-term).

SERVICES AGREEMENT

The MLP and the GP often have no employees. Instead, the Sponsor will provide operational and administrative services to the MLP and be reimbursed, typically on a straight cost reimbursement basis.[45] The employees are retained by the Sponsor and the allocable share of salaries and benefits of these employees reimbursed to the Sponsor by the MLP. Each LPA contains a provision requiring the MLP to reimburse the GP for expenses incurred by (or allocated to) the GP in managing and operating the MLP's business. However, it is common to see a separate services agreement between the MLP and the Sponsor to provide for direct service by the Sponsor's employees to the MLP and a direct reimbursement by the MLP to the Sponsor. Where it is important that the MLP have its own employees, there may also be a secondment provision in the services agreement, whereby Sponsor employees are formally seconded to the MLP when performing services on behalf of the MLP.

LONG-TERM INCENTIVE PLAN

The GP typically establishes a new long-term incentive plan ("LTIP") in connection with the IPO to provide equity incentives to employees who devote a substantial portion of their time to the MLP's affairs. These LTIPs provide a broad range of types of incentives that may be issued, including unit awards, restricted unit awards, phantom units, options and distribution equivalent rights ("DERs") and provide flexibility as to how phantom units and DERs can be settled (*e.g.*, in cash or units, at the discretion of the GP). Most MLPs issue only phantom units and DERs, though restricted unit grants are not uncommon. Due to stock exchange requirements, when new equity compensation plans are adopted, or materially amended, post-IPO, the limited partners must be given the opportunity to vote on the adoption or amendment. In order to minimize the need to hold votes on such matters,[46] LTIPs are broadly drafted to encompass every conceivable type of award that could be granted and cover a large number of units that may be granted under the LTIP. Under the LTIP, a more specific grant agreement is then used to specify the type of award being granted, as well as any provisions applicable to the grant (*e.g.*, vesting provisions).

OTHER AGREEMENTS

There are a number of additional agreements that are occasionally entered into in connection with an MLP IPO but that are not as prevalent as those described above. These may include a purchase rights agreement, granting the MLP a right of first offer (or less commonly a right of first refusal or a call right) on assets retained by the Sponsor but suitable for the MLP's business model or a non-compete agreement, which will allocate business opportunities between the MLP and the Sponsor based on a type of business, geographic location, or other criteria. These types of agreements, along with indemnification for pre-IPO environmental matters and occasionally other matters, are often bundled into an "omnibus agreement."

In addition, there may be new agreements entered into whereby the MLP provides a service to the Sponsor for a fee for utilizing the MLP's assets. This is not uncommon with refinery logistics MLPs that provide substantially all of their services to the refinery Sponsors or gathering and processing MLPs that provide substantially all of their services to their E&P Sponsors. Where the MLP acquires a less-than-100% interest in a subsidiary that remains jointly owned by the Sponsor and the MLP after the IPO, there will also often be revisions made to the constituent documents of the subsidiary.

FORMATION AND IPO CONSIDERATIONS

Next Steps

For those considering an MLP IPO there are a number of items that should be evaluated.

MLP "SUITABILITY"

(CAN I FORM AN MLP?)

A prospective Sponsor should consider whether the business it is considering contributing to an MLP generates qualifying income if a PTP MLP is the goal. For a taxable MLP, the question will be whether tax leakage can be minimized. In addition, the near-term cash generation potential of the assets should be considered. Assets that are not currently generating substantial cash flow in excess of operating or financing costs, or are not realistically expected to be cash flow positive in the near future, may not be suitable for an MLP due to the marketing of MLPs based on expected yield.[47] A common question is the minimum size (as measured by EBITDA) that a business needs in order to be a suitable candidate for an MLP IPO. Since 2011, the forecasted EBITDA in MLP IPOs has ranged from $19.5 million to $900.8 million. In addition, the cash flow profile of the assets should be reviewed.
If a Traditional MLP is the goal (steady and increasing distributions), highly volatile cash flows (even if accompanied by qualifying income) may not be appropriate. However, there may be means of fitting the square peg of volatile cash flows in the round hole of the traditional capitalization structure, such as the entry into new long-term contracts (such as fixed price offtake/sales agreements, take-or-pay/MVC contracts, etc.), commodity hedging, a high DCF to MQD coverage ratio or structuring the MLP's interest in the business as a preferred equity interest. These strategies may justify modifications to the traditional terms and financial measures utilized in the LPA (for example allocating annual take-or-pay payments across quarterly periods, or tracing subsidiary cash flows to preferred equity distributions) in order for the LPA to be appropriate for the specific business.

MLP "ADVISABILITY"

(SHOULD I FORM AN MLP?)

Assuming the business is suitable, a prospective Sponsor should consider whether an IPO is feasible or advisable. First, conveyance of the assets to the MLP may be difficult, or at least expensive, or may require third-party consents to assign assets, contracts or permits. Where the Sponsor has issued high-yield debt, conveyance of assets out of the issuer and restricted subsidiary group to an independently financed, unrestricted MLP may be prohibited by the terms of the relevant indenture or impose other structural or operational constraints. Beyond the feasibility of forming the MLP, the Sponsor should consider whether the tax consequences of the IPO are prohibitive. In certain instances, it may be possible to take steps in advance of the IPO to minimize the tax cost of the IPO (*e.g.*, by clearly tracking indebtedness relating to the assets that will be contributed to the MLP) or employing other techniques to defer taxes that would be otherwise triggered by the IPO transaction.

A frequent question and practical consideration of a prospective Sponsor is "how much can I raise in an IPO?" Historically, since 1992, the gross IPO proceeds (excluding any green shoe exercise) for PTP MLPs have ranged from $35.2 million to $1.1 billion. A recent average for PTP MLPs is approximately $300 million, with sizes below $100 million or above $500 million fairly uncommon.[48]

IPO TIMING

Once the questions of **"Can I form an MLP?"** and **"Should I form an MLP?"** have been answered, the next logical question is "how long will it take?" The timing of an MLP IPO is often driven by the timing of availability of the MLP's financial statements, including both the time to prepare the financial statements and have the annual financial statements audited and the time to update financial statements for staleness requirements. MLPs are required to have at least two years of audited financial statements (with two years of audited balance sheets) and any required unaudited "stub" period financials, with three years of audited financial statements plus an additional two years of earlier unaudited "selected" financial data required if the MLP does not qualify as an emerging growth company.

As discussed above, MLP IPOs are typically marketed off a forecast of financial results and DCF. This forecast is a relatively uncommon feature among other types of IPOs. The forecast typically covers the period starting one quarter after the end of the most recent historical financial statements included in the IPO prospectus, with a one-quarter gap between the historical financial statements and the forecast (*e.g.*, if the most recent historical financial statements ended March 31, 2017, the forecast would be for the four-quarter period from July 1, 2017 through June 30, 2018). The MLP capitalization structure is designed at IPO to provide that all outstanding common and subordinated units will receive at least the MQD during the forecast period. Because of the materiality of the forecast and the uncertainties involved in financial forecasts, the forecast is one of the most focused-on sections when drafting the IPO prospectus, with significant focus from the MLP, the underwriters and their respective counsel. The SEC often has comments on the form and content of the forecast, including the assumptions underlying the forecast. In addition to the forecast, MLP IPO prospectuses customarily include a pro forma presentation of DCF for the MLP's most recent audited fiscal year, as well as last-twelve-month period ending as of the end of the most recent quarterly stub included in the IPO prospectus. This pro forma is colloquially referred to as the "backcast."

CONCLUSION

MLPs have been used to raise capital since 1983. Since 1987, the use of PTP MLPs has been limited to businesses generating qualifying income. The MLP universe has grown substantially, both in terms of number of MLPs, aggregate market capitalization and number of industries represented. For businesses not generating qualifying income, the MLP structure has been used occasionally for taxable entities where the entity-level U.S. federal income tax is manageable. Traditional MLPs have developed a fairly standardized capital structure, but the specifics of a business should be carefully considered to ensure it is suitable for the standard structure. The MLP structure has not been static, but has evolved to accommodate variable distributions, diverse asset classes, changing investor expectations and a diverse array of structural features to accommodate specific business requirements.

ENDNOTES

1 The "master" reference applies to a consolidating partnership in a two-tier structure above one or more "operating" partnerships. In the earliest MLPs, state limited partnership law required filing by all limited partnerships operating in the state of a certificate of limited partnership that included the names of ALL limited partners. This was impractical for PTPs, as the identity of the limited partners could change frequently, or not be readily (or potentially completely) ascertainable by the partnership. The earliest reference we have found appears in *Tax Treatment of Master Limited Partnerships*, report prepared by the Staff of the Joint Committee on Taxation, June 29, 1987.

2 For those who define "MLP" as a "PTP" the concept of a "taxable MLP" is an oxymoron. However, the term is often used to describe entities who share many structural features of MLPs, excluding the pass-through treatment for U.S. federal income tax purposes.

3 Somewhat confusingly, Section 7704(a) provides a general rule that all PTPs shall be taxed as corporations, subject to exceptions specified in subpart (c) and (d) of Section 7704. Our usage of "publicly traded partnership" (and the acronym PTP) in this primer refers to those PTPs that meet the exception to the general rule in 7704(a).

4 Businesses that generate qualifying income involve a qualifying activity directed toward a qualifying resource. Qualifying resources include naturally occurring deposits (gas, oil, and depletable minerals such as coal and sand), oil and gas products (including gasoline and diesel fuel), fertilizer and timber. Qualifying activities include exploration, development, mining, production, processing, refining, transportation, storage and marketing.

5 In addition, the common only capitalization also appears in a limited number of MLPs with the traditional distribution policy where subordinated units and IDRs did not exist at IPO or where eliminated thereafter. The common only capital structure does not make these MLPs Variable Distribution MLPs.

6 Between 2004 and 2013 seven publicly traded limited liability companies treated as partnerships for U.S. federal income tax purposes completed initial public offerings. Early MLPs were often formed in states other than Delaware, such as California (*e.g.*, Gold Company of America, 1984; the Newhall Land and Farming Company, 1985; and Airlease Ltd., 1986), New York (Power Test Investors, 1985), and Texas (*e.g.*, IP Timberlands, LP; Freeport-McMoran Energy Partners, Ltd; and Enserch Exploration Partners, Ltd., all 1986). Twelve shipping MLPs and one marine terminal MLP, most of which are Taxable MLPs, have been formed under the laws of the Republic of the Marshall Islands, which has adopted a limited partnership act similar to that of Delaware (and actually has incorporated the jurisprudence interpreting Delaware's Revised Uniform Limited Partnership Act). In addition, Brookfield Infrastructure Partners, Brookfield Renewable Energy Partners and Brookfield Property Partners are all Bermuda limited partnerships.

7 The "Sponsor" is the entity, individual or group that forms the MLP and contributes the initial assets to the MLP.

8 Yield is the annualized distribution per unit, divided by the trading or offering price.

9 There is a common misconception that distributions are required for PTP MLPs to achieve their tax status. This is not the case, and may be the result of confusion between PTP and REIT requirements.

10 Several MLPs currently pay (or previously paid) monthly, rather than quarterly, distributions. All of these MLPs went public with a quarterly distribution frequency, but switched to monthly after their IPO. Pacific Coast Oil Trust, a royalty trust that went public in 2012, served as the model for the first such MLP to switch. One rationale for switching to a more frequent distribution is making shorting the stock more difficult, as borrowing shares to cover a short is more costly when it spans a record date for a distribution/dividend.

11 Occasionally the forecast purports to present "Cash Available For Distribution," "Available Cash," "Available Cash from Operating Surplus" or "Adjusted Current Earnings," but typically the calculation of all such terms is consistent with DCF as described herein.

12 Occasionally forecasts longer than four quarters are included in IPO prospectuses. YieldCos have typically included longer forecasts of DCF. Of the seven recent IPOs of entities commonly referred to as YieldCos, four included an eight-quarter forecast, two included a six-quarter forecast, and one included a four-quarter forecast.

13 Variable Distribution MLPs only have common units.

14 In addition, as discussed below, a class of equity referred to as IDRs will be retained by the GP or the Sponsor – IDRs are not "units" and represent a variable interest in equity not readily expressed as a percentage. The 50/50 common/subordinated unit split is of units only.

15 Prior to 2011, the GP typically had a fixed 2% interest at every distribution level, referred to as the "GP 2%." Initially this structure was required in order for the GP to be a partner and the partnership to be respected for tax purposes, and the GP was obligated to maintain the 2% interest through additional capital contributions when the MLP issued new equity. The tax requirement was eliminated in the late '80s and, over the succeeding decades, the mandatory capital contribution structure gave way to a dilutable 2% interest. In recent years, a "non-economic" (0.0%) GP interest has become the most common GP interest.

16 In the late 1980s and 1990s, MLPs often utilized another form of distribution support, referred to as an "external" mechanism. The external support mechanism involved the issuance of common units to both the public and the Sponsor. No subordinated units were issued. To the extent the MLP experienced a shortfall in cash to pay the MQD, the Sponsor, through the GP, agreed to contribute cash to the MLP to offset the shortfall – in effect, the Sponsor guarantees the distribution of the MQD to the public, up to a cap. That cash was returnable to the GP under very limited circumstances. This form of external support is not currently used. Depending on specific circumstances applicable to a Sponsor, other forms of distribution support may be preferable (such as a purchase price adjustment for the contributed assets or an assignment of distribution proceeds from the Sponsor to the MLP).

17 Arrearages are paid based on a hypothetical "initial common unit" issued in the IPO, and all common units, regardless of when issued, are entitled to arrearages if the initial common unit was not paid a distribution. Arrearages are paid at par, without compounding or interest.

18 Following the end of the subordination period, the common units are no longer entitled to any arrearages in distributions, and the MQD becomes irrelevant.

19 Accrual of arrearages on both common and subordinated units was the norm in the 1980s, but because arrearages on subordinated units inhibit growth in distributions on the common units, arrearages on subordinated units are not provided for in modern MLPs.

20 DCF is not the same as operating surplus, and thus the forecast is not technically a forecast of the cash that will be treated as operating surplus (and distributed as such by the MLP). However, DCF has become the standard financial reporting metric to depict the amount of cash an MLP can generate and distribute.

21 Most MLPs, other than Variable Distribution MLPs and GP IPOs, forecast DCF in excess of the amount necessary to pay the MQD on all units. The coverage ratio of DCF to aggregate MQD ranged from 1.05x to 1.35x in MLP IPOs since 2011.

22 The four-quarter test period evolved during the mid-1990s in propane MLPs. It is intended to accommodate seasonal fluctuations in adjusted operating surplus.

23 This description matches the current V&E form LPA. Many other LPAs require that "each" unit has been paid the MQD, not that an aggregate amount equal to the aggregate MQD has been paid.

24 The earn test is calculated on a weighted average basis, based on the number of units outstanding in each respective four-quarter period, and on a fully diluted basis for the third four-quarter period, taking into account deemed exercise of any convertible securities or similar derivatives that may be converted in the quarter immediately following the third four-quarter period.

25 Prior to 2005, the typical test was also a three four-quarter test period but was first run roughly five years after the IPO.

26 In the typical structure prior to 2005 (when the tests were first run roughly five years after the IPO), the "early conversion" test was truly early. One quarter of the subordinated units could convert as early as three years after the IPO date (or roughly two years early) and another quarter one year thereafter (*i.e.*, four years after the IPO). Any subordinated units that did not convert early would convert once the three-part test was satisfied five years or more after the IPO.

27 Some LPAs contain a modified version of the early conversion earn test, tested for each quarter of a four-quarter period, rather than in aggregate. This could be substantially harder to achieve, not accommodating seasonal fluctuations in adjusted operating surplus, and result in later conversion due to not aggregating and averaging increasing distributions from lower and higher quarters.

28 The IDR reset provision first appeared in MLP LPAs in 2005, and has been standard (in that it is included more often than not, but with variations in specific terms) since 2007. It is important to note that the provision is an option of the IDR holder, not the MLP, and that negotiated transactions with the same basic structure can be negotiated between the IDR holder and the MLP GP.

29 Maintenance capital expenditures are cash expenditures (whether capitalized or expensed for GAAP purposes) that are made by an MLP to maintain its operating capacity (or operating income, net income, revenue, capital asset base, asset base, or some combination thereof, depending on the specific terms of the applicable LPA).

30 The calculation of adjusted operating surplus and operating surplus for a specific business should be carefully considered early in IPO evaluation. Specific cash generation/receipt/expenditure patterns may justify specific modifications to the applicable definitions, or can result in unanticipated results. For example, some IPOs involve a contribution of a business by the Sponsor, but a hold-back of accounts receivable: this results in no cash receipts by the MLP, resulting in negative operating surplus (unless specifically addressed in the definitions – for example, if working capital is replenished through IPO proceeds, the definitions can deem that to be cash receipts). Similarly, if a business is created from assets of a Sponsor that previously were a cost center, and contracts are entered into at closing of the IPO, the normal billing and collection pattern can result in a first quarter of operations with little (or no) cash receipts or cash expenditures. Take-or-pay payments after the end of a quarter (or year) can be allocated back to the period to which they relate, trading businesses with high inventory costs and commodity exposure can face seasonal, cyclical or other variations, etc. For operating surplus and adjusted operating surplus, one size may fit most, but one size definitely does not fit all.

31 Many MLP LPAs require the distribution of all "available cash," but the determination of available cash is made after the GP establishes reserves for the conduct of the MLP's business, complies with agreements, or provides funds for future distributions.

32 Interestingly, in the late 1980s (around the time Section 7704 was adopted), academics postulated that the MLP form gave investors more control over their investments by providing requirements (or incentives) for distribution of cash rather than retention and reinvestment by the managers of the corporation. See Terando and Omer, *Incentives Behind Corporate Formations of Master Limited Partnerships,* October 1991 ("… the limited partners enjoy the advantages of corporate limited liability, but relinquish much less power to managers than do corporate shareholders.").

33 It is not uncommon for the organizational agreement of the GP (*e.g.*, the limited liability company agreement, where the GP is a limited liability company) to specify that the board of directors directs the management and control of the GP when the GP is acting in its capacity as GP of the MLP, but to reserve control of the GP to the Sponsor (as the owner of the GP) when the GP is acting in other capacities or where the GP is permitted to act in its sole discretion under the LPA (*e.g.*, in determining to consent to mergers, exercise IDR reset rights, exercise call rights, etc.).

34 If the GP does not have directors and officers (*e.g.*, if the GP is a limited partnership with its own GP), the individuals performing the function of directors and officers of the MLP will be the MLP's "directors" and "officers" as defined in the securities laws. That is to say, for federal securities law purposes it does not matter where the individuals sit, it matters what function they perform.

35 Several MLPs do give the limited partners the right to participate in the selection of directors of the GP or their equivalent. MLPs formed as LLCs may have a governance structure similar to a corporation: with a board of directors that is responsible for directing the affairs of the LLC. Alternatively, LLCs may have a governance structure similar to that of a partnership: with a "managing member" designated to direct the LLC's affairs. Several of the MLPs that have been formed as LLCs provide corporate style voting rights for the members, including annual election of directors by unitholders. In addition, certain non-U.S. MLPs engaged in international shipping have boards of directors and granted voting rights to unitholders so that they may qualify for a special tax exception applicable to international transportation income.

36 Where the limited partners do participate in the selection of directors, the MLP would be required to hold an annual meeting.

37 Some LPAs prohibit ownership of any interests in the GP, or any affiliate of the GP (other than the MLP). This could be problematic, due to ownership through mutual funds, or immaterial ownership in sister companies where the sponsor is a conglomerate, private equity fund with many portfolio companies, etc. Recent MLP LPAs have prohibited ownership of affiliates that would have an adverse impact on the ability of the director to act in an independent matter.

38 See *e.g., In re USACafes, L.P., Litig*., 600 A.2d 43 (Del. Ch. 1991); *U S West, Inc., v. Time Warner Inc.,* 1996 WL 307445 (Del. Ch. 1996); *In re Boston Celtics Ltd. Partnership Shareholders Litigation*, C.A. NO. 16511 (Del. Ch. Aug. 6, 1999).

39 DRULPA § 1101(d).

40 Examples include the exercise of the GP's call right, the determination to seek approval of a conflict of interest from the conflicts committee, voting any common or subordinated units owned by the GP, exercising the IDR reset, and proposing or consenting to mergers or amendments to the partnership agreement.

41 Depending on the corporate form and specific governing documents of the GP (or other applicable entity where the officers and directors have roles), the duties may be full corporate fiduciary duties (*e.g.*, where the GP is a corporation) or contractual (*e.g.*, where the GP is an LLC and has specified a contractual standard of care).

42 MLPs formed as limited liability companies will have an LLC agreement (sometimes referred to as an "operating agreement"), and MLPs formed as corporations (like certain YieldCos and one shipping MLP) will have charters and bylaws.

43 While the IPO registration statement describes the MLP as if it is already operating, the business and assets to be contributed to the MLP typically are held by the Sponsor in one or more entities in its existing operating structure. Typically these assets will not be contributed to the MLP, nor will related party contracts with the MLP be entered into prior to the closing of the IPO, substantially reducing the burden of unwinding a failed IPO.

44 Certain LPAs include more robust registration rights provisions in the LPA itself. This may be ill-advised, among other reasons because the amendment provisions applicable to the LPA should not apply to registration rights and other inter-company agreements between the MLP and the Sponsor and because amendment to the registration rights section may require an 8-K. However, the short provision contained in the LPA can be retained as a back-stop to the registration rights agreement.

45 Occasionally the Sponsor is paid a flat fee or reimbursed for a capped amount. It is unusual to see a "cost-plus" structure.

46 Because most MLPs do not have annual meetings of unitholders to elect directors, unitholder votes are uncommon and a special meeting of unitholders would be required to amend the LTIP, including to provide additional units for grant once the originally authorized amount has been exhausted. Unitholder meetings present time and logistical considerations and MLPs may encounter difficulties in obtaining the requisite vote, as the units are often broadly held by retail investors. Accordingly, equity reserved for issuance under the LTIP at IPO may be comparatively larger in magnitude than would be the case for corporate IPOs, where annual votes of shareholders are routine.

47 There are structuring options to combine current cash flowing assets that have limited remaining life with assets under construction that have future cash flow potential.

48 Taxable MLP IPOs may be substantially larger than PTP MLP IPOs.

* *Some matters led by a Vinson & Elkins LLP partner prior to joining the firm.*

NOTES

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