

MASTER LIMITED PARTNERSHIPS PARITY ACT

A bill to level the playing field by giving investors in renewable-energy projects access to a decades-old tax advantage now available only to investors in fossil fuel-based energy projects

U.S. SENATOR CHRIS COONS

At a time when the United States needs to increase domestic energy production and leaders of both political parties say they support an “all of the above” energy strategy, Congress should level the playing field and give all sources of domestic energy — renewable and non-renewable alike — a fair shot at success in the marketplace.

The federal government should not be in the business of picking winners and losers in the energy market, but for nearly 30 years, that’s exactly what it has been doing with a provision in the tax code that authorizes the formation of master limited partnerships (MLPs). An MLP is a business structure that is taxed as a partnership, but whose ownership interests are traded like corporate stock on a market.

By statute, MLPs have only been available to investors in energy portfolios for oil, natural gas, coal extraction, and pipeline projects. These projects get access to capital at a lower cost and are more liquid than traditional financing approaches to energy projects, making them highly effective at attracting private investment. Investors in renewable energy projects, however, have been explicitly prevented from forming MLPs, starving a growing portion of America’s domestic energy sector of the capital it needs to build and grow.

The *Master Limited Partnerships Parity Act* is a straightforward, powerful tweak to the federal tax code that could unleash significant private capital into the energy market.

The legislation, which is just over 200 words long, would level the playing field between traditional and new energy businesses by helping energy-generation and transmission companies form master limited partnerships, which combine the funding advantages of corporations and the tax advantages of partnerships.

By allowing additional forms of energy development to access this market tool, we can go beyond political rhetoric and start delivering an all-of-the-above energy strategy.

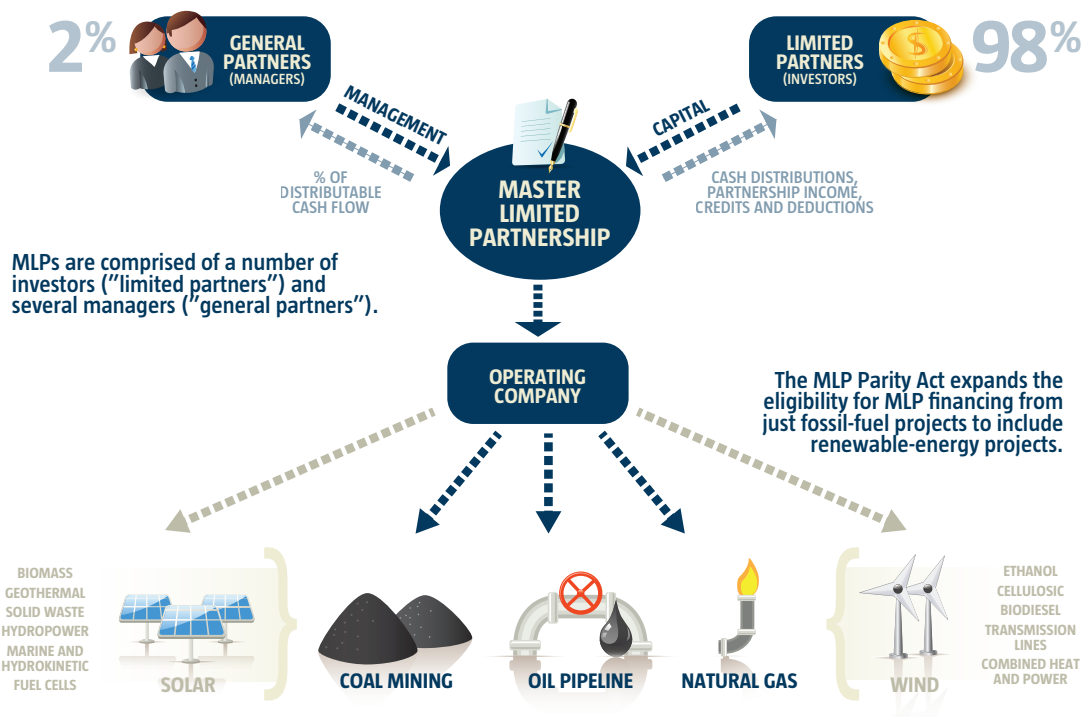
MLPs combine the funding flexibility of a corporation with the tax benefits of a partnership, creatively stimulating private investment in energy projects.



HOW MASTER LIMITED PARTNERSHIPS WORK

An MLP is a business structure that is taxed as a partnership, but whose ownership interests are traded like corporate stock on a market. Whereas profit from publicly traded C corporations is taxed at both the corporate level and the shareholder level, income from MLPs is taxed only at the shareholder level because it is treated as a partnership for tax purposes.

An MLP consists of limited partners (investors) and general partners (managers). The limited partners — who can number in the thousands — provide capital and receive quarterly required distributions generally equivalent to shareholder dividends in a C-corporation. They play no role in the operation of the MLP, while the general partners manage the MLP's daily operations. General partners can take the form of another company or a group of individuals, typically holding a 2 percent ownership stake.



MLPs are comprised of a number of investors ("limited partners") and several managers ("general partners").

The MLP Parity Act expands the eligibility for MLP financing from just fossil-fuel projects to include renewable-energy projects.

Writing in the *New York Times* on June 2, Dan Reicher and Felix Mormann of Stanford University's Steyer-Taylor Center for Energy Policy and Finance described the appeal of MLPs: "Master limited partnerships carry the fund-raising advantages of a corporation: ownership interests are publicly traded and offer investors the liquidity, limited liability and dividends of classic corporations. Their market capitalization exceeds \$350 billion. With average dividends of just 6 percent, these investment vehicles could substantially reduce the cost of financing renewables."

Because MLPs are so attractive to investors, they have been proven to bring new capital into American energy projects. This is especially important in the case of renewable-energy generation, where it is harder for investors to see as quick a return as compared to fossil fuel-based energy generation, for which much of the processing and transportation infrastructure was built decades ago. Constructing the same level of critical infrastructure for renewable energy sources will take time and investment, so the *MLP Parity Act* levels the playing field and helps address that problem.

An MLP must generate at least 90 percent of its income from

The MLP Parity Act has been endorsed by:

American Wind Energy Association

Third Way

Solar Energy Industries Association

Biomass Power Association

Biotechnology Industry Organization

Ocean Renewable Energy Coalition

American Council on Renewable Energy

Natural Resources Defense Council

Advanced Biofuels Association

Offshore Wind Development Coalition

Advanced Ethanol Council

Environmental Entrepreneurs

NRG ENERGY PRESIDENT DAVID CRANE:

"The *MLP Parity Act* is a phenomenal idea. It's a fairly arcane part of the tax law, but it's worked well and has been extremely beneficial to private investment in the oil and gas space. The fact that it doesn't currently apply to renewables is just a silly inequity in our current law."



What are the benefits of an MLP?

Pass-through tax structure (no double taxation) leaves more cash to distribute to investors

Lower cost of capital provides MLPs with advantages in building and acquiring assets

Public trading allows MLPs to raise capital from a broader range of investors than if not traded

Can own rate-regulated assets and still give investors an attractive rate of return

Greater management control than in corporations. Some corporations drop assets into an MLP so the market can realize their value while the corporate parent still controls them.

From the National Association of Publicly Traded Partnerships

qualified sources, such as real estate or natural resources, including crude oil, natural gas, petroleum products, coal, timber, and other minerals. Section 613 of the federal tax code specifically requires qualifying energy sources to be “depletable” resources – meaning we are working against our own goal of an “all of the above” energy strategy that includes additional homegrown renewable energy sources.

HOW THE MLP PARITY ACT HELPS

The *MLP Parity Act* simply expands the definition of “qualified” sources to include clean energy resources and infrastructure projects. Specifically included are those energy technologies that qualify under Sections 45 and 48 of the tax code, including wind, closed and open loop biomass, geothermal, solar, municipal solid waste, hydropower, marine and hydrokinetic, fuel cells, and combined heat and power.

The legislation also allows for a range of transportation fuels to qualify, including cellulosic, biodiesel, and algae-based fuels.

The *MLP Parity Act* does not affect any current MLP entity. All projects currently eligible to structure as MLPs would continue to qualify exactly as they would under existing law.

**MIKE McADAMS, PRESIDENT,
ADVANCED BIOFUELS ASSOCIATION**

“Substantial investments by private companies in research and development have been the catalyst for today’s success in bringing advanced biofuels to commercial markets, but stable and consistent public policies are crucial to encourage and allow additional investment dollars that will help get us across the finish line.”

HISTORY OF MASTER LIMITED PARTNERSHIPS

The first MLP was created in 1981 to attract capital by offering small investors a partnership investment in a liquid security. The success of the Apache Oil Company MLP led to other oil and gas MLPs, as well as MLPs formed for other capital-dependent enterprises.

Congress first established rules for master limited partnerships in 1987 legislation that introduced Internal Revenue Code Section 7704 and, for the first time, defined “publicly traded partnerships.” The MLP structure was limited to businesses deriving 90 percent of their income from specific sources, including dividends, rents, interests, capital gains, and mining and natural resources income identified in Section 613 of the tax code. This definition allowed oil and gas extraction and transportation activities access to the MLP structure, but excluded other energy sources.

In 2008, the *Emergency Economic Stabilization Act* (P.L. 110-343) expanded the definition of qualifying income to include transportation and storage of certain renewable and alternative fuels (ethanol, biodiesel, and a series of liquefied fuels), as well as industrial-source carbon dioxide.

The National Association of Publicly Traded Partnerships estimates there are around 100 MLPs currently being traded on major exchanges, primarily focused on energy-related industries and natural resources. “Midstream” oil and gas projects — gathering, processing, pipelines, and distribution — account for the majority of current MLPs.

Of the estimated \$350 billion in MLP capital currently in the market, approximately \$290 billion (83 percent) has gone into qualifying energy and natural resources. Of that, just over 80 percent has gone into midstream oil and gas pipeline projects.

	MLP	LLC	Corporation
Taxable at entry level	No	No	Yes
Tax items flow through	Yes	Yes	No
Tax deferral on distributions	Yes	Yes	No
Tax reporting	K-1	K-1	DIV-1099
General partner	Yes	No	No
IDRs	Yes	No	No
Investor voting rights	No	Yes	Yes

Source: National Association of Publicly Traded Partnerships



BROAD SUPPORT FOR THE MLP PARITY ACT

David Crane, president of NRG Energy: “The MLP Parity Act is a phenomenal idea. It’s a fairly arcane part of the tax law, but it’s worked well and has been extremely beneficial to private investment in the oil and gas space. The fact that it doesn’t currently apply to renewables is just a silly inequity in our current law.”

Josh Freed, Vice President for Clean Energy, Third Way: “There are 2.3 trillion reasons the United States should grow our domestic clean energy market. That’s the potential size of the global clean energy market. We can win a huge share of it if our national energy policies put clean and fossil technologies on a level playing field and we get more private investment into the clean energy market. That’s why Third Way proposed expanding Master Limited Partnerships, which help finance oil and natural gas development, to include wind, solar, and other clean energy projects. This is a commonsense idea that will give mature clean technologies access to the cheap, private capital they need to get built. We’re thrilled Senator Chris Coons, an honorary co-chair of Third Way, and Senator Jerry Moran are taking the lead to build a bipartisan consensus on this issue that will help clean energy, the economy, and the country.”

Rhone Resch, president and CEO, Solar Energy Industries Association: “This bill is an excellent step toward leveling the playing field between renewable and incumbent energy sources by providing the solar industry with private capital in the same manner enjoyed by the oil and gas industry. The solar industry employs 100,000 Americans, costs for consumers are dropping nationwide and solar deployment grew by 109% last year. Senator Coons’ MLP proposal would build on this success, and SEIA applauds him for putting forward an idea that has the potential to attract additional private sector investment in solar projects. We look forward to working with Senator Coons and other stakeholders to use smart policy to add market liquidity for renewable energy projects and to efficiently utilize tax incentives.”

Bob Cleaves, president, Biomass Power Association: “The Biomass Power Association lauds Senator Coons for taking the lead on this very important issue. His legislation, which harmonizes the Internal Revenue Code to make Master Limited Partnership arrangements available to renewable electricity developers, simplifies the tax laws and moves away from picking energy winners and losers. By obtaining easier access to capital, renewable energy facility developers will be able to replace fossil fuels, reduce greenhouse gases, and secure the electrical grid with stable, baseload power.”

Mike McAdams, president, Advanced Biofuels Association: “We are grateful for Senator Coons’ leadership at a critical point for America’s domestic biofuels industry as we are moving from the beaker to the barrel, in record time. The legislation provides an innovative financial mechanism that could significantly reduce the cost of financing as companies are reaching a game-changing milestone. Substantial investments by private companies in research and development have been the catalyst for today’s success in bringing advanced biofuels to commercial markets, but stable and consistent public policies are crucial to encourage and allow additional investment dollars that will help get us across the finish line. By creating a new and more appealing option for investors, the bill helps level the playing field and ultimately promotes a more cost competitive advanced biofuel alternative to conventional fuel.”

Doug Sims, Natural Resources Defense Council: “NRDC strongly endorses the MLP Parity Act. The tax code currently enables the well established fossil fuel industry to have this financing advantage while denying its use for the newer, cleaner forms of energy that Americans want and need to encourage. That makes no sense. Master Limited Partnerships should be one of the tools available to develop clean, renewable energy. MLPs provide a low risk way for main street to invest in renewable energy. This will create jobs and new investment opportunities while reducing pollution. Sen. Coons is right to propose this forward-looking and fair-minded step to ensure that the today’s clean, domestic energy sources have the same opportunities to succeed as the fossil fuel sources of the past.”

Anthony J. Orlando, president and CEO, Covanta Energy: “I want to congratulate Senators Coons and Moran for their efforts to level the playing field for renewable energy development. Master Limited Partnerships have been available since 1986 to help incentivize oil and natural gas development, and now, thanks to Senators Coons and Moran, we have legislation extending the availability of MLPs that will allow for the expansion of investment opportunities that could provide the capital necessary to promote further development of renewable energy sources, including new and expanded waste-to-energy facilities.”

Jim Lanard, president, Offshore Wind Development Coalition: “MLPs will help to support the establishment of a sustainable offshore wind industry, since they can reduce the cost of capital and attract more investors. While extension of the Investment Tax Credit (ITC) remains our industry’s number one legislative priority, MLPs will serve as a nice complement to ITCs.”



Denise Bode, CEO, American Wind Energy Association: “We commend Senator Coons for his leadership in promoting the eligibility of master limited partnerships to include renewable energy projects. America’s wind energy sector is a success story that has proven its strength by recruiting \$15.5 billion in annual investment in America’s energy infrastructure in recent years despite short-lived policy certainty. MLPs work well for conventional energy infrastructure and will work best to spur more renewable energy investment and job creation if structured properly to match renewable tax incentives. We look forward to working with Senator Coons to enable wind power developers to efficiently utilize MLP structures.”

Brooke Coleman, executive director, Advanced Ethanol Council: “The advanced ethanol industry strongly supports the efforts of Senator Coons and the co-sponsors of Master Limited Partnership Parity Act to level the playing field for advanced technologies when it comes to MLPs. Energy project developers are using MLPs to access the retail investment market, which in turn makes it easier to finance new energy projects. It makes no sense for the federal government to continue to offer this financing vehicle to, in essence, the fossil fuel industry only. The MLP Parity Act would take a serious inequity out of the U.S. tax code and put the country in a better position to create jobs and compete in the emerging global clean energy marketplace.”

Judith Albert, Executive Director, Environmental Entrepreneurs: “The members of Environmental Entrepreneurs (E2) are supportive of Sen. Coons’ MLP Parity Act. This bill would allow renewable energy companies access to a financing structure –Master Limited Partnerships – that has long been available to the fossil fuel industry. Access to this structure will expand the sources of private capital that renewable energy companies can tap and reduce the cost of financing new, job creating projects. If passed, this important measure would be a significant step toward continued development of clean, renewable energy.”

Vice Admiral Dennis McGinn (USN-Ret.), president and CEO, American Council On Renewable Energy: “We commend Senator Coons for his leadership in introducing important legislation to level the playing field and promote greater private investment in our nation’s abundant and affordable renewable energy resources and fuels. Enabling master limited partnership investment in renewable energy and infrastructure can help lower project costs, leading to more economic investment and a more diverse energy mix.”

Barry Granger, vice president for government affairs and government marketing, DuPont: “We appreciate Senator Coons thoughtful, constructive legislation to facilitate the commercialization of advanced biofuels and biopower technologies by extending the tax-efficient Master Limited Partnership structure to investments in these forms of energy. These tax policies have proven effective in encouraging investment in oil and gas infrastructure and can similarly help the domestic advanced biofuels industry.”

Felix Mormann and Dan Reicher, Stanford University Steyer-Taylor Center for Energy Policy and Finance: “There’s another benefit to expanding the pool of renewable energy investors: It would help democratize, and thus build support for, these new energy sources. Today, all American taxpayers fund renewable energy subsidies, but only a deep-pocketed few can cash in on the tax benefits. Publicly traded master limited partnerships ... would empower all Americans to invest and have a stake in the transition to cleaner energy.” <http://nyti.ms/LmGDI7>



OP-ED

How to Make Renewable Energy Competitive

By **FELIX MORMANN** and **DAN REICHER**June 1, 2012 | <http://nyti.ms/LmGDI7>*The New York Times*

STANFORD, Calif. — Renewable energy needs help. Technological innovation has significantly reduced the cost of solar panels, wind turbines and other equipment, but renewable energy still needs serious subsidies to compete with conventional energy. Today, help comes mostly in the form of federal tax breaks.

These tax incentives, and the Congressional battle over extending them for wind projects beyond the end of this year, mean that other, more powerful policies to promote renewables are not getting the attention they deserve. If renewable energy is going to become fully competitive and a significant source of energy in the United States, then further technological innovation must be accompanied by financial innovation so that clean energy sources gain access to the same low-cost capital that traditional energy sources like coal and natural gas enjoy.

Two financial mechanisms that have driven investment in traditional energy projects — real estate investment trusts and master limited partnerships — could, with some help from Washington, be extended to renewable energy projects to lower their cost and make America's energy future cleaner, cheaper — and more democratic.

Federal support for renewable energy today consists primarily of two tax breaks: tax credits and accelerated depreciation rates. But both tools have a very limited reach. Only investors with hefty tax bills, typically big banks or corporations, can exploit them to reduce their tax burden. Most potential investors, including tax-exempt pension funds and, importantly, retail investors trading stocks, don't have big enough tax bills to exploit the break. As a result, the few remaining players whose considerable tax bills place them in the market for tax breaks are able to demand returns of up to 30 percent for investing in renewable energy projects — an investment known as “tax equity.”

There are better options. They may sound wonky, but they could prove revolutionary.

Real estate investment trusts, or REITs, which are traded publicly like stocks, could tap far broader pools

of capital to vastly lower the cost of financing renewable energy. REITs have a market capitalization of over \$440 billion while paying shareholders average dividends below 10 percent — roughly a third of the cost of tax equity investments for renewable energy.

Master limited partnerships carry the fund-raising advantages of a corporation: ownership interests are publicly traded and offer investors the liquidity, limited liability and dividends of classic corporations. Their market capitalization exceeds \$350 billion. With average dividends of just 6 percent, these investment vehicles could substantially reduce the cost of financing renewables.

But current law makes using both of these investment vehicles for renewable energy difficult if not impossible. Washington could help in two ways. First, the Internal Revenue Service needs to clarify the eligibility of renewable power generation for REIT financing. Second, Congress needs to fix a bizarre distinction in the tax code that bars master limited partnerships from investing in “inexhaustible” natural resources like the sun and wind, while allowing investments in exhaustible resources like coal and natural gas. In 2008, as surging gasoline prices were infuriating American voters, Congress amended the tax code to enable master limited partnerships to invest in alternative transportation fuels like ethanol. We should treat power sources, like wind and solar farms, similarly.

There is hope. Senator Chris Coons, Democrat of Delaware, plans to introduce a bill to allow master limited partnership investment in renewable energy. This approach is preferable to a recent proposal by Senator Bernard Sanders, independent of Vermont, and Representative Keith Ellison, Democrat of Minnesota, to eliminate this investment option for fossil-fuel projects. Both moves would level the playing field between conventional and renewable energy, but the Coons bill does so by promoting, rather than limiting, economic growth across the energy industry.

These approaches could help renewable energy projects reduce their financing costs up to fivefold. These cost

improvements could significantly reduce the price of renewable electricity and, over time, erase the need for costlier subsidies. Of course, making renewable energy eligible for master limited partnership and REIT financing would amount to a new kind of subsidy, because both are exempt from income tax. Indeed, some members of Congress fear that expanding master limited partnerships will erode the federal tax base. We don't think so. Investors in master limited partnerships and REITs still pay taxes on dividends. Moreover, these investments would most likely bring many more renewable energy projects online, actually raising overall tax revenue.

A more valid concern is whether renewable energy master limited partnerships might be abused as tax shelters, reminiscent of what happened in the 1980s California “wind rush.” Back then investors cared more about putting turbines in the ground to secure tax credits to lower their tax bill on other income than whether the machines actually produced electricity.

History, however, need not repeat itself. Renewable energy master limited partnerships can guard against such abuse by ensuring that these tax privileges actually result in green electricity.

There's another benefit to expanding the pool of renewable energy investors: It would help democratize, and thus build support for, these new energy sources. Today, all American taxpayers fund renewable energy subsidies, but only a deep-pocketed few can cash in on the tax benefits. Publicly traded master limited partnerships and REITs would empower all Americans to invest and have a stake in the transition to cleaner energy.

Renewable energy has come a long way since the 1970s energy crisis but much work remains. We must complement continued technological innovation with critical financial innovation — to level the playing field, incentivize growth, reduce subsidies and democratize America's energy future.

Felix Mormann is a fellow, and Dan Reicher is the executive director, both at Stanford's Steyer-Taylor Center for Energy Policy and Finance.



U.S. SENATOR CHRIS COONS of DELAWARE

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