

LATHAM & WATKINS LLP

*The*  
**BOOK**  
*of*  
**JARGON®**  
**MLPs**

(Master Limited Partnerships)

The Latham & Watkins Glossary of  
MLP Terminology

First Edition



The Book of Jargon®: MLPs (*Master Limited Partnerships*) is one of a series of practice area-specific glossaries published by Latham & Watkins.

*The definitions contained in it are designed to provide an introduction to the applicable terms often encountered in master limited partnerships. These terms raise complex legal issues on which specific legal advice will be required. The terms are also subject to change as applicable laws and customary practice evolve.*

*As a general matter, The Book of Jargon®: MLPs is drafted from a US perspective. The information contained herein should not be construed as legal advice.*

*If you have suggestions for additional terms or expanded or clarified definitions for the current terms, please send an e-mail to [MLPglossary@lw.com](mailto:MLPglossary@lw.com).*

*Additional Books of Jargon, including The Book of Jargon®: US Corporate and Bank Finance, are available at [lw.com](http://lw.com).*

### **Check out the Latham MLP Portal**

In addition to *The Book of Jargon®: MLPs (Master Limited Partnerships)*, Latham & Watkins has launched the MLP Portal at [www.lathammlp.com](http://www.lathammlp.com). This online resource is a valuable tool for existing MLPs, companies considering going public with an MLP and everyone working within the MLP space. The site includes primers on how MLPs work, a list of all currently traded MLPs as well as robust repositories of documents covering MLP governance, raising capital and M&A activity. Also included are sections on tax considerations and Latham & Watkins' thought leadership in the MLP space. We welcome comments about the portal at [webmaster@lw.com](mailto:webmaster@lw.com).

We love this stuff!



***Accretive:*** an acquisition is “accretive” if it is expected to increase Distributable Cash Flow per Unit either immediately or over time after taking into account the cost of the acquisition

***Adjusted EBITDA or EBITDAX:*** EBITDA or EBITDAX on steroids. Refers to EBITDA or EBITDAX, as applicable, adjusted to eliminate the impact of certain unusual or non-cash items that the MLP believes are not indicative of the future performance of its business.

For issuers that file reports with the SEC, disclosure of EBITDA, EBITDAX, Adjusted EBITDA, Adjusted EBITDAX and other “non-GAAP financial measures” must be done within the confines of Item 10 of Regulation S-K (in the case of certain public filings) and Regulation G of the SEC (in all cases). See EBITDA and EBITDAX.

***Adjusted Operating Surplus:*** Operating Surplus adjusted to reflect the ability of the MLP’s business to generate the cash needed for the MLP to pay the Minimum Quarterly Distribution. Adjusted Operating Surplus takes out the noise of Working Capital Borrowings and Cash Reserves to show whether the MLP is earning its distributions (as opposed to using Working Capital Borrowings or Cash Reserves to pay distributions). Adjusted Operating Surplus is the “earned” part of the “earned and paid” test used to determine the end of the Subordination Period.

***Adjusted Property:*** any Partnership property, the Carrying Value of which has been adjusted pursuant to a Book-Up Event or Book-Down Event in order to account for any Unrealized Gain/Loss on the property

***Agreed Value:*** the fair market value of Contributed Property or Adjusted Property at a specific point in time (i.e., at the time of the contribution of the Contributed Property or at the time of a Book-Up Event or Book-Down Event in the case of Adjusted Property) as determined by the General Partner

***Assignee:*** a person to whom one or more Partner Interests have been transferred in a manner permitted under the Limited Partnership Agreement, but who has not been admitted as a Substituted Limited Partner

***Associate:*** a term used in MLP Partnership Agreements to distinguish certain types of related parties from actual “affiliates” or “indemnitees” of the Partnership and means, when used to indicate a relationship with any person, (a) any corporation or organization of which such person is a director, officer or partner or is, directly or indirectly, the owner of 20 percent or more of any class of voting stock or other voting interest; (b) any trust or other estate in which such person has at least a 20 percent beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity and (c) any relative or spouse of such person, or any relative of such spouse, who has the same principal residence as such person

***Available Cash:*** the MLP’s cash at the end of each quarter, which will be distributed to Unitholders. Technically, Available Cash is defined as

all of the MLP's cash on hand at the end of each fiscal quarter, less Cash Reserves, plus cash from Working Capital Borrowings made after the end of the quarter.

MLPs are typically required by the terms of their Partnership Agreements (not by the tax laws) to pay out 100 percent of their Available Cash to the Limited Partners and the General Partner on a quarterly basis. However, the per-unit distribution amount is subject to the discretion of the General Partner. Some recent MLP IPOs do not have the concept of Available Cash or the requirement to distribute 100 percent of their available cash every quarter.

*Board of Directors:* in the MLP context, this typically refers to the Board of Directors of the General Partner. An MLP has no directors or officers and often no employees; the directors, officers and most if not all employees are at the General Partner.

The MLP's General Partner must have an Audit Committee comprised of at least three independent directors (following a post-IPO phase-in period), but the General Partner is not required to have a majority of independent directors on the Board of Directors. At the time of its IPO, an MLP must have one independent director on the Audit Committee; after 90 days, it must have two independent directors on the Audit Committee; and within 12 months, it must have at least three independent directors on the Audit Committee. The members of the Audit Committee typically also comprise the Conflicts Committee.

*Book-Down Event:* a mark to market event that triggers a negative adjustment to the Capital Accounts of the partners of an MLP or other Partnership

*Book-Tax Disparity:* the difference between the Carrying Value of Contributed Property or Adjusted Property and the tax basis of such Contributed Property or Adjusted Property. The MLP's partners that effectively own these assets at a time that a Book-Tax Disparity is created must eventually bear the imbedded tax cost associated with these assets with built-in tax gain.

*Book-Up Event:* a mark to market event that triggers a positive adjustment to the Capital Accounts of the partners of an MLP or other Partnership. An offering of Common Units to the public typically results in a Book-Up Event if the trading price of the MLP has risen since the last Book-Up Event.

*Call Right:* the General Partner has the right, at any time the General Partner and its affiliates own more than (typically) 80 percent of the outstanding Common Units of the MLP, to purchase all remaining Common Units at a price not less than their Current Market Price. This right is comparable to the right, under many state corporation laws, of a 90 percent stockholder to acquire the remaining 10 percent of the outstanding stock through a short-form merger.

*Capex:* shorthand for Capital Expenditures

*Capital Account:* the Capital Account maintained for a partner under the Partnership Agreement for an MLP or other Partnership. Capital Accounts initially are credited with the fair market value of Contributed Property and the cash contributed to purchase Common Units in an offering (in the case of public investors). Capital Accounts are, as with ordinary partnerships, increased by additional capital contributions and allocations of income and gain, and are decreased by distributions of cash and property and allocation of deductions and loss.

*Capital Contribution:* any cash, cash equivalents or the Net Agreed Value of Contributed Property that a partner contributes to an MLP or other Partnership pursuant to the Partnership Agreement

*Capital Expenditures:* commonly referred to as "Capex," these are cash outlays for physical plant, property or equipment that create future economic benefits for a business. In an MLP Partnership Agreement, these capital expenditures are generally divided into three separate categories:

- *Expansion Capital Expenditures:* expenditures allotted to acquisitions of new assets, improvements to existing assets and other activities aimed at expanding a business. Generally, expansion Capex will include interest on debt incurred and distributions on equity issued to finance such acquisitions or improvements.
- *Maintenance Capital Expenditures:* in contrast to expansion Capex, Maintenance Capital Expenditures are investments in physical assets that do not aim to grow the business, but instead are intended merely to maintain or sustain the current level of operating capacity or income of the business (or the level of oil and gas reserves, in the case of an upstream MLP). Generally, these include the maintenance of existing assets and the replacement of obsolete assets.
- *Investment Capital Expenditures:* a catch-all for all expenditures with purposes other than "expansion" or "maintenance." This concept is not used in all MLPs.

Capital Expenditures other than Maintenance Capital Expenditures are considered separate from Operating Expenditures.

*Capital Improvement:* means the construction of new or the replacement, improvement or expansion of existing capital assets if and to the extent such construction, replacement, improvement or expansion is made to increase, over the long-term, the operating capacity or operating income of the MLP from the operating capacity or operating income of the MLP existing immediately prior to such construction, replacement, improvement, expansion or capital contribution. For purposes of this definition, "long-term" generally refers to a period of not less than 12 months.

*Capital Surplus:* cash distributed to Unitholders in excess of Operating Surplus. At this point, the MLP is essentially returning capital to its Unitholders, rather than distributing cash from operations. This

phenomenon is often referred to as a “return of capital” instead of a “return on capital.” Distributions of Capital Surplus have various effects under the Partnership Agreement, none of which are good for the Unitholders.

*Carrying Value:* the ongoing measure of the value of partnership property as adjusted by depreciation-type charges (similar to book value). Carrying Value may be calculated differently for properties that have been contributed to a Partnership by a partner than for properties that have been purchased by the Partnership itself.

*Cash Available for Distribution:* see Distributable Cash Flow

*Cash Distribution Forecast:* the forecast of Cash Available for Distribution included in an MLP’s IPO prospectus with respect to the 12-month period after the completion of the IPO. The forecast demonstrates the MLP’s expected ability to pay the aggregate annualized Minimum Quarterly Distribution (MQD) on all Common Units and Subordinated Units and the corresponding distribution on the General Partner Interest at the time of the IPO.

*Cash Reserves:* an amount established by the General Partner with respect to a particular quarter to (1) provide for the proper conduct of the MLP’s business, (2) comply with applicable law or any of the MLP’s debt instruments or other agreements or (3) provide funds for distributions to unitholders and the General Partner for any one or more of the next four quarters. The establishment of Cash Reserves reduces the amount of Available Cash for that quarter.

*Certificate of Limited Partnership:* a certificate filed with a state office or agency for purpose of forming a Limited Partnership under the laws of that state.

*Citizenship Eligibility Trigger:* an event that results when the General Partner determines that the MLP is subject to any federal, state or local law that would create a substantial risk of cancellation or forfeiture of any property in which the MLP has an interest based on the nationality, citizenship, or other related status as a Limited Partner (e.g., if the MLP owns oil and gas leases on US federal land). Upon the occurrence of a Citizenship Eligibility Trigger, the General Partner has the right to obtain proof of the nationality, citizenship or other related status of the Limited Partners and, to the extent relevant, their beneficial owners, and to redeem their Limited Partner Interests if they cannot provide the requisite proof of citizenship. See Eligible Holder.

*Commences Commercial Service:* the date on which a Capital Improvement or acquired asset is first put into commercial service following its acquisition or construction and required testing

*Common Unit Arrearage:* during the Subordination Period, the amount by which the Minimum Quarterly Distribution for a quarter exceeds the actual distribution of cash from Operating Surplus for such quarter



*Common Unit:* an interest in the MLP representing a fractional part of the Partnership Interests of all Limited Partners. Like a share of common stock for a corporation, but for an MLP. See also Subordinated Units.

*Conflicts Committee:* a committee of independent directors of the Board of Directors established to review and, if appropriate, approve conflicts of interest. The committee reviews matters believed by the General Partner to involve a conflict of interest between the General Partner and its affiliates, on the one hand, and the MLP and its Limited Partners, on the other hand. The General Partner may, but is not required to seek the approval of the committee on resolutions to conflicts. Any matters approved in good faith by the committee will be deemed fair and reasonable to the MLP; no third-party fairness evaluation is required. See Special Approval.

Members of the conflicts committee cannot be directors, officers or employees of the General Partner or its affiliates. They must meet the independence and experience standards established by the securities exchange on which the MLP is listed and cannot have any material personal interest in the transaction or conflict in question.

*Contributed Property:* any property or other asset, excluding cash, contributed to a Partnership. Such property constitutes Contributed Property only until its Carrying Value has been adjusted upward or downward to account for any Unrealized Gain or Loss prior to the issuance of additional Partnership Interests, after which time it is referred to as "Adjusted Property."

*Current Market Price:* the average of the daily closing prices for the 20 consecutive trading days immediately prior to the reference date for any class of Units listed or admitted to trading on any national securities exchange as of any date. This concept is used with respect to the Call Right and the redemption of a holder who is not an Eligible Holder.

*Current Yield:* a percentage amount that represents an MLP's annualized quarterly distribution divided by its current Unit Price. For example, if an MLP has an annualized quarterly distribution of US\$2.00 and a current Unit Price of US\$20.00, then the yield is said to be 10 percent. As the MLP's Unit Price rises, its yield correspondingly declines.

*D&A:* abbreviation for depreciation and amortization

*DCF:* abbreviation for Distributable Cash Flow. Not to be confused with Discounted Cash Flow Analysis.

*DD&A:* abbreviation for depreciation, depletion, amortization and accretion

*Delaware Revised Uniform Limited Partnership Act:* often referred to simply as "the Delaware Act" or "DRULPA"

*Depreciation Recapture Income:* ordinary income required to be recognized upon the sale of MLP units in order to "recapture" previously deducted depreciation and depletion amounts

***Distributable Cash Flow:*** a measure of the amount of cash that an MLP has available for distribution to Unitholders. The calculation of Distributable Cash Flow can vary from MLP to MLP, but generally it is calculated as (1) EBITDA or EBITDAX, as applicable, less (2) cash interest expense and Maintenance Capital Expenditures.

***Distributed Cash Flow:*** the amount of cash actually distributed by an MLP, which is typically a percentage of Distributable Cash Flow

***Distribution Coverage Ratio:*** the ratio of Distributable Cash Flow to Distributed Cash Flow. For example, if an MLP has Distributable Cash Flow of US\$11.5 million in a quarter and distributes US\$10 million for the quarter, then the Distribution Coverage Ratio is 115 percent. Investors and analysts typically expect an MLP to maintain a Distribution Coverage Ratio of approximately 110 percent to 120 percent, although the desired ratio varies based on the type of MLP. This ratio is an indication of the MLP's ability to maintain its current cash distribution level throughout normal business cycles. The lower the ratio, the less likely the MLP will be able to cover its distribution obligations due to changes in the MLP's business.

***Distribution Yield:*** see Current Yield

***Distribution:*** similar to dividends paid to a stockholder, Distributions represent cash paid by an MLP to its Unitholders

***Dropdown:*** the sale or other transfer of assets or other items of value from the Sponsor to the MLP, whether at formation or after the Initial Public Offering. The Sponsor typically contributes the assets or other items of value to the MLP in exchange for Partnership Interests, cash, or a combination of both. Dropdowns are typically negotiated on behalf of the MLP by the Conflicts Committee.

***DRULPA:*** abbreviation for the Delaware Revised Uniform Limited Partnership Act

***EBITDA:*** abbreviation for earnings before interest, taxes, depreciation and amortization. Because it eliminates the effects of financing and accounting decisions and tax exposure, EBITDA is often used to assess a company's ability to service debt. See also Adjusted EBITDA.

***EBITDAX:*** abbreviation for earnings before interest, taxes, depreciation, amortization and exploration expense. See also Adjusted EBITDAX.

***Eligibility Certificate:*** certification that a Holder of a Limited Partner Interest in an MLP is an Eligible Holder

***Eligible Holder:*** midstream MLPs with pipelines and other assets regulated by the FERC typically require a Holder of a Limited Partner Interest in the MLP to be a "rate eligible holder," which is a person who is either (1) subject to US federal income taxation on the income generated by the Partnership or (2) in the case of entities that are pass through entities for US federal income taxation, all of whose beneficial owners

are subject to US federal income taxation on the income generated by the MLP. These restrictions are associated with the FERC income tax allowance for rate-making purposes.

MLPs, such as those in the upstream and shipping sectors with assets that are subject to laws prohibiting foreign ownership of those assets, typically require a Holder of Limited Partner Interests in the MLP to be a "citizenship eligible holder," which is a person who is a US citizen or an entity owned or controlled entirely by US citizens. See Citizenship Eligibility Trigger.

The Common Units held by a person who is unable to certify that he is an Eligible Holder are subject to redemption by the MLP at the Current Market Price.

*Estimated Maintenance Capital Expenditures:* an estimate made in good faith by the Board of Directors (with the concurrence of the Conflicts Committee) of the average quarterly Maintenance Capital Expenditures that will be incurred over the long term. The Board of Directors typically makes the estimate in any manner it determines is reasonable in its sole discretion. The estimate is typically made annually and whenever an event occurs that is likely to result in a material adjustment to the amount of Maintenance Capital Expenditures on a long-term basis.

Estimated Maintenance Capital Expenditures, as opposed to actual Maintenance Capital Expenditures, are commonly used in businesses that have depleting assets, such as upstream MLPs, or that have substantial, recurring and irregularly spaced Maintenance Capital Expenditures, such as shipping MLPs. For MLPs that use this concept, Estimated Maintenance Capital Expenditures (rather than actual Maintenance Capital Expenditures) count as Operating Expenditures and thereby reduce the amount of Operating Surplus.

*Expansion Capital Expenditures:* see Capital Expenditures

*Fee-Based:* a type of contract calculation that largely avoids direct commodity pricing sensitivity, such as when an MLP receives a fee for the volume of natural gas that flows through its processing plant. Thus, gross margin is directly related to the volume flowing through the system and not to the price of the commodity.

*FERC:* US Federal Energy Regulatory Commission

*General Partner:* the entity that owns the General Partner Interest and, as a consequence, manages and controls the MLP. The General Partner is authorized to perform all acts it deems necessary or appropriate to carry out the MLP's purposes and conduct its business. An MLP cannot act on its own; the General Partner acts on behalf of the MLP and has considerable discretion when acting in its formal capacity. The General Partner is typically not elected by Unitholders and can be removed only by a supermajority vote of Unitholders. As the manager of the MLP, the General Partner must comply with the corporate governance

requirements of both the federal securities laws and of the exchange on which the MLP's securities are listed. The General Partner also typically holds the Incentive Distribution Rights, but that is not always the case.

*General Partner Interest:* the ownership interest, if any, of the General Partner in the MLP (in its capacity as a General Partner without reference to any Limited Partner Interest held by it). The General Partner Interest may be evidenced by General Partner Units. The General Partner Interest gives the General Partner the exclusive right and authority to manage and control the MLP.

*General Partner Unit:* a fractional part of the General Partner Interest having the rights and obligations specified with respect to the General Partner Interest. A General Partner Unit is typically not considered a Unit under the Partnership Agreement, including for purposes of calculating amounts involving Common Units and Subordinated Units.

*GP:* abbreviation for General Partner

*Group Member:* a member of the Partnership Group

*High Splits:* when the holder of the Incentive Distribution Rights (often the General Partner) is receiving distributions at the highest marginal percentage (typically 48 percent, exclusive of the General Partner Interest), it is sometimes said that the holder is "in the high splits." See Incentive Distribution Rights.

*Holder:* see Unitholder

*IDR:* abbreviation for Incentive Distribution Rights

*IDR Reset Common Units:* Common Units issued to the holder of IDRs upon an IDR Reset Election

*IDR Reset Election:* the election of the holder of IDRs, normally the General Partner, that are in the High Splits to exchange existing IDRs for a number of Common Units that generate an equivalent amount of cash distributions. After the reset, the IDR tiers are then adjusted to higher Target Distribution Levels. The election is believed to reduce the MLP's cost of capital by reducing cash paid on the Incentive Distributions Rights and "resetting" the hurdles at higher levels.

*IDR Reset Rights:* the right to make an IDR Reset Election, usually held by the General Partner of an MLP

*IDR Tiers:* the percentage of Available Cash allocated to the holder of Incentive Distribution Rights after the achievement of Target Distribution Levels. See Incentive Distribution Rights.

*Incentive Distribution Rights:* the right, typically held by the General Partner, to an increasing share of Distributions as the MLP increases its cash distributions to Unitholders. The Incentive Distribution Rights typically entitle the holder to receive 13 percent, 23 percent and 48 percent of incremental cash distributions from the MLP after similar

increases in the MQD. The typical rationale for providing Incentive Distribution Rights is twofold: first, the prospect of an increasing share of distributed cash provides incentive for the General Partner to grow the MLP's business; and second, it compensates the General Partner for the Subordination Period during which cash distributions to the General Partner in respect of the Subordinated Units it holds are not guaranteed.

*Incentive Distributions:* the distributions of Available Cash from Operating Surplus made to the holder of Incentive Distribution Rights

*Ineligible Holder:* see Eligible Holder

*Initial Common Units:* the Common Units sold in the Initial Public Offering

*Initial Distribution Rate:* similar to the Minimum Quarterly Distribution of an MLP that has IDRs, but used by MLPs that have no IDRs or Subordinated Units in their capital structure

*Initial Limited Partners:* the Limited Partners of an MLP upon formation, prior to the IPO

*Initial Unit Price:* the price per Common Unit as originally offered to the public in the Initial Public Offering

*Interim Capital Transactions:* (1) borrowings, refinancings or refundings of indebtedness (other than Working Capital Borrowings and items purchased on open account in the ordinary course of business) and sales of debt securities, (2) sales of equity securities, (3) sales or other dispositions of certain other assets, (4) capital contributions received and (5) corporate reorganizations or restructurings. Cash received from Interim Capital Transactions does not count as Operating Surplus.

*Investment Capital Expenditures:* Capital Expenditures other than Maintenance Capital Expenditures or Expansion Capital Expenditures. See Capital Expenditures.

*IRC:* Internal Revenue Code

*K-1:* the tax form received by a Unitholder each year that sets forth the holder's allocable share of the income, gain, loss, deductions and credits of the MLP

*Limited Call Right:* see Call Right

*Limited Partner Interest:* the interest held by Limited Partners in the MLP. Generally, a Limited Partner Interest combines the tax treatment and profit sharing of a traditional Partnership Interest with the liquidity and limited liability of a holder of common stock in a corporation. Holders of Limited Partner Interests have very limited Voting Rights and almost no power over management. The Limited Partner Interests of an MLP are typically in the form of Common Units.

*Limited Partner:* see Unitholder

*Limited Partnership Agreement:* the agreement between the General Partner and the Limited Partners of an MLP that governs their respective rights, responsibilities and authorities. The majority of the agreement deals with cash distributions, tax allocations and the General Partner's standards of conduct.

*Liquidation Date:* in a Partnership Agreement, the date on which an event that gives rise to the dissolution of the Partnership occur

*LLC Agreement:* a contract between the members and managers of a limited liability company that governs their respective rights, responsibilities and authorities. The majority of the agreement deals with cash distributions, tax allocations and the managers' standards of conduct. The equivalent of a Limited Partnership Agreement for an LLC.

*LLC:* abbreviation for Limited Liability Company

*LP:* abbreviation for Limited Partner

*Maintenance Capital Expenditures:* cash Capital Expenditures made to maintain the operating capacity of or the operating income generated by the MLP's capital assets over the long-term, as such assets existed at the time of such expenditure. Maintenance Capital Expenditures do not include Expansion Capital Expenditures or Investment Capital Expenditures. See Capital Expenditures.

*Master Limited Partnership:* Simply put, an MLP is a partnership that is publicly traded and listed on a national securities exchange. Breaking those requirements down: first, it is necessary for the MLP to be a state law entity that can be treated as a tax passthrough entity. Thus, most commonly the MLP is formed as a Delaware limited partnership. Alternatively, the MLP may be a state law limited liability company or even a state law trust, such as a Delaware statutory trust. Although the governance structure may differ among these entity types, any of these entities may be treated as partnerships for federal income tax purposes.

Second, the MLP must be publicly traded. Owners of MLP units have the ability to buy and sell interests in the MLP. The publicly traded element of an MLP simply provides for the same type of liquidity (or float) that is enjoyed by a public corporation — although for the most part float and trading volume of MLPs are relatively small as compared to the float and trading volume for publicly traded corporations. This is largely because of the nature of MLP unitholders. The majority of MLP units are held by retail investors seeking yield. Moreover, given certain tax limitations, these investors are typically domestic, rather than foreign. Institutional ownership of MLPs has been limited (although growing in recent years), mainly because MLPs generate income that is not conducive to ownership by tax-exempt investors.

Third, the MLP must be listed on one of the major exchanges. Today, the most common securities exchange for MLPs is the NYSE, although quite a few MLPs are listed on the NASDAQ.

MLPs are sometimes referred to for tax purposes as Publicly Traded Partnerships, or PTPs.

*Mineral or Natural Resource:* For purposes of the Qualifying Income rule set forth in the tax code, with respect to natural resource-related activities, the term “mineral or natural resource” means fertilizer, geothermal energy and timber, as well as any product eligible for depletion, which includes oil, gas and oil-and-gas related products. Typically, anything that is dug or pumped out of the ground qualifies, which includes coal, lignite, potash, salt, aggregates, limestone, sand and many other hard rock minerals.

Moreover, the US Congress made it clear in the legislative reports accompanying these Qualifying Income rules that, for purposes of determining the limits of what constitutes oil, gas, or oil-and-gas related products, such term includes gasoline, kerosene, number-2 fuel oil, refined lubricating oils, diesel fuel, methane, butane, propane and similar products that are recovered from petroleum refineries or field facilities.

The Qualifying Income rules do provide limitations. Specifically, the rules provide that there are certain products, such as soil, sod, turf, water, mosses and minerals from seawater, air and other similar inexhaustible sources that are excluded. Thus, items that are renewables, such as agricultural products (e.g., wheat or corn), or items that are unlimited in supply such as solar power or wind, do not constitute natural resources for these purposes and, therefore, cannot qualify.

In 2008, the US Congress amended the MLP tax rules to provide that qualifying income includes the storage and transportation of alternative fuels such as biodiesel and ethanol. However, this amendment does not extend to activities beyond storage and transportation. Therefore, the manufacturing or sale of biodiesel or ethanol does not generate Qualifying Income. The 2008 amendment also provided that any income associated with industrial source carbon dioxide generates Qualifying Income, which includes activities such as transportation and marketing.

As a result of these generally broad rules permitting many types of energy operations to satisfy the Qualifying Income test, there have been over 100 energy-related MLPs formed in the past 25 years. The majority of these MLPs are focused on the midstream pipeline sector, but many are focused on upstream, mining, shipping (international and coast-wise), propane, fertilizer, oilfield services and refining.

*Minimum Quarterly Distribution:* in its initial prospectus, the MLP will make a statement as to its intention to distribute a specified minimum level of distributions on a quarterly basis. Pursuant to the terms of the Partnership Agreement, the MLP must make this minimum distribution of Available Cash to holders of Common Units during the Subordination Period before any distributions may be made on the Subordinated Units, and any shortfall in this minimum distribution to the holders of Common Units during the Subordination Period results in a Common Unit Arrearage, which must be extinguished (and other tests satisfied)

before the Subordination Period may end. The MLP does not guarantee its ability to pay, or the actual payment of, the Minimum Quarterly Distribution during any quarter.

*MLP*: abbreviation for Master Limited Partnership. Sometimes referred to as a Publicly Traded Partnership or PTP.

*MQD*: abbreviation for Minimum Quarterly Distribution

*Natural Resource-Related Income*: under Section 7704 of the IRC, an MLP will be treated as a partnership for tax purposes if at least 90 percent of its income is derived from or sufficiently related to natural resources. These Qualifying Income sources include income derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil or products thereof) or the marketing of any mineral or natural resource (including fertilizer, geothermal energy and timber). (See Section 7704)

In practice, the determination of whether an MLP's assets generate qualifying natural resource-related income involves a two-part test entailing (1) determining what constitutes a mineral or natural resource, and (2) determining whether a particular activity directed toward that mineral or natural resource generates Qualifying Income. See also Mineral or Natural Resource and Qualified Activities.

*Net Agreed Value*: a defined term in the Partnership Agreement that means (1) in the case of any Contributed Property, the Agreed Value of such property reduced by any liabilities either assumed by an MLP upon such contribution or to which such property is subject when contributed, and (2) in the case of any property distributed to a partner by the MLP, the MLP's Carrying Value of such property (as adjusted) at the time such property is distributed, reduced by any indebtedness either assumed by such Partner upon such distribution or to which such property is subject at the time of distribution, in either case, as determined under section 752 of the Code. In other words, the Net Agreed Value is intended to reflect the effect of liabilities burdening Partnership property.

*Net Termination Gain/Loss*: for any taxable year, the sum of all items of income, gain, loss or deduction recognized by an MLP after the Liquidation Date or upon the sale of all or substantially all of the assets of the MLP

*Non-Accretive*: an acquisition that does not or is not expected to increase Distributable Cash Flow per Unit

*Non-Citizen Assignee*: a Holder of a Limited Partner Interest that is not a US citizen. Upstream MLPs that have or may acquire lease acreage on US federal lands do not permit Non-Citizen Assignees to hold their Limited Partner Interests.

*Notional General Partner Unit*: a fractional interest in a General Partner Interest that is characterized as a unit for purposes of certain calculations under the Partnership Agreement



*OLP*: abbreviation for Operating Limited Partnership

*Omnibus Agreement*: an agreement among an MLP, the General Partner and the Sponsor that typically provides for indemnification of the MLP with respect to environmental, tax and title matters and reimbursement by the MLP to the General Partner and the Sponsor for general, administrative and other services. Omnibus Agreements sometimes contain preferential purchase rights with respect to certain assets of the Sponsor and non-compete provisions in favor of the MLP.

*Operating Expenditures*: all cash expenditures of an MLP and its subsidiaries other than:

- Payments (including prepayments and prepayment penalties) of principal of and premium on indebtedness, other than Working Capital Borrowings
- Expansion Capital Expenditures and Investment Capital Expenditures and
- Payment of transaction expenses and taxes relating to Interim Capital Transactions or distributions to partners.

Operating Expenditures are deducted from Operating Surplus. Where Capital Expenditures consist of both Maintenance Capital Expenditures and Expansion Capital Expenditures and/or Investment Capital Expenditures, the General Partner typically has the right to determine the allocation between Maintenance Capital Expenditures and Expansion Capital Expenditures and/or Investment Capital Expenditures, and the period over which the Maintenance Capital Expenditures will be deducted as an Operating Expenditure in calculating Operating Surplus.

*Operating Limited Partnership*: typically wholly owned by the MLP, the Operating Limited Partnership is the second tier of a typical three-tier MLP ownership structure. The Operating Limited Partnership typically owns and operates the Operating Subsidiaries.

*Operating Subsidiary*: the third-tier entities in the traditional MLP holding company structure. These entities directly own and control the operating assets of the MLP. The benefits of the MLP structure can be realized only if operating assets are first placed into pass-through or tax-disregarded entities (e.g., Limited Partnerships or limited liability companies).

*Operating Surplus Basket*: this basket is negotiated between the MLP and the underwriters in the Initial Public Offering and is typically two but sometimes as much as four quarters of the MQD. The Operating Surplus Basket will be deemed to constitute Operating Surplus regardless of the source of the cash; that is, the MLP will have Operating Surplus equal to the Operating Surplus Basket even if the MLP's business does not generate any Operating Surplus. This basket gives the MLP a "cushion" to reduce the risk of making distributions from Capital Surplus in the event there is not sufficient Operating Surplus.

*Operating Surplus:* calculated on a cumulative basis, Operating Surplus is a measurement of how much of the MLP's cash distributions to its Partners is being earned from operating the MLP's business. In other words, Operating Surplus determines whether cash distributions are a "return on capital," as opposed to a "return of capital." Operating Surplus for any period generally consists of:

(1) the sum of:

(a) the Operating Surplus Basket

(b) all cash receipts of the MLP and its Operating Subsidiaries for the period beginning on the closing date of the Initial Public Offering and ending with the last day of the relevant period, other than cash receipts from Interim Capital Transactions

(c) all cash receipts of the MLP and its Operating Subsidiaries after the end of the relevant period but on or before the date of determination of Operating Surplus for the period resulting from Working Capital Borrowings

(2) less the sum of:

(a) Operating Expenditures for the period beginning on the closing date of the Initial Public Offering and ending with the last day of the relevant period

(b) the amount of Cash Reserves established by the General Partner to provide funds for future Operating Expenditures

(c) all Working Capital Borrowings not repaid within 12 months after having been incurred

*Organic Growth Capital Expenditures:* investments used in the process of business expansion to increase operating capacity or operating income through the construction and development of new assets, as opposed to mergers and acquisitions

*Outstanding Units:* under the Partnership Agreement, all Units, other than Units that are held by a Holder (other than the General Partner and its affiliates) that holds 20 percent or more of the number of outstanding Common Units, are deemed to be "outstanding" for all purposes. The definition of "outstanding" is intended to deter a Holder from accumulating enough Common Units to control the outcome of any matter requiring a vote of the Limited Partners, such as the removal of the General Partner.

*Parity Units:* Units that are at the same level in an MLP's capital structure as the reference Units. For example, if the MLP issues a class of Preferred Units, then a Parity Unit would be a subsequent class of Preferred Units with the same rights, privileges and preferences as the initial class of Preferred Units.

*Partnership Agreement:* Limited Partnership Agreement

*Partnership Group*: the MLP and its subsidiaries treated as a single, consolidated entity

*Partnership Interest*: an equity interest in a Partnership. In an MLP, the Partnership Interests typically consist of the General Partner Interest, often represented by General Partner Units, and Limited Partner Interests, represented by Common Units, Subordinated Units and Incentive Distribution Rights.

*Partnership Security*: any class or series of equity interest in an MLP. This typically excludes any options, rights, warrants and appreciation rights relating to an equity interest in the Partnership.

*Partnership*: the relationship between two or more persons who join to carry on a trade or business. Each person contributes money, property, labor or skill, and expects to share in the profits and losses of the business.

*Pass-Through Taxation*: a type of taxation, generally applicable to Partnerships and LLCs, whereby the business entity is not taxed on its income but, instead, the income is "passed through" to its stakeholders. Most MLPs are not subject to entity-level taxation (although some shipping MLPs are an exception); revenue is passed through the MLP directly to its partners, who are taxed individually.

*Per Unit Capital Amount*: the Capital Account, as of any date of determination, stated on a per Unit basis, underlying any Unit held by a person other than the General Partner or any affiliate of the General Partner who holds Units

*Percentage Interest*: generally speaking, the percentage interest of a partner of an MLP is calculated by dividing the number of Units held by the partner by all Outstanding Units of the MLP

*Preferred Units*: Preferred Units sit in between debt and Common Units in the capital structure of an MLP. Preferred Units have priority over Common Units in a liquidation, generally pay a fixed dividend (the equivalent of the interest paid on debt) and do not share in the upside to the same degree as Common Units.

*PTP*: abbreviation for Publicly Traded Partnership. See Master Limited Partnership.

*Publicly Traded Partnership*: a Partnership that is traded on a national securities exchange

*QI*: abbreviation for Qualifying Income

*Qualified Activities*: activities that generate "Qualifying Income," thereby making a MLP eligible for pass-through status. Qualifying Activities are in large part those associated with the exploration, development, mining or production, processing, refining, transportation and marketing of a mineral or natural resource. With some limitations, any of these activities can generate Qualifying Income provided the subject of the activities is a recognized mineral or natural resource (see Mineral or Natural Resource).

Section 7704 further provides that Qualifying Income includes any gain from the sale of an asset held originally for the purpose of generating Qualifying Income.

For purposes of the midstream oil and gas sector, as long as the MLP is earning income from the transportation of a Mineral or Natural Resource, that income will be Qualifying Income. In this context, transportation is interpreted widely, but with some parameters. First, although it appears that any movement of a Mineral or Natural Resource from one place to another will generate Qualifying Income, Congress seeks to impose limitations on what kinds of transportation generate Qualifying Income. In the legislative history to Section 7704, Congress indicated that transportation by pipeline of any mineral or natural resource generates Qualifying Income. On the other hand, the legislative history states that the transportation of oil and gas and products of oil and gas to a retail outlet, other than by pipeline, does not generate Qualifying Income. As a result, the transportation of oil, gas and products thereof by truck, rail or barge to a retail outlet does not generate Qualifying Income. For this purpose, the IRS defines retail to include not only traditional retail customers, but also non-energy related industrial and commercial users. However, the legislative history makes it clear that the transportation of those items to a bulk distribution center, such as a terminal, or to a utility providing power to customers does generate Qualifying Income. Also, the transportation of gas or other products by pipelines to private residences generates Qualifying Income for local distribution companies.

In addition, if the MLP is earning income from the marketing of any Mineral or Natural Resource, that income is generally Qualifying Income. Nonetheless, just like transportation income, Congress sought to limit the kind of marketing income that would be Qualifying Income. The legislative history to Section 7704 of the Code indicates that, with respect to the marketing of Minerals and Natural Resources, Qualifying Income does not result "from marketing minerals and natural resources to end users at the retail level." The IRS has taken the position that any sale of fuel to an end user of the fuel constitutes a retail sale for purposes of the natural resource exception, regardless of the quantity of the sale or the nature of the purchaser, unless the purchaser is involved in otherwise qualifying activities under Section 7704 (e.g., an upstream company).

Examples of assets generating Qualifying Income and currently held by MLPs include pipelines, tankers/barges, gathering facilities, refineries, death care (land plots), processing facilities, fractionating facilities, transportation and handling facilities, coal reserves, retail propane sales and timberlands. See also Qualifying Income.

***Qualifying Income:*** Qualifying Income includes, among other things, income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil or products thereof) or the marketing of any Mineral or Natural Resource, as well as certain passive-type income including

interest, dividends and real property rents. An MLP must generate at least 90 percent Qualifying Income in each taxable year in which it is public in order to maintain its status as a partnership for federal income tax purposes. If the MLP fails this test in any year, the MLP will be treated as a corporation for federal income tax purposes and, thereby, lose its Pass-Through Taxation status.

*Quarterly Required Distribution:* see Minimum Quarterly Distribution. Contrary to popular misconception, MLPs are not required by law or contract to distribute any particular amount of cash on a quarterly or other basis.

*Recapture Income:* see Depreciation Recapture Income

*Record Date:* the date established by the General Partner of an MLP for determining the identity of Record Holders for various purposes under the Partnership Agreement, such as making quarterly distributions or receiving notice of meetings of the Limited Partners

*Record Holder:* the person in whose name a Common Unit is registered on the Books of the transfer agent as of the opening of business on a particular business day; or, with respect to Partnership Interests other than Common Units, the person in whose name any such other Partnership Interest is registered on the books that the General Partner has caused to be kept as of the opening of business on such Business Day

*Redeemable Interests:* any Partnership Interests for which a redemption notice has been given and has not been withdrawn

*Redemptive Shoe:* the use by the MLP of the proceeds of an over-allotment option to redeem Common Units from the General Partner or the Sponsor. Unlike a typical over-allotment option, a Redemptive Shoe does not increase the total number of Common Units outstanding. Also called a "non-dilutive shoe."

*SEC:* US Securities and Exchange Commission

*Section 7704 (IRC):* establishes the general rule that publicly traded partnerships will be treated as corporations for tax purposes. This rule is tempered, however, by Section 7704's "Qualifying Income" exception, which is the lifeblood of the MLP. If 90 percent or more of an MLP's income is Qualifying Income, the MLP will be treated as a partnership for tax purposes, complete with the benefits of Pass-Through Taxation. See also "Qualifying Income."

*Special Approval:* approval of an action or a matter by the Conflicts Committee acting in good faith

*Sponsor:* owner of the General Partner and de facto controller of the MLP. During the formation process, the Sponsor forms the General Partner (usually an LP or LLC) then, acting with the General Partner, forms the Limited Partnership that will become the MLP. Upon its formation, the Sponsor contributes qualifying assets to the MLP in exchange for its

equity (typically in the form of a 98 percent Limited Partner Interest) and the MLP's assumption of related liabilities. In practice, the Sponsor retains almost complete control over the MLP's business, operations, and corporate governance due to its ongoing control of the General Partner.

*Structuring Fee:* a percentage of the gross offering proceeds of an MLP IPO paid to an underwriter (usually the lead bookrunner) for providing structuring advice to the Sponsor

*Subordinated Unit:* during the Subordination Period, the MLP is not permitted to make cash distributions in respect of Subordinated Units (typically held by the General Partner or the Sponsor) for any quarter until the MQD for the current quarter and any arrearages in the MQD from prior quarters have been paid on all Common Units. Typically, Subordinated Units make up 49 percent of the initial capital structure of an MLP, although depending on its specific risk profile, an MLP may have a greater (higher-risk) or lesser (lower-risk) proportion of Subordinated Units in its capital structure.

*Subordination Period:* minimum period of time following the Initial Public Offering of an MLP during which the Subordinated Units must remain outstanding. The Subordination Period ends once the MLP meets certain distribution and earnings milestones in the Partnership Agreement. The standard Subordination Period is currently three years, with the possibility of ending in as early as one year if certain heightened earnings and distribution milestones are met. When the Subordination Period ends, all remaining Subordinated Units convert into Common Units on a one-for-one basis and Common Units are no longer entitled to arrearages.

*Substituted Limited Partner:* a person who is admitted as a Limited Partner to the Partnership in place of and with all the rights of a Limited Partner and who is shown as a Limited Partner on the books and records of the Partnership

*Synthetic MLP:* an MLP whose sole or primary asset is a less than 100 percent interest in an operating company. The Sponsor often owns the remaining interest and intends to transfer it, over time, to the MLP through Dropdowns.

*Target Distribution Levels:* the distribution levels that correspond to IDR Tiers

*Tax Shield:* the inverse of the ratio of taxable income to cash distributions, expressed as a percentage. The higher the percentage, the lesser the amount of a cash distribution will be currently taxable to an MLP Unitholder.

*UBTI:* abbreviation for Unrelated Business Taxable Income. Most MLPs generate UBTI with respect to its tax-exempt investors. Note that UBTI is only relevant to tax-exempt investors.

*Unit Majority:* during the Subordination Period, means at least a majority of the aggregate number of Outstanding Common Units and Outstanding Subordinated Units, voting as separate classes. After the Subordination Period, means at least a majority of the aggregate number of Outstanding Common Units.

*Unit:* a fractional Partnership Interest that is designated as a “Unit,” and under a typical MLP Partnership Agreement includes Common Units and Subordinated Units but not General Partner Units or Incentive Distribution Rights.

*Unitholder:* also referred to as a “Limited Partner,” a Unitholder is an equity owner in an MLP. Unitholders are passive investors; they are not entitled to participate in the governance of the MLP (except in very limited circumstances) and do not elect directors of the General Partner (directors are typically appointed by the Sponsor). Generally, the Voting Rights of Unitholders in an MLP are strictly limited to “material events”; Unitholders are deemed to have consented in advance of their purchase of MLP units to these restrictions (see also Voting Rights). Unitholders are entitled to quarterly distributions of the MLP’s Available Cash (see Minimum Quarterly Distribution). Unitholders are predominantly individual, retail-level investors, as opposed to large institutional investors, owing to the unique tax treatment of MLP income.

*Unrealized Gain / Loss:* the difference between the fair market value and the Carrying Value of Partnership property

*Unrecovered Capital:* generally means the Initial Unit Price less the sum of all distributions made in respect to an Initial Common Unit and any distributions of cash (or the Net Agreed Value of any distributions in kind) in connection with the dissolution and liquidation of the Partnership. In each case made in respect to an Initial Common Unit, adjusted as the General Partner determines to be appropriate to give effect to any distribution, subdivision or combination of Units.

*Unrelated Business Taxable Income:* taxable income earned by otherwise tax-exempt entities. Under section 511 of the IRC, when tax-exempt entities such as charities, pension plans and individual retirement accounts (IRAs) invest in an MLP, any portion of income earned by the MLP not “directly connected” with the tax-exempt investor’s tax exempt purpose is considered “unrelated” and, therefore, subject to tax.

*Variable MLP:* an MLP that, by design, does not offer stable quarterly distributions and, instead, offers investors variable distributions with direct exposure to commodity price and cash flow fluctuations of the underlying business. For a summary of common differences between variable MLPs and more traditional MLPs, see Appendix.

*Voting Rights:* Voting Rights in MLPs are vested almost entirely in the General Partner. Generally, the Voting Rights of Unitholders are strictly limited to “material events.” Unitholders are deemed to have consented

in advance of their purchase of MLP units to these restrictions. In voting its Common and Subordinated Units, the General Partner has no fiduciary duty whatsoever to the MLP or to the Unitholders, including a duty to act in the best interests of the MLP or the Unitholders.

MLP Partnership Agreements contain measures designed to prevent a Unitholder or group of Unitholders from attempting to remove the General Partner or otherwise change the MLP's management. Generally, if a person or group other than the General Partner and its affiliates acquire beneficial ownership of 20 percent or more of any class of Units, they will lose voting rights on all of their Units. Moreover, hostile removal of the General Partner can trigger a host of defensive measures, including the immediate conversion of all Subordinated Units into Common Units and the extinguishment of any existing arrearages in the payment of the MQD on Common Units.

*Waterfall:* sometimes called a "payment waterfall" or "flow of funds," refers to the order of application of revenues and is typically utilized in the financing of a project. Think of the funds in question as water running down a flight of stairs with a bucket placed on each step. The water (money) flows to the top step first and fills that bucket before the overflow continues on to the second step, and fills that bucket before proceeding to the third step, etc. In an MLP Partnership Agreement, the Waterfall refers to the priority of cash distributions and allocations of items of income, gain, deduction and loss among the Partners.

*Working Capital Borrowings:* borrowings used by an MLP exclusively for working capital purposes or to pay distributions to partners made pursuant to a credit agreement or other arrangement to the extent such borrowings are either (1) required to be reduced to a relatively small amount each year for an economically meaningful period of time, or (2) intended to be repaid within 12 months from funds other than additional Working Capital Borrowings. Working Capital Borrowings are excluded when determining whether an MLP has satisfied the "earned" test for purposes of ending the Subordination Period.

*Working Capital Facility:* a credit agreement or other arrangement used to fund Working Capital Borrowings



## Appendix

The Book of Jargon®: MLPs (Master Limited Partnerships)

The following table sets forth certain important characteristics of “traditional” MLPs and “variable” MLPs:

	Traditional MLPs	Variable MLPs
<b>Large, single asset</b>	Uncommon	More common
<b>Distribution Stability</b>	Yes	No
<b>Minimum Quarterly Distribution</b>	Yes	No
<b>Coverage Ratio</b>	1.10x – 1.20x	1.0x
<b>Available Cash</b>	Yes	No
<b>Operating Surplus</b>	Yes	No
<b>Capital Surplus</b>	Yes	No
<b>Subordination Period</b>	Typically from 1 to 3 years, but sometimes 5 years	No
<b>Types of Securities</b>		
General Partner Interest	2%	0%
Common Units	Yes	Yes
Subordinated Units	Yes	No
PIK Units	No	Sometimes
Incentive Distribution Rights	Yes	No
<b>Common Unit Arrearages</b>	Yes	No
<b>Maintenance of Distribution Coverage</b>	Yes	No
<b>Working Capital Borrowings to Pay Distributions</b>	Yes	No
<b>Direct exposure to commodity price movements</b>	Avoided	Expected
<b>Direct and immediate exposure to fluctuations in cash generated by the business</b>	No	Yes
<b>Flexible distribution covenants in debt agreements a priority</b>	Yes	Depends

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