Leveling the Playing Field for Energy Innovation

Bipartisan sponsors call to expand the definition of MLPs in the proposed *Financing Our Energy Future Act*

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- Master Limited Partnerships (MLPs) provide pass-through income favored by investors and project developers alike.
- Investor appetite for diverse energy sources and technological innovation is increasing.
- *The Financing Our Energy Future Act* would level the playing field by allowing renewable energy companies access to the MLP structure. We believe this would be good for innovation, diversification, and the market.
- Miller/Howard has supported this bill since its first introduction in 2012 by issuing statements and talking to lawmakers.

In June 2019, the bill formerly known as the *MLP Parity Act*, and now rebranded the *Financing Our Energy Future Act*,[1] was introduced in both the House and the Senate. The sponsors and co-sponsors are a multi-partisan array of well-known senators and representatives hailing from the Republican, Democratic, and Independent parties.

> "*Financing Our Energy Future Act* would give clean energy projects access to a tax advantage currently available only to oil, gas, and coal projects."
>
> ***—US Senator Chris Coons***

In pursuit of innovation and sustainable income, investors are looking for ways to support renewable energy development and deployment. History has shown that the Master Limited Partnerships (MLP) structure is a proven and effective tool for project financing.

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However, current regulations do not allow renewable energy companies to benefit from the MLP structure. *The Financing Our Energy Future Act* would level the playing field by allowing renewable energy companies access to the MLP structure.

First, let's step back and review the MLP structure, its benefits, and the current definition:

The MLP Structure: Master Limited Partnerships are publicly-traded on stock exchanges and generally are income-oriented investments. The company, structured as an MLP, does not pay corporate taxes, as the income is passed through to its investors. To paraphrase Senator Chris Coons, who helped introduce the *Financing Our Energy Future Act:* 'MLPs are taxed like a partnership; traded like an equity.'

The Benefits: From pass-through income to market access, the unique characteristics of this corporate structure give these businesses access to private capital and liquidity. For income investors, MLPs can provide tax-deferred distributions.

> Qualifying income for MLPs includes "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 (including fertilizer, geothermal energy, and timber)..."[3]

The Catch: To be an MLP, 90% of the entity's income must be "qualifying income", which is defined as generally passive-type income such as interest, dividends, and rent, and also includes income and gains derived from the exploration, development, mining or production, processing, refining, transportation, or marketing of minerals or natural resources.[2]
Renewable energy doesn't qualify. MLPs are limited, by their current definition, in their potential to help us diversify and update our energy mix.

The good news is that lawmakers have noticed!

The Solution: Expand the definition of qualifying income and level the playing field.

Since 2012, members of Congress have introduced—and reintroduced—bills that would extend the "publicly traded partnership ownership structure to energy power generation projects and transportation fuels, and for other purposes." Note that the language subtly, but importantly, shifts the priority to *energy generation* over *source of energy generation.*[1]

These "other purposes" that the lawmakers propose adding to the definition include "disposal and utilization of captured carbon oxide," more commonly called 'carbon capture, utilization, and storage' (CCUS). Given that carbon is a known global warming agent, and existing/potential regulatory responses to climate change pose a material risk according to many companies, MLPs that perform CCUS could prove a beneficial, efficient, market- and technology-driven solution for the energy sector. Further, technological advancement in the area of CCUS could play a game-changing role in meeting the goals of the Paris Accord.[1]

Yet the bill never seems to make it further than "referred to committee."

MHI's Support of the *MLP Parity Act/Financing Our Energy Future Act* over the Years:

- **2013:** Founder and CIO, Lowell Miller, issued a public statement and was quoted in a Ceres press release: "There is no apparent logic to the current exclusion of renewable energy companies from the ability to form publicly traded partnerships. A large part of the intent in permitting energy companies to become MLPs was to encourage the development of domestic energy resources and infrastructure...To fail to include renewable energy is, in effect, to say that the government and its tax system wants to implicitly encourage carbon-based energy development and to discourage—or not encourage—renewable energy development."

- **2016:** We lobbied in Washington, DC. Representing Miller/Howard, our Lead ESG Analyst, Nicole Lee, joined Ceres and other institutional investors, speaking directly to lawmakers about investor support for the *MLP Parity Act* among other things.

- **2017:** John Cusick, CFA, the Portfolio Manager who leads our MLP Strategy, made this statement: "We believe there is no downside to extending the definition of qualifying income to clean energy. The Act would encourage renewable energy development, as the cost of capital for these companies would likely be lower under the MLP structure. In addition, we view the development of alternative energy as important for the future of energy security in the US. The further development of clean energy could also result in job growth and have positive consequences for the economy. Lastly, as the definition of the MLP structure is broadened, current partnerships will likely face lower concerns about changes in the tax code as a greater number of entities would be impacted."

More about Miller/Howard and MLPs: MLP Metrics, Open Letter to MLP Management Teams, and our Midstream/MLP engagement updates in our annual Engagement Reports.

1. S.1841 - *Financing Our Energy Future Act* 116th Congress (2019-2020)
2. https://www.federalregister.gov/documents/2017/01/24/2017-01208/qualifying-income-from-activities-of-publicly-traded-partnerships-with-respect-to-minerals-or
3. Internal Revenue Code Section 7704(d)(1)(E)

Nicole Lee
Lead ESG Analyst
Miller/Howard Investments

Nicole Lee provides ESG research and support to the investment team and operational leadership within the ESG team. She also writes the firm's biannual Shareholder Advocacy News. Nicole worked for several years as a clinic coordinator and educator for a nonprofit health organization, during which time she also developed and conducted training programs at two local universities. She received her BS in Sociology from Southern Utah University, and studied Public Health at Westminster College.

John R. Cusick, CFA
Portfolio Manager
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John R. Cusick, CFA, brings deep knowledge of the MLP sector to the firm's portfolio management team. He was previously senior vice president and research analyst at Wunderlich Securities Inc. in New York, covering energy in North America, including partnerships focused on natural gas, liquids, and exploration & production. Prior to that, John spent more than a decade at Oppenheimer & Co. in New York, where he started his career as a junior analyst working on the energy team, and then as a senior research analyst specializing in the midstream sector. He earned his BA in Finance and Marketing from Temple University, and his MBA in Finance from Fordham University School of Business in New York City.

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Risk Factors to Consider When Investing in Master Limited Partnerships (MLPs)

- Cash distributions are not guaranteed and may fluctuate with the MLP's operating or business performance.
- MLPs typically have a General Partner that maintains an aggregate 2% General Partner interest. Unit holders will have limited voting rights and do not own an interest in, vote with, or control the General Partner. The General Partner often cannot be removed without its own consent, and the General Partner has conflicts of interest and limited fiduciary responsibilities, which may permit it to favor its own interests to the detriment of unit holders.
- The MLP may issue additional common units, diluting existing unit holders' interests.
- Unit holders may be required to pay taxes on income from the MLP even if they do not receive cash distributions.
- The IRS could reclassify the MLP as a taxable entity, which could reduce the cash available for distribution to unit holders.

If at any time the GP owns 85% or more of the issued and outstanding limited partner interests, the GP will have the right to purchase all of the limited partnership interests not held by the GP at a price that may be undesirable.

Tax Considerations of MLPs
The tax treatment for investors in MLPs is different than that of an investment in stock, including (a) the investor's share of the MLP's income, deductions and expenses are reported on Schedule K-1, not Form 1099, (b) because of the possibility of unrelated business taxable income, charitable remainder trusts should not invest in this strategy, and other non-taxable investors (such as ERISA and IRA accounts) should carefully consider whether to invest in this strategy, (c) investors may have to file income tax returns in states in which the MLP's do business and (d) MLP tax information is sent directly from the partnership, which generally has until April 15th to provide this information. You should discuss these and any other tax implications with your tax advisor.

Past performance does not guarantee future results.

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