Research

Primer: Master Limited Partnerships in Energy Industries: The Need for Modernization

KIMBERLY VANWYHE, PHILIP ROSSETTI | FEBRUARY 29, 2016

Summary:

• Master Limited Partnerships (MLPs), established over 35 years ago, exclude newer and more diverse forms of energy.
• Renewable energy, currently excluded from MLPs, are as a result, at a competitive disadvantage in raising capital.
• Modernizing MLPs to add renewable energies will result in equitable treatment for the entire energy sector, a more competitive renewable energy industry and will strengthen U.S. energy security.

As attention continues to focus on the future of federal energy policy, one issue that should be considered is an update to the definition of the Master Limited Partnership (MLP) to include renewable energy sources. An updated MLP is a way to further improve U.S. energy security while simultaneously reducing electricity costs.

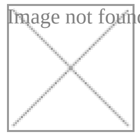
MLPs, The Energy Industry, & The Future
A MLP, is a status granted by the federal tax code (section 7704). The key benefit of the MLP structure is that it is a publicly traded partnership that combines the pass-through, single-layer of tax of a partnership with the capital-raising and liquidity advantages of a publicly traded corporation. The MLP designation is controlled by the qualifying sources of income, which are limited to coal, oil, gas, and some biofuels. The industry qualifications were determined in 1980 and exclude new sources of energy, creating a competitive disadvantage when it comes to raising capital.

Since the 1980s, the U.S. has seen its energy sector diversify with the expansion of solar and wind. Despite the abundance of sunlight and wind, the costs of these energy sources are driven primarily by the initial facility and infrastructural costs. MLP status avoids double taxation, making it easier to attract investors and cut financing costs. This translates into a reduction in the "levelized" cost of the energy. Since these upfront costs comprise so much of the levelized cost of renewable energy (particularly wind, solar, hydropower, and geothermal), anything that improves financing can have a big impact on these energy sources.[1]

The National Renewable Energy Laboratory estimated that increased access to public capital could cut solar and wind costs by 8-16 percent or more. The Union of Concerned Scientists estimated that a mere 3 percent reduction in capital costs would lower the cost of wind power by 17 percent. That would make wind power one of the cheapest electricity sources in the country.

Wind Power
Wind is a prime example of how an MLP would benefit the renewable energy sector as a whole. According to the National Renewable Energy Laboratory, the potential for wind energy in the U.S. is at least 550 terawatt hours. At projected levelized electricity costs from the Energy Information Administration (EIA), this amount of

wind power would be $11.8 billion cheaper than coal (not accounting for capacity). However, a 17 percent reduction in the cost of wind is 58 percent of the levelized cost difference between wind and coal. This means that MLPs would widen this potential to $18.7 billion per year.[2]



Energy Security

An update to MLP tax code would be a boon for U.S. energy security. Diversity in our energy sources makes us more resilient to price shifts or global events that force price changes or disrupt our energy sources. Even if America sources most of its fossil fuels domestically, the prices of those commodities are determined by global markets. A diverse energy portfolio not only creates competition; it also reduces the influence of energy providers abroad on our own markets.

Congressional Activity

Congress has considered modernizing the impact of the tax code on the energy sector. The Master Limited Partnership Parity Act, S.1656 introduced on June 24, 2015 is the second attempt in the past three years to broaden the language for master limited partnerships to include renewable and alternative sources of energy. The bill's purpose is to "amend the Internal Revenue Code, with respect to the tax treatment of publicly traded partnerships as corporations, to expand the definition of 'qualifying income' for such partnerships to include income and gains from renewable and alternative fuels (in addition to fossil fuels), including energy derived from thermal resources, waste, renewable fuels and chemicals, energy efficient buildings, gasification, and carbon capture in secure geological storage."

Conclusion

Updating MLP qualifications to include renewable sources would remedy a competitive disadvantage resulting from an out-of-date tax definition. This is a concept with bipartisan support that will benefit all Americans as it makes energy cheaper, more reliable, and more secure.

1. Of course, the playing field could also be leveled by eliminating the MLP designation of all energy sources, but this is not a feasible legislative option.

2. This estimation is based only on costs per watt, not factoring capacity differences for wind which vary greatly by area.