



## Investor Bulletin: Master Limited Partnerships – An Introduction

05/18/2016

*The Securities and Exchange Commission's Office of Investor Education and Advocacy is issuing this Investor Bulletin to help investors understand Master Limited Partnerships, or MLPs. Because investing in an MLP may be unfamiliar, investors should carefully consider potential benefits – and risks – before making an investment decision.*

### What are Master Limited Partnerships?

Generally, Master Limited Partnerships (MLPs) are exchange-traded investments that are focused on exploration, development, mining, processing, or transportation of minerals or natural resources. MLPs hold cash-generating assets such as oil and gas properties or pipelines. MLPs have certain characteristics that can make them attractive to some investors, including partnership tax consequences, limited liability to investors for the MLP's debts, and anticipated consistent distributions of cash. However, like all investments, MLPs have risks investors should consider before making an investment decision. Those risks include governance features that can favor management over other investors, potential conflicts of interest, and concentrated exposure to a single industry or commodity. Since most MLPs are clustered in the energy sector, they can therefore be sensitive to shifts in oil and gas prices. The 2015-16 decreases in oil prices are an example.

### What are the unique characteristics of an MLP?

- **Control by sponsor.** MLPs begin with a sponsor. That sponsor, often a public company, contributes assets to the MLP. The sponsor exerts control over the MLP by controlling the general partner (GP) of the MLP and appointing the GP's board of directors. The GP manages the affairs of the MLP; the MLP does not have a board of directors of its own. In addition to holding the general partner interests of the MLP, the sponsor also holds limited partner interests as well as incentive distribution rights (IDRs), which are rights to an increasing share of distributions, or payouts, after the distribution level hits certain predetermined thresholds.
- **Limited liability for MLP debts and obligations.** Investors may become limited partners in an MLP by purchasing limited partner interests, known as units. Although the limited partners are liable for the debts and obligations of the MLP, each limited partner's liability generally extends only up to the amount of capital contributed.
- **Cash distribution features.** Most MLPs provide a "forecast" of their intention to pay a minimum cash distribution over the next 12 months. MLPs often state that they expect to continue to pay, if not increase, that distribution over time based upon steady or increased cash flows and sometimes assuming certain events, such as the price of oil or gas, acquisitions (buying new properties or assets) or further development of producing properties.

**Caution!** An MLP's inability to maintain distributions can have a negative impact on the trading price of the limited partner units. As a result, sponsors have an incentive to cause the MLP to maintain a certain level of distributions, even if it requires borrowing by the MLP or refraining from making capital expenditures. Increasing distributions also benefits the sponsor through its ownership of IDRs.

- **MLPs have partnership tax consequences.** As partnerships for federal income tax purposes, MLPs generally do not pay federal taxes. Instead, limited partners report on their tax returns their share of the MLP's income, gains, losses, and deductions, and are taxed at their individual tax rates. Each limited partner receives annually a Schedule K-1 showing its share of the MLP's income, gains, losses, and deductions. MLP investors must pay applicable federal, state, and local income taxes even if the MLP does not provide the investor with cash distributions. Additionally, investors may need to file state tax returns in states where the MLP operates even though the investors do not live in that state.

**Caution!** Investors considering MLPs should consult a tax advisor and relevant IRS publications, such as those relating to Schedule [K-1](http://www.irs.gov/instructions/i1065sk1/ch01.html) (<http://www.irs.gov/instructions/i1065sk1/ch01.html>) and [Unrelated Business Taxable Income](http://www.irs.gov/publications/p598/ch04.html) (<http://www.irs.gov/publications/p598/ch04.html>).

### What are the risks of a Master Limited Partnership?

MLP units can produce regular cash distributions and appreciate in value, but they are not without risk. As with any investment, investors can lose their entire investment or experience lower- than-expected returns. Before investing, investors should carefully evaluate the risks associated with a particular offering. Investors should also be aware of the following risks:

- **Governance and standard of care can favor the sponsor.** Most listed companies must have a majority of independent directors on their boards, but the GP of an MLP is only required to have independent directors on its audit committee. Also, MLPs can opt for a lower standard of care (or duties owed by the GP's directors to the owners/investors) than the more stringent fiduciary standard generally owed to shareholders of corporations under state law. Lack of independence and lower standards of care are factors that could influence the decisions made by the GP's directors, possibly to the detriment of the limited partners of the MLP.
- **Conflicts of Interest.** The sponsor's relationship with the MLP and with the GP creates inherent conflicts of interest. These conflicts arise most frequently in transactions between the sponsor and the MLP, such as when the sponsor wants to sell assets to the MLP or if the sponsor decides to merge the MLP into the GP. If the GP opts for the lower standard of care discussed above, it may consider its own interests ahead of the interests of the MLP and its limited partners and resolve conflicts in a manner favorable to itself.
- **Industry risk and concentrated exposure.** As most MLPs are focused on a single industry or industry segment, investors have concentrated exposure to the volatility of that industry or segment. Changes in the price of commodities in that industry could impact the amount of income that an MLP generates or the ability of the MLP to maintain or expand its operations. Because most MLPs are currently in the energy sector, particularly in the pipeline or energy storage industries, MLPs can be acutely sensitive to shifts in oil and gas prices, as noted above.

#### How do I learn more about an MLP?

When considering investing in an MLP, investors should search [EDGAR \(http://www.sec.gov/edgar/searchedgar/companysearch.html\)](http://www.sec.gov/edgar/searchedgar/companysearch.html) to access an MLP's prospectus (Form 424) and annual (Form 10-K) and quarterly (Form 10-Q) financial reports. Information on using EDGAR can be found [here \(http://investor.gov/researching-managing-investments/researching-investments/using-edgar-researching-public-companies\)](http://investor.gov/researching-managing-investments/researching-investments/using-edgar-researching-public-companies). These publicly available filings include information about the MLP's business strategy, forecasts of future distributions, and risks. To see our Investor Bulletin on How to Read a 10-K, click [here \(http://investor.gov/news-alerts/investor-bulletins/how-read-10-k\)](http://investor.gov/news-alerts/investor-bulletins/how-read-10-k). For additional information on MLPs, see the SEC's [Office of the Investor Advocate, Report on Activities – Fiscal Year 2015 \(http://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf\)](http://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf), filed December 23, 2015, at pp. 17 to 19.

#### Ask questions before you invest – in anything.

When considering an MLP, investors should ask their investment professional the same questions about suitability and risks that they ask with other prospective investments, in addition to reading the prospectus. See our publication on [Questions You Should Ask About Your Investments \(http://investor.gov/Ask-Questions\)](http://investor.gov/Ask-Questions) for more information.

*For additional educational information for investors generally, see the SEC's website for individual investors, [Investor.gov \(http://investor.gov\)](http://investor.gov).*

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