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 on a market like corporate stock.

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 600 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 on a market like corporate stock. 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.

Writing in the New York Times in June 2012, 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 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, ethanol, biodiesel, and algae-based fuels, as well as energy-efficient buildings, electricity storage, carbon capture and storage, renewable chemicals, and waste-heat-to-power technologies.

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.

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 more than 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 $445 billion in MLP capital currently in the market, approximately $400 billion (89 percent) has gone into qualifying energy and natural resources. Of that, just under 80 percent has gone into midstream oil and gas pipeline projects.
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: “The MLP Parity Act helps take government out of the role of picking energy winners and losers. Master Limited Partnerships have a long history of success raising private capital to finance oil and gas pipelines in the United States. This relatively small change to the tax code empowers investors, rather than Congress, to determine what kind of energy projects make financial sense.”

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.”

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. Oil and gas producers are using MLPs to access the retail investment market, which in turn makes it easier to finance new oil and gas projects. Advanced, renewable technology developers are explicitly excluded from eligibility for MLPs. It makes no sense for the federal government to continue to offer this financing vehicle to fossil fuels only. The MLP Parity Act would take a meaningful inequity out of the federal tax code and put the country in a better position to create jobs and compete in the emerging $2 trillion global clean energy marketplace.”

Robert P. Thornton, President & CEO, International District Energy Association: “Since district energy and combined heat and power systems are capital intensive investments, the Master Limited Partnership Parity Act offers significant potential to advance the growth of these highly efficient and resilient clean energy resources. By providing a new source of liquid private capital, the Act can play a vital role in strengthening the infrastructure of our nation’s cities, communities, institutions and military bases.”

Tony Straquadine, Chairman, The Heat is Power Association; Manager of Government Affairs, Alliance Pipeline: “The waste heat to power industry strongly supports the efforts of Senators Coons and Moran and the other co-sponsors of the Master Limited Partnership Parity Act to ensure that projects using a broad array of energy generation technologies can avail themselves of the MLP structure. The ability of waste heat to power projects to qualify for MLPs will make those projects easier to finance, will be attractive to a broader range of energy investors, and will produce emission-free power from an otherwise wasted resource. We applaud your efforts to level the playing field for energy generation resources like ours that improve the competitiveness of our nation’s industrial sector and generate power with no combustion and no emissions.”

Collin O’Mara, Secretary, Department of Natural Resources and Environmental Control, State of Delaware: “Senator Coon’s vision to expand Master Limited Partnerships to include projects that harness all energy resources simply makes sense. At a time when we need to spur private sector investment, create domestic jobs, transition to a clean energy future, and fulfill our climate responsibilities, what better tool can we unleash than expanding upon a tried and true financing vehicle that has spurred billions of dollars of energy investments over the past decades and helped bring energy resources to all corners of our nation. By spurring private investment into large-scale renewable energy projects, like solar, fuel cells, geothermal, and offshore wind, we will drive down the costs of projects and catalyze greater innovation, commercialization, and deployment of the very technologies that are critical to our nation’s economic and environmental future.”

Jim Collins, President, DuPont Industrial Biosciences: “We appreciate the leadership of Senator Coons and his Senate cosponsors and Representative Poe and his House cosponsors on the Master Limited Partnership Parity Act. This constructive bicameral, bipartisan legislation will facilitate the commercialization of advanced renewable fuel technologies by extending the tax-efficient Master Limited Partnership structure to these investments. These tax policies have proven effective in encouraging investment in oil and gas infrastructure and can similarly help in the domestic advanced biofuels industry, bringing investment and jobs to rural America while expanding domestic energy production and reducing our vulnerability to oil price shocks.”

Ted Michaels, President, Energy Recovery Council: “The Energy Recovery Council commends Senator Coons, Senator Moran, and the sponsors for introducing this important legislation which will provide renewable technologies with
access to much needed capital. This legislation is another critical step in recognizing the value of renewable energy and ensuring that technologies such as waste-to-energy can continue to pursue growth opportunities.”

Kurt Waltzer, Special Projects Director, Clean Air Task Force: “The Clean Air Task Force strongly supports the MLP Parity Act. Carbon Capture and Storage is a critical path technology for addressing climate change and we need more pioneer projects. If adopted, this bill will cut the cost of getting that steel in the ground”.

Judi Greenwald and Brad Crabtree, Co-Directors, National Enhanced Oil Recovery Initiative: “On behalf of participating industrial and other companies, labor unions, environmental organizations and state officials, the National Enhanced Oil Recovery Initiative applauds the MLP Act's sponsors for expanding MLP eligibility to increase private investment in carbon capture and storage projects. Capturing carbon dioxide from power plants and many other industrial facilities for use in enhanced oil recovery produces more American oil, creates good-paying jobs, generates net new revenue for the federal treasury, and reduces CO2 emissions.”

Rhone Resch, president and CEO, Solar Energy Industries Association: “This bill is an important step toward leveling the playing field between clean, renewable energy and long-entrenched energy sources in America, by providing the solar industry with access to private capital in the same manner enjoyed by the oil and gas industry for almost 30 years. Today, the U.S. solar industry employs nearly 120,000 Americans, with solar deployment growing and costs to consumers dropping. Senator Coons’ MLP proposal would build on this success, and SEIA applauds him for putting forward an idea that has the potential to attract private sector investment in critically important solar projects. This bill represents smart public policy, and solar represents a clean, safe, affordable and inexhaustible supply of energy for our nation. We look forward to working with Senator Coons and other stakeholders on this important issue.”

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.”

David Gardiner, Executive Director, Alliance for Industrial Efficiency: “We applaud Senators Coons (D-DE), Moran (R-KS), Stabenow (D-MI) and Murkowski (R-AK) for their bi-partisan leadership in introducing the Master Limited Partnership Parity Act. The Alliance for Industrial Efficiency is particularly pleased that the bill extends low-cost financing to Combined Heat and Power and Waste Heat to Power, proven clean energy sources that could provide as much as 20 percent of U.S. electric capacity.”

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.”

Rob Gramlich, Interim CEO, American Wind Energy Association: “America’s wind energy sector is a success story that has proven its strength by recruiting $18 billion in annual private investment in America’s energy infrastructure in recent years despite short-lived policy certainty. We commend Senators Chris Coons, Jerry Moran, Debbie Stabenow, Lisa Murkowski and Representatives Ted Poe, Mike Thompson, Peter Welch and Chris Gibson for their leadership in promoting the eligibility of master limited partnerships to include renewable energy projects. MLPs work well for conventional energy infrastructure and will be one critical tool to ensure that federal incentives continue to drive private investment into the U.S. wind energy market. We look forward to working with Senator Coons, Representative Poe, and the other bill co-sponsors to proceed with legislation that allows wind power developers to efficiently utilize MLP structures.”

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
How to Make Renewable Energy Competitive

By FELIX MORMANN and DAN REICHER
June 1, 2012 | http://nyti.ms/LmGDI7

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.