

Master Limited Partnerships for the Shipping and Offshore Industries Briefing

November 2012



Contents

Introduction	01
What is an MLP?	01
Tax treatment of MLPs	02
Governance of an MLP	03
Why form an MLP?	04
Where to form an MLP	05
Contacts	06

Introduction

Master limited partnerships, or MLPs, have been used since the 1970s in the energy industry. MLPs were first adopted for shipping in 2005 with the initial public offering of Teekay LNG Partners L.P., followed by Teekay Offshore Partners L.P. in 2006 and Capital Product Partners L.P. in 2007. Interest in the MLP structure for shipping IPOs cooled after 2007 but rose again in 2011 with the initial public offering of GOLAR LNG Partners L.P. and in October 2012 with Seadrill Partners LLC (an innovative transaction in which for tax reasons a limited liability company was substituted as the functional equivalent of the traditional master limited partnership).

The New York office of Watson, Farley & Williams has acted for the issuer in each of the shipping and offshore MLP IPOs described above.

What is an MLP?

A master limited partnership is a legal entity that is usually organized as a limited partnership comprised of a single general partner and multiple limited partners. The limited partners are usually (i) a single "sponsor" limited partner, who backs the MLP as a spin-off and will have effective control of the MLP and who has 100% control of the general partner, and (ii) "public" limited partners who collectively control a minority of the MLP's equity.

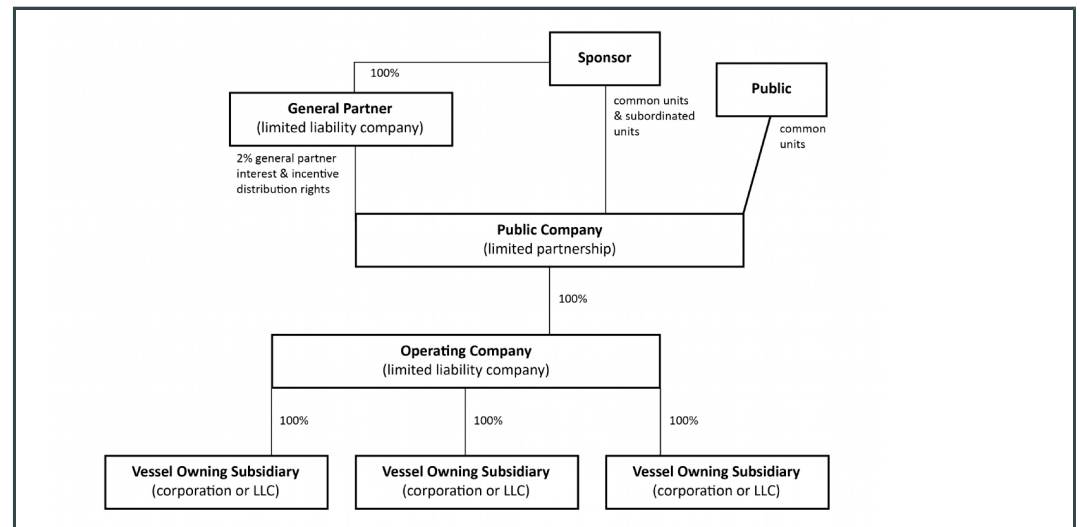
An MLP's common or ordinary equity, referred to as "common units" that represent limited partner interests in the partnership, trade on a securities exchange such as the NYSE or NASDAQ. While the public limited partners receive only common units, the sponsor may receive both common units and subordinated units. The general partner receives a general partner interest (typically equal to a 2% interest in the partnership) as well as incentive distribution rights.

Subordinated units are limited partner interests that receive cash distributions only after the holders of common units have received a minimum quarterly cash distribution equal to a specified amount set forth in the limited partnership agreement (plus any arrearages of such specified amount due from previous quarters). Subordinated units are typically convertible to common units on a one-for-one basis three or four

The New York office of Watson, Farley & Williams has acted for the issuer in each of the shipping and offshore MLP IPOs since 2005.

years after the initial public offering of the MLP, so long as a minimum cash distribution has been paid to all holders of common units for the time period specified in the MLP's limited partnership agreement. Incentive distribution rights represent the right to receive an increasing percentage of quarterly distributions of available cash from operating surplus after the minimum quarterly distribution and specified target distribution levels have been achieved.

A typical MLP structure is shown in the following diagram:



Tax treatment of MLPs

In general, the United States imposes a corporate tax on publicly traded entities. MLPs generally take advantage of an exception to this rule to be taxed as partnerships for US tax purposes so that the income is taxed directly to its partners. In order to qualify for this exemption from taxation of publicly traded entities, 90% of the income must be "qualified income". Qualified income consists of various forms of "passive" income (such as interest, dividends and income from leasing real property) and "active" income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines and ships transporting gas, oil or products thereof) or the marketing of any mineral or natural resource.

All of the shipping IPOs that have used the MLP structure since 2005 are connected to the energy sector, with public offerings by liquefied natural gas (or LNG) carriers (such as Teekay LNG Partners L.P.), floating storage and regasification unit (or FSRU) operators and LNG carriers (such as GOLAR LNG Partners L.P.), crude and product carriers (such as Capital Product Partners L.P.), crude carriers and floating production storage and offloading unit (or FPSO) operators (such as Teekay Offshore Partners L.P.) and offshore drilling companies (such as Seadrill Partners LLC). Each of these companies was formed under the law of the Republic of the Marshall Islands.

Governance of an MLP

Limited partnerships, unlike corporations, are not bound by onerous statutory governance requirements. Instead, limited partnership statutes (such as the Marshall Islands Limited Partnership Act, which closely follows the Delaware Revised Uniform Limited Partnership Act) generally allow the parties to agree on the terms that will govern the rights, obligations and duties of the general partner and the limited partners.

This approach permits the MLP's sponsor to customize the terms of the limited partnership agreement prior to the offering of units to the public (such as the formula that will be used to determine whether and in what amount cash distributions will be paid to the common unit holders).

Like ordinary limited partnerships, an MLP's limited partnership agreement provides that management of the MLP (namely the authority to oversee and direct its operations, policies and management) is vested in the general partner. In some cases, such as in Capital Product Partners L.P. and Golar LNG Partners LP, the limited partnership agreement further provides for the general partner to delegate such management authority to a board of directors and officers at the MLP level with the general partner retaining the right to approve certain types of "major" decisions (such as approval of a proposal to merge the MLP with another entity, sell all or substantially all of its assets, or dissolve the MLP). In contrast, an MLP's limited partnership agreement typically limits the ability of limited partners to participate in the control of the MLP's business and thus provides limited partners with narrowly defined voting rights. The following table outlines certain actions and whether the approval of the general partner, the board of directors and/or the limited partners is commonly required (the table assumes that the MLP's general partner has delegated authority to a board of directors at the MLP level):

Action	Approvals Required
Issuance of additional units	Board approval required; no approval required from holders of common units; general partner approval required for all issuances not reasonably expected to be accretive within 12 months of issuance or which would otherwise have a material adverse impact on the general partner or its interest in the MLP.
Amendment of the partnership agreement	Certain amendments may be made by the board of directors without the approval of the limited partners. Other amendments generally require the approval of limited partners holding a majority of common units.
Merger of the MLP or the sale of all or substantially all of its assets	Approval of limited partners holding a majority of common units and approval of the general partner and the board of directors.

Limited partnerships, unlike corporations, are not bound by onerous statutory governance requirements.

The Limited Partnership Act of the Marshall Islands generally allows the parties to agree freely on rights, obligations and duties.

Election of a majority of the members of the board of directors	The holders of common units are usually granted the right under the limited partnership agreement to appoint a majority (but not all) of the members of the board of directors. A plurality of the votes of the holders of the common units is required to elect board members appointed by such holders. The sponsor has the ability to appoint the remaining members of the board of directors.
Withdrawal of the general partner	Under most circumstances, the approval of a majority of the common units, excluding common units held by the general partner and the sponsor, is required for the withdrawal of the general partner in a manner which would cause a dissolution of the partnership.
Removal of the general partner	Not less than 66⅔% of the outstanding units, including units held by the general partner and the sponsor, voting together as a single class. As a practical matter, since the sponsor will usually hold more than 33⅓% of the common units, removal of the general partner by public holders of common units is impossible.
Transfer of ownership interests in the general partner	No approval required at any time.

Why form an MLP?

The principle reason to form an MLP is access to capital on favorable terms. In addition to the usual benefits of raising publicly traded capital through a corporation, an MLP is much more tax efficient. Shareholders of a corporation are confronted with "double taxation", the corporation is liable to pay taxes on its earnings, and then the shareholders are liable for taxes on any dividends that they receive (or potential taxation upon sale of the corporation's stock). Partners of a limited partnership (or members of a limited liability company that elects to be taxed as a partnership) are taxed only at the individual level; there is no U.S. federal or state income tax at the partnership level. This tax benefit is frequently referred to as "pass-through" income, as income passes through the entity without tax.

Partners are personally responsible for paying taxes on their individual portions of the limited partnership's income, gains, losses and deductions. Limited partners may also record a pro-rata share of the limited partnership's depreciation on their own tax forms, which could have the effect of reducing or deferring such limited partner's taxable income for a particular year. In addition, a portion of certain distributions may qualify as a return of the partner's capital, thereby reducing the partner's taxable basis for a particular year. While each partner is responsible for the taxes on his or her proportionate share of income of the limited partnership, even if the limited partnership does not pay any cash distribution during a particular year or quarter, MLPs generally are designed to be able to attempt to make quarterly distributions to their partners that will exceed any tax owed.

Because of the pass-through treatment, more cash is usually available for distributions to partners than would be available had the company been a corporation. This generally makes MLP units more attractive to investors than equivalent shares of a corporation (notwithstanding the different structure described above), which increases unit value.

Where to form an MLP

As noted above, all of the shipping and offshore MLPs to date have been formed in the Republic of the Marshall Islands. This is due to the favorable tax treatment in the Marshall Islands afforded to non-resident entities and their non-resident equity holders (see the next paragraph) and because the Marshall Islands Limited Partnership Act is based upon the Delaware Revised Uniform Limited Partnership Act, which is well known to investors.

Entities that are formed in the Marshall Islands that do not conduct business or operations in the Marshall Islands ("non-resident entities") are not subject to income tax in the Marshall Islands. Similarly, non-resident equity holders of Marshall Island formed entities, including limited partnerships, limited liability companies and corporations, are not subject to Marshall Islands taxation or withholding on distributions or dividends, including upon distribution treated as a return of capital. Non-resident equity holders are also not subject to Marshall Islands stamp, capital gains or other taxes on the purchase, ownership or disposition of units or stock and are not required under Marshall Islands law to file a tax return relating to ownership of units or stock. Interestingly, because there are no taxes imposed by the Marshall Islands, and many shipping companies formed in the Marshall Islands as MLPs do not operate in the United States (and therefore would not be subject to U.S. income tax if it were a corporation), certain Marshall Islands-formed MLPs elect to be treated as corporations for U.S. federal income tax purposes.

The Marshall Islands Limited Partnership Act resembles provisions of the limited partnership laws of a number of states in the United States, most notably Delaware (upon which the Marshall Islands Limited Partnership Act was based). The Marshall Islands Limited Partnership Act also provides that it is to be applied and construed to make it uniform with the Delaware Revised Uniform Limited Partnership Act and, so long as it does not conflict with the Marshall Islands Limited Partnership Act or decisions of the Marshall Islands courts, interpreted according to the non-statutory law (or case law) of the courts of the State of Delaware. Because potential investors are familiar with issuers formed in states within the United States (particularly Delaware), the Marshall Islands is a logical jurisdiction to form an entity as investors do not require additional understanding relating to governance.

Should you like to discuss any of the issues raised in this briefing, or any other corporate, securities, tax or Marshall Islands legal matter, please get in touch with a member of our team shown on the next page, or your regular contact at Watson, Farley & Williams.

All of the shipping and offshore MLPs have been formed in the Marshall Islands.

Contacts



Dan Rodgers
Partner
New York

drodgers@wfw.com
+1 212 922 2206



Steve Millman
Partner
New York

smillman@wfw.com
+1 212 922 2205



Steve Hollander
Counsel
New York

shollander@wfw.com
+1 212 922 2252

All references to 'Watson, Farley & Williams' and 'the firm' in this brochure mean Watson, Farley & Williams LLP and/or its affiliated undertakings. Any reference to a 'partner' means a member of Watson, Farley & Williams LLP, or a member of or partner in an affiliated undertaking of either of them, or an employee or consultant with equivalent standing and qualification.

To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any United States tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the United States Internal Revenue Code of 1986, as amended, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

This briefing is produced by Watson, Farley & Williams. It provides a summary of the legal issues, but is not intended to give specific legal advice. The situation described may not apply to your circumstances. If you require advice or have questions or comments on its subject, please speak to your usual contact at Watson, Farley & Williams.

© Watson, Farley & Williams 2012

100-000-1683 NEW 20/11/2012