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by Conrad S. Ciccotello,
Georgia State University, and
Chris J. Muscarella,
Pennsylvania State University

THE ENERGY MLP GOES INSTITUTIONAL: IMPLICATIONS FOR STRATEGY AND GOVERNANCE

*by Conrad S. Ciccotello, Georgia State University, and Chris J. Muscarella, Pennsylvania State University**

After Apache Oil created the first publicly traded master limited partnership (MLP) in 1981, this unusual organizational form experienced tremendous growth, with a number of natural resource firms—and even companies as disparate as the Boston Celtics and ServiceMaster—electing to take advantage of its partnership features and thereby avoid double taxation of distributed income. Most of the early MLP entrants are now long gone, victims of poor performance or tax law changes that subsequently made the MLP form undesirable (or even impossible) for all but natural resource industries. Those natural resource companies that have survived as MLPs received little attention during the technology bull market of the 1990s. Recently, however, interest in the MLP structure has been reignited—in part by a renewed focus on domestic energy, but perhaps even more so by an innovative new type of security offering, represented by the 2001 offering of Kinder Morgan Management, LLC (a limited liability company).

Kinder Morgan Management's assets consist solely of its stake in Kinder Morgan Energy Partners, L.P., the largest pipeline master limited partnership in the United States. Kinder Morgan Management pays stock dividends to its (institutional) investors that are equivalent to the cash distributions made by Kinder Morgan Energy Partners to its (retail) investors. Under current tax law, institutional holders must treat cash distributions from MLPs as unrelated business income, which creates an immediate tax liability. In the case of Kinder Morgan Management, however, institutional investors receive no cash, just stock dividends—and they receive those stock dividends from a limited liability company (LLC), not from the MLP directly. The underwriting thus represents a clever side-step of tax restrictions that had previously deterred institutions from investing in MLPs. If underwriting efforts to target institutional investors are successful, the MLP (with an affiliated LLC) could become an even more popular vehicle to hold energy industry assets.

But how will institutional ownership affect MLP strategy and governance? Under the new structure, MLPs will now be able to attract more capital and keep more cash inside the business, permitting them to take advantage of growth opportunities. In the energy industry, these developments could be valuable provided the MLP sticks to investing in "mid-stream" distribution and storage assets that produce steady cash flow. Oil producers are interested in divesting such assets in order to cut costs and raise capital, and so the potential for MLPs is great. The "growth MLP" is not free from risk, however. If an MLP enters more volatile energy sectors, such as exploration or retail, it could increase its exposure to commodity price risk and, more significantly, to fluctuations in demand. Under normal MLP governance, investors would have little to say about investment strategy or cash distribution policy. Ironically, institutions may have even less governance clout in the affiliated LLC.

After providing some background on MLPs, LLCs, and the Kinder Morgan offering, we examine strategy and governance issues raised by this new twist on the MLP.

*Much of the analysis in this article draws on our prior research. Chris Muscarella wrote "Price Performance of Initial Public Offerings of Master Limited Partnership Units," *Financial Review*, Vol. 23 (1988), pp. 513-521; and we co-authored "Matching Organizational Structure with Firm Attributes: A Study of Master Limited Partnerships," *European Finance Review*, Vol. 1 (1997), pp. 169-191, and "Contracts between Managers and Investors: A Study of Master Limited Partnership Agreements," *Journal of Corporate Finance*, Vol. 7 (2001), pp. 1-23.

BACKGROUND ON MLPs AND LLCs

MLPs are limited partnerships with publicly traded equity interests called units. All partnership profits, losses, and deductions flow directly through to the MLP owners based on their proportional ownership and are immediately taxable. The partnership structure is attractive because although shareholders pay tax on their pro rata share of MLP income at the time the income is earned, they are not taxed on any cash distributions received from the MLP, in contrast to corporate shareholders.[1] Much of the rationale for the emergence of MLPs in the early 1980s rested on this favorable tax treatment of cash distributions to investors. At the time, many companies in natural resource industries like oil and gas found themselves generating large amounts of cash but had few profitable new investment opportunities. Unlike other, more aggressive methods of restructuring, such as leveraged buyouts, MLPs were a "quiet restructuring," a way for slow-growth firms with high levels of free cash flow to distribute their excess cash in a tax-efficient manner.[2] Of course, partnership status provides no particular tax advantage over corporate status if the partnership retains a large percentage of its earnings.

The Revenue Act of 1987 curtailed the MLP's tax advantages by limiting the industries, new lines of business, and income sources for which partnership tax treatment was available. In brief, the tax changes required that an MLP earn at least 90% of its income from "qualified" natural resource industries.[3] The reasons for the backlash against favorable MLP tax treatment are difficult to isolate, but may in part have reflected concerns about lost tax revenue and abuse by investors in privately traded limited partnerships. The Revenue Act of 1987 contained some "grandfathering" tax protection for existing MLPs, allowing them to retain the MLP form until 1997. Nevertheless, after 1987 many MLPs reevaluated the changing tax landscape and returned to corporate form. In the last 15 years, virtually all MLPs that have gone public have been in natural resource businesses. Many of these, like Kinder Morgan Energy Partners, operate pipelines and/or storage terminals for oil and gas.

As noted earlier, tax-exempt institutional investors have always been deterred from owning limited partnership units by tax rules that treat cash distributions from MLPs as unrelated business income that is immediately taxable. The tax logic is that since the MLP is not a taxable entity, its cash distributions should pass to a taxable entity and not through another nontaxable entity, such as a pension or mutual fund. Investors owning MLPs must thus be taxable entities, and are required to file tax returns based on pro rata income earned by the MLP (Schedule K-1). This often involves several state tax returns in addition to a federal return.

Along with tax treatment, the other major difference between corporations and MLPs has to do with governance. For example, an MLP partnership agreement might stipulate target payouts of cash to investors and provide tangible incentives such as increased cash payments to the general partner for meeting the targets. In an MLP, the partnership agreement thus acts as the major governing mechanism. Since partnerships do not have a board of directors, however, the general partner (management) has exclusive power to determine cash distributions and to make other business decisions. Removal of management is contemplated in most partnership agreements, but it typically can be accomplished only by a supermajority vote of limited partnership units.

The limited liability company is a more flexible ownership form that offers a combination of desirable features, including limited liability to managers and investors. An LLC can be taxed as either a corporation or a partnership (flow-through), although publicly traded LLCs tend to be taxed as corporations, given that their interests are transferable. All LLCs have an operating agreement, which can specify either a corporate control structure with a board of directors and shares of ownership, or a partnership governance structure.[4]

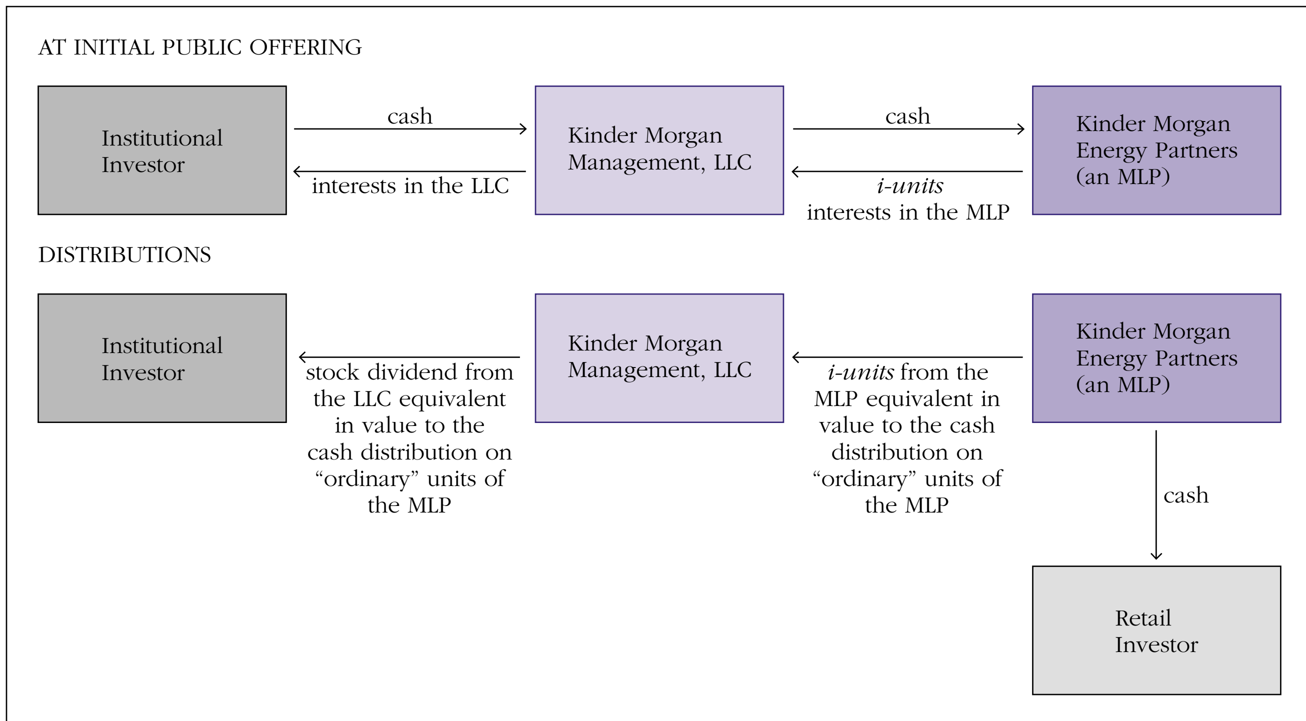
1. For additional information and a more complete description, see R. Michaely and W. Shaw, "The Choice of Going Public: Spin-Offs vs. Carve Outs," *Financial Management*, Vol. 24 (1995), pp. 5-21, and J. Guenther, "Taxes and Organizational Form: A Comparison of Corporations and Master Limited Partnerships," *The Accounting Review*, Vol. 67 (1992), pp. 17-45.

2. For more on restructurings, see J. Kensinger and J. Martin, "Royalty Trusts, Master Partnerships, and Other Organizational Means of 'Unfirming' the Firm," *Midland Corporate Finance Journal*, Vol. 4 (1986), pp. 72-80; and M. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *American Economic Review*, Vol. 76 (1986), pp. 323-329.

3. Section 7704 of the Internal Revenue code states that publicly traded partnerships will be taxed as corporations unless 90% or more of their income comes from exploration, development, mining, processing, refining, transportation, or marketing of any mineral or natural resource.

4. For more information on LLCs, see C. Ciccotello and C. Grant, "LLCs and LLPs: Organizing to Deliver Professional Services," *Business Horizons*, Vol. 42 (1999), pp. 85-91.

FIGURE 1 ■ OFFERING OF KINDER MORGAN LLC AND MLP



THE KINDER MORGAN OFFERING

In its prospectus of May 14, 2001, lead underwriter Goldman Sachs offered 14,875,000 shares constituting the initial public interests in Kinder Morgan Management, LLC, whose assets consist of *i-units* representing a 17.7% ownership share in Kinder Morgan Energy Partners, its MLP affiliate.[5] Kinder Morgan Management has elected to be treated as a corporation for income tax purposes. Kinder Morgan Energy Partners is operated by Kinder Morgan, Inc., a mid-stream energy corporation with an enterprise value of some $18 billion. Following the Goldman-led offering of Kinder Morgan Management with its 17.7% share, common units owned by the public constituted a 63.7% interest in Kinder Morgan Energy Partners, and common units owned by Kinder Morgan, Inc. and its affiliates totaled about 16.6%. (The general partner, Kinder Morgan G.P., Inc., owns the remaining 2% interest.) All but the Kinder Morgan Management holdings continue to receive cash distributions. When Kinder Morgan Energy Partners distributes cash to its unit holders, it distributes *i-units* to Kinder Morgan Management, which in turn distributes stock dividends to its investors. Figure 1 depicts the nature of the offering.

What makes this offering unique is the relationship among Kinder Morgan Management, Kinder Morgan Energy Partners, and the institutional investors, especially with regard to distributions. As stated in the prospectus:

> *When KMMLP [Kinder Morgan Energy Partners] makes distributions on its common units, we (KMLLC) [Kinder Morgan Management] will make distributions on our shares in the form of additional shares. As an owner of our shares, you will receive the number of additional shares equal to the amount of cash distributions you would have received had you owned KMMLP common units divided by the average market price of our shares (p. 1).*

5. See Goldman Sachs, *Prospectus for Shares Representing Limited Liability Interests*, May 14, 2001, p. 1 (hereinafter, "prospectus"). For a general discussion of the offering, see B. Tunick, "Goldman Recasts the Energy MLP, and Files to Sell First-Ever to Institutions: Deal for Kinder Morgan Could Spawn Imitators at Other Banks," *Investment Dealers' Digest*, April 16, 2001, pp. 3-6.

Funneling the cash flow of the near-monopoly power of a distribution and storage system through a tax-advantaged filter is a powerful combination for generating above-average after-tax returns.

Consider the dynamics of this offer. Investors in Kinder Morgan Management do not own units of Kinder Morgan Energy Partners directly. However, the officers of Kinder Morgan Management are also the officers of Kinder Morgan, Inc., which wholly owns the general partner of Kinder Morgan Energy Partners, or Kinder Morgan G.P., Inc. Investors in Kinder Morgan Management receive no cash distributions; they receive stock dividends equivalent in value to the *i-units* received by Kinder Morgan Management from Kinder Morgan Energy Partners. On the surface, this seems like an unnecessarily complex arrangement. Why did Goldman go to all of this trouble instead of just offering additional units of Kinder Morgan Energy Partners directly to investors? Below are four reasons summarized on the first page of the prospectus:

- *Because we (KMLLC) [Kinder Morgan Management] will be treated as a corporation for United States (U.S.) income tax purposes, an owner of our shares will not report on its U.S. income tax return any of our items of income, gain, loss, or deduction. As a result of owning our shares, you will not receive a Schedule K-1 and will not be subject to state tax filings in the various states in which KMMLP [Kinder Morgan Energy Partners] conducts business.*
- *A tax-exempt investor's ownership or sale of our shares will not generate income derived from an unrelated trade or business regularly carried on by the tax-exempt investor, which is generally referred to as unrelated business taxable income or "UBTI," unless its ownership of our shares is debt financed by it.*
- *The ownership of our shares by a mutual fund will be treated as a qualifying asset, which generally includes cash, certain receivables, government securities, and other securities.*
- *We (KMLLC) will be subject to income taxes on our taxable income; however, the i-units owned by us generally will not be entitled to allocations of income, gain, loss, or deduction of KMMLP. Therefore, we do not anticipate that we generally will have material amounts of taxable income resulting from the ownership of i-units.*

In sum, owning Kinder Morgan Management instead of Kinder Morgan Energy Partners does several things. It allows the investor to avoid having to file partnership (Schedule K-1) tax returns. It allows tax-exempt investors (institutions) to own interests without triggering unrelated business taxable income (UBTI). It creates a qualifying asset so that mutual funds may invest. And it promises limited taxable income, thus permitting investors in Kinder Morgan Management to control their current tax liability via the timing of stock sales for capital gains. Indeed, the prospectus (p. 104) states that distributions of additional shares in Kinder Morgan Management would not normally be considered gross income to the recipient, since they are distributed pro rata to all shareholders.

The ingenuity of this offer has received notice. In January 2002, *Investment Dealers' Digest* awarded Goldman Sachs its "Deal of the Year" award for the energy industry.[6] Whether this offering will have the intended tax consequences for institutional investors is still an open question. Goldman did lead a successful secondary offering of more than 12 million shares in Kinder Morgan Management in August 2002, however. This secondary offering provides some indication that the innovation might survive IRS scrutiny.

STRATEGY IN THE INSTITUTIONAL MLP

The advantages of the Kinder Morgan Management/Kinder Morgan Energy Partners structure stem mainly from the easing of tax burdens for investors (especially tax-exempt institutions). The irony of the new structure is in how it facilitates growth. Because Kinder Morgan Energy Partners can now raise more cash (through Kinder Morgan Management) from institutions *and* can retain rather than distribute cash on *i-units*—although the remaining common units continue to receive cash distributions—it appears that the MLP has the potential to become a growth vehicle. In fact, the prospectus (p. 2) states that the business strategy of Kinder Morgan Energy Partners is:

to grow *by…*

- *providing, for a fee, transportation, storage, and handling services which are core to the energy infrastructure of growing markets;*
- *increasing utilization of assets while controlling costs;*

6. *Investment Dealer's Digest*, January 7, 2002, pp. 34-35.

- *leveraging economies of scale from incremental acquisitions; and*
- *maximizing the benefits of its financial structure.*

The prospectus goes on to say that since 1997, when Kinder Morgan, Inc. and Kinder Morgan Energy Partners were founded, Kinder Morgan Energy Partners has closed on "21 acquisitions valued at approximately $4.8B. KMMLP [Kinder Morgan Energy Partners] intends to make additional acquisitions of pipelines, terminals, and other energy-related transportation assets."

The irony is that the MLP was thought to be an organizational vehicle for slow-growth firms to distribute cash in a tax-advantaged way. Can the MLP now be a growth vehicle? The key is to maintain an operating/investment strategy that generates steady cash flow and is thus consistent with the MLP structure. Historically, MLPs that tried to grow in a conglomerate manner, with operations in two or more unrelated businesses (as determined by their two-digit standard industrial classification codes), performed poorly relative to their more focused peers. Moreover, for businesses with a prior history as a corporation, merely becoming an MLP did not cause performance to improve. Focused corporations that converted to MLP form, however, harvested the tax benefits of distributing steady cash flow as an MLP. As noted earlier, tax laws now mandate that at least 90% of MLP "qualified income" come from natural resource businesses, so conglomerate diversification is less of a concern today. So the question now is what assets *within* the natural resource industry are appropriate for the MLP structure?

To address this issue, it helps to take a brief look at the value chain in the energy (oil or natural gas, for example) business. Oil or gas must be located and extracted, refined, transported, stored, and sold to customers, be they wholesale or retail. Oil and gas themselves are basically commodity items. Kinder Morgan Energy Partners has explicitly stated its intention to avoid the retail end of the business due to volatile movements in commodity prices.[7] Volatile commodity prices also affect the exploration end of the oil business—firms sometimes own oil reserves that are cost-ineffective to extract, and at other times massive capital expenditures are needed to extract oil as quickly as possible. The critical strategy component for MLPs would appear to be avoiding components of the energy business with volatile cash flows.

How is the middle of the value chain different? While revenues for transportation and storage—called the "sweet spot" for MLPs—are certainly a function of demand for oil, they are much more stable than the revenues at the exploration and retail ends of the business. The logic is that the cost of transporting oil and gas remains steady even when energy prices fluctuate.[8] One reason is market power. Energy infrastructure typically has little competition, even though it carries a commodity product. Richard Kinder, founder of Kinder Morgan, has described the distribution network as essentially a "toll road."[9] Funneling the cash flows of the near-monopoly power of a distribution and storage system through a tax-advantaged filter is a powerful combination for generating above-average after-tax returns.

Recent trends present MLPs with a great opportunity to acquire additional "mid-stream" assets. A significant percentage of mid-stream energy assets are still held in corporate form.

But, as noted earlier, oil producers have become interested in selling these distribution and storage assets as a means of cutting costs and raising capital. As a tax-advantaged entity, an MLP might be able to outbid a taxable entity such as a corporation for the assets, and so the potential for the MLP remains great.[10]

Because MLP cash distributions are tax-advantaged relative to those of corporations, they attract clienteles of investors who want a steady yield. They are thus a good fit for businesses with predictable cash flows. Corporations are much better suited for the more volatile ends of the value chain, however. Exploration requires large and irregular investments; promises of steady cash are harder to make. Moreover, corporate earnings are taxed twice, first as reported profits and then as dividends. Corporations are thus tax efficient only for those businesses that plow back most of their profits into

7. In its proposed business strategy statement in the May 14, 2001 prospectus is the following: "KMMLP [Kinder Morgan Energy Partners] primarily transports and/or handles products for a fee and generally is not engaged in the purchase and resale of commodity products. As a result, KMMLP does not face significant risks relating directly to movements in commodity prices" (p. 2).

8. See D. Fisher, "Pipeline for Profits," *Forbes*, March 18, 2002, p. 189.

9. See B. Hensel, "Little-Known Pioneer Rising to the Top: Master Limited Partnership Uses a New Method to Achieve Growth," *Houston Chronicle*, May 19, 2002.

10. The value of energy partnerships has increased from $5 billion to $25 billion over the last five years. Estimates place the potential market value of these partnerships at $40-50 billion; see *Houston Chronicle*, May 19, 2002, cited earlier.

The governance irony is that in the typical corporate governance model, retail investors are thought to piggyback on the efforts of institutions. In this new MLP structure, it is the institutions who essentially piggyback on the governance provisions in the retail investor partnership agreement.

the business to create capital gains for investors, who can time the recognition of their capital gains as they see fit. The bottom line for strategy is that the institutional MLP can be tremendously successful in bringing needed investment to energy transportation and storage infrastructure. Whether MLPs will limit themselves to this "sweet spot" or venture into the more volatile tails of the value chain is an interesting question and one perhaps more relevant to governance, a topic to which we now turn.

GOVERNANCE IN THE INSTITUTIONAL MLP

The Kinder Morgan Management/Kinder Morgan Energy Partners offering provides a new twist in MLP ownership and control. In an MLP, of course, the partnership agreement is the outside investors' only source of protection. Because partnership agreements typically offer little protection for retail investors' interests, underwriters have tended to sell only small stakes (well under half the limited partnership units) in these "investor unfriendly" MLPs to the public, with insiders keeping the rest. In turn, MLPs with high levels of insider (general partner and affiliate) ownership tend to have fewer limitations on managers (the general partner). But there is no empirical evidence of value destruction by MLPs that give the general partner a great deal of flexibility. In these MLPs, it is the insiders who own the vast majority of the equity. If they waste assets, they hurt themselves. Governance still exists, then, albeit in a different form than when partnership agreements are highly protective of investors.

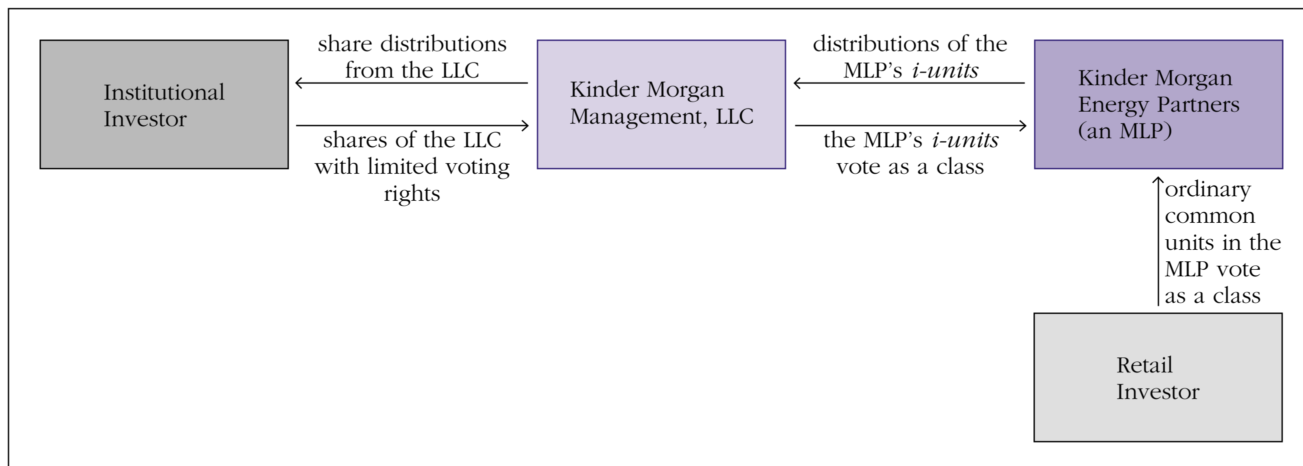
What does this mean for the institutional MLP? First, it is important to note that the interests sold in the offering under discussion are not in Kinder Morgan Energy Partners but rather in Kinder Morgan Management, a limited liability company that has elected to be treated as a corporation for tax purposes. As an LLC, Kinder Morgan Management has flexibility in the design of its management structure. In this case, it follows a traditional corporate governance model, with a board of directors. Institutions can only affect governance in Kinder Morgan Energy Partners through Kinder Morgan Management. The real issue in governance is what control rights the institutional investors have in Kinder Morgan Management.

The initial impression from the Kinder Morgan Management offering prospectus is that investor control rights are very restricted. The prospectus indicates that share owners "have limited voting rights and therefore will have little opportunity to influence or change our management" (p. 1). Examining this issue in a bit more detail reveals what this means. The prospectus states that the class of shares owned by Kinder Morgan Management (institutional) investors does not elect directors of Kinder Morgan Management. Those directors are elected solely by the general partner (Kinder Morgan G.P., Inc.), which is, in turn, wholly owned by Kinder Morgan, Inc.

Are investor control rights in Kinder Morgan Management stronger or weaker than those in a traditional MLP? On the basis of voting rights alone, they are definitely weaker. For example, most MLPs have either simple majority or supermajority removal provisions for the general partner. Kinder Morgan Energy Partners itself has such a provision, requiring that two-thirds of the outstanding units of all classes vote for removal of the general partner. But the investors in Kinder Morgan Management do not own units in Kinder Morgan Energy Partners. Kinder Morgan Management can vote (through the *i-unit* class) to remove the general partner of Kinder Morgan Energy Partners (Kinder Morgan G.P., Inc.), but since Kinder Morgan G.P., Inc. elects the directors of Kinder Morgan Management, such a vote to remove seems unlikely.

When Kinder Morgan Energy Partners distributes cash, Kinder Morgan Management receives more *i-units* of Kinder Morgan Energy Partners, and investors in Kinder Morgan Management receive more shares of Kinder Morgan Management. Over time, investors own more shares of nonvoting stock in Kinder Morgan Management, and Kinder Morgan Management owns more voting units of Kinder Morgan Energy Partners. In short, governance leverage doesn't improve over time with additional ownership—it gets worse. If investors received additional interests in Kinder Morgan Energy Partners directly, they would accrue adding voting power as unit holders. Under the current arrangement, however, investors in Kinder Morgan Management accrue an increasing stake of nonvoting stock. In addition, as Kinder Morgan Management builds *i-units* in Kinder Morgan Energy Partners, it builds protection for its own interests, because removal of the general partner in Kinder Morgan Energy Partners requires a two-thirds majority of all share classes—and Kinder Morgan Management is unlikely to vote its shares for removal. Figure 2 provides a visual summary of this voting rights scenario.

FIGURE 2 ■ VOTING RIGHTS IN THE INSTITUTIONAL MLP



Investors in Kinder Morgan Management are still afforded some protection by the partnership agreement for Kinder Morgan Energy Partners, however. That agreement sets target distributions of cash and provides incentives for the general partner to distribute cash.[11] These provisions are in line with the trend for MLPs formed after 1987 to make better-defined promises regarding cash distributions, where earlier MLPs had tended to make "fuzzier" promises about "distributing 'available' cash," with no specific target amounts and no incentives for managers to make distributions. What's more, some of the early MLPs pursued oil and gas exploration, and often had no "available" cash.

As the MLP structure matured, however, underwriters and managers learned that steady cash distributions were a critical factor for valuation and sale to retail investors.[12] And it is important to remember that Kinder Morgan Energy Partners is still owned primarily by retail investors. The governance irony is that in the typical corporate governance model, retail investors are thought to piggyback on the efforts of institutions. In this new MLP structure, it is the institutions who essentially piggyback on the governance provisions in the retail investor partnership agreement.

Despite their weak voting rights position, it is too strong a statement to say that investors in Kinder Morgan Management have no power. A snapshot of the top institutional owners of Kinder Morgan Management reveals heavy concentration. The top ten institutional investors, including the likes of Capital Guardian, Alex Brown, Oppenheimer, Janus, MFS, and Merrill Lynch, own about 57% of the outstanding shares, and the top ten mutual fund holders own another 24% of the shares.[13] These investors are well positioned to influence management regarding future business or other ongoing business endeavors. Given the size of their holdings, a threat to sell might also attract management's attention and influence decision-making.

SUMMARY

This article examines the initial public offering of Kinder Morgan Management, LLC. In this innovative underwriting led by Goldman in May 2001, institutions own shares in an LLC intermediary to Kinder Morgan Energy Partners, a master limited partnership, and thus escape the tax burdens that have long deterred institutions from owning MLP interests. Given the tax-favored status of MLPs operating in natural resource businesses, and the renewed interest in domestic energy sources, this offering creates the potential for large, new investments by institutions in energy businesses that are housed in the MLP structure. The market appears to recognize the potential. From January 2001 through

11. See *Description of Partnership Agreement, Form 10-K for Kinder Morgan Energy Partners*, filed with the Securities and Exchange Commission on March 14, 2001.

12. M. Rosenwasser and K. Beller, "Master Limited Partnerships," *Review of Securities & Commodities Regulation*, Vol. 20 (1987), pp. 36-40.

13. *Yahoo Finance*, July 10, 2002.

The MLP form was originally designed to be a tax-advantaged vehicle for distributing cash and winding down operations. With this underwriting innovation, however, the MLP is now ideally positioned to be a growth vehicle.

May 2002 there were seven initial public offerings of energy-related MLPs. Goldman itself led a secondary offering of Kinder Morgan Management in August 2002.

Two key observations emerge from our analysis of the Kinder Morgan Management offering. The first is about strategy. The MLP form was originally designed to be a tax-advantaged vehicle for distributing cash and winding down operations. With this underwriting innovation, however, the MLP is now ideally positioned to be a growth vehicle. It can both attract institutional cash through the LLC intermediary as well as conserve cash by making only unit distributions to the LLC intermediary. A growth strategy can work provided the MLP stays in the "sweet spot," namely mid-stream assets related to the distribution and storage of natural resources like oil and gas. These assets bring about steady cash flows and are attractive to both retail and institutional investor clienteles. By staying mid-stream and using their tax-advantaged status to outbid corporate rivals for acquisitions, MLPs could end up owning much of the energy transportation and storage infrastructure in the United States. But MLPs that use their additional cash to venture into the more volatile ends of the energy value chain (exploration and retail) move outside the "sweet spot." The corporate form is better suited for those more volatile operations.

The second observation is about governance. In this new structure, institutional investors in the intermediary LLC have no control rights at all in the MLP (they don't own it directly) and essentially no control rights in the LLC that they do own (per the LLC operating agreement). LLC investors must instead rely indirectly on the MLP partnership agreement to protect them. Since the MLP is an investment designed for retail investors, it is the institutions that benefit from the governance efforts of the retail investors, instead of vice versa.

Despite the organizational complexity of the Kinder Morgan Management/Kinder Morgan Energy Partners structure, the public disclosure of the relationships among the parties stands in stark contrast to the opacity of "off balance sheet" special-purpose entity structures. Like Enron, Kinder Morgan Management is complex. Unlike Enron, however, Kinder Morgan Management has provided the information needed for the market to assess value.

■ CONRAD CICCOTELLO

is Associate Professor at Georgia State University's Robinson College of Business Administration.

■ CHRIS MUSCARELLA

is Professor at Pennsylvania State University's Smeal College of Business Administration.

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