

Sanchez Production Partners LP  
Form S-3  
May 18, 2015  
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As filed with the Securities and Exchange Commission on May 18, 2015

Registration No. 333-

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM S-3**  
**REGISTRATION STATEMENT**  
***UNDER***  
***THE SECURITIES ACT OF 1933***

**Sanchez Production Partners LP**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**11-3742489**  
**(I.R.S. Employer**  
**Identification No.)**

**Charles C. Ward**

**Chief Financial Officer**

**Sanchez Production Partners GP LLC**

**1000 Main Street, Suite 3000**

**Houston, Texas 77002**

**(713) 783-8000**

**(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)**

**1000 Main Street, Suite 3000**

**Houston, Texas 77002**

**(713) 783-8000**

**(Name, address, including zip code, and telephone number,**

**including area code, of agent for service)**

*Copy to:*

**Scott L. Olson**

**Andrews Kurth LLP**

**600 Travis, Suite 4200**

**Houston, Texas 77002**

**(713) 220-4200**

**Approximate date of commencement of proposed sale to the public:** From time to time after the effective date of this Registration Statement, as determined in light of market conditions and other factors.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box.

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Act.

Large accelerated filer  Accelerated filer   
 Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

**CALCULATION OF REGISTRATION FEE**

| <b>Title of Each Class of Securities to be Registered</b>               | <b>Amount to be Registered(1)(2)</b> | <b>Proposed Maximum Offering Price Per Unit(3)(4)</b> | <b>Proposed Maximum Aggregate Offering Price(4)</b> | <b>Amount of Registration Fee(5)</b> |
|---|--------------------------------------|---|---|--------------------------------------|
| Common Units issuable upon conversion of the Class A Preferred Units(1) | 12,703,933                           | \$2.15  | \$27,313,456  | \$3,174                              |

(1) Pursuant to Rule 416(a) under the Securities Act, the number of common units being registered on behalf of the selling unitholders shall be adjusted to include any additional common units that may become issuable as a result of any unit distribution, split, combination or similar transaction.

(2) Includes 10,859,375 common units issuable upon conversion of 10,859,375 Class A Preferred Units that Sanchez Production Partners LP has issued to the selling unitholders named in this prospectus or in any supplement to this prospectus, and 1,844,558 common units issuable upon conversion of 1,844,558 Class A Preferred Units that Sanchez Production Partners LP may issue as payment in kind to the selling unitholders named in this prospectus or in any supplement to this prospectus (assuming such conversion occurs on March 31, 2016). The initial conversion ratio is one Class A Preferred Unit in exchange for one common unit; however, the conversion ratio is subject to adjustment.

- (3) The proposed maximum offering price per common unit will be determined from time to time in connection with, and at the time of, the sale by the holder of such units.
- (4) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act on the basis of the average of the high and low sales prices of the common units on May 14, 2014 of \$2.15, as reported on the NYSE MKT LLC.
- (5) Calculated in accordance with Rule 457(o) under the Securities Act.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that the Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED MAY 18, 2015**

**PROSPECTUS**

**Sanchez Production Partners LP**

**12,703,933 COMMON UNITS**

This prospectus relates to 10,859,375 common units issuable upon conversion of 10,859,375 Class A Preferred Units that Sanchez Production Partners LP has issued to the selling unitholders named in this prospectus or in any supplement to this prospectus or any transferee, assignee or other successor-in-interest that received units from a selling unitholder (collectively, the selling unitholders), and 1,844,558 common units issuable upon conversion of 1,844,558 Class A Preferred Units that we may issue as payment in kind to the selling unitholders (assuming such conversion occurs on March 31, 2016). The initial conversion ratio is one Class A Preferred Unit in exchange for one common unit; however, the conversion ratio is subject to adjustment.

Upon conversion of the Class A Preferred Units, the selling unitholders may from time to time, in one or more offerings, offer and sell up to 12,703,933 common units representing limited partner interests in us (assuming such conversion occurs on March 31, 2016). The Class A Preferred Units held by the selling unitholders named in this prospectus were obtained in connection with a private placement of our Class A Preferred Units.

We will not receive any proceeds from the sale of common units owned by the selling unitholders. For a more detailed discussion of the selling unitholders, please read Selling Unitholders.

The selling unitholders may offer and sell these securities at various times in amounts, at prices and on terms to be determined by market conditions and other factors at the time of such offerings. The selling unitholders may offer and sell these securities to or through one or more underwriters, dealers and agents, who may receive compensation in the form of discounts, concessions or commissions, or directly to purchasers, on a continuous or delayed basis. This prospectus describes the general terms of these securities and the general manner in which the selling unitholders will offer the securities. The prospectus supplement will describe the specific manner in which the selling unitholders will offer the securities and also may add, update or change information contained in this prospectus. The names of any underwriters and the specific terms of a plan of distribution will be stated in the prospectus supplement. The common units may be offered and sold by the selling unitholders from time to time in accordance with the provisions set forth under Plan of Distribution.

Our common units trade on the NYSE MKT under the symbol SPP. The last reported sales price of our common units on the NYSE MKT on May 14, 2015 was \$2.11 per common unit.

**Limited partnerships are inherently different from corporations. Please read Risk Factors on page 1 of this prospectus before you make an investment in our securities.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

**The date of this prospectus is \_\_\_\_\_, 2015.**

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**ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement on Form S-3 that we have filed with the Securities and Exchange Commission, or SEC, utilizing a shelf registration process. Under this shelf registration process, the selling unitholders may, from time to time, sell up to 10,859,375 common units issuable upon conversion of 10,859,375 Class A Preferred Units that we have issued to the selling unitholders, and 1,844,558 common units issuable upon conversion of 1,844,558 Class A Preferred Units that we may issue as payment in kind to the selling unitholders (assuming such conversion occurs on March 31, 2016). The initial conversion ratio is one Class A Preferred Unit in exchange for one common unit; however, the conversion ratio is subject to adjustment. Each time a selling unitholder sells securities, the selling unitholder may be required to provide you with this prospectus and, in certain cases, a supplement to this prospectus containing specific information about the selling unitholder and the terms of the securities being offered.

In making your investment decision, you should rely only on the information contained in or incorporated by reference into this prospectus and any prospectus supplement. Neither we nor any of the selling unitholders have authorized anyone to provide you with any other information. If you receive any unauthorized information, you must not rely on it. Our business, financial condition, results of operations and prospects may have changed since those dates.

You should not assume that the information contained in this prospectus or in the documents incorporated by reference into this prospectus are accurate as of any date other than the date on the front cover of this prospectus or the date of such incorporated documents, as the case may be.

Unless otherwise indicated or unless the context otherwise requires, all references in this prospectus to Sanchez, our partnership, we, our, us or similar references mean Sanchez Production Partners LP and its consolidated subsidiaries. Such terms also refer to Sanchez Production Partners LLC, our predecessor-in-interest prior to our conversion from a

limited liability company into a limited partnership.



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**INCORPORATION BY REFERENCE**

The SEC allows us to incorporate by reference information into this document. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this prospectus. We incorporate by reference the documents listed below, other than any portions of the respective filings that were furnished (pursuant to Item 2.02 or Item 7.01 of current reports on Form 8-K or other applicable SEC rules) rather than filed:

Our Annual Report on Form 10-K for the year ended December 31, 2014;

Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2015;

Our Current Reports on Form 8-K filed January 12, 2015, March 6, 2015, March 11, 2015, March 16, 2015, April 1, 2015, April 15, 2015 and May 14, 2015;

Our Current Report on Form 8-K/A filed May 18, 2015; and

The description of our common units contained in our registration statement on Form 8-A (File No. 001-33147) filed on March 6, 2015.

All documents that we file pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, after the date of this prospectus and until our offerings hereunder are completed will be deemed to be incorporated by reference into this prospectus and will be a part of this prospectus from the date of the filing of the document. Any statement contained in a document incorporated or deemed to be incorporated by reference in this prospectus will be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or in any other subsequently filed document that also is or is deemed to be incorporated by reference in this prospectus modifies or supersedes that statement. Any statement that is modified or superseded will not constitute a part of this prospectus, except as modified or superseded.

We will provide to each person, including any beneficial owner to whom a prospectus is delivered, a copy of these filings, other than an exhibit to these filings, unless we have specifically incorporated that exhibit by reference into the filing, upon written or oral request and at no cost. Requests should be made by writing or telephoning us at the following address:

Sanchez Production Partners LP

1000 Main Street, Suite 3000

Houston, Texas 77002

(713) 783-8000

Attn: Investor Relations

**WHERE YOU CAN FIND MORE INFORMATION**

We have filed a registration statement with the SEC under the Securities Act of 1933, as amended, or the Securities Act, that registers the issuance and sale of the securities offered by this prospectus. The registration statement, including the attached exhibits, contains additional relevant information about us. The rules and regulations of the SEC allow us to omit some information included in the registration statement from this prospectus.

We file annual, quarterly, and other reports and other information with the SEC under the Exchange Act. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. Our SEC filings are also available to the public through the SEC's website at <http://www.sec.gov>.

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General information about us, including our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments and exhibits to those reports, are available free of charge through our website at <http://www.sanchezpp.com> as soon as reasonably practicable after we file them with, or furnish them to, the SEC. Information on our website is not incorporated into this prospectus or our other securities filings and is not a part of this prospectus.

**NOTE REGARDING FORWARD-LOOKING STATEMENTS**

The information contained and incorporated by reference in this prospectus contains forward-looking statements as defined by the SEC that are subject to a number of risks and uncertainties, many of which are beyond our control. These statements may include discussions about our:

business strategy;

acquisition strategy;

financial strategy;

ability to resume, maintain and grow distributions;

drilling locations;

oil, natural gas and natural gas liquids reserves;

realized oil, natural gas and natural gas liquids prices;

production volumes;

lease operating expenses, general and administrative expenses and developmental costs;

future operating results; and

plans, objectives, expectations, forecasts, outlook and intentions.

All of these types of statements, other than statements of historical fact included or incorporated by reference in this prospectus, are forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as may, will, could, should, expect, plan, project, intend, anticipate, believe, e

potential, pursue, target, continue, the negative of such terms or other comparable terminology.

The forward-looking statements contained and incorporated by reference in this prospectus are largely based on our expectations, which reflect estimates and assumptions made by the management of our general partner. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors. Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management's assumptions about future events may prove to be inaccurate. Management cautions all readers that the forward-looking statements contained and incorporated in this prospectus are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or the forward-looking events and circumstances will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to factors listed in the Risk Factors section and elsewhere in this prospectus. The forward-looking statements speak only as of the date made, and other than as required by law, we do not intend to publicly update or revise any forward-looking statements as a result of new information, future events or otherwise. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

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**SANCHEZ PRODUCTION PARTNERS LP**

Sanchez Production Partners LP, a Delaware limited partnership, was formed in 2005 as a limited liability company until our conversion on March 6, 2015 into a limited partnership. We are focused on the acquisition, development and production of oil and natural gas properties, as well as midstream assets. Our proved reserves are located in the Cherokee Basin in Oklahoma, the Woodford Shale in the Arkoma Basin in Oklahoma, the Central Kansas Uplift in Kansas and along the Gulf Coast in Texas and Louisiana. Our primary business objective is to create long-term value and to generate stable cash flows allowing us to invest in our business to grow our reserves and production.

Our headquarters are located at 1000 Main Street, Suite 3000 in Houston, Texas. Our phone number is (713) 783-8000, and our website is accessed at [www.sanchezpp.com](http://www.sanchezpp.com). Information on our website is not incorporated into this prospectus or our other securities filings and is not a part of this prospectus.

**RISK FACTORS**

The securities to be offered by this prospectus may involve a high degree of risk. When considering an investment in any of the securities, you should consider carefully all of the risk factors described in any annual report on Form 10-K, quarterly report on Form 10-Q, current report on Form 8-K or other document incorporated by reference into this prospectus or filed by us with the SEC after the date of this prospectus. If applicable, we will include in any prospectus supplement a description of those significant factors that could make the offering described in the prospectus supplement speculative or risky.

**Risk Related to the Offering**

*Sales by the selling unitholders of our issuable common units that are covered by this prospectus could adversely affect the trading price of our common units.*

We are registering for resale an aggregate of 12,703,933 common units which may be held by the selling unitholders, which represent approximately 40% of our currently outstanding common units. Subject to certain exceptions, we are obligated to keep this prospectus current so that the common units can be sold in the public market at any time. The resale of all or a substantial portion of the common units in the public market, or the perception that these sales might occur, could cause the market price of our common units to decrease and may make it more difficult for us to sell our equity securities in the future at a time and upon terms that we deem appropriate.

**USE OF PROCEEDS**

We will not receive any of the proceeds from the sale of the common units by the selling unitholders.

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**CASH DISTRIBUTION POLICY AND RESTRICTIONS ON DISTRIBUTIONS**

*You should read the following discussion of our cash distribution policy in conjunction with the specific assumptions included in this section. In addition, you should read **Forward-Looking Statements and Risk Factors** for information regarding statements that do not relate strictly to historical or current facts and certain risks inherent in our business.*

*For additional information regarding our historical results of operations, you should refer to our historical **Condensed Consolidated Financial Statements and the notes to those financial statements** incorporated by reference into this prospectus supplement.*

**General**

***Rationale for Our Cash Distribution Policy***

Upon such time as the board of directors of our general partner determines that we have sufficient available cash, we intend to make a minimum quarterly distribution of at least \$0.05 per unit (\$0.20 per unit on an annualized basis) on all of our common units after payment of the preferred quarterly distribution (as defined below) on our Class A Preferred Units. As of May 15, 2015, we do not anticipate having sufficient available cash to be able to make any cash distributions on our units during the next 12 months unless we consummate a significant acquisition that generates sufficient available cash, which is a strategy that we are pursuing. The amount of the available cash shortfall during the next twelve months is anticipated to be at least the full amount of the approximately \$2.1 million that would be needed to make a distribution in each quarter, assuming that all Class A Preferred Units converted into common units on a one-for-one basis and no PIK units (defined below) have been issued.

We expect that if we are successful in executing our business strategy, we will grow our business in a steady and sustainable manner and distribute to our unitholders a portion of any increase in our earnings resulting from such growth. Our cash distribution policy reflects a judgment that our unitholders will be better served by our distributing rather than retaining a substantial amount of the cash derived from our earnings. However, since it will be our policy to set our distributions based on the level of success of our operations, the actual amount of cash that we distribute on our common units will depend principally on the amount of earnings that we can generate from our operations. In addition, as we discuss below, our ability to pay distributions is subject to various restrictions, as well as other factors.

We established the minimum quarterly distribution of \$0.05 per unit in connection with entering into a Shared Services Agreement with SP Holdings, LLC, or SP Holdings, the sole member of our general partner, in May 2014, or Services Agreement. At that time, our common unit price had historically been trading on the NYSE MKT around \$2.00 per common unit. We desired to have an approximate yield of 10% on our common units, which is the midpoint of the range for typical master limited partnership yields.

***Limitations on Cash Distributions and Our Ability to Change Our Cash Distribution Policy***

There is no guarantee that we will make quarterly cash distributions to our unitholders. We do not have a legal or contractual obligation to pay quarterly distributions at our minimum quarterly distribution rate or at any other rate. Our cash distribution policy is subject to certain restrictions and may be changed at any time. The reasons for such uncertainties in our stated cash distribution policy include the following factors:

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Our ability to make cash distributions may be limited by certain covenants in our revolving credit facility. Should we be unable to satisfy these covenants, we will be unable to make cash distributions notwithstanding our cash distribution policy.

Our general partner will have the authority to establish cash reserves for the prudent conduct of our business, including for future cash distributions to our unitholders, and the establishment of or increase

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in those reserves could result in a reduction in cash distributions from levels that we currently anticipate pursuant to our stated cash distribution policy. Our partnership agreement does not set a limit on the amount of cash reserves that our general partner may establish. Any decision to establish cash reserves made by our general partner in good faith will be binding on our unitholders.

Prior to making any distribution on the common units, and pursuant to the Services Agreement, we will pay SP Holdings an administrative fee and reimburse our general partner and its affiliates, including SP Holdings, for all direct and indirect expenses they incur on our behalf. Our partnership agreement does not set a limit on the amount of expenses for which our general partner and its affiliates may be reimbursed. These expenses may include salary, bonus, incentive compensation and other amounts paid to persons who perform services for us or on our behalf and expenses allocated to our general partner by its affiliates. We currently estimate that the aggregate amount of fees and reimbursed expenses pursuant to the Services Agreement will be \$3.9 million annually. Our partnership agreement provides that our general partner will determine in good faith the expenses that are allocable to us. The reimbursement of expenses and payment of fees, if any, to our general partner and its affiliates will reduce our ability to pay distributions to our unitholders.

Even if our cash distribution policy is not modified or revoked, the amount of distributions that we pay under our cash distribution policy and the decision to make any distribution is determined by our general partner.

Under Section 17-607 of the Delaware Act, we may not make a distribution if the distribution would cause our liabilities to exceed the fair value of our assets.

We may lack sufficient cash to pay distributions to our unitholders due to cash flow shortfalls attributable to a number of operational, commercial or other factors as well as increases in our operating or general and administrative expenses, principal and interest payments on our outstanding debt, tax expenses, working capital requirements and anticipated cash needs.

If we make distributions out of capital surplus, as opposed to operating surplus, any such distributions would constitute a return of capital and would result in a reduction in the minimum quarterly distribution and the target distribution levels. Please read Provisions of the Partnership Agreement Relating to Cash Distributions Adjustment to the Minimum Quarterly Distribution and Target Distribution Levels. We do not anticipate that we will make any distributions from capital surplus.

Our ability to make distributions to our unitholders depends on the performance of our assets and subsidiaries and their ability to distribute cash to us. The ability of our subsidiaries to make distributions to us may be restricted by, among other things, the provisions of future indebtedness, applicable state laws and other laws and regulations.

***Our Ability to Grow May be Dependent on Our Ability to Access External Expansion Capital***



We expect to generally distribute a significant percentage of our cash from operations to our unitholders on a quarterly basis, after the establishment of cash reserves and payment of our expenses. Therefore, our growth may not be as fast as businesses that reinvest most or all of their cash to expand ongoing operations. Moreover, our future growth may be slower than our historical growth. We expect that we will rely primarily upon external financing sources, including bank borrowings and issuances of debt and equity interests, to fund our expansion capital expenditures. To the extent we are unable to finance growth externally, our cash distribution policy will significantly impair our ability to grow.

***Our Minimum Quarterly Distribution***

Pursuant to our distribution policy, upon such time as our general partner's board of directors determines that we have sufficient available cash, we intend to declare a minimum quarterly distribution of \$0.05 per unit for each complete quarter, or \$0.20 per unit on an annualized basis after payment of the preferred quarterly

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distribution on our Class A Preferred Units. The payment of the full minimum quarterly distribution on all of our common units outstanding as of May 14, 2015 would require us to have earnings providing amounts available for distribution of approximately \$2.1 million per quarter, or \$8.4 million per year, assuming that all Class A Preferred Units converted into common units on a one-for-one basis and no PIK units have been issued. Our ability to make cash distributions at the minimum quarterly distribution rate will be subject to the factors described above under **General Limitations on Cash Distributions and Our Ability to Change Our Cash Distribution Policy**.

The table below sets forth the number of common units outstanding as of May 14, 2015 and the earnings needed to pay the aggregate minimum quarterly distribution on all of such units for a single fiscal quarter and a four quarter period, assuming that all Class A Preferred Units converted into common units on a one-for-one basis and no PIK units have been issued:

|  | Number of<br>Common Units | Distributions   |                              |
|--|---------------------------|-----------------|------------------------------|
|  |                           | One<br>Quarter  | Annualized<br>(in thousands) |
| Publicly held common units                             | 24,410,651                | \$ 1,763        | \$ 7,054                     |
| Common units held by affiliates of our general partner | 6,972,385                 | 349             | 1,394                        |
| <b>Total</b>   | <b>31,383,036</b>         | <b>\$ 2,112</b> | <b>\$ 8,448</b>              |

SP Holdings is the initial holder of the incentive distribution rights, which entitle the holder to increasing percentages, up to a maximum of 35.5%, of the cash we distribute in excess of \$0.0875 per unit per quarter.

We expect to pay our distributions on or about the last day of each of February, May, August and November to holders of record on or about the 15th day of each such month. If the distribution date does not fall on a business day, we will make the distribution on the business day immediately preceding the indicated distribution date.

For each of the nine quarters ended March 31, 2015, we had no cash available to make a distribution on our common units, with the shortfall being at least the full amount of the approximate \$2.1 million that would have been needed to make a distribution in each such quarter, assuming that all Class A Preferred Units converted into common units on a one-for-one basis and no PIK units have been issued. We do not anticipate being able to make the minimum quarterly distribution on our common units until we acquire assets that generate cash, sell existing assets for cash or undertake a recapitalization event that results in us having additional available cash, none of which we anticipate occurring before June 30, 2015. In addition to the limitations on our availability to make distributions discussed above under **General**, please also see **Risk Factors Risk Related to Our Distributions to Unitholders** in our Current Report on Form 8-K filed with the SEC on March 6, 2015 and incorporated by reference herein regarding the risks involved in our being able to make distributions, including:

our having insufficient cash flow from operations;

our reserve-based credit facility, which may limit our ability to make distributions;

significant declines in natural gas prices that reduce our ability to invest in new drilling opportunities which would generate cash flow to make distributions;

our incurrence of substantial capital expenditures that reduce cash available for distribution;

estimating maintenance capital expenditures higher than actual capital expenditures, which would reduce the cash available for distribution;

hedging activities that result in financial losses and reduced cash flow to make distributions; and

the lack of acquisitions, which may limit any increases in distributions.

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**PROVISIONS OF THE PARTNERSHIP AGREEMENT RELATING TO CASH DISTRIBUTIONS**

Set forth below is a summary of the significant provisions of our partnership agreement that relate to cash distributions.

**Distributions to Class A Preferred Units**

The Class A Preferred Units are entitled to the preferred quarterly distribution amount of \$0.04 per quarter through March 31, 2016, \$0.046 per quarter from April 1, 2016 through March 31, 2017, and \$0.05 per quarter thereafter, subject to certain adjustments described in the partnership agreement. Through June 30, 2016, the preferred distribution amount will be paid in additional Class A Preferred Units, or PIK units, and thereafter, shall be paid, in our general partner's discretion, in PIK units, in cash, or in a combination of PIK units and cash. We will not declare or make any distributions in respect of any other partnership interests (which includes our common units) until the holders of the Class A Preferred Units receive distributions on account thereof.

**Distributions of Available Cash**

*General*

Our partnership agreement requires that, on or about the last day of each of February, May, August and November, we distribute all of our available cash to unitholders of record on the applicable record date.

*Definition of Available Cash*

Available cash generally means, for any quarter, all cash on hand at the end of that quarter:

*less*, the amount of cash reserves established by our general partner to:

provide for the proper conduct of our business (including cash reserves for our future capital expenditures and anticipated future debt service requirements subsequent to that quarter);

comply with applicable law, any of our debt instruments or other agreements; or

provide funds for distributions to our unitholders for any one or more of the next four quarters (provided that our general partner may not establish cash reserves for distributions if the effect of the establishment of such reserves will prevent us from distributing the minimum quarterly distribution on all common units);

*plus*, if our general partner so determines, all or any portion of the cash on hand on the date of determination of available cash for the quarter resulting from working capital borrowings made subsequent to the end of such quarter.

The purpose and effect of the last bullet point above is to allow our general partner, if it so decides, to use cash from working capital borrowings made after the end of the quarter but on or before the date of determination of available cash for that quarter to pay distributions to unitholders. Under our partnership agreement, working capital borrowings are generally borrowings that are made under a credit facility, commercial paper facility or similar financing arrangement, and in all cases are used solely for working capital purposes or to pay distributions to unitholders, and with the intent of the borrower to repay such borrowings within twelve months with funds other than from additional working capital borrowings.

## **Operating Surplus and Capital Surplus**

### *General*

Any distributions that we make will be characterized as made from operating surplus or capital surplus. Distributions from operating surplus are made differently than cash distributions that we would make from capital surplus. Operating surplus distributions will be made to our unitholders and, if we make quarterly distributions above the first target distribution level described below, to the holder of our incentive distribution

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rights. We do not anticipate that we will make any distributions from capital surplus. In such an event, however, any capital surplus distribution would be made pro rata to all common unitholders, until the minimum quarterly distribution is reduced to zero, as described below, and thereafter we will make all distributions from capital surplus as if they were from operating surplus, but the holder of the incentive distribution rights would generally not participate in any capital surplus distributions with respect to those rights.

In determining operating surplus and capital surplus, we will only take into account our proportionate share of our consolidated subsidiaries, provided they are not wholly owned, and our proportionate share of entities accounted for under the equity method.

***Operating Surplus***

We define operating surplus as:

\$20.0 million (as described below); plus

all of our cash receipts, excluding cash from interim capital transactions (as defined below), provided that cash receipts from the termination of a commodity hedge or interest rate hedge prior to its specified termination date shall be amortized in operating surplus in equal quarterly installments over the remaining scheduled term of such commodity hedge or interest rate hedge; plus

working capital borrowings made after the end of a quarter but on or before the date of determination of operating surplus for that quarter; plus

cash distributions (including incremental distributions on incentive distribution rights) paid in respect of equity issued, other than equity issued in connection with consummating our initial public offering, to finance all or a portion of expansion capital expenditures in respect of the period from the date that we enter into a binding obligation to commence the replacement, improvement, addition, expansion, acquisition, construction or development of a capital asset and ending on the earlier to occur of the date the capital asset commences commercial service and the date that it is abandoned or disposed of; plus

cash distributions (including incremental distributions on incentive distribution rights) paid in respect of equity issued, other than equity issued in connection with our initial public offering, to pay interest on debt incurred, or to pay distributions on equity issued, to finance the expansion capital expenditures referred to in the prior bullet; less

all of our operating expenditures (as defined below); less

the amount of cash reserves established by our general partner to provide funds for future operating expenditures; less

all working capital borrowings not repaid within twelve months after having been incurred, or repaid within such twelve-month period with the proceeds of additional working capital borrowings; less

any cash loss realized on disposition of an investment capital expenditure.

As described above, operating surplus does not reflect actual cash on hand that is available for distribution to our unitholders and is not limited to cash generated by our operations. For example, it includes a provision that will enable us, if we choose, to distribute as operating surplus up to \$20.0 million of cash we receive in the future from non-operating sources such as asset sales, issuances of securities and long-term borrowings that would otherwise be distributed as capital surplus. In addition, the effect of including, as described above, certain cash distributions on equity interests in operating surplus will be to increase operating surplus by the amount of any such cash distributions. As a result, we may also distribute as operating surplus up to the amount of any such cash that we receive from non-operating sources.

The proceeds of working capital borrowings increase operating surplus and repayments of working capital borrowings are generally operating expenditures (as described below) and thus reduce operating surplus when repayments are made. However, if working capital borrowings, which increase operating surplus, are not repaid during the twelve-month period following the borrowing, they will be deemed repaid at the end of such period,

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thus decreasing operating surplus at such time. When such working capital borrowings are in fact repaid, they will not be treated as a further reduction in operating surplus because operating surplus will have been previously reduced by the deemed repayment.

We define interim capital transactions as (i) borrowings, refinancings or refundings of indebtedness (other than working capital borrowings and items purchased on open account or for a deferred purchase price in the ordinary course of business) and sales of debt securities, (ii) issuances of equity securities and (iii) sales or other dispositions of assets, other than sales or other dispositions of inventory, accounts receivable and other assets in the ordinary course of business and sales or other dispositions of assets as part of normal asset retirements or replacements.

We define operating expenditures as all of our cash expenditures, including, but not limited to, taxes, amounts paid under the Services Agreement, reimbursements of expenses of our general partner and its affiliates, director, officer and employee compensation, debt service payments, payments made in the ordinary course of business under interest rate hedge contracts and commodity hedge contracts (provided that payments made in connection with the termination of any interest rate hedge contract or commodity hedge contract prior to the expiration of its settlement or termination date specified therein will be amortized in operating expenditures in equal quarterly installments over the remaining scheduled life of such interest rate hedge contract or commodity hedge contract and amounts paid in connection with the initial purchase of a rate hedge contract or a commodity hedge contract will be amortized over the life of such rate hedge contract or commodity hedge contract), estimated maintenance capital expenditures (as discussed in further detail below), and repayment of working capital borrowings; provided, however, that operating expenditures will not include:

repayments of working capital borrowings where such borrowings have previously been deemed to have been repaid (as described above);

payments (including prepayments and prepayment penalties) of principal of and premium on indebtedness other than working capital borrowings;

expansion capital expenditures;

actual maintenance capital expenditures;

investment capital expenditures;

payment of transaction expenses (including taxes) relating to interim capital transactions;

distributions to our partners; or



repurchases of partnership interests (excluding repurchases we make to satisfy obligations under employee benefit plans).

***Capital Surplus***

Capital surplus is defined in our partnership agreement as any distribution of available cash in excess of our cumulative operating surplus. Accordingly, except as described above, capital surplus would generally be generated by:

borrowings other than working capital borrowings;

sales of our equity and debt securities; and

sales or other dispositions of assets, other than inventory, accounts receivable and other assets sold in the ordinary course of business or as part of ordinary course retirement or replacement of assets.

***Characterization of Cash Distributions***

Our partnership agreement requires that we treat all available cash distributed as coming from operating surplus until the sum of all available cash distributed since the closing of our initial public offering equals the operating surplus from the closing of our initial public offering through the end of the quarter immediately

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preceding that distribution. Our partnership agreement requires that we treat any amount distributed in excess of operating surplus, regardless of its source, as capital surplus. We do not anticipate that we will make any distributions from capital surplus.

### **Capital Expenditures**

Expansion capital expenditures are cash expenditures incurred for acquisitions or capital improvements that we expect will increase our operating capacity, operating income or asset base over the long term. Examples of expansion capital expenditures include the construction, development or acquisition of assets associated with the upstream and midstream business to the extent such capital expenditures are expected to expand our operating capacity, our operating income or our asset base. Expansion capital expenditures include interest payments (and related fees) on debt incurred and distributions on equity issued to finance all or a portion of expansion capital expenditures in respect of the period from the date that we enter into a binding obligation to commence the replacement, improvement, addition, expansion acquisition, construction, development or capital contribution of a capital asset and ending on the earlier to occur of the date that such capital improvement commences commercial service and the date that such capital improvement is abandoned or disposed of.

Maintenance capital expenditures are cash expenditures made to maintain, over the long-term, our operating capacity, operating income or asset base. Examples of maintenance capital expenditures are expenditures to develop and replace our oil and natural gas reserves as well as the repair, refurbishment and replacement of gathering and transportation assets, to maintain equipment reliability, integrity and safety and to address environmental laws and regulations.

Because our maintenance capital expenditures can be very large and irregular, the amount of our actual maintenance capital expenditures may differ substantially from period to period, which could cause similar fluctuations in the amounts of operating surplus and cash available for distribution to our unitholders if we subtracted actual maintenance capital expenditures from operating surplus. As a result, to eliminate the effect on operating surplus of these fluctuations, our partnership agreement requires that an estimate of the average quarterly maintenance capital expenditures necessary to maintain our asset base over the long-term be subtracted from operating surplus each quarter as opposed to the actual amounts spent. The amount of estimated maintenance capital expenditures deducted from operating surplus is subject to review and change by our board of directors at least once a year. The estimate is made at least annually and whenever an event occurs that is likely to result in a material adjustment to the amount of our future estimated maintenance capital expenditures, such as a major acquisition or the introduction of new governmental regulations that will impact our business. For purposes of calculating operating surplus, any adjustment to this estimate will be prospective only.

The use of estimated maintenance capital expenditures in calculating operating surplus has the following effects:

it reduces the risk that maintenance capital expenditures in any one quarter will be large enough to render operating surplus less than the minimum quarterly distribution to be paid on all the units for that quarter and subsequent quarters;

it increases our ability to distribute as operating surplus cash we receive from non-operating sources;

it is more difficult for us to raise our distribution above the minimum quarterly distribution and pay distributions on our incentive distribution rights; and

it reduces the likelihood that a large maintenance capital expenditure during one quarterly distribution period will prevent the payment of a distribution on the incentive distribution rights in respect of any quarterly distribution period since the effect of an estimate is to spread the expected expense over several periods, thereby mitigating the effect of the actual payment of the expenditure on any single period.

Investment capital expenditures are those capital expenditures that are neither maintenance capital expenditures nor expansion capital expenditures. Investment capital expenditures largely will consist of capital

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expenditures made for investment purposes. Examples of investment capital expenditures include traditional capital expenditures for investment purposes, such as purchases of securities, as well as other capital expenditures that might be made in lieu of such traditional investment capital expenditures, such as the acquisition of a capital asset for investment purposes or development of facilities that are in excess of the maintenance of our existing operating capacity or operating income, but that are not expected to expand our operating capacity or operating income over the long term.

Capital expenditures that are made in part for maintenance capital purposes, investment capital purposes and/or expansion capital purposes will be allocated as maintenance capital expenditures, investment capital expenditures or expansion capital expenditure by our general partner.

## **Incentive Distribution Rights**

Incentive distribution rights represent the right to receive increasing percentages (13.0%, 23.0% and 35.5%) of quarterly distributions from operating surplus after the minimum quarterly distribution and the target distribution levels have been achieved. SP Holdings holds the incentive distribution rights, but may transfer these rights at any time.

If, for any quarter, we have distributed cash from operating surplus to the common unitholders in an amount equal to the minimum quarterly distribution, then we will make additional distributions from operating surplus for that quarter among the unitholders and SP Holdings (as the holder of our incentive distribution rights) in the following manner:

*first*, 100% to all common unitholders, pro rata, until each unitholder receives a total of \$0.0575 per unit for that quarter (the first target distribution );

*second*, 87.0% to all common unitholders, pro rata, and 13.0% to the holders of our incentive distribution rights, until each unitholder receives a total of \$0.0625 per unit for that quarter (the second target distribution );

*third*, 77.0% to all common unitholders, pro rata, and 23.0% to the holders of our incentive distribution rights, until each unitholder receives a total of \$0.0875 per unit for that quarter (the third target distribution ); and

*thereafter*, 64.5% to all common unitholders, pro rata, and 35.5% to the holders of our incentive distribution rights.

**Table of Contents****Percentage Allocations of Distributions from Operating Surplus**

The following table illustrates the percentage allocations of distributions from operating surplus between the common unitholders and SP Holdings (as the holder of our incentive distribution rights) based on the specified target distribution levels. The amounts set forth under the column heading **Marginal Percentage Interest in Distributions** are the percentage interests of SP Holdings (as the holder of our incentive distribution rights) and the common unitholders in any distributions from operating surplus we distribute up to and including the corresponding amount in the column **Total Quarterly Distribution Per Common Unit**. The percentage interests shown for our common unitholders and SP Holdings (as the holder of our incentive distribution rights) for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution. The percentage interests set forth below assume that SP Holdings has not transferred its incentive distribution rights.

|                                | <b>Total<br/>Quarterly<br/>Distribution<br/>Per Common<br/>Unit</b> | <b>Marginal Percentage Interest<br/>in Distributions<br/><br/>Common<br/>Unitholders</b> | <b>SP<br/>Holdings<br/>(as Holder of<br/>Incentive<br/>Distribution<br/>Rights)</b> |
|--------------------------------|---|--|---|
| Minimum Quarterly Distribution | up to \$0.05  | 100.0%   | 0.0%  |
| First Target Distribution      | above \$0.05<br>up to \$0.0575                                      | 100.0%   | 0.0%  |
| Second Target Distribution     | above \$0.0575<br>up to \$0.0625                                    | 87.0%  | 13.0%   |
| Third Target Distribution      | above \$0.0625<br>up to \$0.0875                                    | 77.0%  | 23.0%   |
| Thereafter                     | above \$0.0875  | 64.5%  | 35.5%   |

**SP Holdings Right to Reset Incentive Distribution Levels**

SP Holdings, as the initial holder of our incentive distribution rights, has the right under our partnership agreement to elect to relinquish the right to receive incentive distribution payments based on the initial target distribution levels and to reset, at higher levels, the target distribution levels upon which the incentive distribution payments to SP Holdings would be set. If SP Holdings transfers all or a portion of our incentive distribution rights in the future, then the holder or holders of a majority of our incentive distribution rights will be entitled to exercise this right. The following discussion assumes that SP Holdings holds all of the incentive distribution rights at the time that a reset election is made. The right to reset the target distribution levels upon which the incentive distributions are based may be exercised, without approval of our unitholders or the conflicts committee of our general partner, at any time when we have made cash distributions to the holders of the incentive distribution rights at the highest level of incentive distribution for the prior four consecutive fiscal quarters. The reset target distribution levels will be higher than the target distribution levels prior to the reset such that there will be no incentive distributions paid under the reset target distribution levels until cash distributions per unit following the reset event increase as described below. We anticipate that SP Holdings would exercise this reset right in order to facilitate acquisitions or internal growth projects that would otherwise not be sufficiently accretive to cash distributions per common unit, taking into account the existing levels of incentive distribution payments being made to SP Holdings.

In connection with the resetting of the target distribution levels and the corresponding relinquishment by SP Holdings of incentive distribution payments based on the target cash distributions prior to the reset, SP Holdings will be entitled to receive a number of newly issued common units based on a predetermined formula described below that takes into account the cash parity value of the cash distributions related to the incentive distribution rights received by SP Holdings for the two quarters prior to the reset event as compared to the average cash distribution per common unit in such quarters.

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The number of common units that SP Holdings would be entitled to receive from us in connection with a resetting of the minimum quarterly distribution amount and the target distribution levels then in effect would be equal to the quotient determined by dividing (x) the amount of cash distributions received by SP Holdings in respect of its incentive distribution rights for the two fiscal quarters ended immediately prior to the date of such reset election by (y) the average amount of cash distributed per common unit with respect to such quarters. SP Holdings would be entitled to receive distributions in respect of these common units pro rata in subsequent periods.

Following a reset election, a baseline minimum quarterly distribution amount will be calculated as an amount equal to the average of the cash distributions paid per common unit for the two full fiscal quarters immediately preceding the reset election (which amount we refer to as the reset minimum quarterly distribution ) and the target distribution levels will be reset to be correspondingly higher such that we would make distributions from operating surplus for each quarter thereafter as follows:

*first*, 100% to all common unitholders, pro rata, until each such unitholder receives an amount per unit equal to 115.0% of the reset minimum quarterly distribution for that quarter;

*second*, 87.0% to all common unitholders, pro rata, and 13.0% to SP Holdings, until each such unitholder receives an amount per unit equal to 125.0% of the reset minimum quarterly distribution for the quarter;

*third*, 77.0% to all common unitholders, pro rata, and 23.0% to SP Holdings, until each such unitholder receives an amount per unit equal to 175.0% of the reset minimum quarterly distribution for the quarter; and

*thereafter*, 64.5% to all common unitholders, pro rata, and 35.5% to SP Holdings.

The following table illustrates the percentage allocation of distributions from operating surplus among our unitholders and SP Holdings (as the holder of our incentive distribution rights) at various distribution levels (1) pursuant to the distribution provisions of our partnership agreement, as well as (2) following a hypothetical reset of the target distribution levels based on the assumption that the quarterly distribution amount per common unit during the two fiscal quarters immediately preceding the reset election was \$0.0875.

|                                   | Quarterly<br>Distribution<br>per Common<br>Unit Prior to<br>Reset | Common<br>Unitholders | SP<br>Holdings<br>(as<br>Holder<br>of our<br>Incentive<br>Distribution<br>Rights) | Quarterly<br>Distribution<br>Per<br>Unit Following<br>Hypothetical<br>Reset |
|-----------------------------------|---|-----------------------|---|---|
| Minimum Quarterly<br>Distribution | up to \$0.05  | 100.0%                | 0.0%  | up to \$0.0875(1)   |
|                                   | above \$0.05  |                       |   | above \$0.0875  |
| First Target Distribution         | up to \$0.0575  | 100.0%                | 0.0%  | up to \$0.1006(2)   |

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|                            |                                  |       |       |                                     |
|----------------------------|----------------------------------|-------|-------|-------------------------------------|
| Second Target Distribution | above \$0.0575<br>up to \$0.0625 | 87.0% | 13.0% | above \$0.1006<br>up to \$0.1094(3) |
| Third Target Distribution  | above \$0.0625<br>up to \$0.0875 | 77.0% | 23.0% | above \$0.1094<br>up to \$0.1531(4) |
| Thereafter                 | above \$0.0875                   | 64.5% | 35.5% | above \$0.1531                      |

- (1) This amount is equal to the hypothetical reset minimum quarterly distribution.
- (2) This amount is 115.0% of the hypothetical reset minimum quarterly distribution.
- (3) This amount is 125.0% of the hypothetical reset minimum quarterly distribution.
- (4) This amount is 175.0% of the hypothetical reset minimum quarterly distribution.

The following table illustrates the total amount of distributions from operating surplus that would be distributed to our unitholders and SP Holdings (as the holder of our incentive distribution rights), in respect of its incentive distribution rights, based on the amount distributed for the quarter immediately prior to the reset. The



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table assumes that immediately prior to the reset there would be 42,242,411 common units outstanding (assuming that all Class A Preferred Units converted into common units on a one-for-one basis and no PIK units have been issued) and the distribution to each common unit would be \$0.0875 per quarter for the quarter prior to the reset.

|                                | Quarterly<br>Distribution<br>Per Common<br>Unit Prior to<br>Reset | Cash Distributions Prior to Reset |   |          |
|--------------------------------|---|-----------------------------------|---|----------|
|                                |   | Common<br>Units                   | Incentive<br>Distribution<br>Rights<br>(in thousands) | Total    |
| Minimum Quarterly Distribution | up to \$0.05  | \$ 2,112                          | \$  | \$ 2,112 |
| First Target Distribution      | above \$0.05<br>up to \$0.0575                                    | 317                               |   | 317      |
| Second Target Distribution     | above \$0.0575<br>up to \$0.0625                                  | 211                               | 32  | 243      |
| Third Target Distribution      | above \$0.0625<br>up to \$0.0875                                  | 1,056                             | 315   | 1,372    |
| Thereafter                     | above \$0.0875  |                                   |   |          |
|                                |   | \$ 3,696                          | \$ 347  | \$ 4,043 |

The following table illustrates the total amount of distributions from operating surplus that would be distributed to our unitholders and SP Holdings (as the holder of our incentive distribution rights) in respect of its incentive distribution rights, with respect to the quarter in which the reset occurs. The table reflects that as a result of the reset there would be 46,208,205 common units outstanding (assuming that all Class A Preferred Units converted into common units on a one-for-one basis and no PIK units have been issued) and the distribution to each common unit would be \$0.0875. The number of common units to be issued to SP Holdings upon the reset was calculated by dividing (1) the amount received by SP Holdings in respect of its incentive distribution rights for the two quarters prior to the reset as shown in the table above, or \$694,014 in the aggregate, by (2) the average cash distributed on each common unit for the two quarters prior to the reset, as shown in the table above, or \$0.1750 per unit in the aggregate.

|                                | Quarterly<br>Distribution<br>Per Common<br>Unit After<br>Reset | Cash Distributions After Reset |   |          |
|--------------------------------|--|--------------------------------|---|----------|
|                                |  | Common<br>Units                | Incentive<br>Distribution<br>Rights<br>(in thousands, except per unit<br>amounts) | Total    |
| Minimum Quarterly Distribution | up to \$0.0875   | \$ 4,043                       | \$  | \$ 4,043 |
| First Target Distribution      | above \$0.0875<br>up to \$0.1006                               |                                |   |          |
| Second Target Distribution     | above \$0.1006<br>up to \$0.1094                               |                                |   |          |
| Third Target Distribution      |  |                                |   |          |

|            |                |
|------------|----------------|
|            | above \$0.1094 |
|            | up to \$0.1531 |
| Thereafter | above \$0.1531 |

\$ 4,043      \$      \$ 4,043

SP Holdings (as the holder of our incentive distribution rights) will be entitled to cause the target distribution levels to be reset on more than one occasion, provided that it may not make a reset election except at a time when it has received incentive distributions for the prior four consecutive fiscal quarters based on the highest level of incentive distributions that it is entitled to receive under our partnership agreement.

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### **Distributions from Capital Surplus**

#### ***How Distributions from Capital Surplus Will Be Made***

Our partnership agreement requires that we make distributions from capital surplus, if any, in the following manner:

*first*, to all common unitholders, pro rata, until the minimum quarterly distribution is reduced to zero, as described below; and

*thereafter*, we will make all distributions from capital surplus as if they were from operating surplus.

#### ***Effect of a Distribution From Capital Surplus***

Our partnership agreement treats a distribution of capital surplus as the repayment of the initial unit price from our initial public offering, which is a return of capital. Each time a distribution of capital surplus is made, the minimum quarterly distribution and the target distribution levels will be reduced in the same proportion as the corresponding reduction in relation to the fair market value of the common units prior to the announcement of the distribution. Because distributions of capital surplus will reduce the minimum quarterly distribution and target distribution levels after any of these distributions are made, it may be easier for SP Holdings to receive incentive distributions. However, any distribution of capital surplus before the minimum quarterly distribution is reduced to zero cannot be applied to the payment of the minimum quarterly distribution.

Once we reduce the minimum quarterly distribution and target distribution levels to zero, all future distributions will be made such that 64.5% is paid to all unitholders, pro rata, and 35.5% is paid to the holder or holders of incentive distribution rights, pro rata.

#### **Adjustment to the Minimum Quarterly Distribution and Target Distribution Levels**

In addition to adjusting the minimum quarterly distribution and target distribution levels to reflect a distribution of capital surplus, if we combine our common units into fewer common units or subdivide our common units into a greater number of common units, our partnership agreement specifies that the following items will be proportionately adjusted:

the minimum quarterly distribution;

the target distribution levels; and

the initial unit price, as described below under Distributions of Cash Upon Liquidation.

For example, if a two-for-one split of the common units should occur, the minimum quarterly distribution, the target distribution levels and the initial unit price would each be reduced to 50.0% of its initial level. Our partnership agreement provides that we do not make any adjustment by reason of the issuance of additional units for cash or property.

In addition, if as a result of a change in law or interpretation thereof, we or any of our subsidiaries is treated as an association taxable as a corporation or are otherwise subject to additional taxation as an entity for U.S. federal, state, local or non-U.S. income or withholding tax purposes, our general partner may, in its sole discretion, reduce the minimum quarterly distribution and the target distribution levels for each quarter by multiplying each distribution level by a fraction, the numerator of which is cash for that quarter (after deducting our general partner's estimate of our additional aggregate liability for the quarter for such income and withholdings taxes payable by reason of such change in law or interpretation) and the denominator of which is the sum of (1) cash for that quarter, plus (2) our general partner's estimate of our additional aggregate liability for the quarter for such income and withholding taxes payable by reason of such change in law or interpretation thereof. To the extent that the actual tax liability differs from the estimated tax liability for any quarter, the difference will be accounted for in distributions with respect to subsequent quarters.

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### **Distributions of Cash Upon Liquidation**

#### ***General***

If we dissolve in accordance with the partnership agreement, we will sell or otherwise dispose of our assets in a process called liquidation. We will first apply the proceeds of liquidation to the payment of our creditors. We will distribute any remaining proceeds to the unitholders and the holders of the incentive distribution rights, in accordance with their capital account balances, as adjusted to reflect any gain or loss upon the sale or other disposition of our assets in liquidation.

The allocations of gain and loss upon liquidation are intended, to the extent possible, to entitle the holders of units to a repayment of the initial value contributed by unitholders for their units in our initial public offering, which we refer to as the initial unit price for each unit. Any further net gain recognized upon liquidation will be allocated in a manner that takes into account the incentive distribution rights of SP Holdings.

#### ***Manner of Adjustments for Gain***

The manner of the adjustment for gain is set forth in the partnership agreement. We will generally allocate any gain to the partners in the following manner:

*first*, 100% to the general partner until the amount allocated under this paragraph equals the amount of losses allocated to the general partner;

*second*, in connection with a liquidation, to the holders of Class A Preferred Units, until the cumulative amounts allocated to the Class A Preferred Units on account of income, gains, losses and deductions as a result thereof is zero;

*third*, 100% to the common unitholders, pro rata, until the capital account for each common unit is equal to: (A) the sum of (1) the initial unit price; (2) the amount of the minimum quarterly distribution for the quarter during which our liquidation occurs reduced by any distribution made from operating surplus in satisfaction of the minimum quarterly distribution with respect to such common unit for such quarter; and (3) the excess of the first target distribution per unit over the minimum quarterly distribution per unit for each quarter of our existence; less (B) the cumulative amount per unit of any distributions from operating surplus in excess of the minimum quarterly distribution per unit that we have distributed to the unitholders, pro rata, for each quarter of our existence;

*fourth*, 87.0% to all unitholders, pro rata, and 13.0% to SP Holdings (as the holder of our incentive distribution rights), until we allocate under this paragraph an amount per unit equal to: (1) the sum of the excess of the second target distribution per unit over the first target distribution per unit for each quarter of our existence; less (2) the cumulative amount per unit of any distributions from operating surplus in excess of the first target distribution per unit that we distributed 87.0% to the unitholders, pro rata, and 13.0% to SP Holdings (as the holder of our incentive distribution rights) for each quarter of our existence;

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*fifth*, 77.0% to all unitholders, pro rata, and 23.0% to SP Holdings (as the holder of our incentive distribution rights), until we allocate under this paragraph an amount per unit equal to: (1) the sum of the excess of the third target distribution per unit over the second target distribution per unit for each quarter of our existence; less (2) the cumulative amount per unit of any distributions from operating surplus in excess of the second target distribution per unit that we distributed 77.0% to the unitholders, pro rata, and 23.0% to SP Holdings (as the holder of our incentive distribution rights) for each quarter of our existence; and

*thereafter*, 64.5% to all unitholders, pro rata, and 35.5% to SP Holdings (as the holder of our incentive distribution rights).

The percentage interests set forth above for SP Holdings assume SP Holdings has not transferred the incentive distribution rights.

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***Manner of Adjustments for Losses***

We will generally allocate any loss first to our common unitholders in proportion to the positive balances in their capital accounts, until the capital accounts of the common unitholders have been reduced to zero, second to the holders of our Class A Preferred Units pro rata in accordance with the number of Class A Preferred Units held by them, until the capital accounts of the holders of Class A Preferred Units have been reduced to zero, and thereafter, to our general partner.

***Adjustments to Capital Accounts***

We will make adjustments to capital accounts upon the issuance of additional units and upon the conversion of the Class A Preferred Units into common units. In doing so, we generally will allocate any unrealized and, for tax purposes, unrecognized gain or loss resulting from the adjustments to the unitholders and the holders of our incentive distribution rights in the same manner as we allocate gain or loss upon liquidation.

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**DESCRIPTION OF THE CLASS A PREFERRED UNITS**

**General**

The Class A preferred units represent a separate class of our limited partnership interests. As of May 14, 2015, there were 10,859,375 Class A Preferred Units outstanding. On March 31, 2015 and April 15, 2015, the selling unitholders listed in this prospectus agreed to purchase 10,859,375 Class A Preferred Units at the price of \$1.60 per Class A preferred unit (the "Unit Purchase Price").

**Distributions**

The Class A Preferred Units are entitled to the preferred quarterly distribution amount of \$0.04 per quarter through March 31, 2016, \$0.046 per quarter from April 1, 2016 through March 31, 2017, and \$0.05 per quarter thereafter, subject to certain adjustments described in the partnership agreement. Through June 30, 2016, the preferred distribution amount will be paid in additional Class A Preferred Units ("PIK units"), and thereafter, shall be paid, in our general partner's discretion, in PIK units, in cash, or in a combination of PIK units and cash. We will not declare or make any distributions in respect of any other partnership interests (which includes our common units) until the holders of the Class A Preferred Units receive distributions on account thereof.

**Conversion**

Each Class A Preferred Unit will automatically convert at the Conversion Rate on the earlier of March 31, 2018 and the closing date for a firm commitment underwritten public offering by us that results in gross proceeds of not less than \$75,000,000, subject to certain exceptions specified in our partnership agreement. The Conversion Rate is equal to the aggregate purchase price for the Class A Preferred Units plus accrued and unpaid distributions thereon, divided by the lesser of the purchase price for the Class A Preferred Units and the lowest price for which we issue common units (other than in connection with an at-the-market offering or our long-term incentive plan). Each of the holders of Class A Preferred Units have the right, from and after March 31, 2016 at the option of such holder, to request conversion in whole or in part of its Class A Preferred Units. We have the right to cause all, but not less than all, of the Class A Preferred Units to convert into common units at any time beginning March 31, 2016. The Class A Preferred Units are subject to blocker provisions which provide that the Class A Preferred Units may not be converted, whether by the holder, by us or automatically, into a number of common units that, when combined with any other common units beneficially owned by the holder, would make the holder the beneficial owner of more than 19.99% of the outstanding common units following conversion. In addition, if any person or group beneficially owns 20% or more of any class of units solely as a result of actions taken by us, then the 20% threshold is increased, with respect to such person, to a percentage equal to such person's new beneficial ownership after the taking of such action plus the difference between 20% and such person's beneficial ownership prior to such action.

**Voting**

Except in connection with an amendment to the terms of the Class A Preferred Units, the holders of Class A Preferred Units have no voting rights.

**Transfer Agent and Registrar**

Computershare Trust Company, N.A. serves as the transfer agent and registrar for the Class A Preferred Units. If we designate another transfer agent and registrar, the name and contact information for such transfer agent and registrar will be provided in a prospectus supplement or in a document we incorporate by reference herein.





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**DESCRIPTION OF THE COMMON UNITS**

**The Units**

The common units are a separate class of limited partner interests in us. The holders of units are entitled to participate in partnership distributions and exercise the rights or privileges available to limited partners under our partnership agreement. For a description of the relative rights and preferences of holders of common units in and to partnership distributions, please read this section and Provisions of the Partnership Agreement Relating to Cash Distributions. For a description of other rights and privileges of limited partners under our partnership agreement, including voting rights, please read The Partnership Agreement.

**Transfer Agent and Registrar**

***Duties***

Computershare Trust Company, N.A. serves as the registrar and transfer agent for the common units. We will pay all fees charged by the transfer agent for transfers of common units except the following, which must be paid by unitholders:

surety bond premiums to replace lost or stolen certificates, taxes and other governmental charges;

special charges for services requested by a holder of a common unit; and

other similar fees or charges.

There will be no charge to unitholders for disbursements of our cash distributions. We will indemnify the transfer agent, its agents and each of their stockholders, directors, officers and employees against all claims and losses that may arise out of acts performed or omitted for its activities in that capacity, except for any liability due to any gross negligence or intentional misconduct of the indemnified person or entity.

***Resignation or Removal***

The transfer agent may resign, by notice to us, or be removed by us. The resignation or removal of the transfer agent will become effective upon our appointment of a successor transfer agent and registrar and its acceptance of the appointment. If no successor is appointed or a successor has not accepted its appointment, our general partner may act as the transfer agent and registrar until a successor is appointed.

**Transfer of Common Units**

Upon the transfer of a common unit in accordance with our partnership agreement, the transferee of the common unit shall be admitted as a limited partner with respect to the common units transferred when such transfer and admission are reflected in our books and records. Each transferee:

represents that the transferee has the capacity, power and authority to become bound by our partnership agreement;

automatically becomes bound by the terms and conditions of our partnership agreement; and

gives the consents, waivers and approvals contained in our partnership agreement.

Our general partner will cause any transfers to be recorded on our books and records no less frequently than quarterly.

We may, at our discretion, treat the nominee holder of a common unit as the absolute owner. In that case, the beneficial holder's rights are limited solely to those that it has against the nominee holder as a result of any agreement between the beneficial owner and the nominee holder.

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Common units are securities and any transfers are subject to the laws governing the transfer of securities. In addition to other rights acquired upon transfer, the transferor gives the transferee the right to become a substituted limited partner in our partnership for the transferred common units.

Until a common unit has been transferred on our books, we and the transfer agent may treat the record holder of the common unit as the absolute owner for all purposes, except as otherwise required by law or stock exchange regulations.

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**THE PARTNERSHIP AGREEMENT**

The following is a summary of the material provisions of our partnership agreement. Our partnership agreement is filed with the registration statement of which this prospectus is a part.

We summarize the following provisions of our partnership agreement elsewhere in this prospectus supplement or the accompanying prospectus:

with regard to distributions, please read Provisions of the Partnership Agreement Relating to Cash Distributions ;

with regard to the duties of, and standard of care applicable to, our general partner, please read Conflicts of Interest and Fiduciary Duties ;

with regard to the transfer of common units, please read Description of the Common Units Transfer of Common Units ; and

with regard to allocations of taxable income and taxable loss, please read Material U.S. Federal Income Tax Consequences.

**Organization and Duration**

We were formed in 2005 as a limited liability company until our conversion on March 6, 2015 into a limited partnership. We will have a perpetual existence unless terminated pursuant to the terms of our partnership agreement.

**Purpose**

Our purpose, as set forth in our partnership agreement, is limited to any business activity that is approved by our general partner and that lawfully may be conducted by a limited partnership organized under Delaware law; provided that our general partner shall not cause us to take any action that the general partner determines would be reasonably likely to cause us to be treated as an association taxable as a corporation or otherwise taxable as an entity for U.S. federal income tax purposes.

Although our general partner has the ability to cause us and our current or future subsidiaries to engage in activities other than the business of engaging in oil and natural gas exploration and production activities, our general partner may decline to do so free of any fiduciary duty or obligation whatsoever to us or the limited partners, including any duty to act in good faith or in the best interests of us or the limited partners. Our general partner is generally authorized to perform all acts that it determines to be necessary or appropriate to carry out our purposes and to conduct our business.

**Cash Distributions**

Our partnership agreement specifies the manner in which we will make cash distributions to holders of our common units and other partnership securities as well as to SP Holdings in respect of its incentive distribution rights. For a

description of these cash distribution provisions, please read Provisions of the Partnership Agreement Relating to Cash Distributions.

**Capital Contributions**

Unitholders are not obligated to make additional capital contributions, except as described below under Limited Liability.

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**Voting Rights**

The following is a summary of the unitholder vote required for approval of the matters specified below. Matters that require the approval of a unit majority require the approval of a majority of the common units. Holders of the Class A Preferred Units have no voting rights except in connection with amendments to the partnership agreement pertaining to the Class A Preferred Units.

In voting their common units, our general partner and its affiliates will have no fiduciary duty or obligation whatsoever to us or the limited partners, including any duty to act in good faith or in the best interests of us or the limited partners.

The incentive distribution rights may be entitled to vote in certain circumstances.

|   |  |
|---|--|
| Issuance of additional units  | No approval right.   |
| Amendment of the partnership agreement  | Certain amendments may be made by our general partner without the approval of the unitholders. Other amendments generally require the approval of a unit majority. Please read Amendment of the Partnership Agreement. In addition, amendments to the partnership agreement pertaining to the Class A Preferred Units requires the consent of each holder of a Class A Preferred Unit to the extent such amendment would adversely affect such holder. |
| Merger of our partnership or the sale of all or substantially all of our assets | Unit majority in certain circumstances. Please read Merger, Consolidation, Conversion, Sale or Other Disposition of Assets.  |
| Dissolution of our partnership  | Unit majority. Please read Dissolution.  |
| Continuation of our business upon dissolution                                   | Unit majority. Please read Dissolution.  |
| Withdrawal of our general partner   | Under most circumstances, the approval of a majority of the common units, excluding common units held by our general partner and its affiliates, is required for the withdrawal of our general partner prior to September 30, 2024 in a manner that would cause a dissolution of our partnership. Please read Withdrawal or Removal of Our General Partner.  |
| Removal of our general partner  | Not less than 66 2/3% of the outstanding units, voting as a single class, including units held by our general partner and its affiliates. Please read Withdrawal or Removal of Our General Partner.  |

|  |  |  |
|--|--|--|
| Transfer of our general partner interest               | No approval right. Please read                     | Transfer of General Partner Interest.      |
| Transfer of incentive distribution rights              | No approval right. Please read                     | Transfer of Incentive Distribution Rights. |
| Transfer of ownership interests in our general partner | No approval right. Please read<br>General Partner. | Transfer of Ownership Interests in the     |

If any person or group other than our general partner and its affiliates acquires beneficial ownership of 20% or more of any class of units (other than the Class A Preferred Units), that person or group loses voting rights on all of its units, unless otherwise required by law or approved by the board of directors of our general partner. This



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loss of voting rights does not apply to any person or group that acquires the units from our general partner or its affiliates and any transferees of that person or group approved by our general partner or to any person or group who acquires the units with the specific prior approval of our general partner.

## **Applicable Law; Forum, Venue and Jurisdiction**

Our partnership agreement is governed by Delaware law. Our partnership agreement requires that any claims, suits, actions or proceedings:

arising out of or relating in any way to the partnership agreement (including any claims, suits or actions to interpret, apply or enforce the provisions of the partnership agreement or the duties, obligations or liabilities among limited partners or of limited partners to us, or the rights or powers of, or restrictions on, the limited partners or us);

brought in a derivative manner on our behalf;

asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of us or our general partner, or owed by our general partner, to us or the limited partners;

asserting a claim arising pursuant to any provision of the Delaware Act; or

asserting a claim governed by the internal affairs doctrine shall be exclusively brought in the Court of Chancery of the State of Delaware (or, if such court does not have subject matter jurisdiction thereof, any other court located in the State of Delaware with subject matter jurisdiction), regardless of whether such claims, suits, actions or proceedings sound in contract, tort, fraud or otherwise, are based on common law, statutory, equitable, legal or other grounds, or are derivative or direct claims. In addition, each party to such claims, suits, actions or proceedings irrevocably waives the right to trial by jury.

If any limited partner, our general partner or any person holding any beneficial interest in us (whether through a broker, dealer, bank, trust company or clearing corporation) brings any of the claims, suits, actions or proceedings described in the bullets above and such person does not obtain a judgment on the merits that substantially achieves, in substance and amount (if the extent of such achievement is disputed, then as determined by the Court of Chancery of the State of Delaware or such other court with subject matter jurisdiction of such claim, suit, action or proceeding), the full remedy sought, then such limited partner, our general partner or person holding any beneficial interest in us shall be obligated to reimburse us and our affiliates (including our general partner, the directors of our general partner and the owner of our general partner) for all fees, costs and expenses of every kind and description, including but not limited to all reasonable attorney's fees and other litigation expenses, that the parties may incur in connection with such claim, suit, action or proceeding. We and our affiliates, as defined in Section 1.1 of our partnership agreement (including our general partner, the directors and officers of our general partner, Sanchez Oil & Gas Corporation, SP Holdings, LLC, Sanchez Energy Partners I, LP and Messrs. Sanchez III and Willinger) would be entitled to recover all of their fees, costs and expenses in any such action, and such losing party would be severally liable for all such fees, costs and expenses.

By taking ownership of a common unit, a limited partner is irrevocably consenting to these limitations and provisions regarding claims, suits, actions or proceedings and submitting to the exclusive jurisdiction of the Court of Chancery of the State of Delaware (or such other court) in connection with any such claims, suits, actions or proceedings. We intend to apply a broad interpretation to each of the foregoing provisions in our partnership agreement in order to apply the fee-shifting provision broadly.

**Limited Liability**

Assuming that a limited partner does not participate in the control of our business within the meaning of the Delaware Act and that he otherwise acts in conformity with the provisions of the partnership agreement, his

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liability under the Delaware Act will be limited, subject to possible exceptions, to the amount of capital he is obligated to contribute to us for his common units plus his share of any undistributed profits and assets. However, if it were determined that the right, or exercise of the right, by the limited partners as a group:

to remove or replace our general partner;

to approve some amendments to our partnership agreement; or

to take other action under our partnership agreement

constituted participation in the control of our business for the purposes of the Delaware Act, then the limited partners could be held personally liable for our obligations under the laws of Delaware, to the same extent as our general partner. This liability would extend to persons who transact business with us under the reasonable belief that the limited partner is a general partner. Neither our partnership agreement nor the Delaware Act specifically provides for legal recourse against our general partner if a limited partner were to lose limited liability through any fault of our general partner. While this does not mean that a limited partner could not seek legal recourse, we know of no precedent for this type of a claim in Delaware case law.

Under the Delaware Act, a limited partnership may not make a distribution to a partner if, after the distribution, all liabilities of the limited partnership, other than liabilities to partners on account of their partnership interests and liabilities for which the recourse of creditors is limited to specific property of the partnership, would exceed the fair value of the assets of the limited partnership. For the purpose of determining the fair value of the assets of a limited partnership, the Delaware Act provides that the fair value of property subject to liability for which recourse of creditors is limited shall be included in the assets of the limited partnership only to the extent that the fair value of that property exceeds the nonrecourse liability. The Delaware Act provides that a limited partner who receives a distribution and knew at the time of the distribution that the distribution was in violation of the Delaware Act shall be liable to the limited partnership for the amount of the distribution for three years.

Limitations on the liability of members or limited partners for the obligations of a limited liability company or limited partnership have not been clearly established in many jurisdictions. If, by virtue of our ownership interest in our subsidiary or any subsidiaries we may have in the future, or otherwise, it were determined that we were conducting business in any jurisdiction without compliance with the applicable limited partnership or limited liability company statute, or that the right or exercise of the right by the limited partners as a group to remove or replace our general partner, to approve some amendments to our partnership agreement, or to take other action under our partnership agreement constituted participation in the control of our business for purposes of the statutes of any relevant jurisdiction, then the limited partners could be held personally liable for our obligations under the law of that jurisdiction to the same extent as our general partner under the circumstances. We will operate in a manner that our general partner considers reasonable and necessary or appropriate to preserve the limited liability of the limited partners.

## **Conversion of Class A Preferred Units**

Each Class A Preferred Unit will automatically convert at the conversion rate on the earlier of March 31, 2018 and the closing date for a firm commitment underwritten public offering that results in gross proceeds of not less than \$75,000,000, subject to certain exceptions specified in the partnership agreement. The conversion rate is equal to the

aggregate purchase price for the Class A Preferred Units plus accrued and unpaid distributions thereon, divided by the lesser of the purchase price for the Class A Preferred Units and the lowest price for which we issue common units (other than in connection with an at-the-market offering or our long-term incentive plan). Each of the holders of Class A Preferred Units has the right, from and after March 31, 2016 at the option of such holder, to request conversion in whole or in part of its Class A Preferred Units into common units. We have the right to cause all, but not less than all, of the Class A Preferred Units to convert into common units at any time beginning March 31, 2016. The Class A Preferred Units are subject to blocker provisions

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which provide that the Class A Preferred Units may not be converted, whether by the holder, by us or automatically, into a number of common units that, when combined with any other common units beneficially owned by the holder, would make the holder the beneficial owner of more than 19.99% of the outstanding common units following conversion.

### **Issuance of Additional Interests**

Our partnership agreement authorizes us to issue an unlimited number of additional partnership interests for the consideration and on the terms and conditions determined by our general partner without the approval of the unitholders.

It is possible that we will fund acquisitions through the issuance of additional common units or other partnership interests. Holders of any additional common units that we issue will be entitled to share equally with the then-existing common unitholders in our distributions. In addition, the issuance of additional common units or other partnership interests may dilute the value of the interests of the then-existing common unitholders in our net assets.

In accordance with Delaware law and the provisions of our partnership agreement, we may also issue additional partnership interests that, as determined by our general partner, may have rights to distributions or special voting rights to which the common units are not entitled. In addition, our partnership agreement does not prohibit our current or future subsidiaries from issuing equity interests, which may effectively rank senior to the common units.

### **Amendment of the Partnership Agreement**

#### ***General***

Amendments to our partnership agreement may be proposed only by our general partner. However, our general partner will have no duty or obligation to propose any amendment and may decline to do so free of any fiduciary duty or obligation whatsoever to us or the limited partners, including any duty to act in good faith or in the best interests of us or the limited partners. In order to adopt a proposed amendment, other than the amendments discussed below, our general partner is required to seek written approval of the holders of the number of units required to approve the amendment or to call a meeting of the limited partners to consider and vote upon the proposed amendment. Except as described below, an amendment must be approved by a unit majority. In addition, amendments to the partnership agreement pertaining to the Class A Preferred Units requires the consent of each holder of a Class A Preferred Unit to the extent such amendment would adversely affect such holder.

#### ***Prohibited Amendments***

No amendment may be made that would:

enlarge the obligations of any limited partner without his consent, unless approved by at least a majority of the type or class of limited partner interests so affected; or

enlarge the obligations of, restrict, change or modify in any way any action by or rights of, or reduce in any way the amounts distributable, reimbursable or otherwise payable by us to our general partner or any of its affiliates without the consent of our general partner, which consent

may be given or withheld in its sole discretion.

The provision of our partnership agreement preventing the amendments having the effects described in the clauses above can be amended upon the approval of the holders of at least 75% of the outstanding units, voting as a single class (including units owned by our general partner and its affiliates). As of March 6, 2015, SEPI and SP Holdings collectively owned approximately 20.5% of our outstanding common units.

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***No Unitholder Approval***

Our general partner may generally make amendments to our partnership agreement without the approval of any limited partner to reflect:

a change in our name, the location of our principal place of business, our registered agent or our registered office;

the admission, substitution, withdrawal or removal of partners in accordance with our partnership agreement;

a change that our general partner determines to be necessary or appropriate to qualify or continue our qualification as a limited partnership or other entity in which the limited partners have limited liability under the laws of any state or to ensure that neither we nor any of our subsidiaries will be treated as an association taxable as a corporation or otherwise taxed as an entity for U.S. federal income tax purposes (to the extent not already so treated or taxed);

a change in our fiscal year or taxable year and related changes;

an amendment that is necessary, in the opinion of our counsel, to prevent us or our general partner or its directors, officers, agents or trustees from in any manner being subjected to the provisions of the Investment Company Act of 1940, the Investment Advisers Act of 1940 or plan asset regulations adopted under the Employee Retirement Income Security Act of 1974, or ERISA, whether or not substantially similar to plan asset regulations currently applied or proposed;

an amendment that our general partner determines to be necessary or appropriate in connection with the creation, authorization or issuance of additional partnership interests or the right to acquire partnership interests;

any amendment expressly permitted in our partnership agreement to be made by our general partner acting alone;

an amendment effected, necessitated or contemplated by a merger agreement that has been approved under the terms of our partnership agreement;

any amendment that our general partner determines to be necessary or appropriate for the formation by us of, or our investment in, any corporation, partnership or other entity, as otherwise permitted by our partnership agreement;

conversions into, mergers with or conveyances to another limited liability entity that is newly formed and has no assets, liabilities or operations at the time of the conversion, merger or conveyance other than those it receives by way of the conversion, merger or conveyance in certain circumstances; or

any other amendments substantially similar to any of the matters described in the clauses above.

In addition, our general partner may make amendments to our partnership agreement, without the approval of any limited partner, if our general partner determines that those amendments:

do not adversely affect the limited partners, considered as a whole, or any particular class of limited partners, in any material respect;

are necessary or appropriate to satisfy any requirements, conditions or guidelines contained in any opinion, directive, order, ruling or regulation of any federal or state agency or judicial authority or contained in any federal or state statute;

are necessary or appropriate to facilitate the trading of limited partner interests or to comply with any rule, regulation, guideline or requirement of any securities exchange on which the limited partner interests are or will be listed for trading;

are necessary or appropriate for any action taken by our general partner relating to splits or combinations of units under the provisions of our partnership agreement;



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are necessary or appropriate in connection with the creation, authorization or issuance of any class or series of partnership securities; or

are required to effect the intent of the provisions of our partnership agreement or are otherwise contemplated by our partnership agreement.

### ***Opinion of Counsel and Unitholder Approval***

Any amendment that our general partner determines adversely affects in any material respect one or more particular classes of limited partners will require the approval of at least a majority of the class or classes so affected, but no vote will be required by any class or classes of limited partners that our general partner determines are not adversely affected in any material respect. Any amendment that would have a material adverse effect on the rights or preferences of any type or class of outstanding units in relation to other classes of units will require the approval of at least a majority of the type or class of units so affected. Any amendment that would reduce the voting percentage required to take any action other than to remove the general partner or call a meeting of unitholders is required to be approved by the affirmative vote of limited partners whose aggregate outstanding units constitute not less than the voting requirement sought to be reduced. Any amendment that would increase the percentage of units required to remove the general partner or call a meeting of unitholders must be approved by the affirmative vote of limited partners whose aggregate outstanding units constitute not less than the percentage sought to be increased. For amendments of the type not requiring unitholder approval, our general partner will not be required to obtain an opinion of counsel that an amendment will neither result in a loss of limited liability to the limited partners nor result in our being treated as a taxable entity for federal income tax purposes in connection with any of the amendments. Any amendment relating to special unitholder meetings, notices of unitholder meetings, quorum and voting requirements, actions without a meeting and the amendment provisions in our partnership agreement require approval of 75% of our outstanding units. No amendments to our partnership agreement, other than those the general partner can adopt without unitholder approval or in connection with a merger or consolidation, will become effective without the approval of holders of at least 90% of the outstanding units, voting as a single class, unless we first obtain an opinion of counsel to the effect that the amendment will not affect the limited liability under applicable law of any of our limited partners.

### **Merger, Consolidation, Conversion, Sale or Other Disposition of Assets**

A merger, consolidation or conversion of us requires the prior consent of our general partner. However, our general partner will have no duty or obligation to consent to any merger, consolidation or conversion and may decline to do so free of any fiduciary duty or obligation whatsoever to us or the limited partners, including any duty to act in good faith or in the best interest of us or the limited partners.

In addition, our partnership agreement generally prohibits our general partner, without the prior approval of the holders of a unit majority, from causing us to sell, exchange or otherwise dispose of all or substantially all of our assets in a single transaction or a series of related transactions, including by way of merger, consolidation or other combination. Our general partner may, however, mortgage, pledge, hypothecate or grant a security interest in all or substantially all of our assets without such approval. Our general partner may also sell all or substantially all of our assets under a foreclosure or other realization upon those encumbrances without such approval. Finally, our general partner may consummate any merger without the prior approval of our unitholders if we are the surviving entity in the transaction, our general partner has received an opinion of counsel regarding limited liability and tax matters, the transaction would not result in a material amendment to the partnership agreement (other than an amendment that the general partner could adopt without the consent of other partners), each of our units will be an identical unit of our partnership following the transaction and the partnership securities to be issued do not exceed 20% of our outstanding

partnership interests (other than incentive distribution rights) immediately prior to the transaction. If the conditions specified in our partnership agreement are satisfied, our general partner may convert us or any of our subsidiaries into a new limited liability entity or merge us or any of our subsidiaries into, or convey all of our assets to, a newly formed entity, if the sole purpose of that conversion, merger or conveyance is to effect a mere change in our legal form into another limited liability entity, we have

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received an opinion of counsel regarding limited liability and tax matters and the governing instruments of the new entity provide the limited partners and our general partner with the same rights and obligations as contained in our partnership agreement. Our unitholders are not entitled to dissenters' rights of appraisal under our partnership agreement or applicable Delaware law in the event of a conversion, merger or consolidation, a sale of substantially all of our assets or any other similar transaction or event.

## **Dissolution**

We will continue as a limited partnership until dissolved and terminated under our partnership agreement and the Delaware Act. We will dissolve upon:

the election of our general partner to dissolve us, if approved by the holders of units representing a unit majority;

there being no limited partners, unless we are continued without dissolution in accordance with applicable Delaware law;

the entry of a decree of judicial dissolution of our partnership;

the withdrawal or removal of our general partner or any other event that results in its ceasing to be our general partner other than by reason of a transfer of its general partner interest in accordance with our partnership agreement or its withdrawal or removal following the approval and admission of a successor; or

any other dissolution event as required by applicable Delaware law.

Upon a dissolution under the penultimate clause above, the holders of a unit majority may also elect, within specific time limitations, to continue our business on the same terms and conditions described in our partnership agreement by appointing as a successor general partner an entity approved by the holders of units representing a unit majority, subject to our receipt of an opinion of counsel to the effect that:

the action would not result in the loss of limited liability under Delaware law of any limited partner; and

neither we nor any of our subsidiaries would be treated as an association taxable as a corporation or otherwise be taxable as an entity for U.S. federal income tax purposes upon the exercise of that right to continue (to the extent not already so treated or taxed).

## **Liquidation and Distribution of Proceeds**

Upon our dissolution, unless our business is continued, the liquidator authorized to wind up our affairs will, acting with all of the powers of our general partner that are necessary or appropriate, liquidate our assets and apply the proceeds of the liquidation as described in Provisions of the Partnership Agreement Relating to Cash

**Distributions** Distributions of Cash Upon Liquidation. The liquidator may defer liquidation or distribution of our assets for a reasonable period of time or distribute assets to partners in kind if it determines that a sale would be impractical or would cause undue loss to our partners.

**Withdrawal or Removal of Our General Partner**

Except as described below, our general partner has agreed not to withdraw voluntarily as our general partner prior to September 30, 2024 without obtaining the approval of the holders of at least a majority of the outstanding common units, excluding common units held by our general partner and its affiliates, and furnishing an opinion of counsel regarding limited liability and tax matters. On or after September 30, 2024, our general partner may withdraw as general partner without first obtaining approval of any unitholder by giving 90 days written notice, and that withdrawal will not constitute a violation of our partnership agreement. Notwithstanding the information

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above, our general partner may withdraw without unitholder approval upon 90 days notice to the limited partners if at least 50% of the outstanding common units are held or controlled by one person and its affiliates, other than our general partner and its affiliates. In addition, our partnership agreement permits our general partner to sell or otherwise transfer all of its general partner interest in us without the approval of the unitholders. Please read [Transfer of General Partner Interest](#).

Upon withdrawal of our general partner under any circumstances, other than as a result of a transfer by our general partner of all or a part of its general partner interest in us, the holders of a unit majority may appoint a successor to that withdrawing general partner. If a successor is not elected, or is elected but an opinion of counsel regarding limited liability and tax matters cannot be obtained, we will be dissolved, wound up and liquidated, unless within a specified period after that withdrawal, the holders of a unit majority agree in writing to continue our business and to appoint a successor general partner. Please read [Dissolution](#).

Our general partner may not be removed unless that removal is approved by the vote of the holders of not less than 66 2/3% of the outstanding units, voting together as a single class, including units held by our general partner and its affiliates, and we receive an opinion of counsel regarding limited liability and tax matters. Any removal of our general partner is also subject to the approval of a successor general partner by the vote of a unit majority. The ownership of more than 33 1/3% of the outstanding units by our general partner and its affiliates gives them the ability to prevent our general partner's removal. As of March 6, 2015, SEPI and SP Holdings collectively owned 20.5% of our outstanding common units.

In the event of the removal of our general partner under circumstances where cause exists or withdrawal of our general partner where that withdrawal violates our partnership agreement, a successor general partner will have the option to purchase the general partner interest and incentive distribution rights of the departing general partner and its affiliates for a cash payment equal to the fair market value of those interests. Under all other circumstances where our general partner withdraws or is removed by the limited partners, the departing general partner will have the option to require the successor general partner to purchase the general partner interest and the incentive distribution rights of the departing general partner and its affiliates for fair market value. In each case, this fair market value will be determined by agreement between the departing general partner and the successor general partner. If no agreement is reached, an independent investment banking firm or other independent expert selected by the departing general partner and the successor general partner will determine the fair market value; if the departing general partner and the successor general partner cannot agree upon an expert, then an expert chosen by agreement of the experts selected by each of them will determine the fair market value.

If the option described above is not exercised by either the departing general partner or the successor general partner, then the departing general partner's general partner interest and all of its affiliates' incentive distribution rights will automatically convert into common units equal to the fair market value of those interests as determined by an investment banking firm or other independent expert selected in the manner described in the preceding paragraph.

In addition, we will be required to reimburse the departing general partner for all amounts due to the departing general partner, including, without limitation, all employee-related liabilities, including severance liabilities, incurred as a result of the termination of any employees employed for our benefit by the departing general partner or its affiliates.

## **Transfer of General Partner Interest**

At any time, our general partner may transfer all or any of its general partner interest to another person without the approval of our common unitholders. As a condition of this transfer, the transferee must, among other things, assume the rights and duties of our general partner, agree to be bound by the provisions of our partnership agreement and

furnish an opinion of counsel regarding limited liability and tax matters.

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### **Transfer of Ownership Interests in the General Partner**

At any time, the owners of our general partner may sell or transfer all or part of its ownership interests in our general partner to an affiliate or third-party without the approval of our unitholders.

### **Transfer of Incentive Distribution Rights**

By transfer of incentive distribution rights in accordance with our partnership agreement, each transferee of incentive distribution rights will be admitted as a limited partner with respect to the incentive distribution rights transferred when such transfer and admission is reflected in our books and records. Each transferee:

represents that the transferee has the capacity, power and authority to become bound by our partnership agreement;

automatically becomes bound by the terms and conditions of our partnership agreement; and

gives the consents, waivers and approvals contained in our partnership agreement.

Our general partner will cause any transfers to be recorded on our books and records no less frequently than quarterly.

We may, at our discretion, treat the nominee holder of incentive distribution rights as the absolute owner. In that case, the beneficial holder's rights are limited solely to those that it has against the nominee holder as a result of any agreement between the beneficial owner and the nominee holder.

Incentive distribution rights are securities and any transfers are subject to the laws governing transfer of securities. In addition to other rights acquired upon transfer, the transferor gives the transferee the right to become a limited partner for the transferred incentive distribution rights.

Until an incentive distribution right has been transferred on our books, we and the transfer agent may treat the record holder of the unit or right as the absolute owner for all purposes, except as otherwise required by law or stock exchange regulations.

### **Change of Management Provisions**

Our partnership agreement contains specific provisions that are intended to discourage a person or group from attempting to remove Sanchez Production Partners GP LLC as our general partner or from otherwise changing our management. Please read [Withdrawal or Removal of Our General Partner](#) for a discussion of certain consequences of the removal of our general partner. If any person or group, other than our general partner and its affiliates, acquires beneficial ownership of 20% or more of any class of units, that person or group loses voting rights on all of its units. This loss of voting rights does not apply in certain circumstances. Please read [Meetings; Voting](#).

### **Limited Call Right**

If at any time our general partner and its controlled affiliates own more than 80% of the then-issued and outstanding limited partner interests of any class, our general partner will have the right, which it may assign in whole or in part to

any of its affiliates or beneficial owners or to us, to acquire all, but not less than all, of the limited partner interests of the class held by unaffiliated persons, as of a record date to be selected by our general partner, on at least 10, but not more than 60, days notice. The purchase price in the event of this purchase is the greater of:

the highest price paid by our general partner or any of its affiliates for any limited partner interests of the class purchased within the 90 days preceding the date on which our general partner first mails notice of its election to purchase those limited partner interests; and

the average of the daily closing prices of the partnership securities of such class over the 20 consecutive trading days preceding the date that is three days before the date the notice is mailed.



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As a result of our general partner's right to purchase outstanding limited partner interests, a holder of limited partner interests may have his limited partner interests purchased at an undesirable time or at a price that may be lower than market prices at various times prior to such purchase or lower than a unitholder may anticipate the market price to be in the future. The tax consequences to a unitholder of the exercise of this call right are the same as a sale by that unitholder of his common units in the market. Please read **Material U.S. Federal Income Tax Consequences Disposition of Units.**

## **Non-Taxpaying Holders; Redemption**

To avoid any adverse effect on the maximum applicable rates chargeable to customers by us or any of our future subsidiaries, or in order to reverse an adverse determination that has occurred regarding such maximum rate, our partnership agreement provides our general partner the power to amend the agreement. If our general partner, with the advice of counsel, determines that our not being treated as an association taxable as a corporation or otherwise taxable as an entity for U.S. federal income tax purposes, coupled with the tax status (or lack of proof thereof) of one or more of our limited partners, has, or is reasonably likely to have, a material adverse effect on the maximum applicable rates chargeable to customers by us or our subsidiaries, then our general partner may adopt such amendments to our partnership agreement as it determines necessary or appropriate to:

obtain proof of the U.S. federal income tax status of our limited partners (and their owners, to the extent relevant); and

permit us to redeem the units held by any person whose tax status has or is reasonably likely to have a material adverse effect on the maximum applicable rates or who fails to comply with the procedures instituted by our general partner to obtain proof of the federal income tax status. The redemption price in the case of such a redemption will be the average of the daily closing prices per unit for the 20 consecutive trading days immediately prior to the date set for redemption.

## **Non-Citizen Assignees; Redemption**

If our general partner, with the advice of counsel, determines that we are subject to U.S. federal, state or local laws or regulations that create a substantial risk of cancellation or forfeiture of any property that we have an interest in because of the nationality, citizenship or other related status of any limited partner, then our general partner may adopt such amendments to our partnership agreement as it determines necessary or advisable to:

obtain proof of the nationality, citizenship or other related status of our limited partners (and their beneficial owners, to the extent relevant); and

permit us to redeem the units held by any person whose nationality, citizenship or other related status creates substantial risk of cancellation or forfeiture of any property or who fails to comply with the procedures instituted by the general partner to obtain proof of the nationality, citizenship or other related status. The redemption price in the case of such a redemption will be the average of the daily closing prices per unit for the 20 consecutive trading days immediately prior to the date set for redemption.

## **Meetings; Voting**

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Except as described below regarding a person or group owning 20% or more of any class of units then outstanding, record holders of units on the record date will be entitled to notice of, and to vote at, meetings of our limited partners and to act upon matters for which approvals may be solicited.

Our general partner does not anticipate that any meeting of our unitholders will be called in the foreseeable future. Any action that is required or permitted to be taken by the unitholders may be taken either at a meeting of the unitholders or without a meeting if consents in writing describing the action so taken are signed by holders of

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the number of units necessary to authorize or take that action at a meeting. Meetings of the unitholders may be called by our general partner or by unitholders owning at least 20% of the outstanding units of the class for which a meeting is proposed. Unitholders may vote either in person or by proxy at meetings. The holders of a majority of the outstanding units of the class or classes for which a meeting has been called, represented in person or by proxy, will constitute a quorum, unless any action by the unitholders requires approval by holders of a greater percentage of the units, in which case the quorum will be the greater percentage.

Each record holder of a unit has a vote according to his percentage interest in us, although additional limited partner interests having special voting rights could be issued. Please read Issuance of Additional Interests. However, if at any time any person or group, other than our general partner and its affiliates, or a direct or subsequently approved transferee of our general partner or its affiliates and purchasers specifically approved by our general partner, acquires, in the aggregate, beneficial ownership of 20% or more of any class of units then outstanding (other than Class A Preferred Units), that person or group will lose voting rights on all of its units and the units may not be voted on any matter and will not be considered to be outstanding when sending notices of a meeting of unitholders, calculating required votes, determining the presence of a quorum or for other similar purposes. This loss of voting rights does not apply (i) to any person or group that acquires the units directly from our general partner or its affiliates, (ii) to any transferees of that person or group approved by our general partner, or (iii) to any person or group who acquires the units with the specific prior approval of our general partner. In addition, if any person or group beneficially owns 20% or more of any class of units solely as a result of actions taken by us, then the 20% threshold is increased, with respect to such person, to a percentage equal to such person's new beneficial ownership after the taking of such action plus the difference between 20% and such person's beneficial ownership prior to such action. Common units held in nominee or street name account will be voted by the broker or other nominee in accordance with the instruction of the beneficial owner unless the arrangement between the beneficial owner and his nominee provides otherwise.

Any notice, demand, request, report or proxy material required or permitted to be given or made to record common unitholders under our partnership agreement will be delivered to the record holder by us or by the transfer agent.

## **Voting Rights of Incentive Distribution Rights**

If a majority of the incentive distribution rights are held by our general partner and its affiliates, the holders of the incentive distribution rights will have no right to vote in respect of such rights on any matter, unless otherwise required by law, and the holders of the incentive distribution rights shall be deemed to have approved any matter approved by our general partner.

If less than a majority of the incentive distribution rights are held by our general partner and its affiliates, the incentive distribution rights will be entitled to vote on all matters submitted to a vote of unitholders, other than amendments and other matters that our general partner determines do not adversely affect the holders of the incentive distribution rights in any material respect. On any matter in which the holders of incentive distribution rights are entitled to vote, such holders will vote together with the common units as a single class, and such incentive distribution rights shall be treated in all respects as common units when sending notices of a meeting of our limited partners to vote on any matter (unless otherwise required by law), calculating required votes, determining the presence of a quorum or for other similar purposes under our partnership agreement. The relative voting power of the holders of the incentive distribution rights and the common units will be set in the same proportion as cumulative cash distributions, if any, in respect of the incentive distribution rights for the four consecutive quarters prior to the record date for the vote bears to the cumulative cash distributions in respect of such class of units for such four quarters.

## **Status as Limited Partner**

By transfer of common units in accordance with our partnership agreement, each transferee of common units shall be admitted as a limited partner with respect to the common units transferred when such transfer and

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admission are reflected in our books and records. Except as described under Limited Liability, the common units and the Class A Preferred Units will be fully paid, and unitholders will not be required to make additional contributions.

## **Indemnification**

Under our partnership agreement, in most circumstances, we will indemnify the following persons, to the fullest extent permitted by law, from and against all losses, claims, damages or similar events:

our general partner;

any departing general partner;

any person who is or was an affiliate of our general partner or any departing general partner;

any person who is or was a manager, managing member, general partner, director, officer, employee, agent, fiduciary or trustee of our partnership, our subsidiaries, our general partner, any departing general partner or any of their affiliates;

any person who is or was serving at the request of a general partner, any departing general partner or any of their respective affiliates as a manager, managing member, general partner, director, officer, employee, agent, fiduciary or trustee of another person owing a fiduciary duty to us or our subsidiaries;

any person who controls our general partner or any departing general partner; and

any person designated by our general partner.

Any indemnification under these provisions will only be out of our assets. Unless our general partner otherwise agrees, it will not be personally liable for, or have any obligation to contribute or lend funds or assets to us to enable us to effectuate, indemnification. We may purchase insurance against liabilities asserted against and expenses incurred by persons for our activities, regardless of whether we would have the power to indemnify the person against liabilities under our partnership agreement.

## **Reimbursement of Expenses**

Our partnership agreement requires us to reimburse our general partner and its affiliates for all direct and indirect expenses they incur or payments they make on our behalf and all other expenses allocable to us or otherwise incurred by our general partner and its affiliates in connection with operating our business. Our partnership agreement does not set a limit on the amount of expenses for which our general partner and its affiliates may be reimbursed. These expenses may include salary, bonus, incentive compensation and other amounts paid to persons who perform services for us or on our behalf and expenses allocated to our general partner by its affiliates. Our general partner is entitled to determine in good faith the expenses that are allocable to us.

## **Books and Reports**

Our general partner is required to keep appropriate books of our business at our principal offices. These books will be maintained for both tax and financial reporting purposes on an accrual basis. For tax and fiscal reporting purposes, our fiscal year is the calendar year.

We will furnish or make available to record holders of our common units, within 105 days after the close of each fiscal year, an annual report containing audited consolidated financial statements and a report on those consolidated financial statements by our independent public accountants. Except for our fourth quarter, we will also furnish or make available summary financial information within 50 days after the close of each quarter. We will be deemed to have made any such report available if we file such report with the SEC on EDGAR or make the report available on a publicly available website which we maintain.

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We will furnish each record holder with information reasonably required for U.S. federal and state tax reporting purposes within 90 days after the close of each calendar year. This information is expected to be furnished in summary form so that some complex calculations normally required of partners can be avoided. Our ability to furnish this summary information to our unitholders will depend on their cooperation in supplying us with specific information. Every unitholder will receive information to assist him in determining his U.S. federal and state tax liability and in filing his U.S. federal and state income tax returns, regardless of whether he supplies us with the necessary information.

## **Right to Inspect Our Books and Records**

Our partnership agreement provides that a limited partner can, for a purpose reasonably related to his interest as a limited partner, upon reasonable written demand stating the purpose of such demand and at his own expense, have furnished to him:

a current list of the name and last known address of each record holder;

information as to the amount of cash, and a description and statement of the agreed value of any other capital contribution, contributed or to be contributed by each partner and the date on which each became a partner;

copies of our partnership agreement, our certificate of limited partnership, related amendments and powers of attorney under which they have been executed;

information regarding the status of our business and financial condition (provided that obligation shall be satisfied to the extent the limited partner is furnished our most recent annual report and any subsequent quarterly or periodic reports required to be filed (or which would be required to be filed) with the SEC pursuant to Section 13(a) of the Exchange Act); and

any other information regarding our affairs that our general partner determines is just and reasonable.

Under our partnership agreement, however, each of our limited partners and other persons who acquire interests in our partnership interests do not have rights to receive information from us or any of the persons we indemnify as described above under Indemnification for the purpose of determining whether to pursue litigation or assist in pending litigation against us or those indemnified persons relating to our affairs, except pursuant to the applicable rules of discovery relating to the litigation commenced by the person seeking information.

Our general partner may, and intends to, keep confidential from the limited partners trade secrets or other information the disclosure of which our general partner believes in good faith is not in our best interests or that we are required by law or by agreements with third parties to keep confidential.

## **Registration Rights**

Under our partnership agreement, we have agreed to register for resale under the Securities Act and applicable state securities laws any common units or other limited partner interests proposed to be sold by our general partner or any

of its affiliates or their assignees, including SEPI, if an exemption from the registration requirements is not otherwise available. These registration rights continue for two years following any withdrawal or removal of our general partner. We are obligated to pay all expenses incidental to the registration, excluding underwriting discounts.

On March 31, 2015 and April 15, 2015, we entered into Registration Rights Agreements, or the Class A Registration Rights Agreements, with the holders of Class A Preferred Units and agreed to register the common units issuable upon conversion of the Class A Preferred Units, including the common units issuable upon PIK units. In certain circumstances, the holders of Class A Preferred Units will have piggyback registration rights as described in the Class A Registration Rights Agreements.



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**MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES**

This section summarizes the material federal income tax consequences that may be relevant to individual citizens or residents of the U.S. owning our common units and, unless otherwise noted in the following discussion, is the opinion of Andrews Kurth LLP insofar as it relates to legal conclusions with respect to matters of federal income tax law. This section is based upon current provisions of the Code, existing and proposed Treasury Regulations and current administrative rulings and court decisions, all of which are subject to change. Changes in these authorities may cause the tax consequences to vary substantially from the consequences described below. Unless the context otherwise requires, references in this section to us or we are references to Sanchez Production Partners LP and our limited liability company operating subsidiaries.

The following discussion does not comment on all federal income tax matters affecting us or our unitholders and does not describe the application of the alternative minimum tax that may be applicable to certain unitholders. Moreover, the discussion focuses on unitholders who are individual citizens or residents of the United States and has only limited application to corporations, estates, entities treated as partnerships for U.S. federal income tax purposes, trusts, nonresident aliens, U.S. expatriates and former citizens or long-term residents of the United States or other unitholders subject to specialized tax treatment, such as banks, insurance companies and other financial institutions, tax-exempt institutions, foreign persons (including, without limitation, controlled foreign corporations, passive foreign investment companies and non-U.S. persons eligible for the benefits of an applicable income tax treaty with the United States), IRAs, real estate investment trusts (REITs) or mutual funds, dealers in securities or currencies, traders in securities, U.S. persons whose functional currency is not the U.S. dollar, persons holding their units as part of a straddle, hedge, conversion transaction or other risk reduction transaction, and persons deemed to sell their units under the constructive sale provisions of the Code. In addition, the discussion only comments, to a limited extent, on state, local, and foreign tax consequences. Accordingly, we encourage each prospective unitholder to consult his own tax advisor in analyzing the state, local and foreign tax consequences particular to him of the ownership or disposition of common units and potential changes in applicable laws.

No ruling has been or will be requested from the IRS regarding any matter affecting us or the consequences of owning our common units. Instead, we will rely on opinions of Andrews Kurth LLP. Unlike a ruling, an opinion of counsel represents only that counsel's best legal judgment and does not bind the IRS or the courts. Accordingly, the opinions and statements made herein may not be sustained by a court if contested by the IRS. Any contest of this sort with the IRS may materially and adversely impact the market for the common units and the prices at which the common units trade. In addition, the costs of any contest with the IRS, principally legal, accounting and related fees, will be borne indirectly by our unitholders and our general partner because the costs will reduce the cash available for distribution. Furthermore, the tax treatment of us, or of an investment in us, may be significantly modified by future legislative or administrative changes or court decisions. Any modifications may or may not be retroactively applied.

All statements as to matters of federal income tax law and legal conclusions with respect thereto, but not as to factual matters, contained in this section, unless otherwise noted, are the opinion of Andrews Kurth LLP and are based on the accuracy of the representations made by us.

For the reasons described below, Andrews Kurth LLP has not rendered an opinion with respect to the following specific U.S. federal income tax issues:

the treatment of a common unitholder whose units are loaned to a short seller to cover a short sale of units (please read Tax Consequences of Unit Ownership Treatment of Short Sales );

whether our monthly convention for allocating taxable income and losses is permitted by existing Treasury Regulations (please read [Disposition of Units Allocations Between Transferors and Transferees](#) ); and

whether our method for depreciating Section 743 adjustments is sustainable in certain cases (please read [Tax Consequences of Unit Ownership Section 754 Election](#) and [Uniformity of Units](#) ).

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### **Partnership Status**

Except as discussed in the following paragraph, a partnership is not a taxable entity and incurs no U.S. federal income tax liability. Instead, each partner is required to take into account his respective share of items of our income, gain, loss and deduction of the partnership in computing his U.S. federal income tax liability, even if no cash distributions are made to him. Distributions by a partnership to a partner are generally not taxable to the partner unless the amount of cash distributed to him is in excess of his adjusted basis in his partnership interest.

Section 7704 of the Internal Revenue Code provides that publicly traded partnerships will, as a general rule, be taxed as corporations. However, an exception, referred to in this discussion as the Qualifying Income Exception, exists with respect to publicly traded partnerships of which 90% or more of the gross income for every taxable year consists of qualifying income. Qualifying income includes income and gains derived from the exploration, development, mining or production, processing, transportation and marketing of natural resources, including oil, natural gas, and products thereof. Other types of qualifying income include interest (other than from a financial business), dividends, gains from the sale of real property and gains from the sale or other disposition of capital assets held for the production of income that otherwise constitutes qualifying income. We estimate that less than 3% of our current gross income does not constitute qualifying income; however, this estimate could change from time to time. Based on and subject to this estimate, the factual representations made by us, and a review of the applicable legal authorities, Andrews Kurth LLP is of the opinion that more than 90% of our current gross income constitutes qualifying income. The portion of our income that is qualifying income may change from time to time.

No ruling has been or will be sought from the IRS, and the IRS has made no determination as to our status or the status of our operating subsidiaries for U.S. federal income tax purposes or whether our operations generate qualifying income under Section 7704 of the Internal Revenue Code. Instead, we will rely on the opinion of Andrews Kurth LLP on such matters. Andrews Kurth LLP is of the opinion, based upon the Internal Revenue Code, its regulations, published revenue rulings, court decisions and factual representations made by us, that we are and will continue to be classified as a partnership, and each of our operating subsidiaries will be disregarded as an entity separate from us, for U.S. federal income tax purposes.

In rendering its opinion, Andrews Kurth LLP has relied on factual representations made by us. The representations made by us upon which Andrews Kurth LLP has relied include, without limitation:

Neither we nor any of our operating subsidiaries have elected or will elect to be treated as a corporation; and

For each taxable year, more than 90% of our gross income has been and will be income that Andrews Kurth LLP has opined or will opine is qualifying income within the meaning of Section 7704(d) of the Internal Revenue Code.

We believe that these representations have been true in the past and expect that these representations will continue to be true in the future.

If we fail to meet the Qualifying Income Exception, other than a failure that is determined by the IRS to be inadvertent and that is cured within a reasonable time after discovery, we will be treated as if we had transferred all of our assets, subject to liabilities, to a newly formed corporation, on the first day of the year in which we fail to meet the Qualifying Income Exception, in return for stock in that corporation and then distributed that stock to common unitholders in liquidation of their interests in us. This deemed contribution and liquidation would be tax-free to

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common unitholders and us so long as we, at that time, do not have liabilities in excess of the tax basis of our assets. Thereafter, we would be treated as a corporation for U.S. federal income tax purposes.

If we were taxable as a corporation for U.S. federal income tax purposes in any taxable year, either as a result of a failure to meet the Qualifying Income Exception or otherwise, our items of income, gain, loss and deduction would be reflected only on our tax return rather than being passed through to common unitholders, and

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our net income would be taxed to us at corporate rates. In addition, any distribution made to a common unitholder would be treated as taxable dividend income to the extent of our current or accumulated earnings and profits, or, in the absence of earnings and profits, a nontaxable return of capital to the extent of the common unitholder's tax basis in his units, or taxable capital gain, after the common unitholder's tax basis in his units is reduced to zero. Accordingly, taxation as a corporation would result in a material reduction in a common unitholder's cash flow and after-tax return and thus would likely result in a substantial reduction of the value of the units.

The remainder of this section assumes that we are and will continue to be classified as a partnership for U.S. federal income tax purposes.

### **Common Unitholder Status**

Common unitholders who become our limited partners will be treated as our partners for U.S. federal income tax purposes. Also, common unitholders whose units are held in street name or by a nominee and who have the right to direct the nominee in the exercise of all substantive rights attendant to the ownership of their units will be treated as our partners for U.S. federal income tax purposes. A beneficial owner of units whose units have been transferred to a short seller to complete a short sale would appear to lose his status as a partner with respect to those units for U.S. federal income tax purposes. Please read "Tax Consequences of Unit Ownership Treatment of Short Sales." As there is no direct or indirect controlling authority addressing assignees of common units who are entitled to execute and deliver transfer applications and thereby become entitled to direct the exercise of attendant rights, but who fail to execute and deliver transfer applications, Andrews Kurth LLP's opinion does not extend to these persons. Furthermore, a purchaser or other transferee of common units who does not execute and deliver a transfer application may not receive some U.S. federal income tax information or reports furnished to record holders of common units unless the common units are held in a nominee or street name account and the nominee or broker has executed and delivered a transfer application for those common units.

Items of our income, gain, loss, or deduction are not reportable by a common unitholder who is not a partner for U.S. federal income tax purposes, and any cash distributions received by a common unitholder who is not a partner for U.S. federal income tax purposes would therefore be fully taxable as ordinary income. These common unitholders are urged to consult their own tax advisors with respect to their status as our partners for U.S. federal income tax purposes.

The references to "common unitholders" in the discussion that follows are to persons who are treated as our partners for U.S. federal income tax purposes.

### **Tax Consequences of Unit Ownership**

#### ***Flow-Through of Taxable Income***

Subject to the discussion below under "Entity-Level Collections," neither we nor our subsidiaries pay any U.S. federal income tax. Instead, each common unitholder is required to report on his income tax return his share of our income, gains, losses and deductions without regard to whether corresponding cash distributions are received by him. Consequently, we may allocate income to a common unitholder even if he has not received a cash distribution. Each common unitholder is required to include in income his share of our income, gain, loss and deduction for our taxable year or years ending with or within his taxable year. Our taxable year ends on December 31.

#### ***Treatment of Distributions***

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Distributions made by us to a common unitholder generally are not be taxable to the common unitholder for U.S. federal income tax purposes to the extent of his tax basis in his units immediately before the distribution. Cash distributions made by us to a common unitholder in an amount in excess of his tax basis in his units

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generally are considered to be gain from the sale or exchange of those units, taxable in accordance with the rules described under *Disposition of Units* below. To the extent that cash distributions made by us cause a common unitholder's at risk amount to be less than zero at the end of any taxable year, the common unitholder must recapture any losses deducted in previous years. Please read *Limitations on Deductibility of Losses*.

Any reduction in a common unitholder's share of our liabilities for which no partner bears the economic risk of loss, known as nonrecourse liabilities, will be treated as a distribution of cash to that common unitholder.

A decrease in a common unitholder's percentage interest in us because of our issuance of additional common units will decrease his share of our nonrecourse liabilities and thus will result in a corresponding deemed distribution of cash, which may constitute a non-pro rata distribution. A non-pro rata distribution of money or property may result in ordinary income to a common unitholder, regardless of his tax basis in his units, if the distribution reduces the common unitholder's share of our unrealized receivables, including recapture of intangible drilling and development costs, depletion and depreciation recapture, and/or substantially appreciated inventory items, both as defined in Section 751 of the Internal Revenue Code, and collectively, Section 751 Assets. To that extent, he will be treated as having received his proportionate share of the Section 751 Assets and having exchanged those assets with us in return for the non-pro rata portion of the actual distribution made to him. This latter deemed exchange will generally result in the common unitholder's realization of ordinary income. That income will equal the excess of (1) the non-pro rata portion of that distribution over (2) the common unitholder's tax basis (generally zero) for the share of Section 751 Assets deemed relinquished in the exchange.

## ***Basis of Units***

A common unitholder's initial tax basis in his units will be the amount he paid for those units plus his share of our nonrecourse liabilities. That basis will be increased by his share of our income and by any increases in his share of our nonrecourse liabilities. That basis generally will be decreased, but not below zero, by distributions to him from us, by his share of our losses, by depletion deductions taken by him to the extent such deductions do not exceed his proportionate share of the adjusted tax basis of the underlying producing properties, by any decreases in his share of our nonrecourse liabilities and by his share of our expenditures that are not deductible in computing taxable income and are not required to be capitalized. A common unitholder's share of our nonrecourse liabilities will generally be based on his share of our profits. Please read *Disposition of Units Recognition of Gain or Loss*.

## **Limitations on Deductibility of Losses**

The deduction by a common unitholder of his share of our losses is limited to his tax basis in his units and, in the case of an individual, estate, trust or corporate common unitholder (if more than 50% of the value of its stock is owned directly or indirectly by or for five or fewer individuals or some tax-exempt organizations) to the amount for which the common unitholder is considered to be at risk with respect to our activities, if that amount is less than his tax basis. A common unitholder subject to these limitations must recapture losses deducted in previous years to the extent that distributions cause his at risk amount to be less than zero at the end of any taxable year. Losses disallowed to a common unitholder or recaptured as a result of these limitations will carry forward and will be allowable as a deduction in a later year to the extent that his tax basis or at risk amount, whichever is the limiting factor, is subsequently increased. Upon the taxable disposition of a unit, any gain recognized by a common unitholder can be offset by losses that were previously suspended by the at risk limitation but may not be offset by losses suspended by the basis limitation. Any loss previously suspended by the at risk limitation in excess of that gain is no longer utilizable.

In general, a common unitholder will be at risk to the extent of his tax basis in his units, excluding any portion of that basis attributable to his share of our nonrecourse liabilities, reduced by (i) any portion of that basis representing amounts otherwise protected against loss because of a guarantee, stop loss agreement, or other similar arrangement and (ii) any amount of money the common unitholder borrows to acquire or hold his units, if



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the lender of those borrowed funds owns an interest in us, is related to another common unitholder or can look only to the units for repayment. A common unitholder's at risk amount will increase or decrease as the tax basis of another common unitholder's common units increases or decreases, other than tax basis increases or decreases attributable to increases or decreases in his share of our nonrecourse liabilities.

The at risk limitation applies on an activity-by-activity basis, and in the case of oil and natural gas properties, each property is treated as a separate activity. Thus, a taxpayer's interest in each oil or gas property is generally required to be treated separately so that a loss from any one property would be limited to the at risk amount for that property and not the at risk amount for all the taxpayer's oil and natural gas properties. It is uncertain how this rule is implemented in the case of multiple oil and natural gas properties owned by a single entity treated as a partnership for U.S. federal income tax purposes. However, for taxable years ending on or before the date on which further guidance is published, the IRS will permit aggregation of oil or gas properties we own in computing a common unitholder's at risk limitation with respect to us. If a common unitholder must compute his at risk amount separately with respect to each oil or gas property we own, he may not be allowed to utilize his share of losses or deductions attributable to a particular property even though he has a positive at risk amount with respect to his units as a whole.

The passive loss limitation generally provides that individuals, estates, trusts and some closely held corporations and personal service corporations are permitted to deduct losses from passive activities, which are generally defined as trade or business activities in which the taxpayer does not materially participate, only to the extent of the taxpayer's income from those passive activities. The passive loss limitation is applied separately with respect to each publicly traded partnership. Consequently, any passive losses we generate will be available to offset only our passive income generated in the future and will not be available to offset income from other passive activities or investments, including our investments, a common unitholder's investments in other publicly traded partnerships, or a common unitholder's salary or active business income. Passive losses that are not deductible because they exceed a common unitholder's share of income we generate may only be deducted by the common unitholder in full when he disposes of his entire investment in us in a fully taxable transaction with an unrelated party. The passive activity loss limitations are applied after certain other applicable limitations on deductions, including the at risk rules and the tax basis limitation.

A common unitholder's share of our net income may be offset by any of our suspended passive losses, but it may not be offset by any other current or carryover losses from other passive activities, including those attributable to other publicly traded partnerships.

### ***Limitation on Interest Deductions***

The deductibility of a non-corporate taxpayer's investment interest expense is generally limited to the amount of that taxpayer's net investment income. Investment interest expense includes:

interest on indebtedness properly allocable to property held for investment;

our interest expense attributable to portfolio income; and

the portion of interest expense incurred to purchase or carry an interest in a passive activity to the extent attributable to portfolio income.

The computation of a common unitholder's investment interest expense will take into account interest on any margin account borrowing or other loan incurred to purchase or carry a common unit.

Net investment income includes gross income from property held for investment and amounts treated as portfolio income under the passive loss limitations, less deductible expenses, other than interest, directly connected with the production of investment income, but generally does not include gains attributable to the disposition of property held for investment. The IRS has indicated that net passive income earned by a publicly traded partnership will be treated as investment income to its common unitholders for purposes of the investment interest expense limitations. In addition, the common unitholder's share of our portfolio income will be treated as investment income.

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***Entity-Level Collections***

If we are required or elect under applicable law to pay any federal, state or local income tax on behalf of any common unitholder or any former common unitholder, we are authorized to pay those taxes from our funds. That payment, if made, will be treated as a distribution of cash to the common unitholder on whose behalf the payment was made. If the payment is made on behalf of a common unitholder whose identity cannot be determined, we are authorized to treat the payment as a distribution to all current common unitholders. We are authorized to amend our partnership agreement in the manner necessary to maintain uniformity of intrinsic tax characteristics of units and to adjust later distributions, so that after giving effect to these distributions, the priority and characterization of distributions otherwise applicable under our partnership agreement is maintained as nearly as is practicable. Payments by us as described above could give rise to an overpayment of tax on behalf of a common unitholder in which event the common unitholder would be required to file a claim in order to obtain a credit or refund.

***Allocation of Income, Gain, Loss and Deduction***

In general, if we have a net profit, our items of income, gain, loss and deduction will be allocated among the common unitholders in accordance with their percentage interests in us. If we have a net loss for an entire year, the loss will be allocated to our common unitholders according to their percentage interests in us to the extent of their positive capital account balances.

Specified items of our income, gain, loss and deduction will be allocated under Section 704(c) of the Internal Revenue Code to account for the difference between the tax basis and fair market value of our assets at the time we issue common units in an offering, which assets are referred to in this discussion as Contributed Property. These allocations are required to eliminate the difference between a partner's book capital account, credited with the fair market value of Contributed Property, and the tax capital account, credited with the tax basis of Contributed Property, referred to in this discussion as the book-tax disparity. The effect of these allocations to a common unitholder who purchases common units in such an offering will be essentially the same as if the tax basis of our assets were equal to their fair market value at the time of the offering. In the event we issue additional common units or engage in certain other transactions in the future, Section 704(c) allocations will be made to all holders of common units to account for the difference between the book basis for purposes of maintaining capital accounts and the fair market value of all property held by us at the time of the future transaction. In addition, items of recapture income will be allocated to the extent possible to the common unitholder who was allocated the deduction giving rise to the treatment of that gain as recapture income in order to minimize the recognition of ordinary income by other common unitholders.

An allocation of items of our income, gain, loss or deduction, other than an allocation required by Section 704(c), will generally be given effect for U.S. federal income tax purposes in determining a common unitholder's share of an item of income, gain, loss or deduction only if the allocation has substantial economic effect. In any other case, a common unitholder's share of an item will be determined on the basis of his interest in us, which will be determined by taking into account all the facts and circumstances, including:

his relative contributions to us;

the interests of all the common unitholders in profits and losses;

the interest of all the common unitholders in cash flow; and

the rights of all the common unitholders to distributions of capital upon liquidation.

***Treatment of Short Sales***

A common unitholder whose units are loaned to a short seller to cover a short sale of units may be considered as having disposed of those units. If so, he would no longer be a partner for tax purposes with respect to those units during the period of the loan and may recognize gain or loss from the disposition. As a result, during this period:

none of our income, gain, loss or deduction with respect to those units would be reportable by the common unitholder;

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any cash distributions received by the common unitholder with respect to those units would be fully taxable; and

all of these distributions would appear to be ordinary income.

Because there is no direct or indirect controlling authority on the issue relating to partnership interests, Andrews Kurth LLP has not rendered an opinion regarding the treatment of a common unitholder whose common units are loaned to a short seller. Therefore, common unitholders desiring to assure their status as partners and avoid the risk of gain recognition are urged to modify any applicable brokerage account agreements to prohibit their brokers from borrowing and loaning their common units. The IRS has announced that it is studying issues relating to the tax treatment of short sales of partnership interests. Please also read *Disposition of Units* *Recognition of Gain or Loss*.

***Tax Rates***

Under current law, the highest effective U.S. federal income tax rate applicable to ordinary income of individuals currently is 39.6% and the maximum U.S. federal income tax rate for net long-term capital gains (generally, gains from the sale of certain investment assets held for more than one year) of an individual is 20%. Such rates are subject to change by new legislation at any time.

In addition, a 3.8% net investment income tax ( NIIT ) is imposed on certain net investment income earned by individuals, estates, and trusts. For these purposes, net investment income generally includes a common unitholder's allocable share of our income and gain realized by a common unitholder from a sale of common units. In the case of an individual, the tax is imposed on the lesser of (i) the common unitholder's net investment income from all investments, or (ii) the amount by which the common unitholder's modified adjusted gross income exceeds \$250,000 (if the common unitholder is married and filing jointly or a surviving spouse) or \$200,000 (if the common unitholder is unmarried). In the case of an estate or trust, the tax is imposed on the lesser of (i) undistributed net investment income, or (ii) the excess adjusted gross income over the dollar amount at which the highest income tax bracket applicable to an estate or trust begins.

***Section 754 Election***

We have made the election permitted by Section 754 of the Internal Revenue Code. That election is irrevocable without the consent of the IRS. That election will generally permit us to adjust a unit purchaser's tax basis in our assets ( inside basis ) under Section 743(b) of the Internal Revenue Code to reflect his purchase price. The Section 743(b) adjustment applies to a person who purchases common units in an offering from the selling unitholder, but does not apply to a person who purchases common units directly from us, and it belongs only to the purchaser and not to other common unitholders. Please also read, however, *Allocation of Income, Gain, Loss and Deduction* above. For purposes of this discussion, a common unitholder's inside basis in our assets has two components: (1) his share of our tax basis in our assets ( common basis ) and (2) his Section 743(b) adjustment to that basis.

The timing and calculation of deductions attributable to Section 743(b) adjustments to our common basis will depend upon a number of factors, including the nature of the assets to which the adjustment is allocable, the extent to which the adjustment offsets any Internal Revenue Code Section 704(c) type gain or loss with respect to an asset and certain elections we make as to the manner in which we apply Internal Revenue Code Section 704(c) principles with respect to an asset to which the adjustment is applicable. Please read *Allocation of Income, Gain, Loss and Deduction*.

The timing of these deductions may affect the uniformity of our common units. Under our partnership agreement, our general partner is authorized to take a position to preserve the uniformity of common units even if that position is not

consistent with these and any other Treasury Regulations or if the position would result in

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lower annual depreciation or amortization deductions than would otherwise be allowable to some common unitholders. Please read *Uniformity of Units*. Andrews Kurth LLP is unable to opine as to the validity of any such alternate tax positions because there is no clear applicable authority. A common unitholder's basis in a common unit is reduced by his share of our deductions (whether or not such deductions were claimed on an individual income tax return) so that any position that we take that understates deductions will overstate the common unitholder's basis in his common units and may cause the common unitholder to understate gain or overstate loss on any sale of such common units. Please read *Uniformity of Units*.

A Section 754 election is advantageous if the transferee's tax basis in his common units is higher than the units' share of the aggregate tax basis of our assets immediately prior to the transfer. In that case, as a result of the election, the transferee would have, among other items, a greater amount of depletion and depreciation deductions and the transferee's share of any gain or loss on a sale of our assets would be less. Conversely, a Section 754 election is disadvantageous if the transferee's tax basis in his common units is lower than those units' share of the aggregate tax basis of our assets immediately prior to the transfer. Thus, the fair market value of the common units may be affected either favorably or unfavorably by the election. A basis adjustment is required regardless of whether a Section 754 election is made in the case of a transfer of an interest in us if we have a substantial built-in loss immediately after the transfer, or if we distribute property and have a substantial basis reduction. Generally a built-in loss or a basis reduction is substantial if it exceeds \$250,000.

The calculations involved in the Section 754 election are complex and will be made on the basis of assumptions as to the fair market value of our assets and other matters. For example, the allocation of the Section 743(b) adjustment among our assets must be made in accordance with the Internal Revenue Code. The IRS could seek to reallocate some or all of any Section 743(b) adjustment we allocated to our tangible assets to goodwill instead. Goodwill, as an intangible asset, is generally either non-amortizable or amortizable over a longer period of time or under a less accelerated method than our tangible assets. We cannot assure you that the determinations we make will not be successfully challenged by the IRS or that the resulting deductions will not be reduced or disallowed altogether. Should the IRS require a different basis adjustment to be made, and should, in our opinion, the expense of compliance exceeds the benefit of the election, we may seek permission from the IRS to revoke our Section 754 election. If permission is granted, a subsequent purchaser of common units may be allocated more income than such purchaser would have been allocated had the election not been revoked.

## **Tax Treatment of Operations**

### ***Accounting Method and Taxable Year***

We use the year ending December 31 as our taxable year and the accrual method of accounting for U.S. federal income tax purposes. Each common unitholder is required to include in income his share of our income, gain, loss and deduction for our taxable year ending within or with his taxable year. In addition, a common unitholder who has a taxable year ending on a date other than December 31 and who disposes of all of his common units following the close of our taxable year but before the close of his taxable year must include his share of our income, gain, loss and deduction in income for his taxable year, with the result that he will be required to include in income for his taxable year his share of more than twelve months of our income, gain, loss and deduction. Please read *Disposition of Units - Allocations Between Transferors and Transferees*.

### ***Depletion Deductions***

Subject to the limitations on deductibility of losses discussed above, common unitholders are entitled to deductions for the greater of either cost depletion or (if otherwise allowable) percentage depletion with respect to our oil and natural

gas interests. Although the Internal Revenue Code requires each common unitholder to compute his own depletion allowance and maintain records of his share of the adjusted tax basis of the underlying property for depletion and other purposes, we intend to furnish each of our common unitholders with information relating to this computation for U.S. federal income tax purposes. Each common unitholder, however, remains responsible for calculating his own depletion allowance and maintaining records of his share of the adjusted tax basis of the underlying property for depletion and other purposes.



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Percentage depletion is generally available with respect to common unitholders who qualify under the independent producer exemption contained in Section 613A(c) of the Internal Revenue Code. For this purpose, an independent producer is a person not directly or indirectly involved in the retail sale of oil, natural gas, or derivative products or the operation of a major refinery. Percentage depletion is calculated as an amount generally equal to 15% (and, in the case of marginal production, potentially a higher percentage) of the common unitholder's gross income from the depletable property for the taxable year. The percentage depletion deduction with respect to any property is limited to 100% of the taxable income of the common unitholder from the property for each taxable year, computed without the depletion allowance. A common unitholder that qualifies as an independent producer may deduct percentage depletion only to the extent the common unitholder's average net daily production of domestic crude oil, or the natural gas equivalent, does not exceed 1,000 barrels. This depletable amount may be allocated between oil and natural gas production, with 6,000 cubic feet of domestic natural gas production regarded as equivalent to one barrel of crude oil. The 1,000 barrel limitation must be allocated among the independent producer and controlled or related persons and family members in proportion to the respective production by such persons during the period in question.

In addition to the foregoing limitations, the percentage depletion deduction otherwise available is limited to 65% of a common unitholder's total taxable income from all sources for the year, computed without the depletion allowance, net operating loss carrybacks, or capital loss carrybacks. Any percentage depletion deduction disallowed because of the 65% limitation may be deducted in the following taxable year if the percentage depletion deduction for such year plus the deduction carryover does not exceed 65% of the common unitholder's total taxable income for that year. The carryover period resulting from the 65% net income limitation is unlimited.

Common unitholders that do not qualify under the independent producer exemption are generally restricted to depletion deductions based on cost depletion. Cost depletion deductions are calculated by (i) dividing the common unitholder's share of the adjusted tax basis in the underlying mineral property by the number of mineral units (barrels of oil and thousand cubic feet, or Mcf, of natural gas) remaining as of the beginning of the taxable year and (ii) multiplying the result by the number of mineral units sold within the taxable year. The total amount of deductions based on cost depletion cannot exceed the common unitholder's share of the total adjusted tax basis in the property.

All or a portion of any gain recognized by a common unitholder as a result of either the disposition by us of some or all of our oil and natural gas interests or the disposition by the common unitholder of some or all of his common units may be taxed as ordinary income to the extent of recapture of depletion deductions, except for percentage depletion deductions in excess of the basis of the property. The amount of the recapture is generally limited to the amount of gain recognized on the disposition.

The foregoing discussion of depletion deductions does not purport to be a complete analysis of the complex legislation and Treasury Regulations relating to the availability and calculation of depletion deductions by the common unitholders. Further, because depletion is required to be computed separately by each common unitholder and not by us, no assurance can be given, and Andrews Kurth LLP is unable to express any opinion, with respect to the availability or extent of percentage depletion deductions to the common unitholders for any taxable year. Moreover, the availability of percentage depletion may be reduced or eliminated if recently proposed (or similar) tax legislation is enacted. For a discussion of such legislative proposals, please read *Recent Legislative Developments*. We encourage each prospective common unitholder to consult his tax advisor to determine whether percentage depletion would be available to him.

***Deductions for Intangible Drilling and Development Costs***

We elect to currently deduct intangible drilling and development costs (IDCs). IDCs generally include our expenses for wages, fuel, repairs, hauling, supplies and other items that are incidental to, and necessary for, the drilling and

preparation of wells for the production of oil, natural gas or geothermal energy. The option to currently deduct IDCs applies only to those items that do not have a salvage value.

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Although we elect to currently deduct IDCs, each common unitholder will have the option of either currently deducting IDCs or capitalizing all or part of the IDCs and amortizing them on a straight-line basis over a 60-month period, beginning with the taxable month in which the expenditure is made. If a common unitholder makes the election to amortize the IDCs over a 60-month period, no IDC preference amount in respect of those IDCs will result for alternative minimum tax purposes.

Integrated oil companies must capitalize 30% of all their IDCs (other than IDCs paid or incurred with respect to oil and natural gas wells located outside of the United States) and amortize these IDCs over 60 months beginning in the month in which those costs are paid or incurred. If the taxpayer ceases to be an integrated oil company, it must continue to amortize those costs as long as it continues to own the property to which the IDCs relate. An integrated oil company is a taxpayer that has economic interests in oil and natural gas properties and also carries on substantial retailing or refining operations. An oil or gas producer is deemed to be a substantial retailer or refiner if it is subject to the rules disqualifying retailers and refiners from taking percentage depletion. In order to qualify as an independent producer that is not subject to these IDC deduction limits, a common unitholder, either directly or indirectly through certain related parties, may not be involved in the refining of more than 75,000 barrels of oil (or the equivalent amount of natural gas) on average for any day during the taxable year or in the retail marketing of oil and natural gas products exceeding \$5 million per year in the aggregate.

IDCs previously deducted that are allocable to property (directly or through ownership of an interest in a partnership) and that would have been included in the adjusted basis of the property had the IDC deduction not been taken are recaptured to the extent of any gain realized upon the disposition of the property or upon the disposition by a common unitholder of interests in us. Recapture is generally determined at the common unitholder level. Where only a portion of the recapture property is sold, any IDCs related to the entire property are recaptured to the extent of the gain realized on the portion of the property sold. In the case of a disposition of an undivided interest in a property, a proportionate amount of the IDCs with respect to the property is treated as allocable to the transferred undivided interest to the extent of any gain recognized. Please read [Disposition of Units](#) [Recognition of Gain or Loss](#).

The election to currently deduct IDCs may be restricted or eliminated if recently proposed (or similar) tax legislation is enacted. For a discussion of such legislative proposals, please read [Recent Legislative Developments](#).

### ***Deduction for United States Production Activities***

Subject to the limitations on the deductibility of losses discussed above and the limitation discussed below, common unitholders will be entitled to a deduction, herein referred to as the Section 199 deduction, equal to 9% of our qualified production activities income that is allocated to such common unitholder but not to exceed 50% of such common unitholder's actual or deemed IRS Form W-2 wages for the taxable year allocable to domestic production gross receipts.

Qualified production activities income is generally equal to gross receipts from domestic production activities reduced by cost of goods sold allocable to those receipts, other expenses directly associated with those receipts, and a share of other deductions, expenses and losses that are not directly allocable to those receipts or another class of income. The products produced must be manufactured, produced, grown or extracted in whole or in significant part by the taxpayer in the United States.

For a partnership, the Section 199 deduction is determined at the partner level. To determine his Section 199 deduction, each common unitholder will aggregate his share of the qualified production activities income allocated to him from us with the common unitholder's qualified production activities income from other sources. Each common unitholder must take into account his distributive share of the expenses allocated to him from our qualified production

activities regardless of whether we otherwise have taxable income. However, our expenses that otherwise would be taken into account for purposes of computing the Section 199 deduction are

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only taken into account only if and to the extent the common unitholder's share of losses and deductions from all of our activities is not disallowed by the basis rules, the at-risk rules or the passive activity loss rules. Please read [Tax Consequences of Unit Ownership](#) [Limitations on Deductibility of Losses](#).

The amount of a common unitholder's Section 199 deduction for each year is limited to 50% of the IRS Form W-2 wages actually or deemed paid by the common unitholder during the calendar year that are deducted in arriving at qualified production activities income. Each common unitholder is treated as having been allocated IRS Form W-2 wages from us equal to the common unitholder's allocable share of our wages that are deducted in arriving at our qualified production activities income for that taxable year. It is not anticipated that we or our subsidiaries will pay material wages that will be allocated to our common unitholders, and thus a common unitholder's ability to claim the Section 199 deduction may be limited.

A common unitholder's otherwise allowable Section 199 deduction for each taxable year is reduced by 3% of the least of (i) the oil related qualified production activities income of the common unitholder for the taxable year, (ii) the qualified production activities income of the common unitholder for the taxable year, or (iii) the common unitholder's taxable income for the taxable year (determined without regard to any Section 199 deduction). For this purpose, the term [oil related qualified production activities income](#) means the qualified production activities income attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary production thereof. We expect that most or all of our qualified production activities income will consist of oil related qualified production activities income.

This discussion of the Section 199 deduction does not purport to be a complete analysis of the complex legislation and Treasury authority relating to the calculation of domestic production gross receipts, qualified production activities income, or IRS Form W-2 Wages, or how such items are allocated by us to common unitholders. Further, because the Section 199 deduction is required to be computed separately by each common unitholder, no assurance can be given, and Andrews Kurth LLP is unable to express any opinion, as to the availability or extent of the Section 199 deduction to the common unitholders. Moreover, the availability of Section 199 deductions may be reduced or eliminated if recently proposed (or similar) tax legislation is enacted. For a discussion of such legislative proposals, please read [Recent Legislative Developments](#). Each prospective common unitholder is encouraged to consult his tax advisor to determine whether the Section 199 deduction would be available to him.

## ***Lease Acquisition Costs***

The cost of acquiring oil and natural gas leaseholder or similar property interests is a capital expenditure that must be recovered through depletion deductions if the lease is productive. If a lease is proved worthless and abandoned, the cost of acquisition less any depletion claimed may be deducted as an ordinary loss in the year the lease becomes worthless. Please read [Depletion Deductions](#). The amortization period for certain geological and geographical expenditures may be extended if recently proposed (or similar) tax legislation is enacted. For a discussion of such legislative proposal, please read [Recent Legislative Developments](#).

## ***Geophysical Costs***

Geophysical costs paid or incurred in connection with the exploration for, or development of, oil or gas within the United States are allowed as a deduction ratably over the 24-month period beginning on the date that such expense was paid or incurred.

## ***Operating and Administrative Costs***

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Amounts paid for operating a producing well are deductible as ordinary business expenses, as are administrative costs to the extent they constitute ordinary and necessary business expenses which are reasonable in amount.

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### ***Tax Basis, Depreciation and Amortization***

The tax basis of our assets, such as casing, tubing, tanks, pumping units and other similar property, will be used for purposes of computing depreciation and cost recovery deductions and, ultimately, gain or loss on the disposition of these assets. The U.S. federal income tax burden associated with the difference between the fair market value of our assets and their tax basis immediately prior to any offering will be borne by our common unitholders as of that time. Please read *Tax Consequences of Unit Ownership Allocation of Income, Gain, Loss and Deduction*.

To the extent allowable, we may elect to use the depreciation and cost recovery methods that will result in the largest deductions being taken in the early years after assets are placed in service. Property we subsequently acquire or construct may be depreciated using accelerated methods permitted by the Internal Revenue Code.

If we dispose of depreciable property by sale, foreclosure, or otherwise, all or a portion of any gain, determined by reference to the amount of depreciation previously deducted and the nature of the property, may be subject to the recapture rules and taxed as ordinary income rather than capital gain. Similarly, a common unitholder who has taken cost recovery or depreciation deductions with respect to property we own will likely be required to recapture some or all of those deductions as ordinary income upon a sale of his interest in us. Please read *Tax Consequences of Unit Ownership Allocation of Income, Gain, Loss and Deduction* and *Disposition of Units Recognition of Gain or Loss*.

The costs incurred in selling our units (called *syndication expenses*) must be capitalized and cannot be deducted currently, ratably or upon our termination. There are uncertainties regarding the classification of costs as organization expenses, which we may be able to amortize, and as syndication expenses, which we may not amortize. The underwriting discounts and commissions we incur will be treated as syndication expenses.

### ***Valuation and Tax Basis of Our Properties***

The U.S. federal income tax consequences of the ownership and disposition of common units will depend in part on our estimates of the relative fair market values and the tax bases of our assets. Although we may from time to time consult with professional appraisers regarding valuation matters, we will make many of the relative fair market value estimates ourselves. These estimates and determinations of basis are subject to challenge and will not be binding on the IRS or the courts. If the estimates of fair market value or basis are later found to be incorrect, the character and amount of items of income, gain, loss or deduction previously reported by common unitholders might change, and common unitholders might be required to adjust their tax liability for prior years and incur interest and penalties with respect to those adjustments.

### ***Disposition of Units***

#### ***Recognition of Gain or Loss***

Gain or loss will be recognized on a sale of common units equal to the difference between the common unitholder's amount realized and the common unitholder's tax basis for the common units sold. A common unitholder's amount realized will equal the sum of the cash or the fair market value of other property he receives plus his share of our nonrecourse liabilities. Because the amount realized includes a common unitholder's share of our nonrecourse liabilities, the gain recognized on the sale of common units could result in a tax liability in excess of any cash received from the sale.

Prior distributions from us in excess of cumulative net taxable income for a common unit that decreased a common unitholder's tax basis in that unit will, in effect, become taxable income if the common unit is sold at a price greater

than the common unitholder's tax basis in that unit, even if the price received is less than his original cost.



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Except as noted below, gain or loss recognized by a common unitholder, other than a dealer in units, on the sale or exchange of a common unit held for more than one year will generally be taxable as capital gain or loss. A portion of this gain or loss, which will likely be substantial, however, will be separately computed and taxed as ordinary income or loss under Section 751 of the Internal Revenue Code to the extent attributable to assets giving rise to unrealized receivables or inventory items that we own. The term unrealized receivables includes potential recapture items, including depreciation, depletion, and IDC recapture. Ordinary income attributable to unrealized receivables and inventory items may exceed net taxable gain realized on the sale of a common unit and may be recognized even if there is a net taxable loss realized on the sale of a common unit. Thus, a common unitholder may recognize both ordinary income and a capital loss upon a sale of common units. Net capital loss may offset capital gains and no more than \$3,000 of ordinary income, in the case of individuals, and may only be used to offset capital gain in the case of corporations. For individuals, trusts and estates, both ordinary income and capital gain recognized on a sale of common units may be subject to NIIT in certain circumstances. Please read Tax Consequences of Unit Ownership Tax Rates.

The IRS has ruled that a partner who acquires interests in a partnership in separate transactions must combine those interests and maintain a single adjusted tax basis for all those interests. Upon a sale or other disposition of less than all of those interests, a portion of that tax basis must be allocated to the interests sold using an equitable apportionment method. Treasury Regulations under Section 1223 of the Internal Revenue Code allow a selling common unitholder who can identify common units transferred with an ascertainable holding period to elect to use the actual holding period of the common units transferred. Thus, according to the ruling, a common unitholder will be unable to select high or low basis common units to sell as would be the case with corporate stock, but, according to the regulations, may designate specific common units sold for purposes of determining the holding period of common units transferred. A common unitholder electing to use the actual holding period of common units transferred must consistently use that identification method for all subsequent sales or exchanges of common units. A common unitholder considering the purchase of additional common units or a sale of common units purchased in separate transactions is urged to consult his tax advisor as to the possible consequences of this ruling and application of the Treasury Regulations.

Specific provisions of the Internal Revenue Code affect the taxation of some financial products and securities, including partnership interests, by treating a taxpayer as having sold an appreciated partnership interest, one in which gain would be recognized if it were sold, assigned or terminated at its fair market value, if the taxpayer or related persons enter(s) into:

a short sale;

an offsetting notional principal contract; or

a futures or forward contract with respect to the partnership interest or substantially identical property.

Moreover, if a taxpayer has previously entered into a short sale, an offsetting notional principal contract or a futures or forward contract with respect to the partnership interest, the taxpayer will be treated as having sold that position if the taxpayer or a related person then acquires the partnership interest or substantially identical property. The Secretary of the Treasury is also authorized to issue regulations that treat a taxpayer who enters into transactions or positions that have substantially the same effect as the preceding transactions as having constructively sold the financial position.

*Allocations Between Transferors and Transferees*

In general, our taxable income or loss will be determined annually, will be prorated on a monthly basis and will be subsequently apportioned among the common unitholders in proportion to the number of units owned by each of them as of the opening of the applicable exchange on the first business day of the month (the Allocation Date ). However, gain or loss realized on a sale or other disposition of our assets other than in the ordinary course of business will be allocated among the common unitholders on the Allocation Date in the month in which that gain or loss is recognized. As a result, a common unitholder transferring common units may be allocated income, gain, loss and deduction realized after the date of transfer.

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Although simplifying conventions are contemplated by the Code and most publicly traded partnerships use similar simplifying conventions, the use of this method may not be permitted under existing Treasury Regulations. Recently, however, the Department of the Treasury and the IRS issued proposed Treasury Regulations that provide a safe harbor pursuant to which a publicly-traded partnership may use a similar monthly simplifying convention to allocate tax items among transferor and transferee unitholders, although such tax items must be prorated on a daily basis. Nonetheless, the proposed regulations do not specifically authorize the use of the proration method we have adopted. Existing publicly-traded partnerships are entitled to rely on those proposed Treasury Regulations; however, they are not binding on the IRS and are subject to change until the final Treasury Regulations are issued. Accordingly, Andrews Kurth LLP is unable to opine on the validity of this method of allocating income and deductions between common unitholders. If this method is not allowed under the Treasury Regulations, or only applies to transfers of less than all of the common unitholder's interest, our taxable income or losses might be reallocated among the common unitholders. We are authorized to revise our method of allocation between common unitholders, as well as among common unitholders whose interests vary during a taxable year, to conform to a method permitted under future Treasury Regulations.

A common unitholder who owns units at any time during a quarter and who disposes of them prior to the record date set for a cash distribution for that quarter will be allocated items of our income, gain, loss and deductions attributable to that quarter but will not be entitled to receive that cash distribution.

### ***Notification Requirements***

A common unitholder who sells any of his common units, other than through a broker, generally is required to notify us in writing of that sale within 30 days after the sale (or, if earlier, January 15 of the year following the sale). A purchaser of common units who purchases units from another common unitholder is also generally required to notify us in writing of that purchase within 30 days after the purchase. Upon receiving such notifications, we are required to notify the IRS of that transaction and to furnish specified information to the transferor and transferee. Failure to notify us of a transfer of common units may, in some cases, lead to the imposition of penalties. However, these reporting requirements do not apply to a sale by an individual who is a citizen of the United States and who effects the sale or exchange through a broker who will satisfy such requirements.

### ***Constructive Termination***

We will be considered to have constructively terminated for federal income tax purposes if there is a sale or exchange of 50% or more of the total interests in our capital and profits within a twelve-month period. A constructive termination results in the closing of our taxable year for all common unitholders. In the case of a common unitholder reporting on a taxable year other than a fiscal year ending December 31, the closing of our taxable year may result in more than 12 months of our taxable income or loss being includable in his taxable income for the year of termination. A constructive termination occurring on a date other than December 31 will result in us filing two tax returns for one calendar year and the cost of the preparation of these returns will be borne by all common unitholders. However, pursuant to an IRS relief procedure for publicly traded partnerships that have technically terminated, the IRS may allow, among other things, that we provide a single Schedule K-1 for the tax year in which a termination occurs. We would be required to make new tax elections after a constructive termination, including a new election under Section 754 of the Internal Revenue Code, and a constructive termination would result in a deferral of our deductions for depreciation. A constructive termination could also result in penalties if we were unable to determine that the constructive termination had occurred. Moreover, a constructive termination might either accelerate the application of, or subject us to, any tax legislation enacted before the constructive termination.

### ***Uniformity of Units***

Because we cannot match transferors and transferees of common units, we must maintain uniformity of the economic and tax characteristics of the units to a purchaser of these units. In the absence of uniformity, we may

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be unable to completely comply with a number of U.S. federal income tax requirements, both statutory and regulatory. A lack of uniformity can result from a literal application of Treasury Regulation Section 1.167(c)-1(a)(6) and Treasury Regulation Section 1.197-2(g)(3), neither of which is anticipated to apply to a material portion of our assets. Any non-uniformity could have a negative impact on the value of the common units. Please read Tax Consequences of Unit Ownership Section 754 Election.

Our partnership agreement permits us to take positions in filing our tax returns that preserve the uniformity of our common units even under circumstances like those described above. These positions may include reducing for some common unitholders the depreciation, amortization or loss deductions to which they would otherwise be entitled or reporting a slower amortization of Section 743(b) adjustments for some common unitholders than that to which they would otherwise be entitled. Andrews Kurth LLP is unable to opine as to validity of such filing positions. A common unitholder's basis in common units is reduced by his share of our deductions (whether or not such deductions were claimed on an individual income tax return) so that any position that we take that understates deductions will overstate the common unitholder's basis in his common units, and may cause the common unitholder to understate gain or overstate loss on any sale of such common units. Please read Disposition of Units Recognition of Gain or Loss and Tax Consequences of Unit Ownership Section 754 Election. The IRS may challenge one or more of any positions we take to preserve the uniformity of common units. If such a challenge were sustained, the uniformity of common units might be affected, and, under some circumstances, the gain from the sale of common units might be increased without the benefit of additional deductions.

## **Tax-Exempt Organizations and Other Investors**

Ownership of units by employee benefit plans, other tax-exempt organizations, non-resident aliens, foreign corporations and other foreign persons raises issues unique to those investors and, as described below, may have substantially adverse tax consequences to them. Prospective common unitholders who are tax-exempt entities or non-U.S. persons should consult their tax advisor before investing in our common units.

Employee benefit plans and most other organizations exempt from U.S. federal income tax, including individual retirement accounts and other retirement plans, are subject to U.S. federal income tax on unrelated business taxable income. Virtually all of our income allocated to a common unitholder that is a tax-exempt organization will be unrelated business taxable income and will be taxable to them.

Non-resident aliens and foreign corporations, trusts or estates that own units will be considered to be engaged in business in the United States because of the ownership of units. As a consequence they will be required to file federal tax returns to report their share of our income, gain, loss or deduction and pay U.S. federal income tax at regular rates on their share of our net income or gain. Under rules applicable to publicly traded partnerships, we will withhold tax, at the highest effective applicable rate, from cash distributions made quarterly to foreign common unitholders. Each foreign common unitholder must obtain a taxpayer identification number from the IRS and submit that number to our transfer agent on a Form W-8 BEN or applicable substitute form in order to obtain credit for these withholding taxes. A change in applicable law may require us to change these procedures.

In addition, because a foreign corporation that owns units will be treated as engaged in a United States trade or business, that corporation may be subject to the United States branch profits tax at a rate of 30%, in addition to regular U.S. federal income tax, on its share of our income and gain, as adjusted for changes in the foreign corporation's U.S. net equity, which is effectively connected with the conduct of a United States trade or business. That tax may be reduced or eliminated by an income tax treaty between the United States and the country in which the foreign corporate common unitholder is a qualified resident. In addition, this type of common unitholder is subject to special information reporting requirements under Section 6038C of the Internal Revenue Code.



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A foreign common unitholder who sells or otherwise disposes of a common unit will be subject to U.S. federal income tax on gain realized on the sale or disposition of that unit to the extent the gain is effectively connected with a United States trade or business of the foreign common unitholder. Under a ruling published by the IRS interpreting the scope of effectively connected income, a foreign unitholder would be considered to be engaged in business in the United States by virtue of the ownership of common units, and part or all of that common unitholder's gain would be effectively connected with that unitholder's indirect U.S. trade or business. Moreover, under the Foreign Investment in Real Property Tax Act, a foreign common unitholder generally will be subject to U.S. federal income tax upon the sale or disposition of a unit if (i) he owned (directly or constructively applying certain attribution rules) more than 5% of our units at any time during the five-year period ending on the date of such disposition and (ii) 50% or more of the fair market value of all of our assets consisted of U.S. real property interests at any time during the shorter of the period during which such common unitholder held the units or the 5-year period ending on the date of disposition. Currently, more than 50% of our assets consist of U.S. real property interests and we do not expect that to change in the foreseeable future. Therefore, foreign common unitholders may be subject to U.S. federal income tax on gain from the sale or disposition of their common units.

## **Administrative Matters**

### ***Information Returns and Audit Procedures***

We intend to furnish to each common unitholder, within 90 days after the close of each calendar year, specific tax information, including a Schedule K-1, which describes his share of our income, gain, loss and deduction for our preceding taxable year. In preparing this information, which will not be reviewed by counsel, we will take various accounting and reporting positions, some of which have been mentioned earlier, to determine each common unitholder's share of income, gain, loss and deduction.

We cannot assure you that those positions will yield a result that conforms to the requirements of the Internal Revenue Code, Treasury Regulations or administrative interpretations of the IRS. Neither we nor Andrews Kurth LLP can assure prospective common unitholders that the IRS will not successfully contend in court that those positions are impermissible. Any challenge by the IRS could negatively affect the value of the units.

The IRS may audit our U.S. federal income tax information returns. Adjustments resulting from an IRS audit may require each common unitholder to adjust a prior year's tax liability and possibly may result in an audit of his own return. Any audit of a common unitholder's return could result in adjustments not related to our returns as well as those related to our returns.

Partnerships generally are treated as separate entities for purposes of federal tax audits, judicial review of administrative adjustments by the IRS and tax settlement proceedings. The tax treatment of partnership items of income, gain, loss and deduction are determined in a partnership proceeding rather than in separate proceedings with the partners. The Internal Revenue Code requires that one partner be designated as the Tax Matters Partner for these purposes. The partnership agreement appoints our general partners as our Tax Matters Partner.

The Tax Matters Partner will make some elections on our behalf and on behalf of common unitholders. In addition, the Tax Matters Partner can extend the statute of limitations for assessment of tax deficiencies against common unitholders for items in our returns. The Tax Matters Partner may bind a common unitholder with less than a 1% profits interest in us to a settlement with the IRS unless that common unitholder elects, by filing a statement with the IRS, not to give that authority to the Tax Matters Partner. The Tax Matters Partner may seek judicial review, by which all the common unitholders are bound, of a final partnership administrative adjustment and, if the Tax Matters Partner fails to seek judicial review, judicial review may be sought by any common unitholder having at least a 1% interest in

profits or by any group of common unitholders having in the aggregate at least a 5% interest in profits. However, only one action for judicial review will go forward, and each common unitholder with an interest in the outcome may participate in that action.



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A common unitholder must file a statement with the IRS identifying the treatment of any item on his U.S. federal income tax return that is not consistent with the treatment of the item on our return. Intentional or negligent disregard of this consistency requirement may subject a common unitholder to substantial penalties.

***Nominee Reporting***

Persons who hold an interest in us as a nominee for another person are required to furnish to us:

the name, address and taxpayer identification number of the beneficial owner and the nominee;

a statement regarding whether the beneficial owner is:

a person that is not a United States person,

a foreign government, an international organization or any wholly-owned agency or instrumentality of either of the foregoing, or

a tax-exempt entity;

the amount and description of units held, acquired or transferred for the beneficial owner; and

specific information including the dates of acquisitions and transfers, means of acquisitions and transfers, and acquisition cost for purchases, as well as the amount of net proceeds from sales.

Brokers and financial institutions are required to furnish additional information, including whether they are United States persons and specific information on units they acquire, hold or transfer for their own account. A penalty of \$100 per failure, up to a maximum of \$1,500,000 per calendar year, is imposed by the Internal Revenue Code for failure to report that information to us. The nominee is required to supply the beneficial owner of the units with the information furnished to us.

***Accuracy-related Penalties***

An additional tax equal to 20% of the amount of any portion of an underpayment of tax that is attributable to one or more specified causes, including negligence or disregard of rules or regulations, substantial understatements of income tax and substantial valuation misstatements, is imposed by the Internal Revenue Code. No penalty will be imposed, however, for any portion of an underpayment if it is shown that there was a reasonable cause for the underpayment of that portion and that the taxpayer acted in good faith regarding the underpayment of that portion.

For individuals, substantial understatement of income tax in any taxable year exists if the amount of the understatement exceeds the greater of 10% of the tax required to be shown on the return for the taxable year or \$5,000 (\$10,000 for most corporations). The amount of any understatement subject to penalty generally is reduced if any

portion is attributable to a position adopted on the return:

for which there is, or was, substantial authority, or

as to which there is a reasonable basis and the relevant facts of that position are disclosed on the return.

If any item of income, gain, loss or deduction included in the distributive shares of common unitholders could result in that kind of an understatement of income for which no substantial authority exists, we must disclose the pertinent facts on our return. In addition, we will make a reasonable effort to furnish sufficient information for common unitholders to make adequate disclosure on their returns to avoid liability for this penalty. More stringent rules would apply to an understatement of tax resulting from ownership of units if we were classified as a tax shelter, which we do not believe includes us, or any of our investments, plans or arrangements.

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A substantial valuation misstatement exists if (a) the value of any property, or the tax basis of any property, claimed on a tax return is 150% or more of the amount determined to be the correct amount of the valuation or tax basis, (b) the price for any property or services (or for the use of property) claimed on any such return with respect to any transaction between persons described in Section 482 of the Internal Revenue Code is 200% or more (or 50% or less) of the amount determined under Section 482 to be the correct amount of such price, or (c) the net Section 482 transfer price adjustment for the taxable year exceeds the lesser of \$5 million or 10% of the taxpayer's gross receipts. No penalty is imposed unless the portion of the underpayment attributable to a substantial valuation misstatement exceeds \$5,000 (\$10,000 for most corporations). The penalty is increased to 40% in the event of a gross valuation misstatement. We do not anticipate making any valuation misstatements.

## ***Reportable Transactions***

If we were to engage in a reportable transaction, we (and possibly you and others) would be required to make a detailed disclosure of the transaction to the IRS. A transaction may be a reportable transaction based upon any of several factors, including the fact that it is a type of transaction publicly identified by the IRS as a listed transaction or that it produces certain kinds of losses for partnerships, individuals, S corporations, and trusts in excess of \$2 million in any single taxable year, or \$4 million in any combination of six successive tax years. Our participation in a reportable transaction could increase the likelihood that our U.S. federal income tax information return (and possibly a common unitholder's tax return) is audited by the IRS. Please read [Information Returns and Audit Procedures](#) above.

Moreover, if we were to participate in a reportable transaction with a significant purpose to avoid or evade tax or a listed transaction, our common unitholders could be subject to the following provisions of the American Jobs Creation Act of 2004:

accuracy-related penalties with a broader scope, significantly narrower exceptions, and potentially greater amounts than described above at [Accuracy-related Penalties](#),

for those persons otherwise entitled to deduct interest on federal tax deficiencies, non-deductibility of interest on any resulting tax liability, and

in the case of a listed transaction, an extended statute of limitations.

We do not expect to engage in any reportable transactions.

## ***Recent Legislative Developments***

The present U.S. federal income tax treatment of publicly traded partnerships, including us, or an investment in our common units, may be modified by administrative, legislative or judicial interpretation at any time. For example, from time to time the Presidential Administration and members of the U.S. Congress propose and consider substantive changes to the existing U.S. federal income tax laws that would affect publicly traded partnerships. One such Administration budget proposal for fiscal year 2016 would, if enacted, tax publicly traded partnerships with fossil fuel activities as corporations for U.S. federal income tax purposes beginning in 2021. We are unable to predict whether such changes, or other proposals, will ultimately be enacted. However, it is possible that a change in law could affect us and may be retroactively applied. Any such changes could negatively impact the value of an investment in our common units.

Legislation has also been proposed that would, if enacted, make significant changes to U.S. federal income tax laws, including the elimination of certain key U.S. federal income tax incentives currently available to oil and natural gas exploration and production companies. These changes include, but are not limited to, (i) the repeal of the percentage depletion allowance for oil and natural gas properties, (ii) the elimination of current deductions for intangible drilling and development costs, (iii) the elimination of the deduction for certain domestic production activities, and (iv) an extension of the amortization period for certain geological and geophysical expenditures. The passage of any legislation as a result of these proposals or any other similar changes in U.S.

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federal income tax laws could eliminate or postpone certain tax deductions that are currently available with respect to oil and natural gas exploration and development, and any such change could increase the taxable income allocable to our common unitholders and negatively impact the value of an investment in our common units.

***State, Local and Other Tax Considerations***

In addition to U.S. federal income taxes, you will be subject to other taxes, including state and local income taxes, unincorporated business taxes, and estate, inheritance or intangible taxes that may be imposed by the various jurisdictions in which we do business or own property or in which you are a resident. We currently do business and own property in multiple states, most of which impose income taxes on individuals, corporations, and other entities. We may also own property or do business in additional states in the future. Although an analysis of those various taxes is not presented here, each prospective common unitholder should consider their potential impact on his investment in us. You may not be required to file a return and pay taxes in some states because your income from that state falls below the filing and payment requirement. You will be required, however, to file state income tax returns and to pay state income taxes in many of the states in which we may do business or own property, and you may be subject to penalties for failure to comply with those requirements. In some states, tax losses may not produce a tax benefit in the year incurred and also may not be available to offset income in subsequent taxable years. Some of the states may require us, or we may elect, to withhold a percentage of income from amounts to be distributed to a common unitholder who is not a resident of the state. Withholding, the amount of which may be greater or less than a particular common unitholder's income tax liability to the state, generally does not relieve a nonresident common unitholder from the obligation to file an income tax return. Amounts withheld may be treated as if distributed to common unitholders for purposes of determining the amounts distributed by us. Please read [Tax Consequences of Unit Ownership](#) [Entity-Level Collections](#). Based on current law and our estimate of our future operations, we anticipate that any amounts required to be withheld will not be material.

It is the responsibility of each common unitholder to investigate the legal and tax consequences, under the laws of pertinent states and localities, of his investment in us. Andrews Kurth LLP has not rendered an opinion on the state, local, alternative minimum tax or foreign tax consequences of an investment in us. We strongly recommend that each prospective common unitholder consult, and depend on, his own tax counsel or other advisor with regard to those matters. It is the responsibility of each common unitholder to file all tax returns, that may be required of him.

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**INVESTMENT IN SANCHEZ PRODUCTION PARTNERS LP BY EMPLOYEE BENEFIT PLANS**

An investment in us by an employee benefit plan is subject to additional considerations because the investments of these plans are subject to the fiduciary responsibility and prohibited transaction provisions of ERISA, and restrictions imposed by Section 4975 of the Internal Revenue Code. For these purposes, the term employee benefit plan includes, but is not limited to, qualified pension, profit-sharing and stock bonus plans, Keogh plans, simplified employee pension plans and tax deferred annuities or IRAs established or maintained by an employer or employee organization. Among other things, consideration should be given to:

whether the investment is prudent under Section 404(a)(1)(B) of ERISA;

whether in making the investment, that plan will satisfy the diversification requirements of Section 404(a)(1)(C) of ERISA; and

whether the investment will result in recognition of unrelated business taxable income by the plan and, if so, the potential after-tax investment return.

The person with investment discretion with respect to the assets of an employee benefit plan, often called a fiduciary, should determine whether an investment in us is authorized by the appropriate governing instrument and is a proper investment for the plan.

Section 406 of ERISA and Section 4975 of the Internal Revenue Code prohibits employee benefit plans, and IRAs that are not considered part of an employee benefit plan, from engaging in specified transactions involving plan assets with parties that are parties in interest under ERISA or disqualified persons under the Internal Revenue Code with respect to the plan.

In addition to considering whether the purchase of common units is a prohibited transaction, a fiduciary of an employee benefit plan should consider whether the plan will, by investing in us, be deemed to own an undivided interest in our assets, with the result that our general partner also would be fiduciaries of the plan and our operations would be subject to the regulatory restrictions of ERISA, including its prohibited transaction rules, as well as the prohibited transaction rules of the Internal Revenue Code.

The Department of Labor regulations provide guidance with respect to whether the assets of an entity in which employee benefit plans acquire equity interests would be deemed plan assets under some circumstances. Under these regulations, an entity's assets would not be considered to be plan assets if, among other things:

the equity interests acquired by employee benefit plans are publicly offered securities; i.e., the equity interests are widely held by 100 or more investors independent of the issuer and each other, freely transferable and registered under some provisions of the federal securities laws;

the entity is an operating company, i.e., it is primarily engaged in the production or sale of a product or service other than the investment of capital either directly or through a majority owned subsidiary or

subsidiaries; or

there is no significant investment by benefit plan investors, which is defined to mean that less than 25% of the value of each class of equity interest, disregarding some interests held by our general partner, its affiliates, and some other persons, is held by the employee benefit plans referred to above, IRAs, and any entity whose underlying assets include plan assets by reason of a plan's investment in such entity (employee benefit plans not subject to ERISA, including governmental plans are not counted as benefit plan investors). Our assets should not be considered plan assets under these regulations because it is expected that the investment will satisfy the requirements in the first bullet point above.

Plan fiduciaries contemplating a purchase of common units should consult with their own counsel regarding the consequences under ERISA and the Internal Revenue Code in light of the serious penalties imposed on persons who engage in prohibited transactions or other violations.

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**PLAN OF DISTRIBUTION**

We are registering the securities described in this prospectus to permit the resale of these securities by the selling unitholders (which as used herein includes donees, pledgees, transferees or other successors-in-interest selling common units received after the date of this prospectus from a selling unitholder as a gift, pledge, distribution or other transfer) from time to time after the date of this prospectus. We will not receive any of the proceeds from the sale by the selling unitholders of the securities.

The selling unitholders may act independently of us in making decisions with respect to the timing, manner and size of each of its sales. The selling unitholders may make sales of the common units from time to time through one or more methods specified herein or through a combination of any of such methods or any other method permitted pursuant to applicable law. Such offers and sales may be made directly to purchasers, through underwriters, through dealers, or through agents, on the NYSE MKT, any other stock exchange, market or trading facility on which such securities are traded, in private transactions or otherwise at prices and under terms prevailing at the time of the sale, at prices related to the then-current market price, at fixed prices, at varying prices determined at the time of sale, or at privately negotiated prices.

The selling unitholders may offer and sell some or all of the common units included in this prospectus by or through a broker-dealer or otherwise in one or more, or a combination, of the following methods, without limitation:

purchases by the broker-dealer as principal, and resale by the broker-dealer for its account;

a block trade in which the broker-dealer may attempt to sell the units as agent, but may resell all or a portion of the block as principal in order to facilitate the transaction;

in a public auction;

transactions in which a broker-dealer may agree with the selling unitholders to sell a specified number of such units at a stipulated price per unit;

transactions in which the broker-dealer as agent solicits purchasers and ordinary brokerage transactions by the broker-dealer as agent;

an offering at other than a fixed price on or through the facilities of any stock exchange on which the common units are listed or to or through a market maker other than on that stock exchange;

short shares;



through the issuance or settlement of derivate securities, including, without limitation, the writing or settlement of call options;

through hedging transactions;

distributions to members, limited partners or stockholders of selling unitholders; and

any other method permitted pursuant to applicable law.

The selling unitholders may also directly make offers to sell some or all of the common units included in this prospectus to, or solicit offers to purchase such common units from, purchasers from time to time in privately negotiated transactions or otherwise. If required, the prospectus supplement related to any such offering by the selling unitholders will set forth the terms of such offering.

The selling unitholders may, from time to time, pledge or grant a security interest in some or all of the common units owned by them and, if they default in the performance of their secured obligations, the pledgees or secured parties may offer and sell their common units, from time to time, under this prospectus supplement, or under an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act

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amending the list of selling unitholders to include the pledgee, transferee or other successors in interest as selling unitholders under this prospectus. The selling unitholders also may transfer their common units in other circumstances, in which case the transferees, pledgees or other successors in interest will be the selling beneficial owners for purposes of this prospectus.

A selling unitholder that is an entity may elect to make a pro rata in-kind distribution of common units to its members, partners or shareholders pursuant to the registration statement of which this prospectus is a part by delivering a prospectus. To the extent that such members, partners or shareholders are not affiliates of ours, such members, partners or shareholders would thereby receive freely tradeable common units pursuant to the distribution through a registration statement.

In connection with the sale of common units or interests therein, the selling unitholders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the common units in the course of hedging the positions they assume. The selling unitholders may also sell their common units short and deliver these common units to close out their short positions, or loan or pledge such common units to broker-dealers that in turn may sell these securities. The selling unitholders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of common units, which common units such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

The selling unitholders also may resell all or a portion of their common units in open market transactions in reliance upon Rule 144 under the Securities Act, provided that they meet the criteria and conform to the requirements of that rule.

If the selling unitholders use one or more underwriters in the sale, the underwriters will acquire the securities for their own account, and they may resell these securities from time to time in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. The securities may be offered and sold to the public either through underwriting syndicates represented by one or more managing underwriters or directly by one or more of such firms. In connection with those sales, underwriters may be deemed to have received compensation from the selling unitholders in the form of underwriting discounts or commissions and may also receive commissions from purchasers of the common units for which they may act as agents. Underwriters may resell common units to or through dealers, and those dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from purchasers for which they may act as agents. The prospectus supplement related to any such offering will include any required information about underwriting compensation to be paid to underwriters, and any discounts, concessions or commissions underwriters allow to participating dealers, in connection with such offering. Unless otherwise disclosed in the prospectus supplement, the obligations of the underwriters to purchase securities will be subject to certain conditions precedent, and the underwriters will be obligated to purchase all of the securities offered by the prospectus supplement if any of the securities are purchased.

From time to time, the selling unitholders may sell the common units included in this prospectus to one or more dealers acting as principals. If required, the prospectus supplement related to any such offering will name such dealers as selling unitholders, and will include information about any compensation paid to the dealers, in such offering. The dealers, which may be deemed to be underwriters as that term is defined in the Securities Act, may then resell the common units to purchasers.

The selling unitholders may sell the common units they hold using a public auction process in which the public offering price and the allocation of the common units will be determined through an auction conducted by an auction agent. The auction process may involve a modified Dutch auction mechanic in which the auction agent (and potentially other brokers) will receive and accept bids from bidders at either a minimum bid price or at price increments in excess of the minimum bid price. The auction agent and any such other brokers may be the

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underwriters of the offering or their affiliates. After the auction closes and those bids become irrevocable, the auction agent will determine the clearing price for the sale of the common units offered in the auction, and subject to agreement between the selling unitholders and the underwriter or underwriters to proceed with the offering, the common units will be allocated to winning bidders by the underwriter or underwriters. If the selling unitholder use a public auction process to sell the common units, a more detailed description of the procedures to be used in connection with any such auction will be set forth in a pricing supplement to this prospectus.

The selling unitholders may designate broker-dealers as agents from time to time to solicit offers from purchasers to purchase the common units included in this prospectus, or to sell such common units in ordinary brokerage transactions, on their behalf. If required, the prospectus supplement related to any such offering will name such agents, and will include information about any commissions paid to the agents in such offering. Agents may be deemed to be underwriters as that term is defined in the Securities Act in such offering.

The selling unitholders or their respective underwriters, broker-dealers, or agents may make sales of the common units that are deemed to be an at-the-market offering as defined in Securities Act Rule 415, which includes sales of such common units made directly on or through the NYSE MKT, the existing trading market for the common units, or in the over-the-counter market or otherwise.

We have agreed to indemnify in certain circumstances the selling unitholders of the common units covered by the registration statement against certain liabilities to which they may become subject in connection with the sale of the securities, including liabilities arising under the Securities Act. The selling unitholders have agreed to indemnify us in certain circumstances against certain liabilities to which we may become subject in connection with the sale of such securities, including liabilities arising under the Securities Act. We and the selling unitholders may agree to indemnify underwriters, dealers and agents who participate in the distribution of securities against certain liabilities to which they may become subject in connection with the sale of the securities, including liabilities arising under the Securities Act.

Certain of the underwriters and their affiliates may be customers of, may engage in transactions with and may perform services for us or our affiliates in the ordinary course of business.

We have agreed to pay the expenses of the registration of the common units offered and sold by the selling unitholders under the registration statement, including, but not limited to, all registration and filing fees, fees and expenses of our counsel and accountants, and reasonable fees and expenses of one counsel for the selling unitholders. The selling unitholders will pay any underwriting discounts and commissions applicable to the common units sold by such selling unitholders.

A prospectus and accompanying prospectus supplement in electronic form may be made available on the websites maintained by the underwriters. The underwriters may agree to allocate a number of securities for sale to their online brokerage account holders. Such allocations of securities for internet distributions will be made on the same basis as other allocations. In addition, securities may be sold by the underwriters to securities dealers who resell securities to online brokerage account holders.

The aggregate maximum compensation the underwriters will receive in connection with the sale of any securities under this prospectus and the registration statement of which it forms a part will not exceed 10% of the gross proceeds from the sale.

Because the Financial Industry Regulatory Authority ( FINRA ) views our common units as interests in a direct participation program, any offering of common units under the registration statement of which this prospectus forms a part will be made in compliance with FINRA Rule 2310.

To the extent required, this prospectus may be amended or supplemented from time to time to describe a specific plan of distribution. The place and time of delivery for the securities in respect of which this prospectus is delivered will be set forth in the accompanying prospectus supplement.

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In connection with offerings of securities under the registration statement of which this prospectus forms a part and in compliance with applicable law, underwriters, brokers or dealers may engage in transactions that stabilize or maintain the market price of the securities at levels above those that might otherwise prevail in the open market. Specifically, underwriters, brokers or dealers may over-allot in connection with offerings, creating a short position in the securities for their own accounts. For the purpose of covering a syndicate short position or stabilizing the price of the securities, the underwriters, brokers or dealers may place bids for the securities or effect purchases of the securities in the open market. Finally, the underwriters may impose a penalty whereby selling concessions allowed to syndicate members or other brokers or dealers for distribution of the securities in offerings may be reclaimed by the syndicate if the syndicate repurchases previously distributed securities in transactions to cover short positions, in stabilization transactions or otherwise. These activities may stabilize, maintain or otherwise affect the market price of the securities, which may be higher than the price that might otherwise prevail in the open market, and, if commenced, may be discontinued at any time. These transactions may be effected on or through the NYSE MKT, the existing trading market for the common units, or in the over-the-counter market or otherwise.

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This prospectus relates to 10,859,375 common units issuable upon conversion of 10,859,375 Class A Preferred Units that we have issued to the selling unitholders identified below or named in any supplement to this prospectus, and 1,844,558 common units issuable upon conversion of 1,844,558 Class A Preferred Units that we may issue as payment in kind to the selling unitholders identified below or named in any supplement to this prospectus (assuming such conversion occurs on March 31, 2016). On March 31, 2015 and April 15, 2015, the selling unitholders listed in this prospectus agreed to purchase 10,859,375 Class A Preferred Units at the Unit Purchase Price.

The following table sets forth information about the maximum number of common units that may be offered from time to time by each selling unitholder under this prospectus. The selling unitholders identified below may currently hold or acquire at any time common units in addition to those registered hereby. In addition, the selling unitholders identified below may sell, transfer, assign or otherwise dispose of some or all of their common units in private placement transactions exempt from or not subject to the registration requirements of the Securities Act. Accordingly, we cannot give an estimate as to the amount of common units that will be held by the selling unitholders upon termination of this offering. Information concerning the selling unitholders may change from time to time and, if necessary, we will supplement this prospectus accordingly.

To our knowledge, except as noted in the following paragraph, none of the selling unitholders has, or has had within the past three years, any position, office or other material relationship with us or any of our predecessors or affiliates, other than their ownership of units. Because each selling unitholder may sell all or a portion of the common units registered hereby, we cannot currently estimate the number or percentage of common units that each selling unitholder will hold upon completion of the applicable offering.

Except as described in this paragraph, none of the selling unitholders is a broker-dealer registered under Section 15 of the Exchange Act or an affiliate of a broker-dealer registered under Section 15 of the Exchange Act. Mr. Brewster is not a broker-dealer, although he is affiliated with Credit Suisse Securities LLC, a registered broker-dealer; Mr. Brewster has indicated that he purchased the Class A Preferred Units in the ordinary course of business and had no agreements or understandings with any person to distribute the Class A Preferred Units or the common units issuable upon conversion thereof.

We have prepared the table and the related notes based on information supplied to us by the selling unitholders on or prior to May 15, 2015. We have not sought to verify such information. Other information about the selling unitholders may change over time.

| <b>Selling Unitholder</b> | <b>Class A Preferred Units Beneficially Owned</b> | <b>Common Units Beneficially Owned(1)</b> | <b>Maximum Number of Common Units to be Sold Pursuant to this Prospectus Issuable Upon Conversion of Class A Preferred Units(2)(3)(4)</b> |
|---------------------------|---|---|---|
|                           |   |   |   |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Raging Capital Master Fund,<br>Ltd.(5) | 5,156,250 | 4,700,658 | 6,032,083 |
| HITE Hedge LP(6)                       | 1,892,343 |           | 2,213,773 |
| HITE MLP LP(6)                         | 1,340,625 |           | 1,568,342 |
| HITE Hedge QP LP(6)                    | 1,268,438 |           | 1,483,894 |
| HITE MLP Advantage LP(6)               | 654,844   |           | 766,075   |
| Michael Brewster                       | 312,500   | 813,581   | 365,581   |
| Darren Schuringa(7)                    | 158,125   | 7,000     | 184,984   |
| Sarah Schuringa(8)                     | 31,250    |           | 36,558    |
| Grace Schuringa(8)                     | 31,250    |           | 36,558    |
| William Hershey(7)                     | 12,500    | 10,000    | 14,623    |
| Michael Borges(7)                      | 1,250     | 96        | 1,462     |

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- (1) Calculated in accordance with Rule 13d-3 under the Exchange Act.
- (2) As of May 15, 2015, the Class A Preferred Units have not been converted in part or in full. Assumes the full conversion on a one-to-one basis of the Class A Preferred Units that have been issued, and may be issued to the selling unitholders as in-kind distributions pursuant to the terms of our partnership agreement (assuming such conversion occurs on March 31, 2016), in each case, giving effect to a pro rata allocation of such issuable Class A Preferred Units in the same proportion as the Class A Preferred Units currently held by such selling unitholders. The Class A Preferred Units are subject to blocker provisions which provide that the Class A Preferred Units may not be converted, whether by the holder, by us or automatically, into a number of common units that, when combined with any other common units beneficially owned by the holder, would make the holder the beneficial owner of more than 19.99% of the outstanding common units following conversion.
- (3) In certain circumstances, the Class A Preferred Units may be converted into common units on a greater than one-to-one basis.
- (4) Pursuant to Rule 416 of the Securities Act, this registration statement also shall cover any additional common units that become issuable, in connection with the common units registered for resale hereby, as a result of any unit distribution, split, combination or similar transaction.
- (5) Raging Capital Master Fund, Ltd. ( Raging Master ) directly owns the Class A Preferred Units and common units listed opposite its name in the table and will be deemed to beneficially own the common units underlying the Class A Preferred Units owned by it during the period beginning 60 days prior to the time such Class A Preferred Units become convertible into common units, subject to the blocker provisions discussed in footnote 2 above. As the Investment Manager of Raging Master, Raging Capital Management, LLC ( Raging Capital ) may be deemed to beneficially own the Class A Preferred Units and common units directly owned by Raging Master and will be deemed to beneficially own the common units underlying the Class A Preferred Units owned by Raging Master during the period beginning 60 days prior to the time such Class A Preferred Units become convertible into common units, subject to the blocker provisions discussed in footnote 2 above. As the Chairman, Chief Investment Officer and Managing Member of Raging Capital, William C. Martin may be deemed to beneficially own the Class A Preferred Units and common units directly owned by Raging Master and will be deemed to beneficially own the common units underlying the Class A Preferred Units owned by Raging Master during the period beginning 60 days prior to the time such Class A Preferred Units become convertible into common units, subject to the blocker provisions discussed in footnote 2 above. Raging Master, Raging Capital and Mr. Martin may be deemed to have shared voting, investment and/or dispositive power with respect to such units. Each of Raging Capital and Mr. Martin specifically disclaims beneficial ownership of such units.
- (6) James Jampel, as general partner of HITE Hedge Capital LP, an entity with voting, investment and/or dispositive power with respect to the equity securities listed, is the natural person who may be deemed to have shared voting, investment and/or dispositive power with respect to the equity securities listed in the preceding table held by the selling unitholder.
- (7) The selling unitholder has delegated voting and dispositive power with respect to the units to his employer, Yorkville Capital Management.
- (8) Allison Schuringa, as custodian for the selling unitholder, exercises voting and dispositive power with respect to the units.

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**LEGAL MATTERS**

The validity of the securities offered in this prospectus will be passed upon for the selling unitholders by Andrews Kurth LLP, Houston, Texas. If certain legal matters in connection with an offering of the securities made by this prospectus and a related prospectus supplement are passed on by counsel for the underwriters of such offering, that counsel will be named in the applicable prospectus supplement related to that offering.

**EXPERTS**

The consolidated financial statements of Sanchez Production Partners LLC (predecessor-in-interest to Sanchez Production Partners LP) as of December 31, 2014 and 2013 and for the years then ended, have been incorporated by reference herein in reliance upon the report of KPMG LLP, independent registered public accounting firm, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

Certain information incorporated by reference in this prospectus regarding our estimated quantities of natural gas reserves was prepared by Netherland, Sewell & Associates, Inc.

**Table of Contents****PART II****INFORMATION NOT REQUIRED IN PROSPECTUS****Item 14. Other Expenses of Issuance and Distribution.**

Set forth below are the expenses (other than underwriting discounts and commissions and any expenses of the selling unitholders) expected to be incurred in connection with the issuance and distribution of the securities registered hereby. With the exception of the SEC registration fee, the amounts set forth below are estimates.

|                                 |          |
|---------------------------------|----------|
| SEC registration fee            | \$ 3,174 |
| Printing and engraving expenses | *        |
| Legal fees and expenses         | *        |
| Accounting fees and expenses    | *        |
| Miscellaneous                   | *        |
| <br>Total                       | <br>\$ * |

\* These fees are calculated based on the number of issuances and amount of securities offered and accordingly cannot be estimated at this time.

**Item 15. Indemnification of Directors and Officers.***Sanchez Production Partners LP*

Subject to any terms, conditions or restrictions set forth in our agreement of limited partnership, Section 17-108 of the Delaware Revised Uniform Limited Partnership Act empowers a Delaware limited partnership to indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever. The section of the prospectus included in the Registration Statement entitled *The Partnership Agreement Indemnification* discloses that we will generally indemnify officers, directors and affiliates of our general partner to the fullest extent permitted by the law against all losses, claims, damages or similar events and is incorporated herein by reference.

*Sanchez Production Partners GP LLC*

Subject to any terms, conditions or restrictions set forth in the limited liability company agreement of Sanchez Production Partners GP LLC, our general partner, Section 18-108 of the Delaware Limited Liability Company Act empowers a Delaware limited liability company to indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever.

Under the limited liability agreement of our general partner, in most circumstances, our general partner will indemnify the following persons, to the fullest extent permitted by law, from and against any and all losses, claims, damages, liabilities, joint or several, expenses (including reasonable legal fees and expenses), judgments, fines, penalties, interest, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings,

whether civil, criminal, administrative or investigative:

any person who is or was an affiliate of our general partner;

any person who is or was a member, director, officer, fiduciary or trustee of our general partner;

any person who is or was an officer, member, partner, director, employee, agent or trustee of our general partner or any affiliate of our general partner, or any affiliate of any such person;

any person who is or was serving at the request of our general partner or any affiliate of our general partner as a director, officer, employee, member, partner, agent, fiduciary or trustee of another person (provided, that such person is not providing, on a fee-for-services basis, trustee, fiduciary or custodial services); and

any person designated by our general partner.

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Our general partner will purchase insurance covering its officers and directors against liabilities asserted and expenses incurred in connection with their activities as officers and directors of our general partner or any of its direct or indirect subsidiaries.

Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended, may be permitted to directors, officers or persons controlling the registrant pursuant to the foregoing provisions, the registrant has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

**Item 16. Exhibits.****(a) Exhibits**

| <b>Exhibit No.</b> | <b>Exhibit</b>  |
|--------------------|---|
| **1.1              | Form of Underwriting Agreement for each of the securities registered hereby   |
| 2.1                | Plan of Conversion (Incorporated by reference to Annex A included in Sanchez Production Partners LP's Registration Statement on Form S-4 (SEC File No. 333-198440), filed on January 26, 2015)  |
| 4.1                | Certificate of Limited Partnership of Sanchez Production Partners LP (Incorporated by reference to Exhibit 4.2 to Sanchez Production Partners LP's Post-Effective Amendment No. 1 to Registration Statement on Form S-4 (SEC File No. 333-198440), filed on March 6, 2015)                    |
| 4.2                | Agreement of Limited Partnership of Sanchez Production Partners LP (Incorporated by reference to Exhibit 4.3 to Sanchez Production Partners LP's Post-Effective Amendment No. 1 to Registration Statement on Form S-4 (SEC File No. 333-198440), filed on March 6, 2015)                      |
| 4.3                | Certificate of Formation of Sanchez Production Partners GP LLC (Incorporated by reference to Exhibit 4.4 to Sanchez Production Partners LP's Post-Effective Amendment No. 1 to Registration Statement on Form S-4 (SEC File No. 333-198440), filed on March 6, 2015)                          |
| 4.4                | Limited Liability Company Agreement of Sanchez Production Partners GP LLC (Incorporated by reference to Exhibit 4.5 to Sanchez Production Partners LP's Post-Effective Amendment No. 1 to Registration Statement on Form S-4 (SEC File No. 333-198440), filed on March 6, 2015)               |
| 4.8                | Form of common unit certificate (Incorporated by reference to Exhibit A to Exhibit 4.2 above)   |
| 4.9                | Registration Rights Agreement, dated March 31, 2015, by and among Sanchez Production Partners LP and the purchasers named therein (Incorporated by reference to Exhibit 4.2 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on April 1, 2015)  |
| 4.10               | Registration Rights Agreement, dated April 15, 2015, by and among Sanchez Production Partners LP and the purchasers named therein (Incorporated by reference to Exhibit 4.1 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on April 15, 2015) |
| 4.11               |   |

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Registration Rights Agreement, dated August 8, 2013, by and between Sanchez Production Partners LP and Sanchez Energy Partners I, LP (Incorporated by reference to Exhibit 10.1 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on August 9, 2013)

4.12

Registration Rights Agreement, dated March 31, 2015, by and between Sanchez Production Partners LP and SEP Holdings III, LLC (Incorporated by reference to Exhibit 4.1 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on April 1, 2015)

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| <b>Exhibit No.</b> | <b>Exhibit</b>   |
|--------------------|--|
| *5.1               | Opinion of Andrews Kurth LLP regarding legality of securities to be registered |
| *8.1               | Opinion of Andrews Kurth LLP regarding tax matters                             |
| *23.1              | Consent of Andrews Kurth LLP (included in Exhibit 5.1)                         |
| *23.2              | Consent of KPMG LLP.   |
| *23.3              | Consent of Netherland, Sewell & Associates, Inc.                               |
| *24.1              | Power of Attorney (included on signature pages).                               |

\* Filed herewith.

\*\* To be filed by amendment or as an exhibit to Current Report on Form 8-K filed at a later date in connection with a specific offering.

**Item 17. Undertakings.**

A. The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the SEC pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in this registration statement;

*provided, however,* that Paragraphs (a)(1)(i), (a)(1)(ii) and (a)(1)(iii) of this section do not apply if the registration statement is on Form S-3 or Form F-3 and the information required to be included in a post-effective amendment by those paragraphs is contained in reports filed with or furnished to the SEC by the registrant pursuant to section 13 or section 15(d) of the Exchange Act that are incorporated by reference in the registration statement, or is contained in a form of prospectus filed pursuant to Rule 424(b) that is part of the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

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(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) That, for the purpose of determining liability under the Securities Act of 1933 to any purchaser:

(i) Each prospectus filed by the registrant pursuant to Rule 424(b)(3) shall be deemed to be part of the registration statement as of the date the filed prospectus was deemed part of and included in the registration statement; and

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(ii) Each prospectus required to be filed pursuant to Rule 424(b)(2), (b)(5), or (b)(7) as part of a registration statement in reliance on Rule 430B relating to an offering made pursuant to Rule 415(a)(1)(i), (vii), or (x) for the purpose of providing the information required by section 10(a) of the Securities Act of 1933 shall be deemed to be part of and included in the registration statement as of the earlier of the date such form of prospectus is first used after effectiveness or the date of the first contract of sale of securities in the offering described in the prospectus. As provided in Rule 430B, for liability purposes of the issuer and any person that is at that date an underwriter, such date shall be deemed to be a new effective date of the registration statement relating to the securities in the registration statement to which that prospectus relates, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such effective date; or

B. The undersigned registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan's annual report pursuant to section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered herein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

C. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions described under Item 15 above, or otherwise, the registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

D. The undersigned registrant hereby undertakes:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

E. The registrant undertakes to send to each limited partner at least on an annual basis a detailed statement of any transactions with Sanchez Production Partners GP LLC or its affiliates, and of fees, commissions, compensation and other benefits paid, or accrued to Sanchez Production Partners GP LLC or its affiliates for the fiscal year completed, showing the amount paid or accrued to each recipient and the services performed.

F. The registrant undertakes to provide to the limited partners the financial statements required by Form 10-K for the first full fiscal year of operations of the partnership.

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Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in Houston, Texas on May 18, 2015.

**Sanchez Production Partners LP**

By: Sanchez Production Partners GP LLC,  
its general partner

By: /s/ Charles C. Ward  
**Charles C. Ward**

**Chief Financial Officer**

**POWER OF ATTORNEY**

KNOW ALL MEN BY THESE PRESENTS, that each of the undersigned officers and directors of Sanchez Production Partners GP LLC hereby constitutes and appoints Gerald F. Willinger and Charles C. Ward, and each of them individually, as his true and lawful attorneys-in-fact and agents, with full power of substitution, for him and on his behalf and in his name, place and stead, in any and all capacities, to sign, execute and file any or all amendments (including, without limitation, post-effective amendments) to this registration statement and any and all registration statements pursuant to Rule 462(b) of the Securities Act of 1933, with any and all exhibits thereto, and all other documents required to be filed therewith, with the Securities and Exchange Commission or any regulatory authority, granting unto each such attorney-in-fact and agent, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises in order to effectuate the same, as fully to all intents and purposes as he himself might or could do, if personally present, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them, or their or his substitutes or substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed below by the following persons in the capacities and on the dates indicated.

| <b>Signature</b>               | <b>Title</b>                              | <b>Date</b>  |
|--------------------------------|---|--------------|
| /s/ Antonio R. Sanchez, III    | Director; Chairman of the Board           | May 18, 2015 |
| <b>Antonio R. Sanchez, III</b> |   |              |
| /s/ Gerald F. Willinger        | Director; Interim Chief Executive Officer | May 18, 2015 |
| <b>Gerald F. Willinger</b>     | (Principal Executive Officer)             |              |

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|                            |                                     |              |
|----------------------------|-------------------------------------|--------------|
| /s/ Charles C. Ward        | Chief Financial Officer & Secretary | May 18, 2015 |
| <b>Charles C. Ward</b>     | (Principal Financial Officer)       |              |
| /s/ Patricio S. Sanchez    | Chief Operating Officer             | May 18, 2015 |
| <b>Patricio S. Sanchez</b> | (Principal Operating Officer)       |              |
| /s/ Kirsten A. Hink        | Chief Accounting Officer            | May 18, 2015 |
| <b>Kirsten A. Hink</b>     | (Principal Accounting Officer)      |              |
| /s/ Alan S. Bigman         | Director                            | May 18, 2015 |
| <b>Alan S. Bigman</b>      |                                     |              |

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| <b>Signature</b>                                    | <b>Title</b> | <b>Date</b>  |
|---|--------------|--------------|
| /s/ Richard S. Langdon<br><b>Richard S. Langdon</b> | Director     | May 18, 2015 |
| /s/ G. M. Byrd Larberg<br><b>G. M. Byrd Larberg</b> | Director     | May 18, 2015 |

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**EXHIBIT INDEX**

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| 4.1                | Certificate of Limited Partnership of Sanchez Production Partners LP (Incorporated by reference to Exhibit 4.2 to Sanchez Production Partners LP's Post-Effective Amendment No. 1 to Registration Statement on Form S-4 (SEC File No. 333-198440), filed on March 6, 2015)                        |
| 4.2                | Agreement of Limited Partnership of Sanchez Production Partners LP (Incorporated by reference to Exhibit 4.3 to Sanchez Production Partners LP's Post-Effective Amendment No. 1 to Registration Statement on Form S-4 (SEC File No. 333-198440), filed on March 6, 2015)                          |
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| 4.8                | Form of common unit certificate (Incorporated by reference to Exhibit A to Exhibit 4.2 above)   |
| 4.9                | Registration Rights Agreement, dated March 31, 2015, by and among Sanchez Production Partners LP and the purchasers named therein (Incorporated by reference to Exhibit 4.2 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on April 1, 2015)      |
| 4.10               | Registration Rights Agreement, dated April 15, 2015, by and among Sanchez Production Partners LP and the purchasers named therein (Incorporated by reference to Exhibit 4.1 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on April 15, 2015)     |
| 4.11               | Registration Rights Agreement, dated August 8, 2013, by and between Sanchez Production Partners LP and Sanchez Energy Partners I, LP (Incorporated by reference to Exhibit 10.1 to Sanchez Production Partners LP's Current Report on Form 8-K (SEC File No. 001-33147), filed on August 9, 2013) |
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| *5.1               | Opinion of Andrews Kurth LLP regarding legality of securities to be registered  |
| *8.1               | Opinion of Andrews Kurth LLP regarding tax matters  |
| *23.1              | Consent of Andrews Kurth LLP (included in Exhibit 5.1)  |

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- \*23.2 Consent of KPMG LLP.
- \*23.3 Consent of Netherland, Sewell & Associates, Inc.
- \*24.1 Power of Attorney (included on signature pages).

\* Filed herewith.

\*\* To be filed by amendment or as an exhibit to Current Report on Form 8-K filed at a later date in connection with a specific offering.