

Cypress Energy Partners, L.P.  
Form 10-K  
March 18, 2019

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

(MARK ONE)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2018**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**Commission File No. 001-36260**

**CYPRESS ENERGY PARTNERS, L.P.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**61-1721523**

(I.R.S. Employer Identification No.)

**5727 South Lewis Avenue, Suite 300**  
**Tulsa, Oklahoma 74105**  
(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code): **(918) 748-3900**

Securities Registered Pursuant to Section 12(b) of the Act:

<b>Common Units Representing Limited Partner Interests</b>	<b>New York Stock Exchange</b>
(Title of each class)	(Name of each exchange on which registered)

Securities Registered Pursuant to Section 12(g) of the Act: **NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

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filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the registrant’s Common Units Representing Limited Partner Interests held by non-affiliates computed by reference to the price at which the limited partner units were last sold as of June 30, 2018 was \$31,149,538.

As of March 11, 2019, the registrant had 12,023,170 common units outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE: NONE**

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## GLOSSARY OF TERMS

The following includes a description of the meanings of some of the terms used in this Annual Report on Form 10-K.

“ <i>Dig site</i> ”	The location where pipeline maintenance occurs by excavating the ground above the pipeline.
“ <i>Flowback water</i> ”	The fluid that returns to the surface during and for the weeks following the hydraulic fracturing process.
“ <i>Gun barrel</i> ”	A settling tank used for treating oil where oil and brine are separated only by gravity segregation forces.
“ <i>Hydraulic fracturing</i> ”	The process of pumping fluids, mixed with granular proppant, into a geological formation at pressures sufficient to create fractures in the hydrocarbon-bearing rock.
“ <i>Hydrotesting</i> ”	A process in which pressure vessels such as pipelines and fuel tanks can be tested for strength and leaks by filling the vessel with a liquid and pressurizing the vessel to the specified test pressure.
“ <i>In-line inspection</i> ”	An inspection technique used to assess the integrity of natural gas transmission pipelines from inside of the pipe.
“ <i>IPO</i> ”	Our initial public offering of common units representing limited partner interests in us.
“ <i>Injection intervals</i> ”	The part of the injection zone in which the well is screened or in which the waste is otherwise directly emplaced.
“ <i>Natural gas liquids</i> ”	The combination of ethane, propane, butane, isobutene and natural gasolines that, when removed from natural gas, become liquid under various levels of higher pressure and lower temperature.
“ <i>OPEC</i> ”	The Organization of Petroleum Exporting Countries.
“ <i>Pig tracking</i> ”	The locating, mapping and monitoring of the in-line inspection pig.
“ <i>Pipeline &amp; Process Services</i> ”	Our Pipeline & Process Services (formerly referred to as our Integrity Services) business segment.
“ <i>Pipeline Inspection</i> ”	Our Pipeline Inspection business segment.
“ <i>Produced water</i> ”	Naturally occurring water found in hydrocarbon-bearing formations that flows to the surface along with oil and natural gas.
“ <i>Proppant</i> ”	

Sized particles mixed with fracturing fluid to hold fractures open after a hydraulic fracturing treatment.

“*Residual oil*” Oil separated and recovered during the saltwater treatment process.

“*Separation tank*” A cylindrical or spherical vessel used to separate oil, gas and water from the total fluid stream produced by a well.

“*Settling tank*” A non-circulating storage tank where gravitational segregation forces separate liquids from solids.

“*Staking*” The process of marking the location where pipeline maintenance will occur.

“*SWD*” Saltwater disposal.

Our Water and Environmental Services business segment.

“*Water Services*”

## NAMES OF ENTITIES

Unless the context otherwise requires, references in this Annual Report on Form 10-K to “Cypress Energy Partners, L.P.,” “our partnership,” “we,” “our,” “us,” or like terms, refer to Cypress Energy Partners, L.P. and its subsidiaries.

References to:

“*Brown*” refers to Brown Integrity, LLC, a 51% owned subsidiary of CEP LLC acquired May 1, 2015;

“*CEM LLC*” refers to Cypress Energy Management, LLC, a wholly owned subsidiary of the General Partner;

“*CEM TIR*” refers to Cypress Energy Management – TIR, LLC, a wholly owned subsidiary of CEM LLC;

“*CEP LLC*” refers to Cypress Energy Partners, LLC, a wholly owned subsidiary of the Partnership;

“*CEP-TIR*” refers to Cypress Energy Partners – TIR, LLC, an indirect subsidiary of Holdings, and an owner of 1,346,800 common units representing 11.2% of our outstanding common units as of March 11, 2019, and an owner of a 36.2% interest in the TIR Entities prior to the sale of its interests to the Partnership effective February 1, 2015;

“*CF Inspection*” refers to CF Inspection Management, LLC, owned 49% by TIR-PUC and consolidated under generally accepted accounting principles by TIR-PUC. CF Inspection is 51% owned, managed and controlled by Cynthia A. Field, an affiliate of Holdings and a Director of our Partnership;

“*General Partner*” refers to Cypress Energy Partners GP, LLC, a subsidiary of Cypress Energy GP Holdings, LLC;

“*Holdings*” refers to Cypress Energy Holdings, LLC, the owner of Holdings II;

“*Holdings II*” refers to Cypress Energy Holdings II, LLC, the owner of 5,610,549 common units representing 46.7% of our outstanding common units as of March 11, 2019;

“*Partnership*” refers to the registrant, Cypress Energy Partners, L.P.;

“*TIR Entities*” refer collectively to TIR LLC; TIR-Canada, TIR-NDE, TIR-PUC and CF Inspection;

“*TIR-NDE*” refers to Tulsa Inspection Resources – Nondestructive Examination, LLC, a wholly-owned subsidiary of CEP LLC;



“*TIR-Canada*” refers to Tulsa Inspection Resources – Canada, ULC, a wholly owned subsidiary of CEP LLC;

“*TIR LLC*” refers to Tulsa Inspection Resources, LLC, a wholly owned subsidiary of CEP LLC;

“*TIR-PUC*” refers to Tulsa Inspection Resources – PUC, LLC, a subsidiary of TIR LLC that has elected to be treated as a corporation for U.S. federal income tax purposes.

## CAUTIONARY REMARKS REGARDING FORWARD LOOKING STATEMENTS

The information discussed in this Annual Report on Form 10-K includes “forward-looking statements.” These forward-looking statements are identified by their use of terms and phrases such as “may,” “expect,” “estimate,” “project,” “plan,” “believe,” “intend,” “achievable,” “anticipate,” “continue,” “potential,” “should,” “could,” and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties and we can give no assurance that such expectations or assumptions will be achieved. Important factors that could cause actual results to differ materially from those in the forward-looking statements are described under “*Item 1A - Risk Factors*” and “*Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operations*” in this Annual Report. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this Annual Report on Form 10-K and speak only as of the date of this Annual Report on Form 10-K. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

## PART I

### ITEM 1. BUSINESS

#### Overview

The Partnership is a Delaware limited partnership formed on September 19, 2013 to become a diversified Partnership serving energy companies throughout North America. We completed our initial public offering in January 2014. We currently provide essential midstream services that include independent pipeline inspection and integrity services to producers and pipeline companies and water and environmental services to U.S. onshore oil and natural gas producers and trucking companies.

Our business is organized into three reportable segments: (1) Pipeline Inspection Services (“Pipeline Inspection”), comprising the TIR Entities’ operations, (2) Pipeline & Process Services (“Pipeline & Process Services”), made up of Brown’s operations and (3) Water and Environmental Services (“Water Services”), constituting saltwater disposal activities in our saltwater disposal entities. Other potential lines of business outlined in U.S. Treasury Regulations and our Internal Revenue Service (“IRS”) private letter ruling (“PLR”) would allow us to further diversify our business activities and lines of business serving the energy industry.

The Pipeline Inspection segment generates revenue primarily by providing essential inspection and integrity services on a variety of infrastructure assets, including midstream pipelines, gathering systems, and distribution systems. Services include non-destructive examination, mechanical integrity, survey, data gathering, and supervision of third-party contractors. Our results in this segment are driven primarily by the number of inspectors that perform services for our customers and the fees that we charge for those services, which depend on the type, skills, technology, equipment, and number of inspectors used on a particular project, the nature of the project, and the duration of the project. The number of inspectors engaged on projects is driven by the type of project, prevailing market rates, the age and condition of customers' assets including pipelines, gas plants, compression stations, storage facilities, and gathering and distribution systems, including the legal and regulatory requirements relating to the inspection and maintenance of those assets. Our customers are also billed for per diem charges, mileage, and other reimbursement items. Revenue and costs in this segment may be subject to seasonal variations and interim activity may not be indicative of yearly activity, considering many of our customers develop yearly operating budgets and enter into contracts with us during the winter season for work to be performed during the remainder of the year. Additionally, inspection work throughout the United States during the winter months (especially in the northern states) may be hampered or delayed due to inclement weather, thus affecting our revenue and costs.

The Pipeline & Process Services segment (formerly our Integrity Services segment) generates revenue primarily by providing essential midstream services including hydrostatic testing services and chemical cleaning related to newly-constructed and existing pipelines and related infrastructure. We generally charge our customers in this segment on a fixed-bid basis, depending on the size and length of the pipeline being tested, the complexity of services provided, and the utilization of our work force and equipment. Our results in this segment are driven primarily by the number of field personnel that perform services for our customers and the fees that we charge for those services, which depend on the type and number of field personnel used on a particular project, the type of equipment used and the fees charged for the utilization of that equipment, and the nature and duration of the project.

The Water Services segment owns and operates nine (9) Environmental Protection Agency Class II saltwater disposal facilities in the Williston Basin region of North Dakota. Eight (8) of the facilities are wholly-owned and we have ten (10) pipelines from multiple E&P customers connected to these saltwater disposal facilities, including two (2) that were developed and are owned by the Partnership. Approximately 94% of our disposal water is produced water that is generated during the production life of an oil and gas well and 45% of our water is delivered via pipeline to our saltwater disposal facilities. We currently serve approximately 86 customers. Our saltwater disposal facilities provide essential midstream services to oil and natural gas upstream producers and their transportation companies. All of the saltwater disposal facilities utilize specialized equipment and remote monitoring to minimize the facilities' downtime and increase the facilities' efficiency for peak utilization. These facilities also utilize oil skimming and recovery processes that remove residual oil from water delivered to our saltwater disposal facilities via pipeline or truck. We sell the oil recovered from these skimming processes, which contributes to our revenues. In addition to these saltwater disposal facilities, we provide management and staffing services to a saltwater disposal facility in which we own a 25% ownership interest.

## **Our Relationship with Cypress Energy Holdings, LLC**

All of the equity interests in our general partner are indirectly owned by Holdings and its affiliates. Holdings is owned by Charles C. Stephenson, Jr.; entities related to Mr. Stephenson's family; Cynthia A. Field; a company controlled by our Chairman, Chief Executive Officer and President, Peter C. Boylan III; Henry Cornell; and a company controlled by Mr. Cornell. Holdings' owners bring substantial industry relationships and specialized, value-creation capabilities that we believe continue to benefit us. Mr. Stephenson has over 50 years of experience as a leader in the oil and natural gas industry. He was the founder, Chairman and Chief Executive Officer of Vintage Petroleum prior to its sale to Occidental Petroleum in 2006 and is also the retired Chairman of Premier Natural Resources, a private oil and natural gas exploration and production company that he co-founded. Mr. Boylan has extensive executive management experience with public and private companies and also has extensive public company directorship experience. As the owners of our general partner and the direct or indirect owners of 64.1% of our outstanding common units and all of our outstanding preferred units, Holdings and its affiliates have a strong alignment of interests with our minority unitholders to ensure the ongoing successful execution of our business plan.

## **Business Strategies**

Our principal business objective is to build a diversified partnership serving energy customers that will allow us, over time, to incrementally increase the quarterly cash distributions that we pay to our unitholders. We expect to achieve this objective through the following business strategies:

*Pipeline Inspection.* We believe the pipeline inspection services market offers attractive long-term growth fundamentals; as such, we intend to continue to position ourselves as a trusted provider of high-quality essential inspection services. Over the last few years, new laws have been enacted in the U.S. that, in the future, will require operators to undertake more frequent and more extensive inspections of their pipeline assets. These requirements are not tied to the current state of the oil and gas industry as a whole. Additionally, a significant portion of the pipeline infrastructure in North America was installed decades ago and is therefore more susceptible to material degradation requiring more frequent inspections. We believe that increasingly stringent U.S. federal and state laws and regulations and aging pipeline infrastructures will result in increased need for inspection and integrity services and higher demand for independent, third-party inspectors capable of navigating these complicated requirements. Most of our clients are investment-grade, well-capitalized companies that have long lead time projects that require our services regardless of the state of the current economy. Our clients also require ongoing maintenance and integrity work on their aging pipelines. Our business is not immune to changes in the energy economy; however, we believe that we can continue to grow organically by acquiring new customers and additional work from existing customers. We continue to grow our business development team to pursue these and other opportunities.

*Pipeline & Process Services.* We experienced significant improvements in our utilization rates in this segment during 2018, after a difficult two-year period during the industry downturn. Improvements were due, in part, to increasing demand and, in part, to improved business development efforts. During 2018, we opened a new office in Odessa, Texas, to better serve the growing Permian basin market. In addition, we added several industry

veterans to our management team in order to further enhance our image and grow the segment. In early 2019, an affiliated entity opened a new location in the Houston market to help us take advantage of the growing work in the industry. This segment had two difficult years during the energy industry downturn, which forced us to implement aggressive measures to manage and reduce its cost structure. We believe these measures were successful, and we plan to continue to focus on the potential synergies that may develop between this segment and our other business segments. We continue to enjoy an excellent reputation in the industry and continue to bid on a substantial amount of new work.

*Water Services.* We believe that the water and environmental services market will continue to offer long-term growth fundamentals and we intend to maintain our position as a high-quality operator of saltwater disposal facilities. We took aggressive actions in 2016 to adjust our cost structure to compensate for the lower volumes associated with the industry downturn. We continue to look for pipeline opportunities with exploration and production (“E&P”) companies that will secure water for our saltwater disposal facilities. Regulations continue to increase and we have proven to our customers that we are a trusted and dependable service provider. Increasingly, E&P companies are having their central procurement and Environment, Health and Safety (“EHS”) personnel conduct inspections of saltwater disposal facilities. This trend should benefit us. We remain an approved vendor for many prestigious investment grade E&P companies that demand very high standards from their vendors. Although the oil and gas industry can be cyclical in nature, our current business strategy is to derive a significant portion of our volume and revenue from existing wells. We intend to capitalize on the continued demand for removal, treatment, storage and disposal of flowback and produced water by posit