

ALJ/WSP/tcg

Decision 88 11 059 NOV 23 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern Pacific)
 Pipe Lines, Inc., San Diego)
 Pipeline Company and Southern)
 Pacific Pipe Lines Partnership,)
 L.P., for Approval of Various)
 Transactions Regarding the)
 Southern Pacific Pipe Lines)
 System and the San Diego)
 Pipeline, in Connection with a)
 Restructuring of the Pipeline)
 Business of Santa Fe Southern)
 Pacific Corporation.)

ORIGINAL

Application 88-08-063
 (Filed August 31, 1988;
 amended October 24, 1988
 and November 9, 1988)

OPINION

This application seeks various approvals in connection with a plan for restructuring and recapitalizing the pipeline business of Santa Fe Southern Pacific Corporation (SFSP) which is currently conducted by two of its indirectly owned subsidiary pipeline corporations, namely, Southern Pacific Pipe Lines, Inc. and San Diego Pipeline Company. SFSP is not a public utility. Applicants in this proceeding are the two pipeline corporations and Southern Pacific Pipe Lines Partnership, L.P. (the operating partnership) to which the pipeline companies, which transport refined petroleum products, will eventually transfer their pipeline operations. Notice of the filing of the application and amendments appeared in the Commission's Daily Calendar of September 6, 1988, October 27, 1988, and November 15, 1988. No protests to the application have been filed.

The subject pipelines handle refined petroleum products as follows:

1. The Southern Pacific Pipe Line, Inc. system is comprised of a "South Line," with two principal segments, one from El Paso, Texas to Tucson and Phoenix, Arizona, and the other from the Los Angeles basin to Phoenix

and various intermediate points; a "North Line," transporting refined petroleum products between and among various cities in Northern and Central California and Western Nevada; and an "Oregon Line," from Portland to Eugene and intermediate points and

2. The San Diego Pipeline Company's system transports refined petroleum products from the Los Angeles basin to San Diego and various intermediate points.

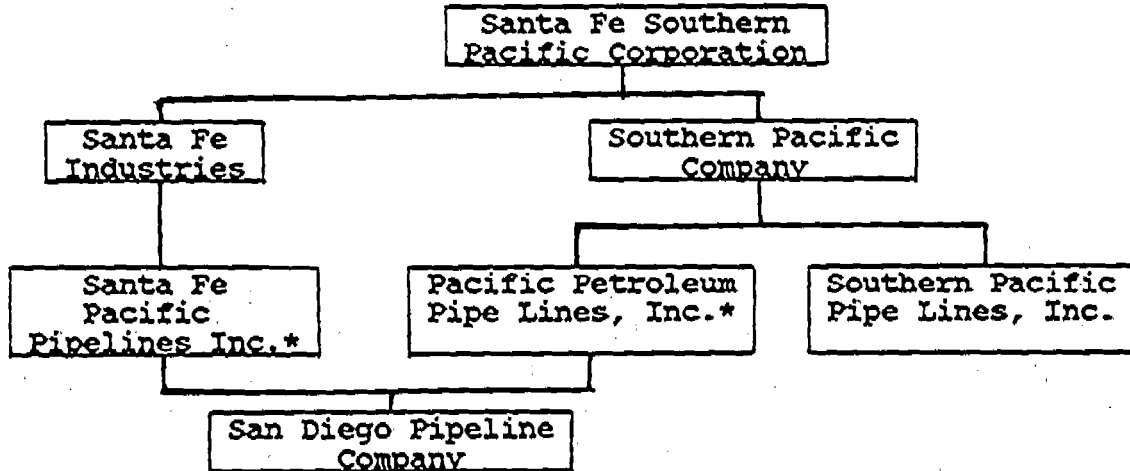
If the proposed transaction receives the necessary approvals from the Commission and if the applicants decide to proceed, the following restructuring would occur: (1) the operating partnership would become the owner of the pipelines and all other assets and liabilities (except certain pension and refund obligations) of the pipeline subsidiaries and would be an intrastate common carrier regulated by the Commission, in lieu of the pipeline subsidiaries; (2) the interest of SFSP in these pipelines (held indirectly, through subsidiaries) would be reduced to approximately 44%; and (3) the balance of the ownership would be sold to the general public as limited partnership interests, called Units, in a master limited partnership (MLP), a Delaware limited partnership, which would own all of the limited partnership interests in the operating partnership.

To accomplish this reorganization and recapitalization, a number of intermediate acts must be taken, and these are described in greater detail below. Each of these intermediate acts would be accomplished sequentially, but virtually contemporaneously, at the time the restructuring is finally implemented.

Corporate Restructure

The current corporate ownership structure of the SFSP pipelines can be diagrammed as follows:

TABLE I

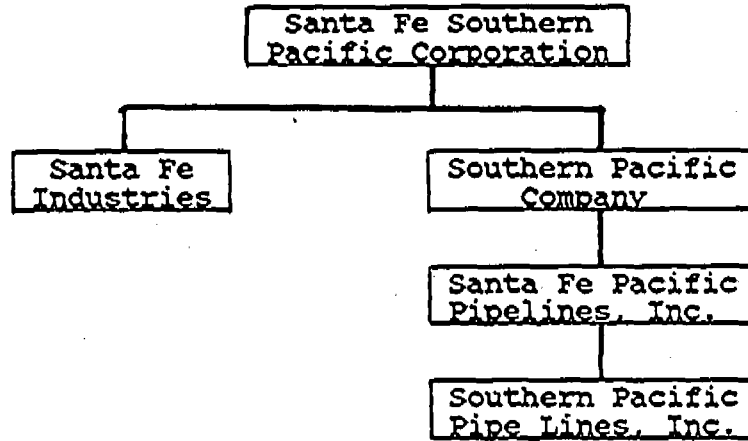


* Despite the name these are not pipeline companies at this time.

The proposed restructuring calls, in passing, for the transfer of stock and mergers between various of the above shown companies, including the merger of San Diego Pipeline Company into Southern Pacific Pipe Lines, Inc.¹ At that point in time all the pipelines will be owned by Southern Pacific Pipe Lines, Inc. and the corporate hierarchy will be as follows:

1 The booked cost of the Southern Pacific Pipe Lines, Inc. system as of July 31, 1988 is \$303,019,115.91. The original cost of the Southern Pacific Pipe Lines, Inc. system as of July 31, 1988 is \$404,370,942.57. The booked cost of the San Diego Pipeline Company as of July 31, 1988 is \$42,633,494.34. The original cost of the San Diego Pipeline Company as of July 31, 1988 is \$52,273,114.50.

TABLE II



Next, the restructuring plan calls for Southern Pacific Pipelines, Inc. to assume \$350 million of debt of SFSP. This \$350 million is part of an approximate \$4 billion outside borrowing made by SFSP, the proceeds of which were used for paying a special dividend to SFSP stockholders. Applicant states that the \$350 million assumption of indebtedness may be considered to be the equivalent of borrowing by the pipeline corporations to reimburse their treasury for previous capital expenditures made from income Southern Pacific Pipe Lines, Inc. used such funds to repay its parents for sums previously supplied for the construction and operation of the pipelines and for retained earnings not previously withdrawn by the parents. Applicant contends that the assumption, taken together with the additional steps in the restructuring, is essential in order to provide a new and more balanced capital structure for the operating partnership.

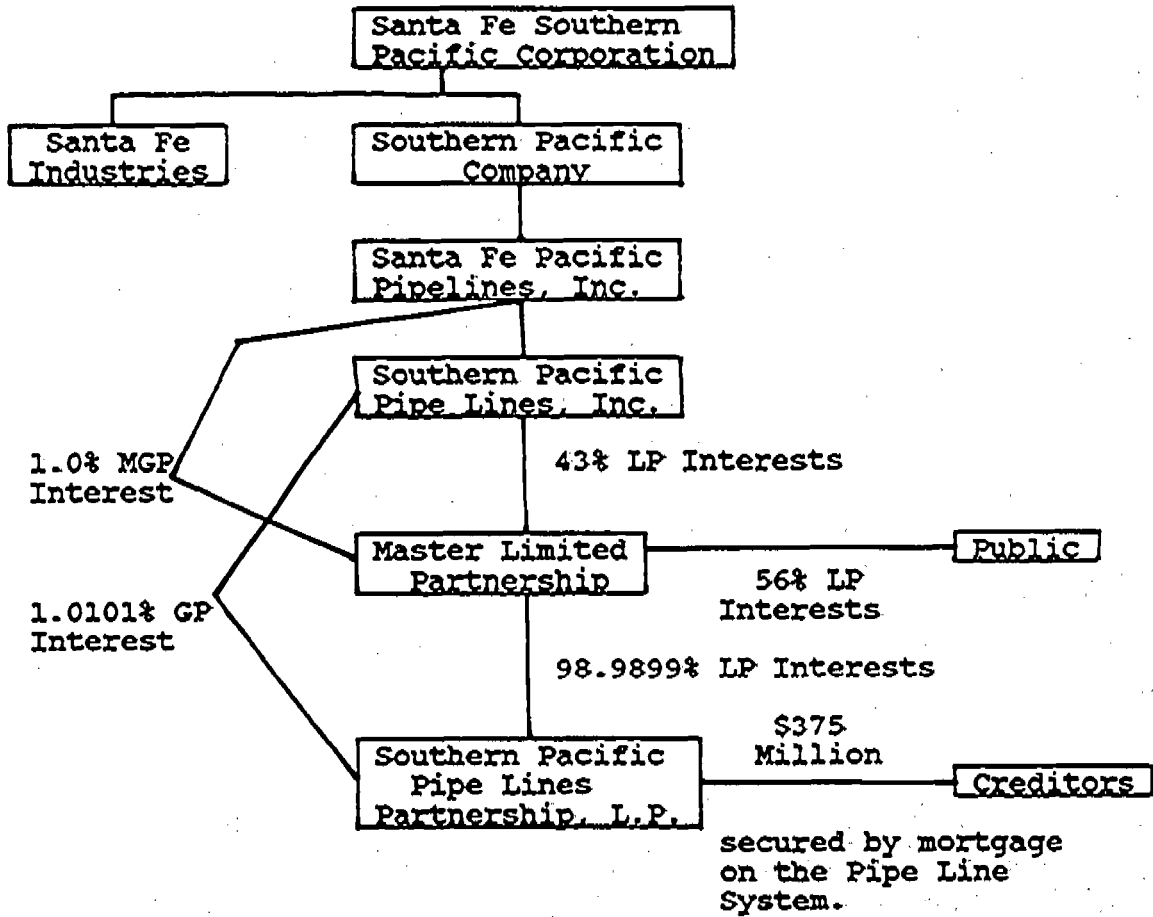
Partnership Formation and Capitalization

The next step involves setting up the MLP and the operating partnerships.

The final partners in the MLP will be Santa Fe Pacific Pipelines, Inc., which will hold a 1% general partnership interest and Southern Pacific Pipe Lines, Inc. which will hold a 43% limited partnership interest represented by limited partnership common units. The remaining 56% partnership interest in MLP will be sold to the public, as substituted limited partners, in limited partnership interest preference units, of which there will be 10,000,000 such units to be sold at approximately \$20 per unit, the proceeds of which will be turned over to the operating partnership.

The general partner in the operating partnership will be Southern Pacific Pipe Lines, Inc., which will own a 1.0101% general partnership interest. The other partner in the operating partnership will be the MLP, which will own a limited partnership interest of 98.9899%. This 98.9899% limited partnership interest will be contributed by Southern Pacific Pipe Lines, Inc. to MLP at the conclusion of a transaction wherein Southern Pacific Pipe Lines, Inc. will have contributed approximately an undivided 82% interest in substantially all of its assets (consisting principally of the pipelines) to the operating partnership in exchange for (1) the 98.9899% general and limited partnership interest in the operating partnership, (2) the agreement by the operating partnership to pay the \$350 million of indebtedness assumed by Southern Pacific Pipe Lines, Inc., and (3) to pay \$80 million of additional debt of Southern Pacific Pipe Lines, Inc. related to the West Line of the expansion project, in each instance such debt being associated with assets contributed by the pipeline corporations to the operating partnership (a total of \$430 million in indebtedness would be assumed by the operating partnership in this step in the transaction). The application states that the asset value to be conveyed by Southern Pacific Pipe Lines, Inc. to the operating partnership is approximately \$723 million. The ownership structure of the pipelines upon completion of restructuring is shown by Table III as follows:

TABLE III



Next, the operating partnership would borrow \$375 million in a privately placed lending transaction and would issue one or more promissory notes in connection with that borrowing. The purpose of this borrowing is to enable payment of part of the \$430 million of indebtedness which has been assumed by Southern Pacific Pipe Lines, Inc. and thereafter by the operating partnership. The precise terms and conditions of the borrowing will be arrived at the time of the actual transaction. In connection with the borrowing, the operating partnership may be required to encumber its assets by a mortgage or deed of trust and security interest thereon. Applicants request that the Commission authorize the issuance of notes or other evidences of this indebtedness and consent to the mortgaging by the operating partnership of its assets, pursuant to Sections 818 and 851 of the Code.

Next, the operating partnership would pay the \$430 million of indebtedness previously assumed by it. Funds for this payment will come from the borrowing of \$375 million discussed above, and from the contribution of approximately \$200 million from the MLP which the MLP obtained from the sale of its 10 million preference shares. Applicants believe that this payment does not require approval of the Commission, but notes it here for the information of the Commission.

Finally, the operating partnership would purchase, for approximately \$133 million, the undivided interest in the pipeline companies then owned by Southern Pipe Lines, Inc. Applicants allege the price is the estimated fair market value of the assets, which price will be subject to adjustment.

The capitalization of the MLP and the operating partnership, as previously described, was planned so that they will have debt/equity structures which are appropriate to a publicly held entity. As wholly-owned subsidiaries in the SFSP corporate family, the pipeline corporation had borrowed internally as needed and have reflected no long-term debt on their balance sheets. Applicants

contend this 100% equity capitalization is not customary for a publicly-held company or partnership. Consistent with this, the operating partnership will have a capital structure which includes debt equal to (a) a pro rata share of the parent company's debt, based on the pipeline company's share of the value of all SFSP assets and (b) a portion of the leveraged cost of certain expenditures being undertaken in the near term to expand and improve pipeline capacity.

The proposed transaction is part of a continuing program by SFSP to structure its transportation, natural resources, and real estate businesses in a more efficient manner and achieve greater value for its shareholders. In recent years, many large U.S. corporations have achieved these goals by placing some or all of their business activities in publicly traded MLPs. For example, in 1986, SFSP placed many of its oil and gas producing properties in Santa Fe Energy Partners, L.P., which is now traded on the New York Stock Exchange. Companies other than SFSP have established MLPs in the petroleum pipeline business. Two examples are Buckeye Partners, L.P. and Permian Partners, L.P., which commenced trading on the New York Stock Exchange in 1986 and 1987, respectively.

The Pro Forma Combined Balance Sheet of the combined partnerships as of June 30, 1988 show that an upward adjustment of \$194,299.00 will be made in the value of the pipeline system upon its being taken over by the operating partnership.

The application states that there will be no change in the service, management, or tariffs of the pipelines occasioned by the restructuring proposed herein.

Resolution No. F-616(2) of the Commission states:
"Requests for exemption from the rule (regarding competitive bidding for debt issues) will only be entertained for debt issues in excess of \$200 million, and will only be granted upon a compelling showing by a utility that because of the size of the

issues an exemption is warranted." Applicants request such an exemption on the basis stated in the resolution.

The application seeks approval for issuance by the operating partnership of up to \$375 million in debt (\$355 million if the underwriters' over-allotment option is fully exercised). Because of the size of that borrowing, the applicants and their financial advisors determined that competitive bidding was impractical. Instead, inquiries regarding the transaction were sent to approximately 200 lenders. Each lender was given a range of incremental amounts, maturity dates and interest rate targets acceptable to the applicants. The responses were analyzed and compared to each other which resulted in identification of 38 participating lenders. With each of these lenders, the applicants have negotiated identical terms except for maturity dates, interest rates and principal amounts.

In the opinion of the applicants and their financial advisors, the commitments obtained from the 38 lenders represent the most competitive and lowest cost arrangement for the proposed indebtedness.

Discussion

On pages 44, 52, and 53 of Exhibit B of the application it shows that the book value of the property, plant, and equipment of the pipelines group is to be increased by \$194,299,000 in the transfer to the newly formed operating partnership. This treatment of the assets is contrary to the long-standing policy of this Commission. When a utility subject to the Commission's jurisdiction acquires the assets at a purchase price above original cost, for ratemaking purposes, we recognize the value of the assets only at original cost, less accumulated depreciation. We will not deny the Application, however, on the basis of this discrepancy in the pro forma accounting submitted by applicants, since approval of rates is not being sought at this time.

Further, the pro forma accounting of the transfer of assets as submitted by applicants does not appear to be in accord with the rules of the Federal Energy Regulatory Commission:

"Property acquired from an affiliated company through purchase or transfer shall be recorded together with the related accrued depreciation and liabilities assumed, if any, in the appropriate property accounts at the same amount that it was recorded on the books of the affiliate. When the purchase price exceeds the net book value of the property acquired, the difference shall be charged to retained income." (18 CFR 352, paragraph 3-1(c).)

Applicant is placed on notice that the Commission, by this decision, does not find the resulting capital structure for the reorganized pipeline utility is reasonable for ratemaking purposes. In future rate proceedings for applicant, the Commission may impute a capital structure more consistent with other comparable utilities.

Applicant is further placed on notice that the Commission, by this decision, does not find the resulting balance sheet valuation of utility property is reasonable for ratemaking purposes. Nor does the Commission depart from historical cost rate regulation for applicant in this proceeding.

Findings of Fact

1. Applicants Southern Pacific Pipe Lines, Inc. and San Diego Pipeline Company are each pipeline corporations owned indirectly by SFSP.
2. Applicants seek approval of various steps in connection with a restructuring of the pipeline business of SFSP.
3. The reorganization steps would be accomplished sequentially, but virtually contemporaneously, at the time the restructuring is finally implemented.
4. Table I in the body of this opinion shows the present corporate set up of the pipeline corporations in relation to SFSP.

5. The restructuring plan calls for the following initial steps to be taken:

- a. Pacific Petroleum Pipe Lines, Inc. to be merged into Southern Pacific Company.
- b. Transfer of Santa Fe Pacific Pipelines, Inc. stock by Santa Fe Industries to Southern Pacific Company through SFSP.
- c. Contribution of 50% of stock of San Diego Pipeline Company by Southern Pacific Company to Santa Fe Pacific Pipelines, Inc.
- d. Contribution by Southern Pacific Company of the stock of Southern Pacific Pipe Lines, Inc. to Santa Fe Pacific Pipelines, Inc.
- e. Merger of San Diego Pipeline Company into Southern Pacific Pipe Lines, Inc.

6. Table II shows the corporate set up upon completion of the proposed corporate restructuring plans.

7. Upon completion of the steps outlined in Finding 5e., all the pipeline assets and liabilities will be in the name of Southern Pacific Pipe Lines, Inc.

8. The stock transfers and mergers outlined in Finding 5a. through 5e., are not adverse to the public interest.

9. The restructuring plans next call for the formation of the following partnerships:

- a. The MLP's general partner will be Santa Fe Pacific Pipelines, Inc. with a 1% interest and the limited partners will be Southern Pacific Pipe Line, Inc. with a 43% interest and members of the public who will have purchased a total of 56% substituted limited partnership interest.
- b. The operating partnership, whose general partner will be Southern Pacific Pipe Lines, Inc. with a 1.0101% interest and whose limited partner will be MLP with a 98.9899% interest. ✓

10. Upon the formation of the operating partnership, Southern Pacific Pipe Lines, Inc. will transfer the pipeline system to the operating partnership.

11. Limited partnership interests in MLP in the form of preference units, will be sold to the public. There will be approximately 10 million units to be sold for approximately \$20 per unit, the proceeds of such sale to be given to the operating partnership as part of the consideration for MLP's limited partnership interest in the operating partnership.

12. The restructuring, including the sale of substitute limited partnership interests to the public, as set out in Findings 9, 10, and 11 are not adverse to the public interest.

13. The assumption of the \$350 million debt by Southern Pacific Pipe Lines, Inc. and the agreement by the operating partnership to pay such debt is in recognition of the sums previously supplied by the pipeline companies' parents for the construction and operation of the pipelines and for retained earnings of the pipeline companies not previously withdrawn by the parents.

14. The \$80 million debt to be assumed by the operating partnership is associated with assets contributed by Southern Pacific Pipe Lines, Inc. to the operating partnership.

15. Applicants request authority for the operating partnership to borrow approximately \$375 million through the issuance of privately placed promissory notes, bonds or mortgages on its pipelines for the purpose of paying that amount of money described in Findings 13 and 14.

16. The book value of the pipeline property plant and equipment is intended to be increased by \$194,299,000 upon the transfer of the pipeline companies to the operating partnership.

17. The issuance of common and limited partnership preference units in the MLP, which are evidences of ownership of MLP, is for the purpose of reorganizing the capitalization of the pipeline

system on restructuring and is therefore for the purpose stated in PU Code § 817(g).

18. A public hearing is not necessary.

19. It can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment.

20. Applicants' request for a waiver of the Competitive Bidding Rule is based on good cause.

Conclusions of Law

1. The transfers of stock, mergers, and assumptions of control of the pipelines as set forth in Findings of Fact 5a. through 5e. are for a lawful purpose and should be authorized.

2. The issuance of common and preference units representing equity ownership by the limited partners in the operating partnership as provided for in the application is for a lawful purpose and should be authorized.

3. The transfer of the pipeline system from Southern Pacific Pipe Lines, Inc. to the operating partnership is for a lawful purpose and should be authorized.

4. The assumption of the \$350 million debt by Southern Pacific Pipe Lines, Inc. and the agreement of the operating partnership to pay that debt is for a lawful purpose.

5. The assumption by the operating partnership of the \$80 million debt of Southern Pacific Pipe Lines, Inc. is for a lawful purpose.

6. The issuance of notes, etc. by the operating partnership as requested in the application is for a lawful purpose pursuant to PU Code § 817(f).

7. The issuance of limited partnership interest in the operating partnership to Southern Pacific Lines, Inc. and the transfer of such interest to the MLP as proposed in the application is for a lawful purpose and should be authorized.

8. Applicants' request that the operating partnership be exempted from the Commission's Competitive Bidding Rule for debt issue should be granted.

9. The two amendments to the application do not enlarge or alter the requests contained in the original application but merely offer argument in support of the original application and therefore do not extend the original protest period.

This authorization is not a finding of the value of the rights and properties to be transferred.

ORDER

IT IS ORDERED that:

1. The transfers of stock, mergers, and assumptions of control set forth in Findings of Fact 5a. through 5e. are authorized.

2. The assumption of up to \$350 million of the indebtedness of Santa Fe Southern Pacific Corporation by Southern Pacific Pipe Lines, Inc. is approved.

3. The contribution by Southern Pacific Pipe Lines, Inc. of an undivided approximately 83% interest in substantially all of its assets to the Southern Pacific Pipe Lines Partnership, L.P. (the operating partnership) in exchange for a 1.0101% general partner interest and 98.9899% limited partnership interest in the operating partnership and the agreement by the operating partnership to pay up to \$350 million of indebtedness assumed by Southern Pacific Pipe Lines, Inc. and to pay up to \$80 million of additional Southern Pacific Pipe Lines, Inc. debt is approved.

4. The issuance by the operating partnership to Southern Pacific Pipe Lines, Inc. of evidence of the ownership by the latter of said partnership interests is approved.

5. The operating partnership's borrowing of up to \$375 million for the purpose of capitalizing the partnership and discharging or lawfully refunding its obligations is approved.

6. The encumbrance of the operating partnership's assets by a mortgage or deed of trust and security interest thereon as may be required in connection with the borrowing of up to \$375 million by the operating partnership is approved.

7. The operating partnership's borrowing of up to \$375 million is exempt from the requirements of the Commission's Competitive Bidding Rule and may be placed on a negotiated basis.

8. Applicants shall apply the proceeds of the indebtedness authorized for the purposes specified in the application.

9. The contribution of limited partnership interest of Southern Pacific Pipe Lines, Inc. in the operating partnership to the master limited partnership in exchange for limited and general partnership interests therein is approved.

10. The sale by Southern Pacific Pipe Lines, Inc. to the operating partnership of the remaining approximately 17% undivided interest in the pipeline systems for approximately \$128 million is approved.

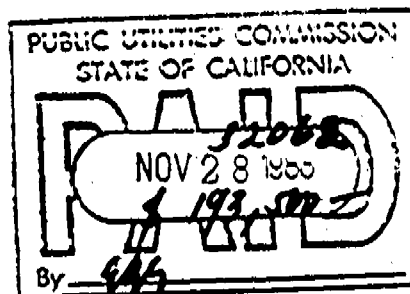
11. Applicants shall pay a fee in the amount of \$193,500 set by Public Utilities (PU) Code § 1904(b).

12. The application is granted as set forth above.

13. Authority granted by this order to issue debt will become effective when applicants pay the fee set by PU Code § 1904(b). In all other respects, this order is effective today.

Dated NOV 23 1988, at San Francisco, California.

STANLEY W. FULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OKANIAN
Commissioners



I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.

[Signature]
Victor W. Winters, Executive Director

Next, the operating partnership would borrow \$375 million in a privately placed lending transaction and would issue one or more promissory notes in connection with that borrowing. The purpose of this borrowing is to enable payment of part of the \$430 million of indebtedness which has been assumed by Southern Pacific Pipe Lines, Inc. and thereafter by the operating partnership. The precise terms and conditions of the borrowing will be arrived at the time of the actual transaction. In connection with the borrowing, the operating partnership may be required to encumber its assets by a mortgage or deed of trust and security interest thereon. Applicants request that the Commission authorize the issuance of notes or other evidences of this indebtedness and consent to the mortgaging by the operating partnership of its assets, pursuant to Sections 818 and 851 of the Code.

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7. Upon completion of the steps outlined in Finding 5e., all the pipeline assets and liabilities will be in the name of Southern Pacific Pipe Lines, Inc.

8. The stock transfers and mergers outlined in Finding 5a. through 5e., are not adverse to the public interest.

9. The restructuring plans next call for the formation of the following partnerships:

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11. Limited partnership interests in MLP in the form of preference units, will be sold to the public. There will be approximately 10 million units to be sold for approximately \$20 per unit, the proceeds of such sale to be given to the operating partnership as part of the consideration for MLP's limited partnership interest in the operating partnership.

12. The restructuring, including the sale of substitute limited partnership interests to the public, as set out in Findings 9, 10, and 11 are not adverse to the public interest.

13. The assumption of the \$350 million debt by Southern Pacific Pipe Lines, Inc. and the agreement by the operating partnership to pay such debt is in recognition of the sums previously supplied by the pipeline companies' parents for the construction and operation of the pipelines and for retained earnings of the pipeline companies not previously withdrawn by the parents.

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15. Applicants request authority for the operating partnership to borrow approximately \$375 million through the issuance of privately placed promissory notes, bonds or mortgages on its pipelines for the purpose of paying that amount of money to SFSP described in Finding 13.

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