

ORIGINAL



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MEMORANDUM

TO: Docket Control Center

FROM: Steven M. Olea
Director
Utilities Division

DATE: November 29, 2012

RE: SEMSTREAM ARIZONA PROPANE, L.L.C. – NOTICE OF INTENT TO REORGANIZE PURSUANT TO A.A.C. R14-2-803, OR, ALTERNATIVELY, APPLICATION FOR A LIMITED WAIVER OF THE AFFILIATED INTEREST RULES PURSUANT TO A.A.C. R14-2-806 (DOCKET NO. G-20471A-12-0425)

Attached is the **REDACTED** version Staff Report for SemStream Arizona Propane, L.L.C. application for a notice of intent to reorganize pursuant to A.A.C R14-2-803 or, alternatively, application for a limited waiver of the affiliated interest rules pursuant to A.A.C. R14-2-806. Staff further recommends that a hearing should not be held in this matter.

SMO:BEK:kdh

Originator: Barbara Keene

Arizona Corporation Commission
DOCKETED

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***Confidential information has been deleted

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Docket No.: G-20471A-12-0425

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

SEMSTREAM ARIZONA PROPANE, L.L.C.

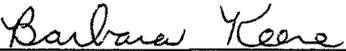
DOCKET NO. G-20471A-12-0425

**APPLICATION FOR A NOTICE OF INTENT TO REORGANIZE PURSUANT TO
A.A.C. R14-2-803, OR, ALTERNATIVELY, APPLICATION FOR A LIMITED WAIVER
OF THE AFFILIATED INTEREST RULES PURSUANT TO A.A.C. R14-2-806**

NOVEMBER 29, 2012

STAFF ACKNOWLEDGMENT

The Staff Report for SemStream Arizona Propane, L.L.C., Docket No. G-20471A-12-0425, was the responsibility of the Utilities Division Staff listed below. Barbara Keene was responsible for the review and analysis of SemStream Arizona Propane, L.L.C. application for a notice of intent to reorganize pursuant to A.A.C R14-2-803 or, alternatively, application for a limited waiver of the affiliated interest rules pursuant to A.A.C. R14-2-806.



Barbara Keene
Public Utilities Analyst Manager

EXECUTIVE SUMMARY
SEMSTREAM ARIZONA PROPANE, L.L.C.
DOCKET NO. G-20471A-12-0425

On October 1, 2012, SemStream Arizona Propane, L.L.C. (“SemStream Arizona”) filed an application for a limited waiver of the Affiliated Interest Rules pursuant to A.A.C. R14-2-806 or, alternatively, for Commission approval of a reorganization of SemStream Arizona in which Alliant Gas, L.L.C. (“Alliant”) will acquire all of the issued and outstanding units of membership in SemStream Arizona from SemStream Arizona’s direct parent, SemStream, L.P.

SemStream Arizona is a Delaware limited liability company that provides underground propane gas utility service to the public in and around Payson and Page and currently serves approximately 9,000 customers. SemStream Arizona is a wholly-owned subsidiary of SemStream LP, which is a Delaware limited partnership. SemStream LP is, in turn, a subsidiary of SemGroup Corporation, a Delaware corporation. SemGroup is a publicly-traded company that provides gathering, transportation, processing, storage, distribution, marketing and other midstream services primarily to independent oil and natural gas producers, refiners of petroleum products and other market participants located in the Mid-Continent and Rocky Mountain regions of the United States and internationally. SemStream Arizona’s retail propane operations are the only such operations that SemGroup indirectly holds. SemGroup has made a strategic decision to sell these propane operations, so it can concentrate on the midstream petroleum market.

Alliant is a Texas limited liability company that provides underground propane service to residential and commercial developments in several communities in Texas where natural gas is not available. Alliant is a wholly-owned subsidiary of Pinnacle Propane, L.L.C., a Texas limited liability company, which operates traditional retail propane delivery services. Pinnacle, in turn, is a subsidiary of JP Energy Partners LP, a Delaware limited partnership. Pinnacle is one of the 15 largest propane distributors in the United States and has a significant number of metered gas distribution systems throughout the country. JP Energy distributes approximately 50 million gallons of propane annually through Alliant and Pinnacle. Alliant Gas has over 2,500 customers while Pinnacle serves between 25,000 and 30,000 customers.

Staff’s analysis indicates that Alliant Gas is a proper and fit entity to acquire all of the issued and outstanding units of membership in SemStream Arizona and retain its CC&N. Alliant has adequate resources and management expertise to operate propane distribution in Arizona. Staff’s investigation indicates that Pinnacle is a major distributor of propane in the gas industry and that its vast assets could benefit Alliant Gas’ prospective customers in and around the towns of Payson and Page.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
BACKGROUND.....	1
TRANSACTION	2
STAFF ANALYSIS	3
PIPELINE SAFETY ISSUES.....	4
CONSUMER SERVICE ISSUES	4
PUBLIC NOTICE	4
RECOMMENDATIONS	5

Introduction

On October 1, 2012, SemStream Arizona Propane, L.L.C. (“SemStream Arizona”) filed an application with the Arizona Corporation Commission (“Commission”) for a limited waiver of the Affiliated Interest Rules pursuant to A.A.C. R14-2-806 or, alternatively, for Commission approval of a reorganization of SemStream Arizona in which Alliant Gas, L.L.C.. (“Alliant”) will acquire all of the issued and outstanding units of membership in SemStream Arizona from SemStream Arizona’s direct parent, SemStream, L.P. (“SemStream LP”)

Background

SemStream Arizona Propane, L.L.C.

SemStream Arizona is a Delaware limited liability company that provides underground propane gas utility service to the public in and around Payson and Page, Arizona pursuant to Commission Decision Nos. 69394 (March 22, 2007) and 69579 (May 21, 2007). SemStream Arizona is a wholly-owned subsidiary of SemStream LP, which is a Delaware limited partnership. SemStream LP is, in turn, a subsidiary of SemGroup Corporation, a Delaware corporation (“SemGroup”). SemGroup is a publicly-traded company (NYSE: “SEMC”) that provides gathering, transportation, processing, storage, distribution, marketing and other midstream services primarily to independent oil and natural gas producers, refiners of petroleum products and other market participants located in the Mid-Continent and Rocky Mountain regions of the United States and internationally.

SemStream Arizona currently serves approximately 9,000 customers in the Page and Payson areas. SemStream Arizona's customers receive their propane delivered through metered underground systems or with leased tanks and metered-tank service. SemGroup states that its focus is on a variety of midstream services, primarily to oil and natural gas producers, refiners and other petroleum market participants. SemStream Arizona’s retail propane operations are the only such operations that SemGroup indirectly holds. SemGroup has made a strategic decision to sell these propane operations, so it can concentrate on the midstream petroleum market.

Alliant Gas, L.L.C.

Alliant is a Texas limited liability company that provides underground propane service to residential and commercial developments in several communities in Texas where natural gas is not available. Alliant is a wholly-owned subsidiary of Pinnacle Propane, L.L.C., a Texas limited liability company (“Pinnacle”), which operates traditional retail propane delivery services. Pinnacle, in turn, is a subsidiary of JP Energy Partners LP, a Delaware limited partnership (“JP Energy”). Pinnacle is one of the 15 largest propane distributors in the United States and has a significant number of metered gas distribution systems throughout the country. JP Energy distributes approximately 50 million gallons of propane annually through Alliant and Pinnacle.

Alliant has substantial experience in operating underground propane distribution systems which are similar to SemStream Arizona's Payson and Page systems. Alliant currently serves over 18 communities in the San Antonio-Austin areas with over 2,500 customers and distributes approximately 2 million gallons of propane a year. Also, Alliant is a subsidiary of Pinnacle, which is one of the largest propane distributors in the country. Pinnacle has between 25,000 and 30,000 customers and distributes approximately 33 million gallons of propane a year. JP Energy also owns Pinnacle Propane Express which has approximately 15,500 customer locations and distributes approximately 15 million gallons annually.

Transaction

On September 12, 2012, SemStream LP and Alliant executed a purchase and sale agreement under which Alliant will acquire from SemStream LP all of the issued and outstanding units of membership interest in SemStream Arizona. Pursuant to the agreement, Alliant will also purchase certain non-regulated assets held by SemStream LP. The transfer of units to Alliant will integrate SemStream Arizona into a corporate structure similar to its current position under the SemGroup structure in that SemStream Arizona will remain a wholly-owned subsidiary within a larger organization. After the transaction is completed, SemStream Arizona will change its name, but its personnel and operations will remain the same in all material respects.

The purchase price for the units in SemStream Arizona is approximately \$9.2 million and, subject to adjustment, will be paid to SemStream LP at closing. After the transaction closes, SemStream Arizona will remain the same legal entity, except that it will be a subsidiary of Alliant rather than SemStream LP. The transaction does not involve the sale, lease, assignment, encumbrance, transfer or conveyance of any of SemStream Arizona's used and necessary plant, assets, revenue or property.

Additionally, pursuant to the terms of the September 12, 2012 purchase and sale agreement, the purchase price to be paid to SemStream LP is subject to the following downward adjustments, depending upon the timing of the transaction's closing:

- a) After November 30, 2012, but on or before January 31, 2013, \$250,000;
- b) After January 31, 2013, but on or before March 31, 2013, \$500,000; and
- c) After March 31, 2013, \$1,000,000.

In the course of conducting its due diligence on the transaction, Alliant did not identify any portion of the Page or Payson operations that are overstaffed or in need of any change in workforce. Accordingly, Alliant anticipates retaining all positions in the Payson and Page divisions after its acquisition of SemStream Arizona. Alliant has said it may increase employment in both Payson and Page as it sees plenty of growth opportunities in the areas. This

will assist in assuring a smooth transition and the uninterrupted provision of safe and reliable propane service to current and prospective customers.

Staff Analysis

As mentioned previously, SemGroup's focus is on a variety of midstream services, primarily to oil and natural gas producers, refiners and other petroleum market participants. SemStream Arizona's retail propane operations are the only such operations that SemGroup indirectly holds. SemGroup has made a strategic decision to sell these propane operations, so it can concentrate on the midstream petroleum market. In turn, the acquisition of SemStream Arizona's membership units by Alliant is very consistent with Alliant's existing propane profile and JP Energy's goal of targeted propane growth and geographic diversity.

Alliant has indicated that the current transaction will not impair SemStream Arizona's access to necessary capital or its access to necessary propane supplies. Alliant is part of the JP Energy structure, and SemStream Arizona will have access to significant capital resources and experience in the energy and capital markets and propane delivery. JP Energy also has established partnerships with numerous lending institutions and its credit facility provides significant flexibility for access to capital at fair and reasonable rates. [REDACTED]

The Purchase Agreement provides for a purchased price of \$9.2 million, subject to adjustment, and will be paid to SemStream LP at closing. SemStream LP is also subject to downward adjustments, depending upon the timing of the transaction's closing. As of December 31, 2011, SemStream Arizona's Payson division had an approximate book value of \$14.2 million and the Page division had a book value of \$2.3 million. Based on the tentative figures, it appears that the sale of the SemStream Arizona would result in a loss. However, in the event that this transaction results in a net gain to SemStream LP or an acquisition adjustment to SemStream Arizona, Staff recommends that the JP Energy LP's shareholders be responsible for the net impact of this transaction, and that Arizona ratepayers be held harmless.

Ordinarily, the Commission does not permit recovery of any acquisition adjustment arising from a sale of assets or stock, especially, when the Applicants have not demonstrated any extraordinary circumstances compelling this transaction. Accordingly, Staff recommends that any acquisition adjustment arising from this transaction be absorbed by the shareholders of SemStream Arizona or that the Commission denies SemStream Arizona of any recovery of this acquisition adjustment, in future rate proceedings. However, in the event that the Commission determines it appropriate to defer consideration of the treatment of any acquisition adjustment to a future proceeding, Staff recommends that the Commission require SemStream Arizona to meet the minimum standard for recovery, as espoused in Decision No. 63584. Decision No. 63584 required Arizona-American Water Company to "demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of Citizens' systems that would not have been realized had the transaction not occurred before the Commission would consider recovery of any acquisition adjustment in a future rate proceeding."

[PARAGRAPH REDACTED]

Staff's analysis indicates that Alliant Gas is a proper and fit entity to acquire all of the issued and outstanding units of membership in SemStream Arizona and retain its Certificate of Convenience and Necessity ("CC&N"). Alliant has adequate resources and management expertise to operate propane distribution in Arizona. Staff's investigation indicates that Pinnacle is a major distributor of propane in the gas industry and that its vast assets could benefit Alliant Gas' prospective customers in and around the towns of Payson and Page.

Staff believes that the transfer of membership of SemStream Arizona to Alliant Gas is in the public interest. However, Staff does not believe that a waiver of the affiliated interest rules should be granted. JP Energy is a growing company and has made many acquisitions in the past two years. Staff believes it would be in the Commission's best interest to receive the annual reports required by the affiliate interest rules, since JP Energy has such a broad scope of businesses under its umbrella.

Pipeline Safety Issues

As previously discussed, Alliant Gas intends to retain the current employees of SemStream Arizona upon conclusion of this transaction. The Commission's Pipeline Safety Division reports no pipeline safety issues with the Payson or Page Division.

Staff recommends that SemStream Arizona maintains all procedures and records needed to demonstrate compliance with pipeline safety regulations at the Payson and Page offices.

Consumer Service Issues

Staff's inquiry confirmed that SemStream Arizona was in good standing with the Corporations Division of the Arizona Corporation Commission.

The Consumer Services database shows six complaints dating back to 2009. The complaints were related to billing and service issues. All complaints have been resolved and closed.

Public Notice

Consistent with the Procedural Order in this proceeding, SemStream Arizona noticed its customers on November 14, 2012, that Alliant Gas will acquire all of the issued and outstanding units of membership interest in SemStream Arizona from its current parent company, SemStream, L.P. Notices were also published in *Payson Roundup* on November 9 and in the *Arizona Daily Sun* on November 12.

Recommendations

Staff recommends the approval of a reorganization of SemStream Arizona or successor name of entity in which Alliant Gas, L.L.C. will acquire all of the issued and outstanding units of membership in SemStream Arizona from SemStream Arizona's direct parent, SemStream, L.P. subject to the following conditions:

1. That SemStream Arizona retains the tariff, rates and charges approved by the Commission in Decision No. 73160 for the Payson Division and in Decision No. 66101 for the Page Division, pending conclusion of a future rate case.
2. That SemStream Arizona maintain a separate accounting record for both the Payson and Page Divisions and retain copies of the related books and records in Arizona.
3. That SemStream Arizona and its parents make available to Staff their books and records, upon request during a rate case or other proceedings.
4. That SemStream Arizona shall not seek regulatory recovery of any costs arising from this transaction in a future rate proceeding.
5. That the Commission deny SemStream Arizona recovery of any acquisition adjustment resulting from this transaction.
6. That if the Commission decides to defer consideration of regulatory recovery of acquisition costs and acquisition adjustment in a future proceeding, that SemStream Arizona be required to "demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of the Page and Payson Divisions' systems that would not have been realized had the transaction not occurred, before the Commission would consider recovery of any acquisition adjustment in a future rate proceeding."
7. That SemStream Arizona maintains adequate level of staffing, including qualified technical personnel, sufficient to avoid degradation of service to its customers in Arizona.
8. That SemGroup Corporation assumes full responsibility for any gain or loss arising from the reorganization SemStream Arizona.
9. That SemStream Arizona complies with all Commission rules, orders and other requirements relevant to the provision of service in Arizona.
10. That SemStream Arizona file timely financial and other reports required by the Commission in the proper format.

SemStream Arizona Propane, L.L.C.

Docket No. G-20471A-12-0425

Page 6

11. That SemStream Arizona maintain all procedures and records needed to demonstrate compliance with pipeline safety regulations at the Payson and Page offices.