STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

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TO PARTIES OF RECORD IN APPLICATION 21-02-013:

This is the proposed decision of Administrative Law Judge Charles Ferguson. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's December 15, 2022 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties to the proceeding may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, *ex parte* communications are prohibited pursuant to Rule 8.2(c)(4).

/s/ MICHELLE COOKE
Michelle Cooke
Acting Chief Administrative Law Judge

MLC:sgu

Attachment

Decision **PROPOSED DECISION OF ALJ FERGUSON** **(Mailed 11/10/2022)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Mr. John D. Grier for Authority to Sell and Transfer and CorEnergy Infrastructure Trust, Inc. to Acquire Control of Crimson California Pipeline, L.P. (PLC-26) and San Pablo Bay Pipeline Company, LLC (PLC-29) Pursuant to Public Utilities Code Section 854.	Application 21-02-013

DECISION DENYING JOINT APPLICATION FOR A CHANGE OF CONTROL OF THE CRIMSON PIPELINE, L.P. (PLC-26) AND THE SAN PABLO BAY PIPELINE COMPANY, LLC (PLC-29)

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DECISION DENYING JOINT APPLICATION FOR A CHANGE OF CONTROL OF THE CRIMSON PIPELINE, L.P. (PLC-26) AND THE SAN PABLO BAY PIPELINE COMPANY, L.L.C (PLC-29)

Summary

This decision denies the Application of Mr. John D. Grier for Authority to Sell and Transfer and CorEnergy Infrastructure Trust, Inc. to Acquire Control of Crimson California Pipeline, L.P. (PLC-26) and San Pablo Bay Pipeline Company, LLC (PLC-29), Application 21-02-013.

Application 21-02-013 is closed.

1. Background

The salient aspects of this joint application and the proposed transaction are as follows.

1.1. Pre-Filing Background

Two years before the filing of the instant Application (A.) 22-02-013, the Commission, in Decision (D.) 20-01-003, granted permission to a subsidiary of The Carlyle Group L.P. (Carlyle), a large, publicly traded, global, private equity firm listed on the Nasdaq Stock Market, to acquire control of a California pipeline utility that this Commission regulates, Crimson California Pipeline, L.P. (Crimson California). At the time of that decision, Crimson California was indirectly, partly owned by Carlyle but exclusively controlled by its majority shareholder, John Grier, one of the Joint Applicants in that proceeding as well as this one.

The proposed change of control the Commission authorized in D.20-01-003 was never consummated. Instead, Carlyle increased its minority equity interest in the indirect parent of Crimson California to 49.5 percent, then sold all its 49.5 percent interest to CorEnergy Infrastructure Trust, Inc. (CorEnergy).

1.2. Application

In A.21-02-013, CorEnergy and John Grier (also referred to herein as Joint Applicants) request permission to change control of Crimson California, the pipeline utility that was the subject of D.20-01-003, as well as its sister pipeline utility, San Pablo Bay Pipeline Company, L.L.C., (hereinafter referred to together as Crimson Utilities) both of which are still exclusively controlled by John Grier. The proposed transaction would transfer exclusive control of the Crimson Utilities to CorEnergy alone.

1.2.1. The Utilities, Their Parent, and the Pipeline Systems Involved

The Crimson Utilities own and operate extensive common carrier crude oil pipeline systems located in southern and northern California including the KLM Pipeline System which is a long-haul pipeline system consisting of approximately 295 miles of pipe running from points in the San Joaquin Valley production area to San Francisco Bay Area refinery connections.

From a corporate structure perspective, the Crimson Utilities are partnerships that are ultimately owned and controlled by Crimson Midstream Holdings, L.L.C. (Crimson Midstream). It is the contractual right to control the Crimson Utilities and the percentage ownership of equity in Crimson Midstream that are the primary focus of the instant proceeding, even though Crimson Midstream is not directly subject to the Commission's jurisdiction.

1.2.2. Applicant CorEnergy, the Buyer

CorEnergy is what is known in the investment world as a real estate investment trust (REIT).

Congress authorized REITs by amending the Internal Revenue Code (IRC) to provide tax-free treatment to the otherwise taxable income of REITs in expectation that REITs would provide Americans of average financial means

opportunities, which they would not otherwise have, to invest safely in large-scale real estate investments. To earn tax-free treatment from the Internal Revenue Service (IRS) at the corporate parent level, a REIT must, first and foremost, make mostly investments in "real estate,"[1] and then distribute at least 90% of its taxable income from those investments to its shareholders.[2] The qualifying streams of a REIT's income pass to the REIT's shareholders free of federal income tax at the REIT's corporate parent's level, hence the return on investment for the REIT's shareholders is greater than it would be for a taxable, non-REIT investment company.

Historically, REITs have built, bought, or financed projects like office buildings, apartment complexes, housing developments or industrial parks and then sold or leased them to others. However, since 2007, a small percentage of REITs have built or bought infrastructure developments, such as LNG terminals, roads, bridges, cellphone towers, wind turbine towers, electric transmission lines, pipelines, or offshore drilling rigs, then sold or leased them to, among

[1] *See* IRC 26 U.S.C. § 856.

[2] *Ibid.* In some instances, due to the failure of a specific stream of income to meet IRS requirements for REIT-treatment, a REIT may be required to have a subsidiary receiving such income pay the full amount of federal tax assessable against the subsidiary, while seeking tax-free treatment for the rest of the parent REIT's qualifying income streams. Here, CorEnergy has represented that if the income it receives from shippers serviced by either of the two Crimson Utilities is ever deemed by the IRS unsuitable for tax-free treatment for any reason, the pipeline(s) will pay the appropriate federal tax. There are various reasons why the IRS may deem the revenue from Crimson Utilities unsuitable for REIT treatment, but those are matters for the IRS.

others, utilities.[3] CorEnergy is one of this unique group of so-called "infrastructure" REITs.[4]

CorEnergy believes it has distinguished itself even further within the infrastructure subset of REITs. Several years before negotiating the transaction before this Commission, CorEnergy launched an effort to obtain a Private Letter Ruling (PLR) from the IRS which eventually, in 2019, resulted in the IRS issuing PLR 201907001. CorEnergy interprets this PLR as allowing it to receive tax-free treatment for income realized from its equity investments in the parent company of the Crimson Utilities, now amounting to 49.5 percent, and subsequently taking control of the Crimson Utilities if approved by this Commission, whereas most, or all, other infrastructure REITs are, until further notice from the IRS, limited to tax-free treatment only if they follow one of the traditional investment protocols

[3] In 2007 the IRS issued Private Letter Ruling (PLR) 200725015 explaining that an infrastructure system (an electric transmission line) qualified as a real property asset within the meaning of the IRC, 26 U.S.C. §§ 856(c)(4)(A) and (5)(C) (i.e., the line was real property, not a removable fixture to real property) and that the inquiring REIT's specific activities in relation to leasing the system would not cause income received under the lease of such a system to be treated as other than "rents from real property" under 26 U.S.C. § 856(d) (*i.e.,* REIT income qualifying for tax-free treatment). This marked the beginning of infrastructure REITs. Thereafter, infrastructure REITs could buy, then leaseback, infrastructure originally owned by a utility, as a means of providing a cash infusion to the utility and a dependable stream of lease payments, tax-free to the REIT for it to distribute to its investors.

[4] Prior to 2013, CorEnergy was a non-REIT entity conducting business as a typical "C" corporation. J.A. Exh. 3 (Reschley), at 1, line 13 – at 2, line 17. In 2013, CorEnergy elected to be treated by the IRS as a REIT. *Ibid.* CorEnergy currently owns a FERC-regulated natural gas pipeline along the Mississippi River north of St. Louis. Transcript (Tr.) May 18, 2021, prehearing conference (PHC), at 17, lines 10-15; at 19, lines 9-11. Until 2019/2020, CorEnergy owned additional oil and gas gathering systems in Wyoming and the Gulf of Mexico, however, due to the downturn in demand for petroleum products engendered by the COVID-19 pandemic, CorEnergy was forced to dispose of significant assets prior to initiating this proceeding. J.A. Exh. 6 (Reschley, Mudge and Webb), at 24, line 15 –25, line 7.

for REITs, such as leasing a pipeline to a utility that then operates the pipeline.[5] The meaning of PLR 201907001 is an issue in this proceeding.

By February 2021, CorEnergy was ready to act on what it believes the IRS authorized it to do in PLR 201907001. As noted, after the issuance of D.20-01-003 on January 23, 2020, authorizing Carlyle to acquire control of one of the Crimson Utilities, Carlyle increased its equity interest in Crimson Midstream from 25.1 to 49.5 percent, less than a percentage point from full control.

At this point, however, Carlyle changed its plans for the acquisition. Instead of controlling one of the two California pipeline utilities, Carlyle was now interested in acquiring a company with pipeline facilities in the Gulf of Mexico. As explained in note 4, above, CorEnergy owned underperforming pipeline assets in the Gulf of Mexico from which it wished to free itself. Carlyle was willing to exchange its 49.5 percent interest in Crimson Midstream for 100 percent ownership of certain of CorEnergy's assets in the Gulf of Mexico, provided CorEnergy also pay Carlyle $67 million in cash. Based on its belief that PLR 201907001 permits tax-free REIT-treatment of revenue CorEnergy would receive as dividend payments from an equity investment in Crimson Midstream, CorEnergy was willing to make such an arrangement with Carlyle. The transaction between Carlyle and CorEnergy was consummated on February 4, 2021. Just a few days later, the instant Application was filed with the

[5] PLR 201907001 was issued by the IRS on February 17, 2019, six months before the application by Carlyle for permission to acquire control of one of the two Crimson Utilities, which the Commission granted in D.20-01-003. PLR 201907001 was issued by the IRS in response to a hypothetical inquiry submitted by CorEnergy. The PLR assumes that CorEnergy would either (1) build or buy an offshore drilling rig and lease it to an operator; (2) build or buy an undersea pipeline system and lease it to oil producers; and/or (3) build or buy onshore storage facilities for crude oil and lease space in the storage tanks to users. PLR 201907001 does *not* describe or discuss the prospect of an equity investment by CorEnergy in the parent of Crimson Utilities or the acquisition of control over these two, or any other, state-regulated pipeline utility in the US.

Commission by CorEnergy, joined by Mr. Grier, seeking permission for CorEnergy to gain full control over both Crimson Utilities.

The request presented by the instant Joint Application to approve such a transaction with a REIT is a case of first impression for this Commission.[6]

1.2.3. Applicant John Grier, the Seller

John Grier was the co-applicant with Carlyle in the previous proceeding that culminated in D.20-01-003 and is the co-applicant again here. He is the majority owner of Crimson Midstream and through it, the Crimson Utilities. He currently holds 50.5 percent of the equity in Crimson Midstream. In addition, by the express terms of the current operating agreement for Crimson Midstream, John Grier has sole and exclusive control over the operation and management of the Crimson Utilities.

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[6] Lengthy research has found that only in Texas, on a single occasion, has a state public utilities commission in the US allowed a REIT to control a utility serving a significant portion of the public. In that instance, the Texas commission initially authorized REIT-ownership of a large electric transmission utility. However, four years later, the Texas commission approved the dissolution of the same REIT and sale of its assets to a subsidiary of a traditional, investor-owned, utility holding company, Sempra. *See Joint Report and Application of Oncor Electric Delivery Company LLC, Sharyland Distribution & Transmission Services, L.L.C., Sharyland Utilities, L.P., and Sempra Energy for Regulatory Approvals under PURA §§ 14.101, 37.154,39.262, and 39.915,* 2019 Tex. PUC Lexis 932, at p. 3 ("InfraReit's separate corporate existence will cease after the merger, thus eliminating the current REIT structure"); at p.16, Finding 105 ("The proposed transactions … eliminate the REIT structure currently employed").

The Commission has previously issued Certificates of Public Convenience and Necessity (CPCNs) to telco start-ups where very low barriers for entry ($100,000 capital or a similar guarantee from an affiliate of the applicant) would encourage robust competition in the construction of new, digital segments of the telecommunications infrastructure of our state. An expert witness for the Joint Applicants cited three telco CPCNs that were issued to subsidiaries of REITs as precedent for their application here. J.A. Exh. 3 (Reschley), at 9, lines 15 – 21. One of the CPCNs was never activated. No evidence that either of the other two ever operated was introduced here, much less that they developed into established utility companies that play an important role in the economy of California. Given the absence of evidence that any of these recipients of CPCNs ever played a significant role in California's economy, the issuance of these three CPCNs is not precedent here.

Like the operating agreement the Commission reviewed in D.20-01-003, the current Crimson Midstream operating agreement between John Grier and CorEnergy provides for a four-member board of managers, two of whom are appointed by John Grier and two who are now appointed by CorEnergy, instead of Carlyle.[7] The managers of Crimson Midstream must vote based on the equity ownership of the person or entity appointing them and the managers can be replaced at the will of the person appointing them.[8] Thus, due to his majority equity interest in Crimson Midstream, John Grier has apparent authority to control Crimson Midstream. However, a critical provision in the Crimson Midstream Operating Agreement strengthens John Grier's control over the Crimson Utilities independent of anything else in the agreement. That provision says that "with respect to all decisions regarding the ownership, management and the operation of the assets of Subsidiaries … that are subject to regulation by the California Public Utilities Commission [i.e., the two Crimson Utilities] … *John D. Grier is and shall remain in control of all decisions regarding such assets*."[9] (Emphasis added.)

1.2.4. Mechanics of the Proposed Change of Control

At minimum, what John Grier seeks our permission to do is two things: (i) convey to CorEnergy, enough of his *voting rights* associated with his 50.5 percent equity interest in Crimson Midstream to give CorEnergy apparent control over the Crimson Utilities and (ii) nullify §§ 5.1 (e) (i) and (ii) of the

[7] A.21-02-013, Exhibit A, Third Amended and Restated Limited Liability Company Agreement Crimson Midstream Holdings Company, LLC, (Crimson Midstream Operating Agreement), at § 5.1(a).

[8] *Id.* at §5.1(c).

[9] A.21-02-013, Exhibit A, Crimson Midstream Agreement, at §§ 5.1 (e) (i) and (ii).

Crimson Midstream Operating Agreement. Those two steps would allow CorEnergy to appoint all four members of the board of managers at Crimson Midstream and effectively exercise complete control over the Crimson Utilities. In return, John Grier would receive the right to convert his stock in Crimson Midstream into stock in CorEnergy, at times and in amounts he deems appropriate.[10] If John Grier converts all his holdings in Crimson Midstream to equity in CorEnergy he would become the largest shareholder in CorEnergy and own 40 percent of its equities. CorEnergy represented that it will then transfer all its assets into Crimson Midstream;[11] appoint Mr. Grier to the boards of the Crimson Utilities and CorEnergy (so long as he owns at least 25 percent of CorEnergy's equity); and make an agreed upon cash payment to him.

1.3. Procedural Background

As noted above, approximately a year after the Commission approved the sale of control of Crimson California to Carlyle, on February 4, 2021, Carlyle entered into an agreement to sell its 49.5 percent interest in Crimson Midstream to CorEnergy.[12] On that same day, February 4, 2021, CorEnergy and John Grier, signed the current Crimson Midstream Operating Agreement.[13]

Just days later, on February 9, 2021, the instant Joint Application for permission to change control of both Crimson Utilities to CorEnergy was filed with the Commission.

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[10] CorEnergy's equities trade on the NYSE, whereas Crimson Midstream's equity is not publicly traded at all, it can only be transferred in a private sale. If the change of control is approved, Mr. Grier retains discretion to choose which path to pursue for sale(s) of his equity.

[11] This requires conveying title to a natural gas pipeline that CorEnergy owns in the Midwest.

[12] A.21-02-013, Exhibit G, Purchase Agreement by and among CGI Crimson Holdings, L.L.C., Crimson Midstream Holdings, LLC, John D. Grier, and CorEnergy Infrastructure Trust, Inc.

[13] A.21-02-013, Exhibit A, Crimson Midstream Operating Agreement.

The assigned Commissioner and assigned Administrative Law Judge (ALJ) convened a telephonic PHC on May 18, 2021, attended by representatives from each of the Joint Applicants. No shippers appeared.

The assigned Commissioner issued her scoping memo on August 26, 2021. She confirmed the categorization of the proceeding as "ratesetting" and concluded that formal evidentiary hearings were unnecessary because no shipper, member of the public nor representative of an enforcement branch of the Commission had requested an opportunity to appear in the proceeding to oppose or otherwise object to the proposed change of control.

In the absence of any party appearing in opposition to the proposed transaction, the assigned Commissioner appended a lengthy list of questions to her scoping memo for the Joint Applicants to address and submit in the form of written testimony. She set September 21, 2021, as the date for filing written replies to her questions. At the Joint Applicants' request, the ALJ extended the deadline for filing their prepared testimony to November 23, 2021.

The assigned Commissioner and ALJ convened a remote status conference (STC) on December 8, 2021, to discuss the written testimony submitted by the Joint Applicants. In attendance were the Applicant, John Grier; his counsel James Squeri, Esq.; and two Crimson Utilities executives, Valerie Jackson and Larry Alexander. Co-Applicant, CorEnergy, was represented by its counsel Ronald Liebert, Esq. and CorEnergy's president, David Schulte, who was accompanied by CorEnergy executives Betsy Sandring and Daniel Jackson. Also attending as potential expert witnesses were Robert Mudge and James Zahniser-Word, both employed at the Brattle Group consultancy; James Reschley, Esq., from the Husch Blackwell law firm; and Michael Webb, Ph.D., Vice President of Regulatory Economics Group, LLC.

On February 22, 2022, the ALJ ordered additional information from the Joint Applicants in the form of further written testimony to be prepared and submitted on or before March 31, 2022. The Joint Applicants complied.

On October 11, 2022, by order of the ALJ, all the written testimony and responses to the questions posed by the Commissioner in her scoping memo and the ALJ ruling dated February 22, 2022, were marked for identification and admitted as evidence into the record of this proceeding. On the same date, the ALJ granted Joint Applicants' motion requesting confidential treatment for very limited portions of the prepared testimony.

2. Jurisdiction

The Joint Applicants must first secure Commission authorization for the proposed change of control of a public utility pursuant to Public Utilities Code §§ 701, 851 and 854, before the proposed change in control can occur.

3. Burden of Proof and Standard of Review

3.1. Burden of Proof

This is a ratesetting proceeding.[14] The evidentiary standard in a ratesetting matter is preponderance of the evidence.[15] As the Joint Applicants, John Grier and CorEnergy bear the burden of proof to prove their case for the authorization they seek in the instant Application.

Preponderance of the evidence is defined "in terms of probability of truth, *e.g.*, 'such evidence, when weighed with that opposed to it, has more convincing force and the greater probability of truth'."[16]

[14] Resolution ALJ 176-3473 and Scoping Memo.

[15] *See* D16-12-063, at 9, *citing* D.12-12-030, at 44.

[16] D.12-12-030, at 42, *aff'd* D.15-07-044, at 28-30.

3.2. Public Interest Review Standard

Public Utilities Code § 851, in relevant part, requires Commission approval before a public utility may sell the whole or any part of its property or rights "necessary or useful in the performance of its duties to the public."[17] In addition, § 854(a) requires Commission authorization before any person or corporation may acquire or merge with any public utility.

The Commission has long interpreted §§ 851, *et seq.,* to prohibit acquisitions, mergers, and transfers of control unless the Commission has found the proposed transaction to be in the public interest. Section 854 also sets forth the required findings and required public interest factors the Commission must consider in evaluating whether a proposed transaction is in the public interest.

The Joint Applicants contend that the public interest factors enumerated in §§ 854(b) and (c) do not apply to the proposed change of control.[18] This is not correct.

In D.16-06-014, a change of control decision for the Wild Goose Gas Storage facility, the Commission expressly affirmed that it had "discretion to consider the criteria set forth in §§ 854(b) and (c), that is, criteria included in the 'in the public interest' standard, if … inclined to do so", and it required the Joint Applicants there to "show that the [change of control] is in the public interest."[19]

Likewise, the Commission has acknowledged that while the letter of §§ 851, *et seq*. may not expressly apply to oil pipeline utilities, it has regularly taken into account the public interest factors addressed in these statutes for

[17] Subsequent references to section refer to the Public Utilities Code unless otherwise noted.

[18] Joint Application, at 19 - 20.

[19] D.16-06-014, at 18-19.

guidance when reviewing sales, acquisitions, or mergers of many types of utilities.[20]

Accordingly, this decision will weigh all pertinent public interest considerations as part of its examination of the proposed change of control, including those set forth in §§ 851 *et seq.*

3.3. Public Indifference vs. Tangible Benefits Standards

In weighing the public interest considerations to determine whether the proposed change of control is "in the public interest," there are several Commission decisions applying an "indifference standard," where no harm or adverse impact to the public has been identified.[21] There are also decisions applying a higher bar of "tangible" public benefit,[22] as a standard, with a required showing of tangible benefits that accrue to the public from the proposed transaction.

As applied here, the "indifference" standard means that while the transaction need not meet every requirement in §§ 854(b) and (c), the evidence, when weighed, should demonstrate that there are no negative impacts to the public due to the transfer of control.[23] In other instances, when the Commission has applied a heightened "tangible benefits standard" to determine whether the proposed transaction was in the public interest, the Commission has required the proponents of the proposed transaction to demonstrate affirmatively that

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[20] D.16-11-014, at 10.

[21] D.11-12-007, at 5. As noted, above, in note 17 and accompanying text, in this proceeding, the Joint Applicants contend that the applicable standard is a "not harmful to the public interest" standard as opposed to an "in the public interest" standard.

[22] *Ibid.*

[23] D.01-09-057, at 51-52. (*See* also D.11-12-007, at 6-7.)

"tangible benefit" to the public results from the proposed transaction.[24] Here, as discussed in Section 5.3 of this decision, the Joint Applicants have failed to demonstrate by a preponderance of evidence that the proposed transaction meets either standard.

4. Issues

The threshold issue to be addressed here is: Is the proposed change of control for the Crimson Utilities in the public interest, considering the public interest factors set forth in § 854?[25]

5. Discussion and Analysis

5.1. Preface

Here, care must be exercised by keeping in mind that both the California Public Utilities Code and that portion of the Internal Revenue Code governing REITs bear on this proposed transaction.

Like many states, California's Public Utilities Code is based on the fundamental principle that a state should protect both the personal safety and the pocketbooks of the public ahead of the interests of investors when regulating the delivery of a utility service. On the other hand, the REIT provisions in the IRC are aimed exclusively at bettering the finances of the investing public, particularly investors of moderate means.

Notwithstanding their differing goals, both pieces of legislation work harmoniously with one another whenever a typical REIT protocol is followed, for example, when a REIT acquires ownership of a pipeline or transmission line, then leases the physical line to a utility in the business of transporting

[24] D.16-12-014, at 12.

[25] Two other issues were identified in the scoping memo but are not addressed in this decision, since the denial of the requested relief herein makes those issues moot.

hydrocarbons or electrons. The inclusion of a lease in such business arrangements separates the REIT from all business decisions and risks associated with conducting a utility business, including regulatory oversight by a state.

Thus, this traditional REIT protocol is consistent with the Congressional intent behind the REIT provisions in the IRC, namely, to minimize investment risk for Americans of average means, REITs must restrict themselves to "passive" investments in real property or lose their REIT status.[26] The transaction proposed for our approval in this proceeding is different from the usual REIT protocol described above in a critical way.

5.2. The Proposed Transaction

The Joint Applicants' proposed transaction does not involve leasing of an infrastructure asset by a REIT to a utility. Instead, the Joint Applicants propose a sale of control over two pipeline utilities to the REIT, while noting that if the transaction is approved, the Crimson Utilities would continue to operate exactly as they do now, pursuant to tariffs on file with the Commission. The proposal does not follow the intent of the REIT legislation that the "bulk of [a REIT entity's] income is from passive income sources and not from the active conduct of a trade or business."[27]

Rather than purchasing or building a pipeline to lease to Crimson Utilities, as is a typical REIT protocol, the Joint Applicants propose that CorEnergy will buy control of the Crimson Utilities, by purchasing John Grier's voting rights or actual shares in Crimson Midstream, and then then elect to treat the revenue

[26] House Report No. 2020, reprinted in 1960-2 C.B. 819, 822 - 23 ("[O]ne of the principal purposes of … imposing restrictions on types of income [for] qualifying real estate investment trust[s] is to be sure the bulk of the income is from passive income sources and not from the active conduct of a trade or business.").

[27] *See* note 26, above.

stream from the utilities as REIT-compliant and distribute at least 90 percent of the taxable portion of it to CorEnergy shareholders.

Mechanically, the transactional documents require Mr. Grier to do two things: (1) transfer to CorEnergy his right to vote his shares of Crimson Midstream or the shares themselves and (2) amend the Crimson Midstream Operating Agreement[28] by deleting §§ 5.1 (e) (i) and (ii), which currently assign John Grier the exclusive right to make all decisions regarding the ownership, management and the operation of the Crimson Utilities regardless of how much or how little equity in Crimson Midstream John Grier owns.

As a result, CorEnergy would possess the majority voting position in Crimson Midstream and John Grier and his two representatives on the Crimson Midstream board of managers would be reduced to a minority voting position. In addition, by deleting §§ 5.1 (e) (i) and (ii) from the Crimson Midstream Operating Agreement, which currently bars everyone except John Grier from controlling the Crimson Utilities, control of the operations and strategic decisions for the Crimson Utilities would be transferred to CorEnergy, which up until now has had only a passive, indirect, minority shareholder role with respect to Crimson Utilities.

In short, the transaction is not a customary REIT transaction. Rather, it is an acquisition of a contractual right to control all the activities of the Crimson Utilities and eventually ownership of at least a majority, if not all, of the equity in the indirect parent of the utilities, and thereafter the REIT would be

[28] Application 21-02-013, Exhibit A.

conducting business as a utility, rather than strictly investing in infrastructure that would be leased to a utility.

5.3. Public Interest Review of the Proposed Transaction

As discussed below, the Joint Applicants have failed to demonstrate by a preponderance of evidence that their proposed change of control is "in the public interest." Upon consideration of the public interest factors, including the public impacts, the proposed transaction does not meet either the indifference standard (avoidance of negative impacts to those who may be affected by the transfer of control) or the tangible benefits standard (affirmative showing of tangible benefit to ratepayers resulting from the proposed transaction).

In fact, the record of this proceeding demonstrates that there are at least two glaring aspects of the proposed transaction that present potential negative impacts to the public at large: (i) the IRS has not yet approved this atypical REIT arrangement; and (ii) the financial strength of the acquiring entity is not acceptable. Depending on how CorEnergy might in the future elect to treat the income stream from Crimson Utilities, one or both deficiencies must be corrected before a renewed request for a change of control will be considered. Applicants should note that in any new application correcting the two deficiencies may still be insufficient to meet the aforementioned "tangible benefits" and "public interest" standards.

5.3.1. Compliance with the IRC Has Not Been Demonstrated

The Joint Applicants have made it clear that they want the revenue stream from the shippers served by Crimson Utilities counted as REIT income after the change in control to CorEnergy. However, before their proposed transaction, involving control of long-established utilities, can be approved, the Joint

Applicants must demonstrate that the proposed transaction is lawful.[29] That requires a showing that the arrangement proposed in the Joint Application has been found worthy of REIT treatment by the IRS. If it does not, it would not attract the investors for Crimson that CorEnergy expects; and, more importantly, we will not approve of the transaction.

The Joint Applicants have attempted to prove that the proposed transaction has already been approved by the IRS by putting into evidence IRS Private Letter Ruling PLR 201907001.[30] In their view, this letter releases CorEnergy from the requirement that it only engage in passive investments rather than investments that would give it management and operational control of a business or trade. Hence, CorEnergy believes PLR201907001 establishes that the IRS has approved the type of transaction for which they request approval from this Commission. Joint Applicants urge the Commission to join them in interpreting PLR 201907001 as releasing CorEnergy from the established protocol of buying or building pipelines, transmission lines, or cell towers and leasing them to utilities, a protocol that ensures that a REIT will avoid actively conducting or operating the utility's business.[31] Their proposed application of PLR 201907001 to the transaction presented here is unacceptable for the following reasons.

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[29] *See* D.04-11-019, at 5 ("First, we must determine whether the sale [of utility assets] is lawful").

[30] A corporate taxpayer initially elects REIT status for a source of income and files its tax returns as required by the REIT portion of the IRC. IRS may challenge the election if it disagrees with the taxpayer's election. The taxpayer can reduce the risk of having made an improper election by submitting a request for a private letter ruling from IRS prior to electing REIT status for a source of income, which is the course CorEnergy followed when it requested PLR 201907001.

[31] *See* note 26, above.

First, PLR 201907001 specifically addresses a fact pattern involving the direct purchase of pipelines by CorEnergy and thereafter the lease of those same pipelines.[32] The transaction proposed in this proceeding is far different. It is a proposal to purchase the right to control and manage the operation of a utility pipeline business. There is no proposal by CorEnergy to acquire title to any real property here as there was in PLR 201907001. Instead, CorEnergy proposes to purchase personal property, that is, equities and/or voting rights in Crimson Midstream.

Second, even though it addresses a completely different fact scenario than here, PLR 201907001 strictly follows the Congressional mandate requiring only passive investment by a REIT. PLR 201907001 requires lease contracts between CorEnergy and the shippers on the pipelines described in the PLR. Based on the existence of such leases, the IRS, in the PLR, says only that the revenue from such leases can be treated as tax-free REIT revenue. The ruling is perfectly consistent with the typical REIT protocol of leasing hard assets to a third-party in order to remain passive and not engage in a business or trade. However, there will be no leases here in California because this Commission does not regulate leases, it regulates tariffs and it does not treat tariffs and leases as interchangeable. Furthermore, the Joint Applicants themselves have both acknowledged this reality and repeatedly said that there will be no leases employed by CorEnergy or Crimson Utilities, if their proposed change of control is approved by the

[32] PLR 201907001, at 4 ("Taxpayer [CorEnergy] intends to purchase oil and gas pipelines from unrelated third parties"); and, at 7-8 ("Pipeline Use Agreements will provide the user with the exclusive right to use a fixed portion of … the Pipelines *throughout the term of the lease*") (emphasis added). (Herein, page citations to PLR 201907001 refer to the pages of PLR 201907001 as they appear on the IRS website. A copy of PLR 201907001 with different pagination is included in J.A. Exh. 3 (Reschley), Appendix D.)

Commission.[33] That being the case, a PLR, like PLR 201907001, that follows (i) the Congressional mandate to award tax-free treatment only to income streams from passive investments and (ii) the maxim that leases provide requisite passivity, will not be treated by this Commission as governing the legality of a transaction where leases cannot and will not be used as a means for collecting income.

Accordingly, there is no meaningful similarity between the proposed transaction described in PLR 201907001 and the transaction proposed by the Joint Applicants in the instant proceeding. Instead, there are significant differences that cannot be ignored. PLR 201907001 keeps the important concept of passivity for REITs intact, whereas what CorEnergy proposes to us is a transaction that completely discards the concept of passivity and allows CorEnergy actively to control the Crimson Utilities. Certainly, if the IRS approves of doing away with the core concept that REITs make only passive real estate investments, it would have said so clearly and unmistakably in PLR 201907001. The fact that PLR 201907001 says nothing about disposing of the requirement that REITs limit themselves to investing passively in real estate indicates to us that the IRS had no intention of condoning anything of the sort.

PLR 201907001 also presumes that no REIT structure, hence no tax-free treatment, would be superimposed on the subsidiary entity managing and operating the hypothetical pipeline(s), and it further presumes that CorEnergy

[33] *See* J.A. Exh. 3 (Reschley), at 16, lines 8 – 9 ("C[orEnergy] does not have to lease the pipelines to a third-party that contracts with the pipeline customers in order to retain its REIT tax status"); *see also id.,* at 29, lines 16 – 17 ("C[orEnergy] will not use [a] complicated REIT lease structure to qualify as a REIT."); *and, id.* at p. 35, lines 14 – 15; *and* J.A. Exh. 6 (Reschley, Mudge and Webb), at 5, lines 10 – 11 ("no separate lease is necessary for the participation of a REIT in the Crimson Utilities").

would always deal at arms-length with that entity. By requiring that the pipelines be operated by a fully taxable, non-REIT entity with which CorEnergy would always deal at arms-length, it ensured that CorEnergy would not become actively involved in the pipeline business and that the operator of the pipeline would not enjoy the tax-free treatment accorded to a REIT. In other words, the PLR walls-off CorEnergy from participating tax-free in the petroleum industry as well as the pipeline industry. Exactly the opposite is proposed here. CorEnergy will operate and manage two pipeline utilities.

Finally, the lack of passivity in the transaction proposed in this proceeding cannot be corrected for by maintaining a majority of disinterested, independent directors on CorEnergy's board of directors. It does not matter that a majority of CorEnergy's board of directors are independent-minded directors. They would be obligated to protect and further the investment expectations of their REIT investors while simultaneously possessing ultimate control over the operations of the Crimson Utilities. A potentially serious conflict like this was not addressed in any way by the IRS in PLR 201907001.

The Joint Applicants offered circumstantial evidence other than PLR 201907001 to persuade us that the IRS has approved the transaction presented in this application. They point out that the IRS has not made any effort to reject CorEnergy's election to treat the dividend distributions it has received from Crimson Midstream since purchasing Carlyle's 49.5 percent of the equity in Crimson Midstream in February 2021 as tax-free REIT income.[34] However, inaction on the part of the IRS is not evidence that the IRS has concluded that CorEnergy's purchase of control of the Crimson Utilities would

[34] *See* J.A. Exh. 3 (Reschley), at 17, lines 8 – 19.

fully comply with the REIT statute. A minority equity interest in a pipeline company does not bestow active control of the utility on the minority shareholder. Furthermore, like the IRS and other agencies with enforcement duties, this Commission does not treat absence of regulatory disapproval as approval of a proposed or existing course of conduct.

As discussed above, the Joint Applicants have failed to demonstrate that PLR 201907001 released CorEnergy from the passivity requirement of the REIT provisions in the IRC.

5.3.2. Acceptable Financial Strength Has Not Been Demonstrated

The lack of a definitive ruling from the IRS casts doubt on the probability that REIT investors will be attracted to the Crimson Utilities once CorEnergy obtains control. That puts more emphasis on CorEnergy being able to show other means of bringing financial strength to the proposed acquisition.

In D.20-01-003, the Commission approved a transfer of control of one of the Crimson Utilities to a Delaware limited liability company controlled through a series of affiliates by the Carlyle Group L.P., a publicly traded company with hundreds of billions of dollars of assets on its balance sheet. This Commission had no concern regarding the financial strength behind the acquiring Carlyle subsidiary. It is certainly not necessary for an applicant to match Carlyle's financial strength for the Commission to approve a change of control of the Crimson Utilities, but there should not be any concerns about the financial strength and stability of the acquiring entity.

CorEnergy's financial condition, at this time, does raise concerns for purposes of changing its relationship to Crimson Utilities from minority to majority owner. To acquire Carlyle's 49.5 percent interest in Crimson

Midstream, CorEnergy not only transferred $67 million in cash to Carlyle, but also title to one of CorEnergy's pipeline systems in the Gulf of Mexico, which together substantially diminished CorEnergy's assets. In addition, during the Covid-19 pandemic, CorEnergy lost title to another, separate pipeline system it owned in the Gulf of Mexico, due to the worldwide downturn in demand for hydrocarbons. Together CorEnergy recognized a $286 million diminution of its assets during the pandemic period and during the same period its market capitalization shrunk substantially.

Thus, in this proceeding, in contrast to D.20-01-003, the Joint Applicants seek Commission approval for a transfer of control over Crimson Utilities, not to a company with far greater financial strength than the Crimson Utilities but rather to a company whose financial strength has been declining and possibly is no greater than Crimson Utilities' financial capabilities should a crisis arise. This is a significant concern, as transfer of control to a financially weakened entity is not in the public interest.

In this proceeding, rather than promote its own financial performance, CorEnergy emphasizes that Crimson Utilities will benefit financially from the proposed change in control because, for the first time in their existence, the Crimson Utilities, as subsidiaries of CorEnergy, whose stock is traded on NASDAQ, will have access through CorEnergy to the private and institutional investors who invest in NASDAQ-listed companies.[35] The record of this proceeding does reflect that CorEnergy shares are traded on the NASDAQ

[35] *See* J.A. Exh. 4 (Mudge), at 30, lines 10 – 12 ("[I]t is important first to recognize that publicly-traded REIT C-corps like C[orEnergy] have attractive access to external capital markets"); *see also, id.,* at line 30 ("REIT C-corps have had ample access to equity and debt capital markets over recent years").

platform and as subsidiaries of CorEnergy, the Crimson Utilities would be linked to that platform and the investors who trade on it.

But the record evidence does not show that this will make Crimson Utilities stronger than they would be if they were left in the full and exclusive control of John Grier. Nor does it show that Crimson Utilities could expect financial help from CorEnergy in stressful times. Traders on the NASDAQ platform must purchase shares of CorEnergy even if they are mostly attracted to Crimson Utilities. The evidence shows that CorEnergy's performance record during the pandemic has dampened investment interest in CorEnergy rather than boosted it. Investors did not perceive CorEnergy as a haven during the pandemic, as might have been the case for REITs in general. On the other hand, the record evidence does show that John Grier and the Crimson Utilities were able to attract a company like Carlyle, with its vast assets and participation in the public markets, without CorEnergy's assistance. The record shows that Mr. Grier and the Crimson Utilities also attracted investment interest from CorEnergy. Consequently, CorEnergy is not the only way for John Grier and the Crimson Utilities to access trading platforms for publicly traded companies, if Mr. Grier and the Crimson Utilities desire to do so.

In this proceeding, the Joint Applicants have presented substantial expert testimony directed at showing that CorEnergy will have sufficient liquidity to ensure that the Crimson Utilities will continue to operate in a safe and reliable manner through the types of stressful circumstances reasonably to be expected for California utilities.

Their written testimony, particularly those portions submitted by John Mudge and Dr. Webb, addresses three types of hypothetical crises that

might befall Crimson Utilities and put financial strain on both Crimson Utilities and CorEnergy if the Commission approves the proposed transaction:

a. An unplanned, operating need for $10 million due to events beyond the utilities' control, for example, a sudden, significant increase in inflation driving operating costs $10 million beyond what was expected;
b. A planned maintenance program totaling $20 million, such as replacement of a section of aged pipeline; or,
c. An unplanned capital expense of $20 million, needing immediate attention, such as loss of a portion of a pipeline due to a wildfire or earthquake.

John Mudge, a principal of the Brattle Group, an economic consulting organization in Washington, D.C., addressed the three hypothetical crises in the most detail for CorEnergy. His prepared testimony[36] comprises the whole of Chapter 4 of the Joint Applicants' prepared testimony. Mr. Mudge assessed CorEnergy's ability to keep the Crimson Utilities adequately capitalized through good times and bad by comparing various statistics for a group of 35 regulated utilities in the US doing business as C-corporations to a multitude of REITs which are also C-corporations but have elected to operate under the REIT regimen and have adhered to the fundamental IRC requirement that REITs must distribute at least 90 percent of their otherwise taxable income to their shareholders.

Mr. Mudge, like Dr. Webb and the Joint Applicants' third expert, John Reschley, concluded that a utility "operat[ing] under REIT ownership" will possess "financial resiliency" more or less equal to a utility operating under

[36] Joint Applicants Exhibit (J.A. Exh.) 4 (Mudge), at 1 – 57.

non-REIT ownership structures.[37] There are some statistics that indicate the selected utility group C-corporations possess more financial resiliency than the Crimson Utilities with a REIT structure superimposed on them in normal business environments,[38] and some statistical evidence that indicates in some stressful times the REIT group would have more resilience than the utilities operating as regular C-corporations whereas the utilities would have more resilience in other stressful situations.[39] But, generally, in both normal and stressful business scenarios, the two groups appear more or less equivalent to one another in the testimony provided by the Joint Applicants.

In his prepared testimony, Dr. Webb opines on how each of the three types of financial crises would likely be handled by a pipeline utility company with a REIT ownership structure (*i.e.,* hypothetically, the Crimson Utilities under the control of CorEnergy) versus a pipeline utility company with a non-REIT ownership structure (Crimson Utilities under the control of closely held parent, as is the current situation). Such information, as well as testimony provided by Mr. Mudge and Mr. Reschley, would be useful in the context of a rulemaking or investigative proceeding by the Commission into the general question under what circumstances would it be advisable for us to encourage ownership of a

[37] J.A. Exh. 4 (Mudge), at 2. Dr. Webb concludes "the REIT C-corp [ownership] structure introduces no additional risk to the utility or its ratepayers and in certain circumstances reduces risk." J.A. Exh. 5 (Webb), at 16, lines 13 - 16. John Reschley, an attorney, concludes that "a REIT C-corp [ownership structure] will not adversely affect Crimson Utilities' ability to serve its customers, in that the federal income tax rules do not have any effect on the pipeline operations." J.A. Exh. 3 (Reschley), at 9, lines 3 - 7.

[38] *See* J.A. Exh. 4 (Mudge), at Figure 27 (showing $4.8 M in cash available after CapEx for the utility group but only $3.2 M for San Pablo Bay Pipeline Company operating as a REIT entity); *id.,* at Figure 28 (showing $9.4 M cash available after dividends for the selected utility group vs. $7.8 M in cash for San Pablo Bay Pipeline Company hypothetically operating as a REIT).

[39] *Id.* at Figure 28.

California utility by a REIT, but it is not helpful for a change of control proceeding such as this one.

For example, of the 29 charts included in Mr. Mudge's prepared testimony, 17 compare aggregated performance statistics for various industry groups to aggregated statistics for the entire REIT industry, a comparison that has little value because it is CorEnergy's performance statistics that are critical here. To illustrate, Mr. Mudge's testimony contains charts showing how much debt and equity financing all REITs together issued during 2007 – 2021 (Figure 8); the market capitalization of all REITs together compared to 35 selected, IOUs and the S&P Index (Figure 9); the total equity issuances by all REITs compared to the same business sectors during 2007- 2021(Figure 10); the average frequency of equity issuances during 2007 - 2021 by all REIT companies as compared to the same 35 IOUs as a group and the S&P companies as a group (Figure 11). There are 13 more similar charts.[40] And, another seven of Mr. Mudge's charts relate only to the Texas Public Utility Commission proceedings that initially approved of a REIT controlling an electric transmission utility and subsequently approved of replacing the REIT with a traditional IOU subsidiary.[41] Only three of Mr. Mudge's charts illustrate hypothetical crises that Crimson Utilities might have to endure.[42]

Accordingly, while the majority of Mr. Mudge's charts are instructive about the performance of REITs as a group, it is not possible to derive any

[40] *See* J.A. Exh. 4 (Mudge), at Figures 12 – 18, 23.

[41] *See* J.A. Exh. 4 (Mudge), at Figures 1 – 7.

[42] *See id.*, Figures 25, 27 and 28.

information specifically about CorEnergy's financial strength from 24 of his 29 charts.[43]

The remaining five of Mr. Mudge's charts do offer specific information about CorEnergy. However, these five charts do not provide sufficient evidence to show that CorEnergy will be able to provide adequate financial resources to Crimson Utilities under stressful conditions. Instead, the information contained on these five charts raises concerns that it would not be appropriate for the Commission to permit a change of control of Crimson Utilities to CorEnergy at this time.

Figure 19 depicting CorEnergy's equity and debt issuances shows that CorEnergy did access the debt and equity markets prior to 2015, but hardly did so thereafter, if at all (Figure 19 does not include data for 2020 and 2021).

Figure 20 reinforces that observation by comparing CorEnergy's common equity issuances in the timeframe 2008 – 2021, which does include the pandemic years 2020 – 2021, the beginning of the current inflationary pressures, and predictions of Federal Reserve interest rate hikes to come, to the common equity issuances of five other infrastructure REITs during the same period.[44] The chart shows that the last common equity issuance by CorEnergy was in 2015, whereas three of the five other infrastructure REITs chosen by Mr. Mudge continued to access the markets after 2015. Figure 20 also shows there were six common equity issuances by three of the infrastructure REITs after 2015 and none by CorEnergy.

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[43] Mr. Mudge does not claim CorEnergy is representative of the REIT groupings that he depicts in 17 of his charts. Nor does he explain how CorEnergy's financial data compares to any of the 17 charts depicting aggregated REIT industry-wide statistics.

[44] CorEnergy first elected REIT status in 2013. (*See* note 1, above. Figure 20 depicts pre- and post-REIT election for CorEnergy.)

Figure 21 confirms the information in Figure 20 and further shows that the value of CorEnergy's common equity issuances in the period 2012 – 2021 was the lowest in value of common equities issued by all the other infrastructure REITs used for comparison purposes, during the same period. It also shows that the next lowest issuance value by an infrastructure REIT (SB Communications) was two and a half times greater than the value of CorEnergy's issuances during the same period.

In his next chart, Figure 22, Mr. Mudge compared CorEnergy to all equity REITs, a very much larger group than the infrastructure REITs shown in Figures 19 – 21. The focus of Figure 22 is a comparison of debt to enterprise value. Significantly, on two occasions for CorEnergy, 2015 and 2020, this ratio rose to 48 and 51 percent respectively. The average ratio for all other REITs in the same two years was noticeably lower, 36 and 40 percent. Figure 22 also indicates that the average for all REITs, in all years between 2013 and 2020, never approached 48 or 51 percent. Figure 22 contains two notes to explain why CorEnergy's debt-to-enterprise-value ratio reached 48 and 51 percent. It attributes the 48 percent ratio in 2013 to low oil prices and a leveraged asset purchase that year. Figure 22 explains the 51 percent ratio in 2020 was due to the impacts of Covid 19, resulting in asset sales by CorEnergy.

Other evidence provided by the Joint Applicants, and described in the next paragraph, corroborates the fact that CorEnergy shed significant assets before and during the pandemic.

Finally, Figure 24 shows the cash available to CorEnergy in years 2016 – 2019 after paying dividends to its shareholders as required by the Internal Revenue Code. The average cash remaining for CorEnergy in each of the four years depicted on Figure 24, after paying dividends, is $11 million. This number

is obviously lower than the $20 million stress tests that the Joint Applicants' experts used for determining whether REITs in general, rather than CorEnergy specifically, would fare better than a select group of non-REIT utilities, when stressed. Figure 24, while candid, does not help the Joint Applicants' case.

Mr. Reschley's and Dr. Webb's prepared testimony contains similarly unhelpful evidence. Mr. Reschley confirms in his testimony that one of CorEnergy's "tenants" declared bankruptcy in 2020/2021. He further states that for the calendar tax year ended December 31, 2020, CorEnergy recognized a $146.5 million loss and a separate $140.3 million loss, totaling $286.8 million.[45]

On page 26 of his prepared testimony, Mr. Reschley points out that the losses recognized by CorEnergy on its tax return in 2020 will shelter large amounts of earned income in subsequent years thereby providing more cash on hand for Crimson Midstream and its subsidiaries, the Crimson Utilities. However, no one could possibly call losing hundreds of millions of dollars in asset value to create a tax shelter, a winning business strategy or one that should be repeated. Tax shelters for capital losses are a benefit created by the Congress to help taxpayers in need, not a reward for good business practice.

Nor is there much positive benefit in the $50 million CorEnergy revolving credit facility identified by Mr. Reschley as an added benefit for the Crimson Utilities. There is a greater value to the ability to internally generate profits, increase assets and attract equity investments. Furthermore, borrowing against the unencumbered value of assets is not something that only REITs can

[45] J.A. Exh. 3 (Reschley), at 19, lines 1-25; s*ee also, id.,* at 20, line 1 – at 21, line 6, where Mr. Reschley describes the circumstances of the losses in more detail and identifies these losses as the motivation for CorEnergy to "reposition[ ]…[its] asset portfolio from a focus on non-operated leased assets to one of owned and operated assets" on the basis of its interpretation of PLR 201907001 as allowing it to avoid confining itself to passive investments.

do, it can be done by the Crimson Utilities as well and exclusively for their own benefit, whereas CorEnergy's revolving credit line would be equally available to CorEnergy's existing pipeline subsidiary as well as the Crimson Utilities.

Dr. Webb, whose ultimate opinion is that there would be no adverse effect on the Crimson Utilities if CorEnergy were given control over them and possibly there could be a benefit, also acknowledged that CorEnergy had a difficult time handling the economic effects of Covid-19.[46]

However, the clearest evidence of CorEnergy's current financial status was provided by John Schulte, CorEnergy's founder and Chief Executive Officer. Mr. Schulte pointed out that CorEnergy's stock plunged in value and currently trades in the $2.00 - $3.00 range due to the prior loss of assets and use of stock dividends instead of cash dividends paid to shareholders[47] As Mr. Schulte put it, "CorEnergy's stock price can't recover … because [of] the permanent loss of capital … until such time as we are able to rebuild productive assets inside the company. [¶] We had a market cap of $800 million before COVID and today it is $80 million."[48]

Again, in contrast, over the same period that CorEnergy slid from $800 million to $80 million in market capital, Crimson Utilities demonstrated that they could, with no outside help from any REIT or any type of publicly traded company, attract capital investment from not only CorEnergy but also Carlyle Group, a publicly traded company with hundreds of billions of dollars of assets.

[46] J.A. Exh. 6 (Reschley, Mudge and Webb), at 24, line 15 – at 25, line 7.

[47] Tr., December 8, 2021, STC, at 76 – 77.

[48] *Id.* at 78.

The record evidence in this proceeding does not support the conclusion that it is in the best interests of shippers, the consuming public or the public at large, to transfer control of the Crimson Utilities to CorEnergy at this time. Control of the Crimson Utilities will be left in the hands of John Grier. CorEnergy will remain a large, but minority, shareholder of Crimson Midstream, entitled to its proportionate share of the dividends declared by Crimson Utilities.

If we approve the proposed transaction in the instant proceeding and CorEnergy gains control of the Crimson Utilities right now, CorEnergy's diminished financial strength as the new majority owner would raise significant concern for the Commission. CorEnergy need not be the equal of an organization like Carlyle, in terms of financial strength, to take control of Crimson Utilities. However, a preponderance of evidence should show that CorEnergy can comfortably handle the kind of stresses that can reasonably be expected in California, especially now as California struggles with record inflationary prices for petroleum products and severe constraints on the ability of refineries to produce finished products. That has not been demonstrated here.

5.3.3. The Proposed Change of Control Is Not in the Public Interest

As discussed above, the record of this proceeding demonstrates that there are at least two glaring aspects of the proposed transaction that present potential negative impacts to the shippers, the consuming public and/or the public at large: (i) the IRS has not yet approved of this atypical REIT arrangement; and (ii) the financial strength of the acquiring entity is not acceptable. Therefore, the proposed transaction does not meet either the indifference standard (no negative impacts to the shippers, the consuming public or the general public would be caused by the proposed transfer of control) or the tangible benefits standard (an

affirmative showing of tangible benefit to shippers, the consuming public and/or the general public, resulting from the proposed transaction). As such, the Joint Applicants have failed to demonstrate by a preponderance of evidence that their proposed change of control is "in the public interest."

6. Conclusion

The Joint Application is denied.

The relationship of CorEnergy to Crimson Midstream will be left as it currently exists, that of an indirect, minority shareholder of both pipeline utilities through Crimson Midstream. How CorEnergy elects to treat dividend income it receives from Crimson Midstream for tax purposes is a matter exclusively for CorEnergy and the Internal Revenue Service to determine.

In the event that the Joint Applicants intend to return and refile a similar application for the transfer of control proposed in this instant proceeding, the deficiencies in the Joint Application that have been identified in this decision must be corrected before such application may be reconsidered. Specifically, absent a favorable Congressional change in the REIT provisions of the IRC, a more definitive ruling by the IRS than PLR 201907001 approving a change of control transaction like the one proposed here, is necessary. Likewise, a new application must show substantial improvement in the financial strength of CorEnergy. Applicants should note that correcting these two deficiencies may not be sufficient: the Commission sets a high bar for determining that novel transactions like the one proposed here meet the aforementioned "public interest" and "tangible benefits" standards.

7. Comments on Proposed Decision

The proposed decision of ALJ Charles Ferguson in this matter was mailed to the parties in accordance with § 311 of the Public Utilities Code and comments

were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____ by _____.

8. Assignment of Proceeding

Darcie L. Houck is the assigned Commissioner and Charles Ferguson is the assigned ALJ in this proceeding.

Findings of Fact

1. John Grier and his affiliates currently have voting control of both Crimson Pipeline, L.P. (PLC-26) and San Pablo Bay Pipeline Company, LLC (PLC-29) (together, the Crimson Utilities) by virtue of their ownership of 50.5 percent of the equity in Crimson Midstream Holdings, L.L.C., the ultimate parent of the Crimson Utilities.

2. Independent of his equity interest in Crimson Midstream Holdings, L.L.C., John Grier himself has significant control of both Crimson Utilities by virtue of §§ 5.1 (e) (i) and (ii) of the Crimson Midstream Operating Agreement currently in effect.

3. CorEnergy is the minority shareholder of Crimson Midstream Holdings, L.L.C. and owns 49.5 percent of its equity.

4. Since 2013, CorEnergy has elected under the IRC of the United States to be treated as a REIT.

5. In this proceeding both CorEnergy and John Grier (Joint Applicants) propose to transfer control over the Crimson Utilities from John Grier to CorEnergy.

6. The proposed transfer of control would be accomplished by John Grier waiving his rights under §§ 5.1 (e) (i) and (ii) of the Crimson Midstream

Operating Agreement and selling sufficient voting rights and/or the underlying securities, with all appurtenant rights to CorEnergy.

7. A similar transfer of control of Crimson California Pipeline. L.P. (PLC-26) from John Grier and his affiliates to a subsidiary of The Carlyle Group L.P. (Carlyle) was approved in D.20-01-003, but never consummated.

8. On February 4, 2021, Carlyle sold its 49.5 percent, minority interest in Crimson Midstream to CorEnergy.

9. Carlyle is now and when D.20-01-003 was issued, a publicly traded company listed on the NASDAQ Stock Market with market capitalization in the hundreds of billions of dollars.

10. CorEnergy's shares are listed on the New York Stock Exchange.

11. During the Covid-19 pandemic CorEnergy's market capitalization fell from a high of $800 million to $80 million.

12. CorEnergy's stock has recently traded in the $2.00 - $3.00 range. Previously, it traded at twice that range or more.

13. CorEnergy's asset value fell $286 million during the Covid-19 pandemic.

14. The record of this proceeding demonstrates that there are at least two aspects of the proposed transaction that present potential negative impacts to the shippers, the general public and/or the consuming public: (i) the IRS has not yet approved of this atypical REIT arrangement; and (ii) the financial strength of the acquiring entity is not acceptable.

Conclusions of Law

1. The evidentiary standard in a ratesetting matter is preponderance of the evidence.

2. As the Joint Applicants, John Grier and CorEnergy bear the burden to prove their case for authorization to consummate the transaction proposed in the Joint Application.

3. Public Utilities Code § 851, in relevant part, requires Commission approval before a public utility may sell the whole or any part of its property or rights "necessary or useful in the performance of its duties to the public."

4. Public Utilities Code § 854(a) requires Commission authorization before any person or corporation may acquire or merge with any public utility.

5. The Commission has long interpreted Public Utilities Code §§ 851, *et seq*., to prohibit acquisitions, mergers, and transfers of control unless the Commission has found the proposed transaction to be in the public interest.

6. Public Utilities Code § 854 sets forth the required findings and required public interest factors the Commission must consider in evaluating whether a proposed transaction is in the public interest.

7. In D.16-06-014, a change of control decision for the Wild Goose Gas Storage facility, the Commission expressly affirmed that it had "discretion to consider the criteria set forth in §§ 854(b) and (c), that is, criteria included in the 'in the public interest' standard, if … inclined to do so", and the Joint Applicants there were required to "show that the [change of control] is in the public interest."

8. While the letter of Public Utilities Code §§ 851, *et seq.,* may not explicitly apply to oil pipeline utilities, the Commission has consistently considered the public interest factors addressed in these statutes for guidance in sales/acquisitions/mergers of other utilities, and it is reasonable to consider them in this instant proceeding.

9. In weighing the public interest considerations to determine whether the proposed change of control is "in the public interest," there are several Commission decisions applying an "indifference standard," where no harm or adverse impact to the general public or the consuming public is identified; and there are also a few decisions applying a higher bar of "tangible ratepayer benefit," as the standard, with a required showing of tangible benefits that accrue to the general public or the consuming public from the proposed transaction.

10. The proposed transaction does not meet either the ratepayer indifference standard (no negative impacts to ratepayers affected by the transfer of control) or the tangible benefits standard (affirmative showing of tangible benefit to ratepayers resulting from the proposed transaction).

11. The Joint Applicants have failed to demonstrate by a preponderance of evidence that their proposed change of control is "in the public interest."

12. IRS Private Letter Ruling PLR 201907001 does not address the transaction proposed to this Commission in the Joint Application.

13. The Joint Applicants have not made a sufficient showing under Public Utilities Code § 854 to merit approval of their proposed change of control.

14. Application 21-02-013 should be denied, without prejudice.

15. Application 21-02-013 should be closed.

O R D E R

IT IS ORDERED that:

1. Application 21-02-013 seeking Commission approval of the proposed acquisition by CorEnergy Infrastructure Trust, Inc. of control of Crimson California Pipeline, L.P. (PLC 26) and San Pablo Bay Pipeline Company, LLC (PLC-29) from John Grier and his affiliates is denied, without prejudice.

2. Application A.21-02-013 is closed.

This order is effective today.

Dated _____, at San Francisco, California.