Decision ______________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Pipeline System LLC for Authorization to Increase Its Rates and Charges for Crude Oil Transportation Services on Its Line 63 System Effective November 1, 2006.	Application 06-09-024 (Filed September 29, 2006)

DECISION GRANTING APPLICATION OF PACIFIC PIPELINE SYSTEM LLC FOR RATE INCREASE

1. Summary

This decision grants the application[1] of Pacific Pipeline System LLC (PPS) to increase its rates and charges for all crude oil transportation services on its Line 63 system by 9.5%, effective November 1, 2006. This increase is necessary because of decreased volumes of crude oil transported on the Line 63 main long-haul trunk system and increases in PPS' operating costs since its last general rate increase (GRC) in 2004.

The approved rate increase is forecast to increase PPS' revenues by approximately $1.75 million annually, yielding a projected overall rate of return (ORR) of 6.17% and a return on equity (ROE) of 6.18% for the Line 63 system. This ORR and ROE are slightly lower than authorized by the Commission in

[1] PPS filed this application on September 29, 2006. In Resolution ALJ-3180, dated October 5, 2006, we preliminarily categorized this proceeding as ratesetting and preliminarily determined that no hearings are necessary. No protests were filed to this application.

PPS' last GRC.[2] Although PPS contends that this ORR and ROE are significantly less than appropriate rates of return for crude oil pipelines, PPS is willing to accept these lower rates of return in order to remain competitive in its market.

2. Background

PPS is a Delaware limited liability company authorized to do business in California.[3] Its principal place of business is located in Long Beach, California.

PPS owns and operates two separate common carrier crude oil pipeline systems. Each system has a separate set of tariffs on file with the Commission. One system, Line 2000, or the Pacific System, consists of a 130-mile, 20-inch insulated pipeline that extends from Kern County to the Long Beach and El Segundo areas. PPS has not requested a rate increase for Line 2000 in this application.

The second system is the Line 63 System. The Line 63 System includes a 118-mile, 16-inch and 14-inch trunk line from Kern County to the City of Carson, with an average pumping capacity of approximately 105,000 barrels per day. The Line 63 System also includes gathering and distribution lines. The gathering lines gather oil from various locations in the San Joaquin Valley, and transport

[2] In Decision (D.) 04-12-040, the Commission approved a 9.5% rate increase on PPS' Line 63 system, in order to provide PPS an opportunity to earn an ORR of 6.97% and a ROE of 6.99%.

[3] As of the date of the filing of this application, PPS was an indirect, wholly-owned subsidiary of Pacific Energy Partners, L. P., a publicly-traded limited partnership formed under Delaware. The Commission approved this ownership structure in D.02-06-069. However, in D.06-09-017, the Commission approved a transfer of control of PPS to Plains All American Pipeline, L. P. (Plains). According to the application, this transaction was expected to close in the final quarter of 2006.

this oil north to Bakersfield refineries and south into Los Angeles Basin refineries. Line 63 also receives high viscosity, high sulfur crude oil, such as Outer Continental Shelf Oil (OCS), at the Pentland Station and transports this oil to refineries and oil terminals in the Los Angeles Basin. In addition, Line 63 receives crude oil from the East Los Angeles and Wilmington fields, also for delivery to various refineries and oil terminals in the Los Angeles.

In this application, PPS has requested a rate increase for services on the Line 63 system only.

3. PPS' History of Rate Increases

In D.01-01-006, the Commission authorized PPS to increase its rates and charges for all crude oil transportation services on its Line 63 System by 5%, effective October 1, 2000, which provided an opportunity to earn an overall return of 7.56% and an equity return of 7.1%. Based on the projected throughputs for that test year, the request increased annual revenues by approximately $1.04 million.

Subsequently, the Commission authorized PPS to further increase rates by approximately $2.1 million to recover rising electricity costs, as requested in Advice Letter 12 and as revised in 12-A, effective August 1, 2001. The Commission Energy Division approved implementation of Advice Letters 12 and 12-A by letter dated August 21, 2001, pursuant to delegated authority in General Order 96-A.

In D.04-12-020, the Commission authorized PPS to increase its rates and charges for all crude oil transportation services on the Line 63 system by 9.5%, yielding an opportunity to earn an ORR of 6.97% and a ROE of 6.99%. We found PPS' requested increase was justified by its increased costs and the need for a reasonable return. We noted that these rates of return, which were requested by

PPS, were significantly lower than authorized returns for natural gas utilities in California and oil pipelines regulated by the Federal Energy Regulatory Commission (FERC) and other jurisdictions. PPS was willing to accept these lower rates of return, because market forces limited the rates that PPS could realistically charge for services on Line 63.

In D.05-07-036, the Commission also approved a temporary surcharge of $0.10 per barrel on all shipments of crude oil received by PPS in the San Joaquin Valley and shipped through on its Line 63 trunk line system to destinations in the Los Angeles Basin, in order to recover the costs of repairs to the Line 63 system and the clean-up and restoration of Posey Canyon and Lake Pyramid that resulted from the storms and landslides in Winter 2004-05. D.05-07-036 approved an increase of ½% without further Commission approval and authorized another 9.5% increase to cover these costs if PPS submitted an advice letter that demonstrated the need for additional revenue to the Commission Energy Division. Advice Letter No. 28, which became effective on March 2, 2006, approved the additional 9.5% temporary surcharge for repairs and clean-up necessitated by the extremely wet winter of 2004-05.

4. PPS' Requested Rate Increase

A. Reduced Revenues Due to Decreased Throughputs on Line 63

PPS contends that the decrease in San Joaquin Valley oil and OCS production and the shift of crude oil to alternative markets not served by the Line 63 system has caused decreased long-haul trunk throughputs on Line 63. According to the application, during the period from July 1, 2005 to June 30, 2006, long-haul trunk line throughput on Line 63 averaged only 47,619 barrels per day, which represents a continuing trend of declining throughput.

For example, PPS states that in its 2000 GRC application, PPS forecast that long-haul trunk throughput would decrease to approximately 66,600 barrels per day for the period from August 1, 2000 to July 31, 2001. In its 2004 GRC application, PPS stated that throughput volumes for the period from September 2003 through August 2004 had further decreased to 59,428 barrels per day and were averaging 57,238 barrels per day for the period from January 1, 2004 to the date of the 2004 GRC application.

According to the application, PPS has advised the Commission in its last two GRC applications that declining production of oil in the San Joaquin Valley and of OCS was decreasing throughputs on its Line 63 system below the levels used to establish rates in the 2000 GRC application. For example, in its 2004 GRC application, PPS forecast that during that the test year September 1, 2004 to August 31, 2005, throughputs would continue to decrease to approximately 16.4% less than the throughput estimates used to establish rates in the 2000 GRC application.

PPS acknowledges that other trunk shipments to Bakersfield area refineries and shipments within the Los Angeles Basin have partially offset the decrease in long-haul shipments. However, because of the shorter distances involved and the lower tariff charges associated with these services, PPS' overall revenues have decreased. Therefore, although PPS anticipated that the rates authorized in its 2004 GRC decision[4] would generate revenues of approximately $25.94 million, PPS now expects that unless the rates are increased, the decreased long-haul throughput on Line 63, as partially offset by other transportation

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[4] D.04-12-020

services, will generate only approximately $23.82 million for test year July 1, 2006 through June 30, 2007.

B. PPS' Increased Operating Expenses

PPS also contends that its operating expenses for Line 63 are increasing. In its 2004 GRC application, PPS projected operating expenses of $16.99 million, excluding depreciation and amortization expenses, and the rates adopted in D.04-12-040 reflected these projections. Line 63 operating expenses, excluding depreciation and amortization expenses and the expenses for repairs and clean-up that resulted from the storms and landslides during Winter 2004-05, were $18.32 million for the 12-month period which ended on June 30, 2006. For the test year period July 1, 2006 to June 30, 2007, PPS forecasts that its operating expenses will be $17.92 million or approximately $0.93 million above the level currently reflected in its general rates.

PPS explains that the increase in its operating expenses results primarily from higher fuel and power expenses, right-of-way and pipeline rental expenses and maintenance expenses. For example, PPS forecast its fuel and power expenses to be approximately $3.40 million in the 2004-05 test year. For the most recent 12 months of data, PPS' fuel and power expenses were $4.68 million and for the upcoming test year, PPS forecasts fuel and power expenses to be $3.91 million.

PPS' right-of-way and pipeline rental expenses are also increasing. PPS uses leased pipelines in order to expand its transportation service in the San Joaquin Valley, which partially offsets the decrease in volume and revenues from long-haul trunk transportation service. PPS forecasts that its right-of-way and pipeline rental expenses will increase from $2.76 million as stated in the 2004 GRC to $3.66 million, which represents an increase of $0.90 million.

In addition, pipeline maintenance expenses incurred in the ordinary course of business have increased by approximately $0.46 million from the amount assumed in PPS' last GRC. These expenses do not include the cost of repairs and clean-up associated with the storms and landslides of Winter 2004-05, which are being recovered through the temporary surcharge imposed pursuant to D.05-07-036.

C. Change in Capital Structure of PPS' Parent Company

For the purpose of this application, PPS wishes the Commission to also consider the capital structure of its new parent company, Plains. According to the application, Plains' pro forma capital structure, giving effect to the merger, will be 49.19% equity and 50.81% debt, which is more highly leveraged than the 54.29% equity and 45.71% debt used in PPS' 2004 GRC. Further, after the merger, Plains' embedded cost of debt will be 6.15%, which is significantly less than the 6.95% embedded debt cost that PPS used in its 2004 GRC application.

D. Rate of Return

PPS claims that because of its decreased revenues and increased operating expenses since the 2004 GRC, PPS is not currently earning the rate of return authorized by the Commission in D.04-12-040. PPS forecasts that unless its rates for services on Line 63 are increased, its actual ORR and ROE will decline further to approximately 3.49% and 0.75%, respectively, in the test period from July 1, 2006 to June 30, 2007.

PPS states that the requested 9.5% rate increase is necessary in order to permit PPS to earn an ORR of approximately 6.17% and a ROE of approximately 6.18%, which is slightly lower than the ORR authorized by the Commission in D.04-12-040. PPS notes that in D.04-12-040, the Commission stated that the reasonable return on equity for Line 63 would be 14.5% for the test year

October 1, 2004 to September 31, 2005, but that PPS did not seek a full rate of return in its 2004 GRC because of market pressures. However, PPS is willing to continue to accept the lower rates of return requested in this application because competitive market pressures limit PPS' ability to charge rates that would yield the full return on equity that is reasonable.[5]

Discussion

Under § 455.3 and General Order (G.O.) 96-A, oil pipeline corporations, such as PPS, may, under some circumstances, change or increase their rates before obtaining Commission approval, upon giving 30 days advance notice of the proposed increase to shippers and the Commission.[6, 7]

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[5] PPS has submitted a rate of return analysis prepared by Professor J. Peter Williamson, the Lawrence F. Whitemore Professor of Finance Emeritus at Amos Tuck School of Business Administration, Dartmouth College as Exhibit 11 to this application. Professor Williamson concluded that an appropriate ROE for PPS for the test year beginning on June 30, 2006 would be 13.6%. However, PPS states that in order to recover a ROE of 13.6%, PPS would need to increase its rates by 22%, which is not realistic in this marketplace.

In addition, PPS points out that in D.92-05-018, the Commission determined that a 13.54% ROE was reasonable for SFPP, LP, a product pipeline company. PPS contends that crude oil pipelines, such as Line 63, involve more economic risks than product pipelines, such as SFPP.

[6] Section 455.3 states:

a.) Notwithstanding any other provision of law, including, but not limited to § 454, no later than January 1, 1998, the commission shall adopt rules and regulations that substantially revise the manner in which oil pipeline corporations may change and use rates.

b.) The revised rules and regulations shall adhere to the following criteria:

(1) Pipeline corporations shall be required to give the commission and all shippers no less than 30 days' notice of rate changes.

Footnote continued on next page

However, under § 455.3 and G.O. 96-A, Section VI, a pipeline corporation may not impose rate increases which, individually or cumulatively, exceed 10% within a 12-month period without first obtaining Commission approval.

Here, PPS gave the required 30-day notice to shippers that use Line 63's services on September 29, 2006.[8] However, since the Commission granted PPS a ½% rate increase effective July 21, 2005 in D.05-07-036 and a 9.5% increase effective March 2, 2006 pursuant to Advice Letter No. 28, under Section 455.3, PPS may impose only an additional ½% increase without our prior approval.

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(2) After the 30-day notice of rate change, pipeline corporations shall be permitted to change rates and use those rates prior to commission approval.

(3) The commission shall have authority to suspend a rate change and use of the changed rate for a period of time not to exceed 30 days from expiration of the 30-day notice period specified in paragraph (1).

(4) Pipeline corporations shall refund, with interest, any portion of the rate change that is subsequently disallowed by the commission to all shippers within 30 days of the commission's decision becoming final. Interest shall accrue from the date the new rate is first charged.

(5) Any increase in the shipping rate charged by an oil pipeline corporation prior to commission approval shall not exceed 10% per 12-month period.

c.) It is the intent of the Legislature that oil pipeline corporations be permitted to use new rates after the suspension of a rate change, if any, by the commission pursuant to paragraph (3) of subdivision (b) prior to commission approval, provided any disallowed portion of the new rate is fully refunded with interest.

[7] In D.97-12-069, the Commission approved amendments to G.O. 96-A, Section VI, to reflect the enactment of § 455.3. The language of G.O. 96-A, Section VI, as amended, closely parallels that of § 455.3.

[8] Exhibit 13, Application.

We find that PPS has made a *prima facie* showing that its requested rate increase of 9.5% is reasonable. This increase will enable PPS to earn a ROE and ORR that are slightly lower than those authorized in PPS' 2004 GRC, but which are acceptable to PPS. Since PPS is willing to accept these lower rates of return in order to remain competitive, we need not address whether a higher rate of return for PPS' operations on Line 63 would be justified here. PPS may impose this rate increase retroactive to November 1, 2006, as requested, based on PPS' September 29, 2006 notice of the proposed increase to shippers and the Commission.

Conclusion

For all of the foregoing reasons, the application is approved.

Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Section 311(g)(2) of the Public Utilities Code and Rule 14.6(c)(2) of the Commission Rules of Practice and Procedure, the otherwise applicable 30-day period for public review and comment is waived.

Assignment of Proceeding

Dian M. Grueneich is the assigned Commissioner and Myra J. Prestidge is the assigned Administrative Law Judge in this proceeding.

Categorization and Need for Hearings

Based on our review of this application, we affirm the preliminary determinations made as to categorization and the need for a hearing made in Resolution ALJ 176-3180, dated October 5, 2006.

Findings of Fact

1. The rate increase sought by PPS applies only to the Line 63 System and not to the Pacific System.

2. The Commission authorized PPS' most recent rate increase in D.05-07-036, effective July 21, 2005, which approved an increase of ½% immediately and an additional rate increase of up to 9.5%, if PPS filed an advice letter showing the need for additional revenue to fund the repairs and clean-up necessitated by the storms and landslides that occurred in Winter 2004-05.

3. Advice Letter No. 28, which became effective on March 2, 2006, approved a 9.5% increase for PPS in order to fund the repairs and clean-up necessitated by the storms and landslides that occurred in Winter 2004-05.

4. The annual increase of approximately $1.75 million that PPS requests in this application will afford it the opportunity to earn an ORR of 6.17% and a ROE of 6.18%.

5. In D.04-12-041, the Commission approved an ORR of 6.97% and a ROE of 6.99% for PPS as requested by PPS, but noted that these rates of return were well below authorized returns for natural gas utilities in California and for oil pipelines regulated by FERC and other jurisdictions.

6. Although PPS contends that a higher rate of return is justified, PPS is willing to accept an ORR of 6.17% and a ROE of 6.18% resulting from the 9.5% rate increase approved in this order, because competitive market pressures limit PPS' ability to charge rates that would reflect the full return on equity.

7. Pursuant to Pub. Util. Code § 455.3, on September 29, 2006 PPS gave the Commission and all shippers that use Line 63 services 30 days advance notice of this proposed rate change.

8. There have been no protests to this application.

Conclusions of Law

1. Under Section 455.3, oil pipeline corporations may, after giving 30 days' notice to shippers and the Commission, change or increase their rates by an

amount that does not exceed a 10% increase within 12 months, before obtaining Commission approval.

2. Under Section 455.3, since the Commission most recently approved a 9.5% increase for PPS effective March 2, 2006, PPS may impose only a ½% increase without our prior approval at this time.

3. This application for a 9.5% increase effective November 1, 2006 should be approved because PPS has demonstrated that its request is just and reasonable.

O R D E R

IT IS ORDERED that:

1. Pacific Pipeline System LLC (PPS) is authorized to increase its rates and charges for all crude oil transportation services on its Line 63 System by 9.5% or approximately $1.75 million annually, effective November 1, 2006.

2. PPS shall file an advice letter with the Commission Energy Division to conform its tariffs within 21 days of this order.

3. This proceeding is closed.

This order is effective today.

Dated ____________________, at San Francisco, California.