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ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Application of FOUR CORNERS PIPE LINE COMPANY, a Delaware corporation, for authority to increase transportation rates for crude petroleum and petroleum products pursuant to the provisions of Section 454 of the Public Utilities Code of the State of California.	Application 82-04-66 (Filed April 28, 1982: amended July 7, 1982)

(See Decision 83-04-046 for appearances.)

FINAL OPINION

Four Corners Pipe Line Company (applicant or Four Corners) operates as a pipeline company transporting crude and refined petroleum products in California. In this application it seeks authority under Public Utilities Code § 454 for a general increase in its intrastate rates of approximately 30%. This decision grants the remainder of the requested increase not granted on an interim basis.

At the public hearing held on February 8, 1983, Four Corners and the Commission staff (staff) indicated that they were in disagreement with respect to the factors which the Commission should consider in determining reasonable levels of earnings for petroleum pipeline companies.

A stipulation was filed on February 25, 1983 signed by counsel for Four Corners and the staff under which an increase of approximately 12.9% was agreed to by the parties. On March 14, 1983 Four Corners filed a pleading accepting an interim rate increase and requesting a public hearing concerning unresolved issues.

Decision (D.) 83-04-046 issued April 6, 1983 granted interim authority to Four Corners to raise its rates by 12.9% subject to refund, pending a final decision in this matter.

Further hearing was held before Administrative Law Judge Mallory in San Francisco on April 21, and 22, 1983, and the matter was submitted.

Operational History

Four Corners originated in about 1957 as an interstate common carrier pipeline system jointly owned by a number of oil companies. The pipeline system was primarily designed to transport oil to Los Angeles from the area where the states of New Mexico, Arizona, Utah and Colorado intersect (four corners area). However, in the late sixties and early seventies, oil production from the four corners area dropped significantly and the east to west oil pipeline system became unprofitable.

At about the same time, there were two developments which suggested there would be a surplus of oil on the west coast and a need to transport it east. First, the federal government began increasing oil production from the Elk Hills area in the San Joaquin Valley. Second, it appeared that crude oil from the North Slope would be transported to the west coast and there would be a need to transport that oil east.

To meet the projected demand to transport oil east, Atlantic Richfield Company (ARCO), in 1976, purchased the interests of the other shareholders in Four Corners and became the sole owner. Four Corners then embarked upon a significant program of capital expansion which included:

1. The reversal of the east to west line to become a line capable of transporting crude oil from west to east.
2. The construction and expansion of major distribution centers in Long Beach and Carson

to distribute oil from the San Joaquin Valley to refineries in the Los Angeles basin and to pump oil eastward to the four corners area.

3. The construction of major pumping facilities to transport crude oil throughout the expanded system.

On May 1, 1978, under a stipulation entered into between ARCO and this Commission (PUC) (D.88640 in Case 9893, issued March 21, 1978, 83 CPUC 582), ARCO transferred to Four Corners and dedicated to public use certain of its private crude oil and petroleum products and pipeline facilities in California. The most significant was ARCO's San Joaquin Valley-Los Angeles pipeline.

These facilities were then combined with Four Corners interstate pipeline system, which transported oil from Los Angeles to the four corners area and operated as a common carrier under the jurisdiction of the Federal Energy Regulatory Commission (FERC).

Current Operations

Four Corners' primary operations are: (1) the transportation of crude oil from the San Joaquin Valley to refineries in the Los Angeles basin; (2) the transportation of crude oil within the Los Angeles basin; and (3) the transportation of crude oil from the Los Angeles area to other states over Four Corners' west/east pipeline system.

In addition to Four Corners' primary operations, there are a number of other pipeline related operations, including: (1) owner and operator of a small number of products pipelines; (2) owner and operator of a small number of unconnected crude oil pipelines: (3) owner and operator of a crude oil pipeline distribution and gathering system near Bakersfield; (4) owner of a carbon dioxide pipeline; and (5) operating agent of some marine terminals and private interfacility pipeline systems owned by ARCO (Western Pipelines).

Four Corners' 1,600 pipeline miles are spread over five states: California, New Mexico, Colorado, Utah, and Arizona.

System 11

About 850 of these pipeline miles are dedicated solely to interstate traffic on its System 11, which includes the pipeline from Los Angeles to the four corners area (Line 90) and gathering and distribution lines within the four corners area. System 11 includes Four Corners' west to east crude oil pipeline system. It consists of: (1) 700 miles of pipeline beginning in Long Beach and ending in the four corners area (Line 90); (2) approximately 150 miles of gathering and distribution lines in the four corners area; and (3) 10 high pressured automated pump stations which move the oil over the pipelines.

System 10

System 10 (about 450 miles) is located in California and transports oil to locations inside and outside of California. The major portions of System 10 consist of:

1. The two major petroleum pipelines--Lines 1 and 63, and their gathering lines--which begin in the San Joaquin Valley and end in the Long Beach/Carson area (Line 63 ends at Four Corners' Hynes Distribution Center and Line 1 ends at the Watson Refinery); and
2. The Los Angeles Distribution System, which includes Line 93, which transports oil to most of the major oil companies' refineries and a section of Line 63 which connects the Hynes and Carson distribution facilities.

System 10 also includes a variety of smaller pipelines which gather and distribute oil within the Bakersfield area (the Bakersfield Distribution System), and a small number of other small unconnected crude oil pipelines within California.

The current capacity of the two San Joaquin Valley to Los Angeles basin lines is about 105,000 barrels per day. The oil is moved through these pipelines through five automated diesel and electric main line pump stations, which are also part of System 10.

Other Systems

About 300 miles are dedicated solely to California intrastate traffic. These exclusively intrastate lines consist primarily of isolated pipelines and the distribution pipeline system in the Bakersfield area.

California System

The California System, as that term is used in this proceeding, consists of System 10, System 50, System 55, and an allocated portion of the general facilities.

Common Systems

Four Corners operates three major facilities that provide services for the California System and the interstate system. For purposes of this rate proceeding, the costs of these systems are allocated between the California System and the interstate system. These general facilities are:

1. The Hynes Distribution Center, which is the focal point of the pipeline system. This is where the crude oil from the San Joaquin Valley is shipped and from Hynes such oil is either transported on Line 90 in System 11 or to refineries in the Los Angeles basin. Hynes is the receiving point for the San Joaquin Valley oil and the origin point for the Los Angeles distribution lines and for System 11. It has approximately 650,000 barrels of storage capacity and several pumping units that distribute the oil in the Los Angeles basin and to points east.

2. The Control Center, which is located at Hynes, centrally monitors the entire pipeline system, including (a) the pressure within the pipeline system; (b) the temperature; (c) the flow rates; (d) tank levels; (e) pump status and control; and (f) the valve status and control. The system also electronically alarms and logs any abnormal conditions, tracks shipments of oil, detects leaks, and provides operating data for the system.

3. The Cherry Avenue Office Building. This building houses the administrative personnel, with the exception of the three district managers and their staffs.

Four Corners currently employs about 300 people in its pipeline operations.

Current Tariffs

FERC tariffs apply to virtually all movements in System 11; PUC tariffs apply to movements in Systems 50 and 55; and both FERC and PUC tariffs apply to movements in System 10.

FERC tariffs apply to approximately one-third of the movements of crude oil from the San Joaquin Valley to the Los Angeles basin on oil which does not terminate in the Los Angeles basin, but continues on to the four corners area from the Hynes facility. Since Four Corners' FERC tariffs are segmented, the FERC shipper pays a separate FERC tariff rate for the San Joaquin/Los Angeles segment plus a separate FERC tariff rate for the west/east segment. FERC tariffs also apply to a small percentage of the crude oil transported within the Los Angeles basin distribution pipelines which moves through Hynes to the four corners area.

PUC tariffs apply to transportation from a California origination point in System 10 to a final destination point in California. The System 10 FERC tariff rates are at the levels sought in this proceeding. Four Corners desires to maintain uniformity in its FERC and PUC tariffs, as it believes that System 10 costs are identical for like inter- and intrastate movements and that in some cases the oil shipments are commingled and are transported at the same time in the same pipeline, and arrive at Hynes at the same time. If the full amount of the rate increase sought in this proceeding is granted, the FERC and PUC tariffs will be on comparable levels.

The Evidence

Evidence was presented on behalf of Four Corners by its manager of Planning and Evaluation (concerning pipeline operations);

its chief financial officer, controller and treasurer (operating expenses and depreciation expenses); and the manager of the Management Consulting Services Division of Ernest D. Whinney, an international auditing and management firm (return on equity and cost of debt).

Evidence on behalf of the staff was presented by three financial examiners and a transportation engineer. Two financial examiners explained the audit made of Four Corners records and the recommendations based thereon. A third presented recommended test year levels of operating expenses, rate base, rate of return on equity, cost of debt, and capital structure. The transportation engineer recommended test year operating revenues based on other test year data recommended by the financial examiner.

The Issues

Many issues were resolved by stipulation or agreement prior to or during the course of the hearing. The following are the unresolved issues in this proceeding:

I. Economic Issues

A. Reasonable test year expenses

B. Return on equity

C. Debt cost under agreed capital structure

II. Recommendations in the Staff's Audit Report (Exhibit 1)

A. Allocations of indirect expenses on books of record between California jurisdictional and other operations of applicant.

B. Separation of paid invoices and payroll records between California jurisdictional and other operations of applicant.

The staff and Four Corners agreed to many of the audit report recommendations which will be adopted.

The staff and Four Corners also agreed to the capital structure and rate base proposed by the staff and the related treatment of debt costs for income tax calculation.

Comparison of Operating
Revenues, Expenses, and Rate Base

The following is the staff's estimated test year operating results based on its adjusted operating and interest expenses and other assumptions:

TABLE 1

Four Corners Pipeline Company

Staff's Estimated 1983 Results of Operation
(000)

Description	Present Rates	Requested Increase	Staff Recommendation
Operating Revenue	$24,231	$31,500	$28,655
Operating Expense (Staff Adj.)	21,308	21,308	21,308
Net Operating Income (Before Inc. Taxes)	2,923	10,192	7,347
Interest Expense	953	953	953
Taxable Operating Income	1,970	9,239	6,394
Federal & State Income Tax (50%)	985	4,620	3,197
Net Operating Income	1,938	5,752	4,150
Rate Base (Calif. System)	33,200	33,200	33,200
Rate of Return	5.84%	16.78%	12.50%
Increase in Rates		30.00%	18.26%

Four Corners challenged staff adjustments in operating expense, interest expense used for calculation of income taxes, cost of debt in capital structure, and the staff's recommended return on equity. Four Corners contends that actual 1982 operating expenses should be used in place of the partially estimated 1982 operating expenses originally submitted; that known increases in insurance expense and payroll expense should be included in test year operating expenses; that the FERC depreciation rates are reasonable and should be adopted for the test year; that the interest expenses for calculation of test year income taxes should be based on the cost of debt and relative proportion of debt in the agreed imputed capital structure; that the cost of debt capital should be 12.0% rather than 8.69% as assumed by the staff; and that the reasonable return on equity is 17.0% rather than 14.74% proposed by the staff. Applicant's revised test year results of operations based on these contentions are set forth in Table 2.

TABLE 2

Four Corners Pipeline Company

Applicant's Estimated 1983 Test Year Results of Operation
(000)

Operating Revenue	$32,153
Less Operating Expenses	(23,300)
Net Operating Income Before Taxes	8,853
Less Taxes	(3,763)
Net Operating Income	5,090
Plant Investment	33,200
Return on Investment	15.33%
Tax Computation	
Net Operating Income Before Taxes	8,853
Less Interest Expense	(1,327)
Income Subject to Taxes	7,526
Federal and State Taxes (50%)	3,763

(Red Figure)

Disallowed Operating Expenses

The staff urged that the originally submitted 1982 operating expenses which were partially estimated should be used as a basis for developing test year operating expenses in lieu of the full year actual operating expenses, which became available when the processing of this application was delayed. Actual operating expenses should be used when available in place of estimated operating expenses, as the former are more accurate than the latter. The sole basis for the staff's request is that there must be a cutoff in the updating of data to be used in this proceeding. Inasmuch as the final hearing was held long after the filing of the application and the close of applicant's books for 1982, the use of actual 1982 operating expenses will be reasonable for the development of estimated 1983 test year expenses.

The following table sets forth the additional 1983 expenses which applicant contends will be incurred and which should be added to 1982 actual expenses to determine 1983 test year operating expenses.

TABLE 3

Applicant's Estimate of
1983 California Operating Expenses

1982 Operating Expenses	$18,800,000
Adjustment for inflation (6%)	1,100,000
Subtotal	19,900,000
Additional 1983 expenses attributable to enhancement of Pipelines 1 and 63	1,900,000
Additional 1983 expenses attributable to enhancement of Ellwood-Aminoil Pipeline	100,000
Additional 1983 Insurance Expense	900,000
Additional 1983 Depreciation Expense	100,000
Additional 1983 Staffing Expense	400,000
Total 1983 Operating Expenses	$23,300,000

Inflation Factor

The inflation factor of 6% was proposed by the staff and was accepted by Four Corners.

Pipeline Enhancement

In 1982, Four Corners acquired and then converted a natural gas pipeline to a crude oil pipeline (Line 1-1) and enhanced Lines 1 and 63. As a result of this conversion and the additional operations resulting from it, Four Corners will incur additional expenses (particularly fuel and power costs), with respect to this pipeline system in the amount of $1,900,000. Four Corners also will incur an annual operating expense of $100,000 for enhancement of its Ellwood-Aminoil Pipeline. The staff did not object to the additional expenses attributable to the enhancement of these lines.

Insurance Premiums

Additional annual insurance expenses of $900,000 were arrived at in the following manner: 1982 insurance expenses (excluding workers' compensation) totaled $329,854.05. A 6% inflation adjustment raises that amount to a total of approximately $349,000. For 1983, ARCO has notified Four Corners that its allocated share of ARCO's insurance premium is $1,271,900. Four Corners' insurance is covered under ARCO's insurance policy, which ARCO allocated among its divisions and subsidiaries. Thus, the increase between 1982 actual insurance expenses, adjusted for inflation, and 1983 insurance expenses is approximately $900,000.

The additional premium allocated to Four Corners was attributable entirely to automobile and public liability insurance. ARCO allocated its total premium for automobile and public liability insurance among its divisions and subsidiaries on the basis of the amount of losses each division or subsidiary incurred between 1978 and 1981. ARCO's allocation system is consistent with the methodology used by insurance companies in assessing premiums.

Four Corners followed ARCO's system of allocation based on losses. As a result, the increase to Four Corners was allocated to the California System because the losses resulting in the premium increase for liability insurance were attributable to the California System. Four Corners determined that this allocation system was fair as virtually all of Four Corners' exposure to third-party liability is in the California System, which runs through many heavily populated areas.

ARCO's method of allocation of increased insurance premiums to Four Corners and Four Corners' reason for its allocation of the increased premium to its California System appears reasonable and should be adopted.

Additional Depreciation Expense

The method used by Four Corners to determine the additional 1983 depreciation expense was to determine from differences in year-end ledger balances, the carrier property placed in service in 1982 in each property account. Those amounts were then multiplied by the FERC prescribed depreciation rates for each account. This produced for each account the 1983 depreciation on carrier property placed in service during 1982. Four Corners then added these individual accounts, which totaled $289,057.06. Four Corners assumed the property was placed in service ratably throughout 1982. This was a conservative approach because records show that most of the costly property was placed in service later in the year. On the basis of the assumption that property was placed in service ratably, Four Corners divided the $289,000 figure in half to arrive at an increased depreciation expense for 1983 of approximately $145,000.

This method of determining 1983 depreciation expense on carrier property is reasonable and will be adopted.

Personnel Additions

Applicant's Exhibit 7 is a compilation of its 1983 personnel additions, together with salaries for such personnel allocated to its California System. The salaries included in

Exhibit 7 are only for those personnel actually added to Four Corners' payroll on or before April 4, 1983. Inclusion of these expenses in 1983 test year operating results is reasonable.

Debt Costs

Staff and applicant agree that a reasonable capital structure for Four Corners is a capital structure similar to that of its parent consisting of 66.7% equity and 33.3% debt.[1] The staff developed the cost of debt from the data set forth in ARCO's 1981 Annual Report to Stockholders. The debt issues shown in that report were issued over a period beginning in 1970. Staff determined that the average cost of ARCO's debt was 6.9%. Four Corners contends that, as it was acquired by ARCO on September 1, 1976, it did not have the benefit of the lower costs of ARCO's debt issued before that date; and that its own debt was issued at a higher cost than ARCO's average debt cost. In late-filed Exhibit 18, Four Corners sets forth all of ARCO's debt issues.

Exhibit 18 states that 10 of the 18 debt issues listed with an outstanding balance as of December 31, 1981 were incurred prior to September 1, 1976 when ARCO acquired all of the outstanding stock of Four Corners. One of the 8 debt issues incurred thereafter was tax-exempt special purpose bonds. The weighted average annual interest rate (as of December 31, 1981) of the 7 nonexempt issues incurred after ARCO acquired all of the stock of Four Corners is 11.49%. Our staff recalculated the average cost of debt of the 7 nonexempt debt issues and determined the December 31, 1982 average debt cost of those issues is 12.6%. This compares with Four Corners' actual embedded cost of debt of 12.13% as shown on its FERC Annual Report. (Attachment 1 to Exhibit 3.)

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[1] The staff initially included preferred stock in the assumed capital structure because preferred stock is part of ARCO's capital structure. As there is no financial advantage or necessity for Four Corners to issue such stock, it was eliminated from the adopted capital structure.

We concur with Four Corners that ARCO debt issued after its acquisition of Four Corners should be used for computation of debt costs used in connection with the agreed imputed debt structure for ratemaking purposes.

In computing test year income taxes, the interest expense deduction should be the imputed interest cost based on the assumed capital structure and an adopted cost of debt of 12.0%.

Return on Equity

The staff report (Exhibit 1) contains the following comments and recommendations of staff witness Nagao. Four Corners was last authorized a rate of return of 11.70% in D.91253 dated January 15, 1980 in Application 58738. Four Corners' last authorized rate of return of 11.70% equates to an equity return of 14.74% when applied to ARCO's capital structure and capital costs as of December 31, 1979. A similar analysis using ARCO's capital structure and capital costs as of December 31, 1981 shows that Four Corners' requested rate of return of 14.74% equates to an equity return of 18.12%.

Staff witness Nagao stated that he believes that Four Corners' request is excessive, and he recommended an equity return of 14.74% and an overall rate of return of 12.51%. He arrived at this rate of return by applying the company's last adopted return on equity to ARCO's capital structure and cost of debt. Witness Nagao made no other study to support his recommendation as he stated that there are insufficient oil pipeline companies operating in California on which to make a comparable analysis of equity returns.

CORRECTION

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TO ASSURE LEGIBILITY

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Staff witness Nagao stated that he believes that Four Corners' request is excessive, and he recommended an equity return of 14.74% and an overall rate of return of 12.51%. He arrived at this rate of return by applying the company's last adopted return on equity to ARCO's capital structure and cost of debt. Witness Nagao made no other study to support his recommendation as he stated that there are insufficient oil pipeline companies operating in California on which to make a comparable analysis of equity returns.

Four Corners' witness presented a study of return on equity in Exhibit 3. The witness stated that based on his studies he recommended that Four Corners should be allowed at an equity return of 17%. A debt cost of 12.0% and an equity return of 17% applied to a capital structure of one-third debt and two-thirds equity would result in an overall rate of return on investment of 15.3%.

The witness testified that his recommendation was determined in the following manner. The required return on equity is the sum of the riskless return plus a risk premium. The riskless return is the current yield on U.S Treasury bonds as measured by the last 12-month data covering March 30, 1982 to March 30, 1983, which averaged 12.16%. The witness used the capital asset pricing model (CAPM) to measure the risk premium component. The risk premium, as measured in CAPM, consists of three components, i.e. the expected return on risk-free investment; the expected return on all investments in the economy; and the beta factor, or the risk premium applicable to a particular investment. The average market risk premium, measured by the changes in the New York Stock Exchange Index for the period June 30, 1978 to March 30, 1983, was calculated to be 5.51%. The beta for natural gas pipelines (as oil pipeline stocks are not traded) was estimated to 0.755. The risk premium is determined by multiplying the average risk premium on all investments of 5.51% by the beta of 0.755, which produces a risk premium for gas pipelines of 4.16%. The risk premium of 4.16% and the risk-free return of 12.16% equal the expected equity return for gas pipelines of 16.32%.

The witness believes that oil pipelines are more risky than gas pipelines, which would require an equity return for Four Corners at least 1½ percentage points greater than the calculated CAPM equity return for gas pipelines, resulting in an expected equity return for Four Corners of at least 17.82%.

According to the witness, Four Corners has a significant operating risk from the possible closure of its major producing field, Elk Hills. This field is scheduled for abandonment in about two years unless congressional legislation is passed to curtail abandonment.

In addition to CAPM development, the witness reviewed this Commission's decisions establishing returns on equity for major utilities in the period since Four Corners' last general increase. The authorized returns on equity for telephone, gas and electric utilities in the period May 1981 through December 1982 range from 15.75% (Southern California Gas Company) to 17.40% (Pacific Telephone and Telegraph Company). The gas and electric utilities' returns on equity range from 15.75% to 16.25% (San Diego Gas & Electric Company). According to the witness, oil pipeline utility operations are not less risky than the operations of major gas or electric utilities. Also compared in the summary were the equity returns on water companies, which range from 9.74% (Washington Water & Light) to 15.0% (C.P. National Corp.). In the opinion of the witness, oil pipeline utilities are more risky than water companies and oil pipelines should have a higher equity return.

We have carefully analyzed all the data presented on this issue. As we have stated in innumerable decisions, the determination of a reasonable equity return is largely a matter of judgment, after consideration of all pertinent available information. Clearly the data presented by applicant would indicate a return on equity of 16.5 to 17.0% if we conclude, as did applicant's witness, that oil pipeline operations bear a greater risk than natural gas pipelines, electric and gas utilities, and water companies. We are not convinced that oil pipeline companies are riskier than those utilities.

The percentage of common equity in a utility's total capital is one important measure of risk, i.e. a low debt ratio results in better interest coverage and lower risk. Applicant has 67% common equity in its capital structure. By comparison, gas pipeline companies average about 45%, while the common equity of electric, gas distribution, and telephone utilities ranges from 35% to 45%.

After giving consideration to all of the evidence, we find that a rate of return on common equity in the range of 15.5% to 16.0% is fair and reasonable. Based on the capital structure, imbedded cost of debt, and equity return which we find reasonable, the following compilation shows the range of rates of return which are reasonable for this proceeding.

TABLE 4

Four Corners Pipeline Company

Rate of Return
(000)

		Capital Ratios	Cost Factors	Weighted Cost Totals
Long-Term Debt	$ 4,273,105	33.03%	12.0%	3.96%
Common Equity	8,665,221	66.97	15.5-16.0	10.38-10.72
Total	$12,938,326	100%		14.34-14.68%

Based on the cost factors set forth in the above table, we find a rate of return between the range of 14.34%-14.68% will be reasonable for the purposes of this proceeding.

Adopted Operating Results

The following table sets forth the adopted test year results of operations based on the annual revenues requested by applicant and the operating expenses and the method of tax computation found reasonable in the preceding discussion.

TABLE 5

Four Corners Pipeline Company

Adopted California Jurisdictional
Results of Operations
1983 Test Year
(+000)

Operating Revenues Requested by Applicant	$31,500
Operating Expenses	23,300
Net Operating Income Before Taxes	8,200
Income Taxes	(3,436)
Net Operating Income	4,764
Rate Base	33,200
Rate of Return on Rate Base	14.35%
Return on Equity	15.52%

(Red Figure)

As can be seen from the above table, the 14.35% rate of return and 15.52% return on equity fall within the range found reasonable for oil pipeline companies of 14.34%-14.68% and 15.5%-16.0%, respectively.

Based on the foregoing we conclude that the requested rate increase should be granted. Inasmuch as the corresponding interstate rates are already in effect and as there is no opposition to the rate increase from Four Corners' shippers, the order should become effective on date of signature.

Audit Report Recommendations

The Revenue Requirements Division, Energy Branch auditors made the following recommendations (Chapter 6 of Exhibit 1):

a. Applicant should be granted a 12.51% rate of return.

b. PUC should formally adopt the FERC Uniform System of Accounts.

c. The primary and supporting accounting records be maintained in conformance with the prescribed Uniform System of Accounts.

d. The General Ledger, Detail Plant, Property and Equipment Ledger, Depreciation Records, Revenues and Expense Control Accounts be set up to clearly identify all systems separately and distinctly rather than being combined or commingled.

e. All original source ledgers, journals, journal entries, vouchers, paid invoice, payrolls, etc., be made readily available upon request.

f. All transactions with ARCO be fully documented with original source documents rather than copies or with internal correspondence and/or memorandums, and that the basis for any allocation be explained in sufficient detail for audit purposes.

g. Separate records be kept for PUC intrastate utility operations as distinguished from FERC interstate utility operations, and that common items be carefully identified for purposes of allocation between the two utility functions.

h. All accounting records be posted in a chronological time sequence manner with all line items from one voucher posted together.

i. All vouchers give a full description of account number, description, explanation, and reason for debits and credits.

j. All plant additions be carefully documented to show reconciliation between Authorization for Expenditure, Report of Completion, and Detail Plant, Property and Equipment Ledger.

k. The nonutility revenues and expenses be identified in sufficient detail to spell out the nature of the revenues and expenses.

l. Form P, FERC Annual Report, clearly reflects the contents of the General Ledger and that any large and unusual items in the Balance Sheet and Income Statement be explained.

m. Journal entries for all plant retirements clearly record the original cost, accrued depreciation, and gain or loss from sale or other disposition.

n. All employees maintain time sheets to indicate the nature of work performed for utility, nonutility, and affiliated companies.

o. All paid invoices, payroll records, and other expense vouchers be competely separated for Systems 10 and 50 (California Intrastate) to provide an audit trail that can be independently reviewed by the PUC auditors.

p. ARCO should be billed for $270,000 depreciation expense for the period July 1977 to September 1979 in connection with Western Pipeline.

q. Accounts Receivables and the Accounts Payables to ARCO should not be "netted" out. Payments should be by specific invoices: cash advances should be accounted for separately; and payments or settlement of accounts should be clearly identified in separate gross transactions which leave an audit trail.

r. Overheads and other indirect expenses should be allocated based on the PUC Four Factor Method: namely, Carrier Utility Plant, Carrier Operating Expenses, Number of Customers, Number of Employees, or any other combinations. The reason: this method has been used by PUC for gas, electric, telephone and water companies for many years since 1956; therefore, for consistency in ratemaking procedures the staff recommended that Four Corners follow the same PUC method rather than its own method.

Paragraph (a), the rate of return recommendation, is discussed under a different heading.

Four Corners concurred in the recommendations set forth in paragraphs (b), (c), (d), (h), (i), (j), (k), (l), and (n).

Four Corners suggested changes in the language of paragraphs (f), (g), and (m). Staff auditors disagreed with the suggested changes in paragraphs (f) and (g) and agreed with (m). We have reviewed the testimony concerning the revised language for paragraphs (f) and (g) and conclude that the revised language would remove ambiguities and would accomplish the results sought to be obtained by the staff recommendations.

Paragraphs (f), (g), and (m), revised as follows, will be adopted:

f. All transactions with ARCO be fully documented and the basis for any allocation should be explained in sufficient detail for audit purposes.

g. Accounting records should clearly distinguish intrastate operations from interstate operations whenever practicable. Systems or facilities having combined operations should be separately identified.

m. Journal entries for all plant retirements separately record the original cost and salvage value or proceeds from sale or other disposition.

The stipulated language of paragraph (n) is as follows:

n. All employees shall maintain timesheets to indicate the nature of the work performed for California jurisdictional utility and other operations.

Four Corners opposed the adoption of audit recommendations in paragraphs (e), (o), (p), and (q). These recommendations would require Four Corners to maintain books and records in a form different than that required under the adopted FERC Uniform System of Accounts. Other utilities are not required to record on their books and records expenses allocated between California jurisdictional and nonjurisdictional operations, although such allocations are made by the utility and the staff for ratemaking purposes. Audit recommendations (e), (o), (p), and (q) will not be adopted.

Findings of Fact

1. Four Corners was granted interim increase in rates of 12.9% by D.83-04-046 as amended by D.83-05-103.

2. Four Corners seeks the balance of the 30% increase sought in this application.

3. The increase, if granted, would place the California intrastate rates for Four Corners' California System on a comparable level with its FERC-approved interstate rates.

4. Equality of intra- and interstate rates for essentially the same transportation services is a justifiable goal.

5. A return on equity in the range of 15.5% to 16% is reasonable for an oil pipeline company for the purposes of this proceeding.

6. An imputed capital structure comprised of one-third debt and two-thirds equity is reasonable for an oil pipeline company.

7. ARCO's average cost of debt since the date of ARCO's acquisition of Four Corners of approximately 12% is reasonable for the purposes of this proceeding.

8. The adopted operating revenues, operating expenses, income taxes, rate base, and rate of return set forth in Table 5 of the preceding opinion are reasonable for the purposes of this proceeding.

9. The balance of the rate increase sought in this application and not granted by interim order is justified, and will be reasonable and nondiscriminatory.

10. The adopted audit report recommendations set forth in the preceding opinion are reasonably required for effective regulation. The audit report recommendations not adopted are not reasonable and are not required.

Conclusions of Law

1. The balance of the requested rate increase not heretofore authorized should be granted.

2. The adopted audit report recommendations should be required to be implemented by Four Corners.

3. The order should become effective on the date of signature as there is no opposition from applicant's shippers, the authorized rates will result in parity between applicant's California jurisdictional rates and its interstate rates, and because this application is based on test year 1983 operating results and the full amount of the rate increase will be in effect for only a partial year.

FINAL ORDER

IT IS ORDERED that:

1. Four Corners Pipe Line Company (Four Corners) is authorized to increase the rates and charges in its Tariffs Cal. PUC 22, 24, 25, 27, 28, 29, 33, 40, 43, 44, 45, 47, 48, 49, 51, 52, and successive issues thereof, between points of origin and destination shown in Exhibit A to its amended application by 30%, in lieu of the interim increases granted before.

2. The tariff publication authorized in the preceding paragraph may be filed with the Commission on the effective date of this order to become effective five days after the date of filing.

3. Four Corners shall implement the procedures adopted in the preceding opinion in maintaining its books and accounting records.

This order is effective today.

Dated AUG 3 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. CREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

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

Joseph E. Bodovitz, Executive Director

We concur with Four Corners that ARCO debt issued after its acquisition of Four Corners should be used for computation of debt costs used in connection with the agreed imputed debt structure for ratemaking purposes.

In computing test year income taxes, the interest expense deduction should be the imputed interest cost based on the assumed capital structure and an adopted cost of debt of 12.0%.

Return on Equity

The staff report (Exhibit 1) contains the following comments and recommendations of staff witness Nagao. Four Corners was last authorized a rate of return of 11.70% in D.91253 dated January 15, 1980 in Application 58738. Four Corners' last authorized rate of return of 11.70% equates to an equity return of 14.74% when applied to ARCO's capital structure and capital costs as of December 31, 1979. A similar analysis using ARCO's capital structure and capital costs as of December 31, 1981 shows that Four Corners' requested rate of return of 14.74% equates to an equity return of 18.12%.

Staff witness Nagao stated that he believes that Four Corners' request is excessive, and he recommended an equity return of 14.74% and an overall rate of return of 12.51%. He arrived at this rate of return by applying the company's last adopted return on equity to ARCO's capital structure and cost of debt. Witness Nagao made no other study to support his recommendation as he stated that there are insufficient oil pipeline companies operating in California on which to make a comparable analysis of equity returns. ~~Witness Nagao stated that he was unfamiliar with the techniques of return on equity studies, therefore, he attempted no other form of analysis.~~