PACIFIC ENERGY PARTNERS LP
Form 10-Q
May 09, 2005

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

ý **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended March 31, 2005**

**OR**

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from to**

Commission File Number **1-313345**

# PACIFIC ENERGY PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **DELAWARE** | **68-0490580** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**5900 Cherry Avenue**

**Long Beach, CA 90805-4408**

(Address of principal executive offices)

**(562) 728-2800**

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ý No o

There were 19,258,330 of the registrant s Common Units and 10,465,000 of the registrant s Subordinated Units outstanding at March 31, 2005.

**PACIFIC ENERGY PARTNERS, L.P.**

**FORM 10-Q**

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**PACIFIC ENERGY PARTNERS, L.P. (Note 1)**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

| | March 31, 2005 | December 31, 2004 |
|---|---|---|
| | (in thousands) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 22,097 | $ 23,383 |
| Crude oil sales receivable | 51,999 | 28,609 |
| Transportation and storage accounts receivable | 21,997 | 20,137 |
| Canadian goods and services tax receivable | 7,595 | 7,632 |
| Insurance proceeds receivable (note 2) | 11,495 | |
| Due from related parties (note 3) | 128 | |
| Crude oil inventory | 26,449 | 9,174 |
| Prepaid expenses | 4,928 | 4,159 |
| Other | 3,654 | 2,451 |
| Total current assets | 150,342 | 95,545 |
| Property and equipment, net | 715,580 | 718,624 |
| Investment in Frontier | 8,200 | 7,886 |
| Other assets, net | 45,968 | 47,850 |
| | $ 920,090 | $ 869,905 |
| | | |
| **LIABILITIES AND PARTNERS CAPITAL** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 17,273 | $ 15,127 |
| Accrued crude oil purchases | 65,493 | 27,231 |
| Line 63 oil release reserve (note 2) | 13,496 | |
| Accrued interest | 5,538 | 1,124 |
| Due to related parties (note 3) | | 533 |
| Derivatives liability current portion | 1,410 | 400 |
| Other | 5,930 | 3,630 |
| Total current liabilities | 109,140 | 48,045 |
| Senior notes and credit facilities, net (note 4) | 356,369 | 357,163 |
| Deferred income taxes | 34,248 | 34,556 |
| Environmental liabilities | 7,022 | 7,269 |
| Other liabilities | 340 | 406 |
| Total liabilities | 507,119 | 447,439 |
| Commitments and contingencies (notes 2 and 8) | | |
| Partners capital: | | |
| Common unitholders (19,258,330 and 19,158,747 units outstanding at March 31, 2005 and December 31, 2004, respectively) | 356,708 | 361,427 |
| Subordinated unitholders (10,465,000 units outstanding at March 31, 2005 and December 31, 2004) | 38,096 | 41,521 |
| General Partner interest | 6,714 | 6,280 |
| Undistributed employee long-term incentive compensation (note 5) | | 116 |
| Accumulated other comprehensive income | 11,453 | 13,122 |

| | | | | |
|---|---|---|---|---|
| Net partners capital | | 412,971 | | 422,466 |
| | $ | 920,090 | $ | 869,905 |

See accompanying notes to condensed consolidated financial statements.

**PACIFIC ENERGY PARTNERS, L.P. (Note 1)**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**(Unaudited)**

| | Three Months Ended March 31, 2005 | Three Months Ended March 31, 2004 |
|---|---|---|
| | (in thousands, except per unit amounts) | |
| Pipeline transportation revenue | $ 28,037 | $ 24,727 |
| Storage and terminaling revenue | 10,322 | 10,123 |
| Pipeline buy/sell transportation revenue | 9,106 | |
| Crude oil sales, net of purchases of $114,391 and $81,115 for the three months ended March 31, 2005 and 2004 | 1,782 | 4,812 |
| Net revenue | 49,247 | 39,662 |
| Expenses: | | |
| Operating | 21,754 | 18,917 |
| Line 63 oil release costs (note 2) | 2,000 | |
| General and administrative | 5,172 | 3,854 |
| Accelerated long-term incentive plan compensation expense (note 5) | 3,115 | |
| Transaction costs (notes 3 and 6) | 1,807 | |
| Depreciation and amortization | 6,529 | 5,242 |
| | 40,377 | 28,013 |
| Share of net income of Frontier | 357 | 393 |
| Operating income | 9,227 | 12,042 |
| Interest expense | (5,598) | (4,126) |
| Other income | 353 | 161 |
| Income before income taxes | 3,982 | 8,077 |
| Income tax (expense) recovery: | | |
| Current | (732) | |
| Deferred | 171 | |
| | (561) | |
| Net income | $ 3,421 | $ 8,077 |
| Net income (loss) for the general partner interest (note 6) | $ (1,702) | $ 162 |
| Net income for the limited partner interests | $ 5,123 | $ 7,915 |
| | | |
| Basic net income per limited partner unit | $ 0.17 | $ 0.32 |
| Diluted net income per limited partner unit | $ 0.17 | $ 0.31 |
| | | |
| Weighted average limited partner units outstanding: | | |
| Basic | 29,655 | 24,999 |
| Diluted | 29,673 | 25,149 |

See accompanying notes to condensed consolidated financial statements.

**PACIFIC ENERGY PARTNERS, L.P. (Note 1)**

**CONDENSED CONSOLIDATED STATEMENT OF PARTNERS CAPITAL**

**(Unaudited)**

| | Limited Partner Units | | Limited Partner Amounts | | General Partner Interest | Undistributed Employee Long-Term Incentive Compensation | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|---|---|
| | Common | Subordinated | Common | Subordinated | | | | |
| | | | | (in thousands) | | | | |
| Balance, December 31, 2004 | 19,159 | 10,465 | $ 361,427 | $ 41,521 | $ 6,280 | $ 116 | $ 13,122 | $ 422,466 |
| Net income (note 6) | | | 3,315 | 1,808 | (1,702) | | | 3,421 |
| Distribution to partners | | | (9,579) | (5,233) | (302) | | | (15,114) |
| General partner contribution (note 6) | | | | | 2,407 | | | 2,407 |
| Employee compensation under long-term incentive plan | | | | | | 2,886 | | 2,886 |
| Issuance of common units pursuant to long-term incentive plan (note 5) | 99 | | 1,545 | | 31 | (3,002) | | (1,426) |
| Foreign currency translation adjustment | | | | | | | (537) | (537) |
| Change in fair value of hedging derivatives | | | | | | | (1,132) | (1,132) |
| Balance, March 31, 2005 | 19,258 | 10,465 | $ 356,708 | $ 38,096 | $ 6,714 | $ | $ 11,453 | $ 412,971 |

See accompanying notes to condensed consolidated financial statements.

**PACIFIC ENERGY PARTNERS, L.P. (Note 1)**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

| | Three Months Ended March 31, 2005 | Three Months Ended March 31, 2004 |
|---|---|---|
| | (in thousands) | (in thousands) |
| Net income | $ 3,421 | $ 8,077 |
| Change in fair value of hedging derivatives | (1,132) | (4,236) |
| Change in foreign currency translation adjustment | (537) | |
| Comprehensive income | $ 1,752 | $ 3,841 |

See accompanying notes to condensed consolidated financial statements.

**PACIFIC ENERGY PARTNERS, L.P. (Note 1)**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Three Months Ended March 31, 2005 | Three Months Ended March 31, 2004 |
|---|---|---|
| | (in thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 3,421 | $ 8,077 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 6,529 | 5,242 |
| Amortization of debt issue costs | 459 | 311 |
| Non-cash portion of employee compensation under long-term incentive plan | 1,545 | 659 |
| Deferred tax benefit | (171) | |
| Share of net income of Frontier | (357) | (393) |
| Distributions from Frontier, net | | 289 |
| | 11,426 | 14,185 |
| Net changes in operating assets and liabilities: | | |
| Crude oil sales receivable | (23,327) | 5,556 |
| Transportation and storage accounts receivable | (1,832) | 676 |
| Insurance proceeds receivable | (11,495) | |
| Crude oil inventory | (17,246) | (2,995) |
| Other current assets and liabilities | (1,681) | 422 |
| Accounts payable and other accrued liabilities | 8,716 | 1,319 |
| Accrued crude oil purchases | 38,176 | (5,981) |
| Line 63 oil release reserve | 13,496 | |
| Other non-current assets and liabilities | (301) | |
| | 4,506 | (1,003) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 15,932 | 13,182 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to property and equipment | (4,389) | (2,413) |
| Acquisition deposit | | (9,920) |
| Other | 129 | |
| NET CASH USED IN INVESTING ACTIVITIES | (4,260) | (12,333) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Issuance of common units, net of fees and offering expenses | | 114,250 |
| Capital contributions from the general partner | 2,438 | 2,443 |
| Proceeds from note payable to bank | 26,833 | 16,500 |
| Repayment of long-term debt | (25,854) | (89,500) |
| Deferred financing costs | (600) | (175) |
| Distributions to partners | (15,114) | (12,390) |
| Related parties | (661) | 156 |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | (12,958) | 31,284 |
| | | |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (1,286) | 32,133 |
| CASH AND CASH EQUIVALENTS, beginning of reporting period | 23,383 | 9,699 |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS, end of reporting period | $ 22,097 | $ 41,832 |

See accompanying notes to condensed consolidated financial statements.

**PACIFIC ENERGY PARTNERS, L.P.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2005**

**(Unaudited)**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

Pacific Energy Partners, L.P. and its subsidiaries (the Partnership ) are engaged principally in the business of gathering, transporting, storing and distributing crude oil and related products in California and the Rocky Mountain region of the U.S. and Canada. The Partnership generates revenue primarily by transporting crude oil on its pipelines and by leasing storage capacity. The Partnership also buys, blends and sells crude oil, activities that are complementary to the Partnership s pipeline transportation business. The Partnership operates primarily in California, Colorado, Montana, Wyoming and Utah in the United States, and in Alberta, Canada and conducts its business through two regional business segments: the West Coast Business Unit and the Rocky Mountain Business Unit.

We are managed by our general partner, Pacific Energy GP, LP, a Delaware limited partnership, which, prior to its conversion to a limited partnership on March 3, 2005, was Pacific Energy GP, Inc., a corporation owned 100% by a subsidiary of The Anschutz Corporation ( TAC ). On March 3, 2005, TAC sold all of its interest in Pacific Energy GP, Inc. to LB Pacific, LP ( LBP ), which was formed by the Lehman Brothers Merchant Banking Group ( LBMB ) in connection with the purchase (see Note 3 Related Party Transactions ). Pacific Energy GP, LP is managed by its general partner, Pacific Energy Management LLC, a Delaware limited liability company.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and with Securities and Exchange Commission ( SEC ) regulations. Accordingly, these statements have been condensed and do not include all of the information and footnotes required for complete financial statements. These statements involve the use of estimates and judgments where appropriate. In the opinion of management, all adjustments, consisting of normal recurring accruals considered necessary for a fair presentation, have been included. The results of operations for the three months ended March 31, 2005 are not necessarily indicative of the results of operations for the full year. All significant intercompany balances and transactions have been eliminated during the consolidation process.

The condensed consolidated financial statements include the ownership and results of operations of the Rangeland system, including the Mid-Alberta Pipeline ( MAPL ), since the acquisition of those assets on May 11, 2004 and June 30, 2004, respectively.

These financial statements should be read in conjunction with the Partnership s audited consolidated financial statements and notes thereto included in the Partnership s annual report on Form 10-K for the year ended December 31, 2004. Certain prior year balances in the accompanying condensed consolidated financial statements have been reclassified to conform to the current year presentation.

**Income Taxes**

The Partnership and its U.S. and Canadian subsidiaries are not taxable entities in the U.S. and are not subject to U.S. federal or state income taxes, as the tax effect of operations is passed through to its unitholders. The Partnership s Canadian subsidiaries are taxable entities in Canada and are subject to Canadian federal and provincial income taxes and other Canadian income taxes. In addition, monies repatriated from Canada into the U.S. may be subject to withholding taxes.

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. The Partnership intends to repatriate its Canadian subsidiaries earnings in the future. As such, the Partnership records a provision for Canadian withholding taxes on any repatriable earnings of its Canadian subsidiaries.

**Net Income per Unit**

Basic net income per limited partner unit is determined by dividing net income after deducting the amount allocated to the general partner interest, by the weighted average number of outstanding limited partner units.

Diluted net income per limited partner unit is calculated in the same manner as basic net income per limited partner unit above, except that the weighted average number of outstanding limited partner units is increased to include the dilutive effect of outstanding options and restricted units by application of the treasury stock method. Following is a reconciliation of the basic weighted average outstanding limited partner units to diluted weighted average limited partner units.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| | (in thousands) | |
| Basic weighted average limited partner units | 29,655 | 24,999 |
| Effect of restricted units | | 134 |
| Effect of options | 18 | 16 |
| Diluted weighted average limited partner units | 29,673 | 25,149 |

**Allocation of Net Income**

Net income is allocated to the Partnership s general partner and limited partners based on their respective interest in the Partnership. The Partnership s general partner is also directly charged with specific costs that it has individually assumed and for which the limited partners are not responsible (see Note 6 Allocation of Net Income ).

**New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 123 (revised December 2004), *Share-Based Payment (SFAS 123R)*. This Statement is a revision of SFAS No. 123. SFAS 123R establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services. SFAS 123R is effective for the Partnership as of the beginning of the first annual reporting period that begins after June 15, 2005. The Partnership has not yet determined the impact of the adoption of SFAS 123R on the Partnership s consolidated financial statements.

On March 30, 2005 the FASB issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations (FIN 47)*, to clarify the term *conditional asset retirement obligation* as that term is used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. The Interpretation also clarifies when an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective for the Partnership no later than the end of fiscal years ending after December 15, 2005. The Partnership is in the process of determining the impact of FIN 47 on its financial statements.

**2. LINE 63 OIL RELEASE RESERVE**

On March 23, 2005, a release of approximately 3,400 barrels of crude oil occurred on Line 63 when it was severed as a result of a landslide induced by heavy rainfall in the Pyramid Lake area of Los Angeles County. Over the period March 2005 through March 2006, the Partnership expects to incur an estimated $13.5 million for oil containment and clean-up of the impacted areas, future monitoring costs, potential third-party claims and penalties, and other costs. As of March 31, 2005, the Partnership had incurred approximately $3.3 million of the total expected costs related to the oil release for work performed through that date. Additionally, the Partnership expects to incur approximately $1.0

million to repair the pipeline, which will be expensed as incurred.

The Partnership has a pollution liability insurance policy with a $2.0 million deductible that covers containment and clean-up costs, third-party claims and penalties. The insurance carrier has, subject to a reservation of certain rights, acknowledged coverage of the incident under the policy and has begun processing and paying invoices related to the clean-up. The Partnership believes that, subject to the $2.0 million deductible, it will be entitled to recover substantially all of its clean-up costs and any third party claims associated with the release. The Partnership s insurance coverage will not cover the cost to repair the pipeline. For the three months ended March 31, 2005, the Partnership accrued a receivable of $11.5 million for insurance receipts it deems probable.

Accrued costs relating to the release of $13.5 million net of accrued insurance receipt of $11.5 million, or $2.0 million, are recorded in Line 63 oil release costs in the accompanying condensed consolidated statements of income for the three months ended March 31, 2005.

The foregoing estimates are based on facts known at the time of estimation and the Partnership s assessment of the ultimate outcome. Among the many uncertainties that impact the estimates are the necessary regulatory approvals for, and potential modification of, remediation and repair plans, the limited amount of data available at the time of the assessment of the impact of soil and water contamination, the current uncertainty of the geological conditions that will be encountered during the repairs of the damaged pipeline, changes in costs associated with environmental remediation services and equipment and the possibility of third-party legal claims giving rise to additional expenses. Therefore, no assurance can be made that costs incurred in excess of this provision, if any, would not have a material adverse effect on the Partnership s financial condition, results of operations, or cash flows, though the Partnership believes it is likely that most, if not all, of any such excess cost, to the extent attributable to clean-up and third-party claims, would be recoverable through insurance. As new information becomes available in future periods, the Partnership may change its provision and recovery estimates.

## 3. RELATED PARTY TRANSACTIONS

### Sale of The Anschutz Corporation s Interest in the Partnership

On March 3, 2005, TAC sold all of its interest in Pacific Energy GP, Inc. to LBP, which was formed by LBMB in connection with the purchase. The acquisition by LBP (the LB Acquisition ) included the 100% ownership interest in Pacific Energy GP, Inc., which owned (i) the 2% general partner interest in the Partnership and the incentive distribution rights, and (ii) 10,465,000 subordinated units of the Partnership representing a 34.6% limited partner interest in the Partnership. Immediately prior to the closing of the LB Acquisition, Pacific Energy GP, Inc. was converted to Pacific Energy GP, LLC, a Delaware limited liability company; and immediately after the closing of the LB Acquisition, Pacific Energy GP, LLC was converted to Pacific Energy GP, LP (the General Partner ). Immediately following the consummation of the LB Acquisition, the General Partner distributed the 10,465,000 subordinated units of the Partnership to LBP.

In connection with the conversion of the Partnership s General Partner to a limited partnership, the General Partner ceased to have a board of directors, and is now managed by its general partner, Pacific Energy Management LLC, a Delaware limited liability company ( PEM or the Managing General Partner ), which is 100% owned by LBP. PEM has a board of directors (the Board of Directors or Board ) that manages the business and affairs of PEM and, thus, indirectly manages the business and affairs of the General Partner and the Partnership. All of the officers and employees of Pacific Energy GP, Inc. were transferred to fill the same positions with PEM, and the PEM Board established the same committees as had been maintained by Pacific Energy GP, Inc. prior to the LB Acquisition. PEM also adopted Pacific Energy GP, Inc. s governance guidelines and its compensation structure and employee benefits plans and policies.

Additionally, on March 21, 2005, an affiliate of First Reserve Corporation ( First Reserve ) acquired from LBMB a 30% partnership interest in LBP. LBMB and its affiliates continue to own a 70% partnership interest in LBP. As a result of its ownership interest, First Reserve is entitled to and has nominated one director to the Board of Directors of PEM. The director nominated by First Reserve was appointed by LBP to the Board on April 6, 2005.

The Board of Directors of PEM is now comprised of six of the directors who served on the board of directors of Pacific Energy GP, Inc. prior to the LB Acquisition, together with five new directors appointed by LBP.

### Cost Reimbursements

***Managing General Partner:*** The Partnership s Managing General Partner employs all U.S.-based employees. All employee expenses incurred by the Managing General Partner on behalf of the Partnership are charged back to the Partnership.

***Special Agreement:*** On March 3, 2005, Douglas L. Polson, previously the Chairman of the Board of Directors of Pacific Energy GP, Inc., entered into a Special Agreement and a Consulting Agreement with PEM. In accordance with the Special Agreement, Mr. Polson resigned as Chairman of the Board of Directors of Pacific Energy GP, Inc. effective March 3, 2005. Mr. Polson was paid approximately $0.9 million, representing accrued but unused vacation, accrued salary through March 3, 2005 and payment in satisfaction of other obligations under his employment agreement. The severance portion of this payment of approximately $0.9 million was recorded as an expense in Transaction costs in the accompanying condensed consolidated income statements (see Note 6 Allocation of Net Income ). LBP reimbursed this amount, which was recorded as a partner s capital contribution. Pursuant to the Consulting Agreement, Mr. Polson has agreed to perform advisory services to PEM from time to time as shall be mutually agreed between Mr. Polson and the Chief Executive Officer of PEM. In consideration for Mr. Polson s services under the Consulting Agreement, which has a one-year term, Mr. Polson will receive a monthly consulting fee of $12,500 and reimbursement of all reasonable business expenses incurred or paid by Mr. Polson in the course of performing his duties thereunder.

***LB Pacific, LP and TAC:*** LBP and TAC reimbursed the Partnership for certain other costs relating to the LB Acquisition. These included $1.2 million for the Consent Solicitation (as defined and further described in Note 4 Long-Term Debt , below) and $0.3 million for legal and other expenses (also see Note 6 Allocation of Net Income ).

**Other Related Party Transactions**

***Revenue from Related Parties:*** Rocky Mountain Pipeline system (   RMPS   ) serves as the contract operator for certain gas producing properties owned by a subsidiary of TAC in Wyoming and Utah, in exchange for which RMPS is reimbursed its direct costs of operation and is paid an annual fee of $0.3 million as compensation for the time spent by RMPS management and for other overhead services related to their activities.

RMPS also receives an operating fee and management fee from Frontier Pipeline Company ( Frontier ) in connection with time spent by RMPS management and for other services related to Frontier s pipeline s activities. RMPS received $0.2 million and $0.1 million for the three months ended March 31, 2005 and 2004, respectively.

***Expenses Paid to Related Parties:*** The Partnership utilizes the financial accounting system owned and provided by TAC under a shared services arrangement for a fee of $0.1 million per year and TAC charges the Partnership for any out-of-pocket costs it incurs. The fixed annual fee includes all license, maintenance and employee costs associated with the Partnership s use of the financial accounting system. The Partnership will continue to use the financial accounting system after the close of the LB Acquisition pursuant to a transition services agreement until December 31, 2005, or earlier if elected by the Partnership.

In January 2003, the Partnership began leasing approximately 4,700 square feet of office space from an affiliate of TAC, for a term of five years at an annual cost of $0.1 million per year. This space was increased to 5,400 square feet in 2004.

***Due from (to) Related Parties:*** Due from related parties consists of $0.1 million due from PEM and $0.5 million due to Pacific Energy GP, Inc. at March 31, 2005 and December 31, 2004, respectively.

**4. LONG-TERM DEBT**

The Partnership s long-term debt obligations are shown below:

| | March 31, 2005 | December 31, 2004 |
|---|---|---|
| | (in thousands) | |
| Senior secured U.S. revolving credit facility, bearing interest at 4.4% on March 31, 2005, due July 2007 | $ 52,000 | $ 51,000 |
| Senior secured Canadian revolving credit facility, bearing interest at 4.9% on March 31, 2005, due May 2007 | 53,737 | 54,005 |
| Senior notes, net of unamortized discount of $4,125 and including fair value increase of $1,063, with a coupon of 71/8%, due June 2014 | 246,938 | 248,491 |
| Future payment for MAPL assets, net of unamortized discount of $439, due June 2007 | 3,694 | 3,667 |
| Long-term debt | $ 356,369 | $ 357,163 |

Under the Indenture governing the Partnership s Senior Notes, the Partnership would have been required to make a Change of Control Offer to the note holders if the LB Acquisition would have caused a rating decline. In order to avoid triggering the Change of Control Offer provision, the Partnership solicited the consent (the Consent Solicitation ) of the holders of the Senior Notes to amend certain provisions of the Indenture, including an amendment to the definition of Change of Control. The Consent Solicitation commenced on January 28, 2005 and expired on February 10, 2005. During that time, a majority of the holders of the Senior Notes consented to the adoption of the proposed amendments and as such the proposed amendments were approved. Thereafter, a supplemental indenture that incorporated the proposed amendments was executed by the parties to the Indenture. Fees of approximately $0.6 million paid to holders of the Senior Notes were capitalized and included in Other assets in the accompanying condensed consolidated balance sheet at March 31, 2005 and will be amortized over the remaining life of the Senior Notes. Solicitation related fees and expenses of approximately $0.6 million are included in Transaction costs in the accompanying condensed consolidated statements of income. LBP and TAC reimbursed the Partnership for the costs of the Consent Solicitation, which are recorded as a partner s capital contribution (see Note 3 Related Party Transactions ).

Additionally, the U.S. and Canadian revolving credit facilities also contained change of control provisions. The Partnership amended the U.S. and Canadian revolving credit facilities to account for the change in control of its General Partner.

**5. VESTING OF UNIT GRANTS UNDER LONG-TERM INCENTIVE PLAN**

On March 3, 2005, in connection with the LB Acquisition and with the change in control of the Partnership s General Partner, all restricted units outstanding under the Partnership s Long-Term Incentive Plan immediately vested pursuant to the terms of the grants. The Partnership issued 99,583 common units and recognized a compensation expense of $3.1 million, which is included in Accelerated long-term incentive plan compensation expense in the accompanying condensed consolidated statements of income.

**6. ALLOCATION OF NET INCOME**

The allocation of net income between the Partnership s general partner and limited partners is as follows.

| | Three Months Ended March 31, 2005 | | 2004 | |
|---|---|---|---|---|
| | (in thousands) | | | |
| Net income | $ 3,421 | | $ 8,077 | |
| Transaction costs reimbursed by general partner: | | | | |
| Senior Notes consent solicitation and other costs | 893 | | | |
| Severance and other costs | 914 | | | |
| Total transaction costs reimbursed by general partner | 1,807 | | | |
| Income before transaction costs reimbursed by general partner | 5,228 | | 8,077 | |
| General partner s share of income | 2 | % | 2 | % |
| General partner allocated share of net income before transaction costs | 105 | | 162 | |
| Transaction costs reimbursed by general partner | (1,807 | ) | | |
| Net income (loss) allocated to general partner | $ (1,702 | ) | $ 162 | |
| | | | | |
| Income before transaction costs reimbursed by general partner | $ 5,228 | | $ 8,077 | |
| Limited partners share of income | 98 | % | 98 | % |
| Limited partners share of net income | $ 5,123 | | $ 7,915 | |
| | | | | |
| Net income (loss) allocated to general partner | $ (1,702 | ) | $ 162 | |
| Net income allocated to limited partners | 5,123 | | 7,915 | |
| Net income | $ 3,421 | | $ 8,077 | |

LBP and TAC reimbursed the Partnership for certain costs incurred in connection with the LB Acquisition. The Partnership was reimbursed $1.2 million for costs incurred in connection with the consent solicitation, $0.3 million of legal and other costs and $0.9 million relating to severance costs (see Note 3 Related Party Transactions ), for a total of $2.4 million. Of the $1.2 million incurred for the consent solicitation, $0.6 million was capitalized as deferred financing costs and $0.6 million was expensed.

## 7. SEGMENT INFORMATION

The Partnership s business and operations are organized into two regional business segments: West Coast Business Unit and Rocky Mountain Business Unit. The West Coast Business Unit includes: (i) Pacific Pipeline System LLC, owner of Line 2000 and Line 63, (ii) Pacific Marketing and Transportation LLC, owner of the PMT gathering and blending system, and (iii) Pacific Terminals LLC, owner of the Pacific Terminals storage and distribution system. The Rocky Mountain Business Unit includes: (i) Rocky Mountain Pipeline System LLC, owner of the Partnership s interest in various pipelines that make up the Western Corridor and Salt Lake City Core systems, (ii) Ranch Pipeline LLC, the owner of a 22.22% partnership interest in Frontier Pipeline Company, and (iii) PEG Canada, L.P. and its Canadian subsidiaries, which own and operate the Rangeland system (for the period since May 11, 2004). General and administrative costs, which consist of executive management, accounting and finance, human resources, information technology, investor relations, legal, and business development, are not allocated to the individual business units. Information regarding these two business units is summarized below:

| | West Coast Business Unit | Rocky Mountain Business Unit | Intersegment and Intrasegment Eliminations | Total |
|---|---|---|---|---|
| | (in thousands) | | | |
| **Three months ended March 31, 2005** | | | | |
| Business unit revenue: | | | | |
| Pipeline transportation revenue | $ 17,443 | $ 12,456 | $ (1,862) | $ 28,037 |
| Storage and distribution revenue | 10,472 | | (150) | 10,322 |
| Pipeline buy/sell transportation revenue(1) | | 9,106 | | 9,106 |
| Crude oil sales, net of purchases(2) | 1,812 | | (30) | 1,782 |
| Net revenue | 29,727 | 21,562 | | 49,247 |
| Expenses: | | | | |
| Operating | 14,507 | 9,289 | (2,042) | 21,754 |
| Line 63 oil release costs(3) | 2,000 | | | 2,000 |
| Depreciation and amortization | 3,477 | 3,052 | | 6,529 |
| Total expenses | 19,984 | 12,341 | | 30,283 |
| Share of net income of Frontier | | 357 | | 357 |
| Operating income from segments(4) | $ 9,743 | $ 9,578 | | $ 19,321 |
| Business unit assets(5) | $ 538,568 | $ 350,600 | | $ 889,168 |
| Capital expenditures(6) | $ 750 | $ 2,932 | | $ 3,682 |
| | | | | |
| **Three months ended March 31, 2004** | | | | |
| Business unit revenue: | | | | |
| Pipeline transportation revenue | $ 15,691 | $ 10,543 | $ (1,507) | $ 24,727 |
| Storage and distribution revenue | 10,223 | | (100) | 10,123 |
| Crude oil sales, net of purchases(2) | 4,812 | | | 4,812 |
| Net revenue | 30,726 | 10,543 | | 39,662 |
| Expenses: | | | | |
| Operating | 14,706 | 5,818 | (1,607) | 18,917 |
| Depreciation and amortization | 3,765 | 1,477 | | 5,242 |
| Total expenses | 18,471 | 7,295 | | 24,159 |
| Share of net income of Frontier | | 393 | | |