

1 **Q. Please state your name and business address.**

2 A. My name is Kenneth L. Elgin. My business address is Chandler Plaza Building,
3 1300 South Evergreen Park Drive SW, Olympia, Washington, 98504-7250.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. The Regulatory Services Division of the Washington Utilities and Transportation
7 Commission employs me as its Case Strategist.

8

9 **I. SCOPE OF TESTIMONY AND RECOMMENDATION**

10 **Q. What is the scope of your testimony?**

11 A. I describe the case presented by Olympic Pipe Line (“Olympic”) for interim rate
12 relief. I discuss what standards the Commission should apply in analyzing
13 applications for interim rate relief under Title 81. I then attempt to apply those
14 standards to Olympic’s situation. Based upon my analysis, and the analysis of
15 Staff witness Mr. Colbo, I make a recommendation for interim rate relief.

16

17 **Q. Please summarize Staff’s recommendation.**

18 A. Olympic should receive interim rate relief in the amount of \$2,719,829 for its
19 Washington intrastate operation, subject to refund. This is a 19.48% increase to
20 current rates.

21 **Q. Are you sponsoring any exhibits in this proceeding?**

22 A. Yes. I am sponsoring Exhibit Nos. ____ (KLE-2) through ____ (KLE-4).

23

24

1 I have testified before the Commission on many occasions. I have
2 testified before the FERC on issues related to rate design and risk for interstate
3 natural gas pipelines. I have also testified in Superior Court regarding the
4 regulation of investor-owned utilities, including issues of rate of return and
5 valuation under the public service laws, as administered by the Commission
6 pursuant to Title 80 RCW. I have been the lead analyst for numerous tariff filings
7 and in that capacity I have presented Staff recommendations to the Commission at
8 its regular open public meeting. I have made several studies of the cost of capital
9 for energy companies in rate case filings, all of which led to a settlement of this
10 issue. I have provided testimony and analysis in other contested cases that either
11 resulted in settlements or requests to have the Docket withdrawn by the applicant.
12 Finally, I have been retained by the Department of Revenue providing analysis of
13 utility rate making issues.

14 During my seventeen years of experience working on energy and financial
15 issues, I have developed a thorough working knowledge of both the operations
16 and financial profiles of all energy utilities operating in Washington.

17 Exhibit No. ___ (KLE-2) contains a list of the formal proceedings and
18 related Dockets in which I have prepared testimony for proceedings before the
19 Commission and the FERC. It also contains a list of major cases where I have
20 provided analysis of significant issues for the Commission.

1 **III. OVERVIEW OF OLYMPIC’S CASE FOR INTERIM RATE RELIEF**

2 **Q. Please summarize Olympic’s case for interim rate relief.**

3 A. Olympic alleges it is “rapidly losing money” from the continued operation of its
4 oil pipeline. (Amended Petition at 2). Olympic testifies that it has about
5 \$141,800,000 of debt outstanding, and it has accrued, unpaid interest of an
6 additional \$8,000,000. Olympic says it needs to spend an additional \$24 million
7 in 2002 for new capital projects. The Company claims that without interim rate
8 relief, it will be unable to raise needed capital from external sources for these new
9 projects. (Supplemental Testimony of Mr. Batch, Exhibit No. ____ (BCB-5) at 3-
10 5).

11 **IV. STANDARDS FOR INTERIM RATE RELIEF**

12 **Q. What precedent does the Company rely upon for its request for interim rate**
13 **relief?**

14 A. Olympic relies upon the Commission’s Second Supplemental Order in *Utilities &*
15 *Transportation Commission v. Washington Natural Gas Co.*, Cause No. U-80-111
16 (March 3, 1981) (Amended Petition at pages 2-3). In that case, Washington
17 Natural Gas Company filed a general rate request, and it sought an emergency
18 interim surcharge to general rates. In its Order, the Commission rejected the
19 request for rate relief in the form of an emergency surcharge. However, the
20 Commission did grant interim rate relief based on what is commonly referred to
21 as the “PNB Test.” (See *Utilities & Transportation Commission v. Pacific*
22 *Northwest Bell Telephone Company*, Second Supplemental Order, Cause No. U-
23 72-30 tr (October 10, 1972)(“PNB Order”).

1 **Q. Has the Commission recently evaluated requests for emergency rate relief?**

2 A. Yes. The Commission recently issued orders in two cases involving requests for
3 immediate rate relief in situations that were alleged to be emergencies: *In re*
4 *Avista Corporation, d/b/a Avista Utilities*, Docket No. UE-010395, 6th
5 Supplemental Order (September 24, 2001) and *Utilities & Transportation*
6 *Commission v. Puget Sound Energy, Inc.*, Docket Nos. UE-011163/011170, 6th
7 Supplemental Order (October 4, 2001).

8
9 **Q. Did the Commission apply the PNB Test in each of those recent Orders?**

10 A. Yes. In the case involving Avista Utilities, the Commission determined that a
11 utility, upon showing that its financial health would continue to decline, causing
12 jeopardy to both the utility and ratepayers, is entitled to immediate rate relief.
13 The Commission made a distinction between interim rate relief (*i.e.*, within the
14 context of a general rate case) and the emergency request of Avista (which did not
15 involve a general rate application). However, the Commission analyzed Avista's
16 request within the framework of the PNB Test. (6th Supp. Order in Docket UE-
17 010395 at 12-27).

18 The case involving Puget Sound Energy was also outside the context of a
19 general rate filing. The Commission ruled that Puget Sound Energy did not
20 provide sufficient evidence to show that an emergency existed warranting
21 immediate rate relief. The Commission reasoned that "... such relief
22 must...provide a clear showing of the adverse consequences...and must
23 demonstrate why relief in a general rate case, or in an interim request associated

1 with a general rate increase, would be inadequate to protect the Company and its
2 ratepayers from severe financial consequences.” (6th Supp. Order in Docket Nos.
3 UE-011163 and 011170 at 8). The Commission applied the PNB Test in that case
4 as well. (*Id.* at 12).

5
6 **Q. Does Staff agree that the PNB Test should be utilized in this case, which**
7 **arises under Title 81 RCW?**

8 A. Yes. The PNB Test provides a useful framework for considering requests for
9 interim rate relief. Moreover, since the statutory schemes in Title 80 and Title 81
10 are sufficiently similar, the same standards should apply.

11 In reaching this conclusion, I compared RCW 80.28.010 (1) & (2) and
12 80.36.080 (governing the duties of the Commission to establish rates for utilities
13 and telecommunications companies), with RCW 81.28.010, which prescribes
14 similar duties in establishing rates for common carriers, such as Olympic. These
15 statutes provide similar direction to the Commission: to ensure that rates for
16 service rendered by a public service company are, “...fair, just, reasonable and
17 sufficient.”

18 In addition, it is instructive to note that the legislature directed the
19 Commission to place similar obligations on public service companies under both
20 Title 80 and Title 81 regarding the adequacy of service. Under both RCW
21 80.28.010 and 81.28.010, the Commission is directed to ensure that facilities are
22 safe, adequate, sufficient and reasonable. Finally, in both Title 80 and 81 the

1 Commission has authority to order improved service for public service
2 companies. (*See* RCW 80.28.030, RCW 81.28.240 and RCW 81.44.010)

3 Moreover, for purposes of issuing securities, Commission regulation of
4 public service companies under Title 80 and 81 is similar. Chapter 80.08 RCW
5 and Chapter 81.08 RCW prescribe the types of securities a public service
6 company may issue, and limits the use of proceeds received from the issuance of
7 the securities. In general, the two titles regulate public service companies
8 similarly for purposes of securities, all of which is designed to ensure that the
9 securities issued by any public service company are for long-lived assets
10 dedicated to serving the public.

11 There is one difference between Title 80 and 81 to note. In Title 80,
12 public service companies are expressly required to provide all available service to
13 those reasonably entitled to demand it. (*See* RCW 80.28.110 (electric, gas and
14 water companies) and RCW 80.36.090 (telecommunications companies)). In
15 Title 81, the Commission has the power to order that specific facilities of a
16 common carrier be improved if existing services are inadequate or insufficient.
17 (*See* RCW 81.28.240). While these service obligations are not identical, the
18 difference is not sufficient to require a materially different standard for interim
19 rate relief.

20 Therefore, as a general matter, I recommend that for public service
21 companies subject to Title 81, such as Olympic, the Commission should apply the
22 same standards it applies for emergency rate relief involving public service
23 companies under Title 80.

1 Q. Please state and then explain the "PNB Test."

2 A. The Commission first stated the test in the PNB Order in 1972, as follows:

- 3 1) The Commission has authority in proper circumstances to grant interim
4 rate relief to a utility but this should be done only after an opportunity for
5 an adequate hearing.
- 6 2) An interim rate increase is an extraordinary remedy and should be granted
7 only where an actual emergency exists or where necessary to prevent
8 gross hardship or gross inequity.
- 9 3) The mere failure of the currently realized rate of return to equal that
10 approved as adequate is not sufficient, standing alone, to justify the
11 granting of interim relief.
- 12 4) The Commission should review all financial indices as they concern the
13 applicant, including rate of return, interest coverage, earnings coverage
14 and the growth, stability or deterioration of each, together with the
15 immediate and short term demands for new financing and whether the
16 grant or failure to grant interim relief will have such an effect on financing
17 demands as to substantially affect the public interest.
- 18 5) Interim relief is a useful tool in an appropriate case to fend off impending
19 disaster. However, the tool must be used with caution and applied only
20 where not to grant would cause clear jeopardy to the utility and detriment
21 to its ratepayers and stockholders. That is not to say that interim relief
22 should be granted only after disaster has struck or is imminent, but neither
23 should it be granted in any case where full hearing can be had and the
24 general case resolved without clear detriment to the utility.
- 25 6) The commission must reach its conclusion with its statutory charge to
26 "Regulate in the public interest" in mind. This is our ultimate
27 responsibility and a reasoned judgment must give appropriate weight to all
28 salient factors.

29
30 Since the PNB Order in 1972, the Commission in determining whether to approve
31 emergency rate relief has consistently utilized these standards.

32 In general, the PNB Test requires analysis that focuses on the short-term
33 needs of the public service company to raise additional external capital for
34 constructing and maintaining the facilities needed to serve the public, and whether
35 that company has sufficient earnings to issue additional debt to raise that capital.

1 This involves an analysis of any financial covenants restricting the
2 company from issuing additional debt in the capital markets. Generally, the
3 analysis determines what earnings are necessary to meet the pertinent covenants
4 related to the company's bonds or preferred equity. The analysis provides the
5 connection between the additional earnings interim rates will produce, and the
6 specific financing covenants and requirements of the company that must be
7 satisfied in order to finance.

8
9 **Q. What types of information and analysis was presented to the Commission in**
10 **the case relied on by Olympic, Cause No. U-80-111, that supported the**
11 **Commission's determination that interim relief was appropriate in that case?**

12 A. The Commission had evidence demonstrating that Washington Natural Gas
13 Company was in default of its indentures, which prohibited it from issuing new
14 debt necessary to carry out its obligations as a public service company. There
15 was also evidence concerning the expenditures necessary for Washington Natural
16 to discharge its obligation as a public service company. The Commission had
17 previously issued orders approving the Company's financings pursuant to Chapter
18 80.08 RCW, and the Commission had evidence of the Company's long-term
19 financing plan. Finally, the Commission had an analysis of the near-term revenue
20 needs necessary to enable Washington Natural Gas to issue new debt.

21

1 **Q. In your opinion, does Olympic's direct testimony provide support for its**
2 **request for interim rate relief similar to that provided in Cause No. U-80-**
3 **111?**

4 A. No. Olympic's petition and testimony simply assert that Olympic is suffering
5 continued operating losses, it is in default and unable to pay interest on its
6 outstanding loans and, as a result of these circumstances, it is unable to raise
7 additional capital to fund its 2002 capital budget.

8
9 **Q. What type of analysis and evidence would be expected of Olympic in order to**
10 **support its request for interim rate relief?**

11 A. First, it would be necessary to show that the additional capital expenditures for
12 2002 are essential and could not be deferred. Furthermore, Olympic would state
13 what type of actions it has taken to date to minimize its operating expenses to
14 offset operating losses. The Company would present a detailed, long-term
15 financial plan for evaluation by the Commission. Finally, Olympic must make the
16 connection between the interim relief it seeks and its ability to obtain the
17 immediate financing it needs.

18 In other words, Olympic has not provided in its testimony an analysis
19 establishing that failing to receive the relief it seeks "will have such an effect on
20 financing demands as to substantially affect the public interest."
21

1 **Q. How then should the Commission proceed in this Docket?**

2 A. Olympic has experienced losses and it appears that these past losses may be
3 affecting its ability to obtain needed capital for essential new facilities. This,
4 coupled with the reasons described below regarding the nature of Olympic's debt,
5 lead me to recommend a course of action that embodies the spirit, if not the letter,
6 of the PNB Test. I provide a study of the Company's capital expenditures to
7 date, along with an analysis of the amounts of permanent financing that can
8 reasonably be expected as necessary to finance these assets. I then calculate a
9 minimum level of earnings to ensure that Olympic has sufficient revenues to pay
10 the fixed capital costs supporting the investments in its infrastructure.

11
12 **V. OLYMPIC'S OUTSTANDING DEBT OBLIGATIONS AND THEIR**
13 **IMPACT ON STAFF'S ANALYSIS**
14

15 **Q. What is the amount of debt outstanding on Olympic's books through 2001?**

16 A. Olympic has approximately \$141,800,000 of debt outstanding. (See
17 Supplemental Testimony of Mr. Batch, Exhibit No. ___ (BCB-5) at page 3, line
18 3). This figure is based on the thirteen notes listed by Mr. Batch on page 3, lines
19 10-22 of his Supplemental Testimony.

20
21 **Q. What is the nature of that debt?**

22 A. As Mr. Batch shows in his testimony, ten of the notes are very short-term: one
23 and one-half to three months. Large sums are involved in these short-term notes.

1 For example, on June 13, 2000, Olympic issued a note to Equilon for
2 \$43,160,406, to be paid in full just two months later, on August 17, 2000. When
3 this note was issued, Olympic had insufficient earnings to pay it when due.

4 Even the three long-term notes are due within a very short-time frame.
5 The January 1, 1994 Prudential note is due February 15, 2002. The June 6, 2000
6 Chase note was due December 14, 2001. The June 22, 2001 ARCO note is due
7 July 1, 2006.

8 In addition, the lenders are predominately from "internal" sources. Eleven
9 of the thirteen notes are from Equilon and ARCO, the shareholders of Olympic
10 Pipe Line.

11

12 **Q. Which of the notes are in default?**

13 A. All notes except the June 6, 2000 Chase note and the January 1, 1994 Prudential
14 note are in technical default.

15

16 **Q. Did that preclude Olympic from obtaining any additional loans?**

17 A. No. For example, Olympic issued the June 22, 2001 note to ARCO while
18 Olympic was in technical default on other ARCO notes. This note is actually a
19 \$30 million revolving credit line, on which \$10,000,000 has been drawn by
20 Olympic to date.

21

22 **Q. Do any of the outstanding notes have restrictive covenants that prohibit**
23 **Olympic from issuing any additional debt?**

1 A. Yes. The terms of the January 1, 1994 Prudential note prevent Olympic from
2 issuing any debt additional to the notes listed by Mr. Batch in his Supplemental
3 Testimony. Exhibit No. ____ (KLE-3) is a copy of the relevant sections of this
4 note describing the restriction on Olympic from issuing additional debt.
5 However, this restriction alone would not restrict access to the \$20,000,000
6 remaining on the June 22, 2001 ARCO revolving credit line. Olympic would be
7 entitled to draw on this credit line if the note was not in default. As I noted
8 previously, this credit line was established when Olympic was already in default,
9 so it is unclear what conditions are actually needed to be met before these funds
10 will be made available. ARCO has not provided any written indication to
11 Olympic of what conditions must be met before these funds will be made
12 available. (Olympic response to Staff Data Request No. 21).

13
14 **Q. How do these facts surrounding Olympic's debt obligations impact your**
15 **analysis?**

16 A. The PNB Test effectively assumes the company's debt is publicly traded debt,
17 and that restrictions in the loan agreements regarding additional financing are
18 complied with. Neither condition appears to apply in this case. Olympic's debt is
19 not publicly traded, and Olympic was able to issue additional debt to ARCO while
20 in default on other ARCO loans.

21 Olympic has no long term financing plan. The restriction in the January 1,
22 1994 Prudential note precludes any additional loans. Absent waiver of that
23 restriction, and absent an equity infusion from Olympic's owners, the only

1 practical source of additional funds in the short term is the remaining \$20,000,000
2 in the June 22, 2001 ARCO credit line.

3 The absence of any objective, written criteria under which ARCO will
4 commit to provide additional funds under that credit line makes it virtually
5 impossible to demonstrate any objective, defensible connection between the
6 appropriate amount of interim relief that should be granted, and Olympic's ability
7 to obtain additional financing.

8
9 **VI. STAFF'S ANALYSIS OF THE APPROPRIATE LEVEL OF INTERIM**
10 **RATES**

11
12 **Q. Given the situation you have described regarding Olympic's existing debt**
13 **obligations, how then did you go about evaluating Olympic's need for**
14 **interim rate relief in the context of the PNB Test?**

15 **A.** I made an analysis of Olympic's investments in facilities, and the cost of capital
16 to finance those projects, in an effort to derive a measure of appropriate interim
17 rate relief.

18 Since Olympic's testimony does not adequately explain whether the
19 amount of debt on its books accurately reflects Olympic's investments in facilities
20 necessary to serve the public, it was necessary for me to make the general
21 assumption that the amounts Olympic has capitalized on its books are appropriate
22 for rate purposes. I made one adjustment for the Cross-Cascades Pipeline project
23 (which I discuss below). This will need to be examined further in the general rate
24 case phase of this Docket.

1 Furthermore, it was necessary for me to assume that Olympic would
2 finance these facilities with permanent sources of capital.

3

4 **Q. Under these assumptions, how did you go about determining an appropriate**
5 **level of interim rate relief for Olympic?**

6 A. I analyzed the capitalized assets expected to be on Olympic's books by the end of
7 2001, and how those assets would be financed.

8 I focused upon the most critical objective financial indicator that
9 determines the degree to which a firm faces a financial emergency. This analysis
10 is an evaluation of a firm's fixed-charge coverage ratio. The calculation of pre-
11 tax interest coverage provides a measure of the minimum level of pre-tax earnings
12 necessary for a firm to pay current interest expense and issue any new debt.

13 Generally, covenants contained in debt instruments of public service
14 companies commonly look to earnings as an indicator of financial protection.
15 Unless the company is able to generate sufficient revenues to cover its interest
16 expense with some "room to spare," these "times interest" coverage covenants
17 restrict the company from issuing additional debt.

18 For purposes of applying the PNB Test to the circumstances facing
19 Olympic in this case, I recommend that the company be given sufficient revenues
20 to generate a reasonable pre-tax earnings coverage of one and one-half times the
21 interest related to investment in assets on the Company's books through the end
22 of 2001 devoted to public service. I did not analyze Olympic's actual debt
23 expense, since my analysis assumes that the Company has a permanent source of

1 capital to support its investment in facilities and must generate sufficient pre-tax
2 earnings to cover those capital costs.

3

4 **Q. Why have you chosen to focus on pre-tax interest coverage?**

5 A. Covenants contained in articles of incorporation, first mortgage indenture or
6 preferred equity issuances for public service companies typically restrict a firm
7 from borrowing additional funds when the pre-tax coverage falls below the 1.5
8 times interest threshold. Indeed, this is precisely the calculation the Commission
9 relied upon in Cause No. U-80-111 to determine the interim rate relief needs of
10 Washington Natural Gas Company. Though this covenant is not contained in the
11 notes issued by Olympic, given the practical constraints of this case, it is
12 reasonable to apply the same sort of coverage analysis.

13

14 **Q. On what evidence specific to Olympic did you rely in analyzing the pre-tax
15 interest coverage issue?**

16 A. In addition to the evidence I discuss elsewhere in my testimony, I began my
17 analysis evaluating the assets Olympic had on its books in 2000, and expected
18 additions for 2001. Then, I compared those assets to the liabilities and Olympic's
19 permanent capital on its balance sheet for each year.

20

21 **Q. Were there any adjustments to the amounts on Olympic's balance sheet
22 necessary in order to calculate the amounts you believe are appropriate for
23 rate purposes?**

1 A. Yes. It was necessary to adjust the amount of assets appearing on the balance
2 sheet to account for the Company's investment in what is called the Cross-
3 Cascades Pipeline project. As I understand it, there are significant expenditures
4 associated with this project included on the Company's balance sheet. This
5 project is not serving the public at this time, and it would be inappropriate to
6 include these investments in any application of the PNB Test. Olympic is not
7 requesting to include its investment in the Cross-Cascades Pipeline project in its
8 general rate request.

9

10 **Q. What is the amount the Company has on its books to date associated with the**
11 **Cross-Cascade project?**

12 A. In response to a data request, Olympic identified \$21.5 million invested in the
13 project to date. This amount is removed from my calculation of Olympic's
14 investment in facilities serving the public.

15

16 **Q. Please describe your analysis of the Company's balance sheet.**

17 A. According to its Annual Report for 2000, Olympic reported a net plant balance of
18 \$97.2 million (historical cost less depreciation). Adjusting this figure for its \$21.5
19 million investment in the Cross-Cascade Pipeline project leaves approximately
20 \$75.7 million in facilities serving the public.

21 Olympic reported the following amounts of permanent capital for 2000:
22 \$30,000,000 in notes payable; \$70,579,222 in notes payable to affiliated
23 companies; and \$15,500,000 in long-term debt, for a total of about \$116 million.

1 Therefore, at the end of 2000, Olympic had \$116 million of liabilities supporting
2 \$75.7 million in facilities. As you can see, this mismatch between assets and
3 liabilities creates a significant problem, and, unfortunately, the problem only gets
4 worse as the analysis of the balance proceeds through 2001.

5 Exhibit ____ (KLE-4) contains my calculation of the figures for 2001.
6 Please note that for purposes of this case I have rounded the figures in that
7 exhibit. According to Olympic's response to Staff and Intervenor Data Requests,
8 Olympic will spend \$25 million on capital improvements in 2001. Since Olympic
9 depreciates its facilities at the aggregate rate of about 2% per year, the net amount
10 of Olympic's investments in facilities at the end of 2001 will be about \$98
11 million.

12 For purposes of interim rate relief analysis, \$98 million is the amount of
13 long-lived assets that must be permanently financed, and rates should generate
14 sufficient earnings to support on the capital costs of these assets.

15 On the liabilities side, according to the Supplemental Testimony of Mr.
16 Batch, Exhibit No. ____ (BCB-5) at page 3 (the last three lines of the table)
17 Olympic issued \$30,000,000 of unsecured notes in 2001.

18 Therefore, at the end of 2001, Olympic's balance sheet will show long-
19 lived assets in the amount of approximately \$98 million, with liabilities
20 approaching \$146 million (\$116 million plus \$30 million).

21

22 **Q. What conclusion do you reach from your analysis of Olympic's balance sheet**
23 **for 2000 and Olympic's projected balance sheet for 2001?**

1 A. There are several conclusions. First, Olympic is currently financed exclusively
2 with debt. Second, Olympic may be issuing debt to support ongoing operating
3 expenses. The mismatch between assets and liabilities precludes an analysis of
4 the outstanding debt and the interest costs associated with these liabilities. The
5 analysis must focus on the assets that can reasonably be expected to provide
6 service to the public. This analysis indicates a cash flow problem requiring a
7 solution.

8
9 **Q. In your opinion, how should the Commission respond to this cash-flow**
10 **problem for Olympic?**

11 A. As I stated earlier, the application of a reasonable, objective, one and one-half
12 times interest coverage test is the best practical solution, and it falls within the
13 spirit of the PNB Test for determining whether a company is entitled to interim
14 rate relief.

15 If a firm is able to generate sufficient revenues and pay a reasonable level
16 of interest expense that can be tied to its investments, it should be able to secure
17 additional financing. However, the application of the PNB Test in this
18 circumstance must take into account the fact that the financial problems facing
19 Olympic were driven primarily by past operations that severely curtailed the use
20 of its facilities. Therefore, Staff's recommendation takes into consideration the
21 prospective circumstances facing Olympic, and its improving financial situation
22 due to its renewed ability to move substantial product on the pipeline.

1 **Q. How did you calculate the reasonable amount of earnings necessary to enable**
2 **Olympic to meet a one and one-half times level of interest expense?**

3 A. I began with my previous calculation of what is a reasonable estimate of
4 Olympic's 2001 assets that should be permanently financed. As I described
5 earlier, at the end of 2001, Olympic is expected to have approximately \$98
6 million invested in its facilities and serving the public.

7 I then calculated the cost of the capital supporting this level of investment.
8 According to Mr. Batch's Supplemental Testimony, Exhibit No. ___ (BCB-5) at
9 page 3, the Company's cost of debt is 7 percent for all but \$44 million of its
10 outstanding debt. The \$30 million note held by Chase carries an interest rate of
11 4.10 %, and the \$14 million note held by Prudential carries an interest rate of
12 6.49%. Since the Prudential and Chase notes (the Chase note replaced a previous
13 note with the Texas Commerce Bank) have been on the Company's books the
14 longest, it is reasonable to assume these support the long-term investment in
15 Olympic's facilities. Therefore, for the remainder of the Company's investment
16 in facilities, approximately \$54 million, I have used an interest rate of 7%, under
17 the assumption that this is the cost of debt associated with the remainder of the
18 Company's investment in facilities serving the public.

19 I also took into account that Olympic is not in default of the Chase and
20 Prudential notes, and assumed the affiliated notes (the notes issued by
21 shareholders) are supporting the remainder of Company's investments in pipeline
22 facilities.

1 The estimated annualized cost of Olympic's debt supporting the \$98
2 million in investments is \$5.920 million, or 6.05%. This calculation is provided
3 in Exhibit ____ (KLE-4). I recommend that the Commission provide interim rate
4 relief in the amount necessary to generate total company earnings before interest
5 and taxes of one and one-half times this estimated interest expense. One and one-
6 half times \$5.920 million is \$8.880 million.

7 Mr. Colbo provides an analysis of the Company's forecasted 2001 test-
8 year operations. He computes the total additional revenues needed to provide the
9 earnings necessary to produce this level of interest coverage for Olympic's total
10 operations, and the Washington share of this amount. This analysis reflects an
11 interim rate increase of 19.48%, or \$2,719,829 (Washington share).

12 The Commission should not rely upon the total debt expense of Olympic
13 for the entire amount of debt outstanding. As I testified earlier, there is a
14 mismatch between capital invested in the business and the amount of debt
15 currently outstanding. I cannot reconcile the capital expenditures made by
16 Olympic with the total amount of its outstanding debt.

17 If Olympic has issued debt for purposes of supporting ongoing operations,
18 that debt should not be considered appropriate for rates, since it is payment for
19 operating costs incurred in the past. Therefore, limiting the calculation to an
20 estimate of Olympic's investments ensures that any interim rate relief is
21 reasonably related to, and will provide reasonable support for, the facilities
22 serving the public.

23

1 **Q. Please summarize your analysis and recommendation.**

2 A. My analysis is simply an attempt to incorporate three distinct elements essential to
3 the application of the PNB Test. These three elements are: 1) to make a
4 connection between the investments in essential public facilities and the sources
5 of permanent capital needed to fund these investments; 2) to provide an
6 objectively reasonable level of earnings; and 3) to provide a nexus between the
7 interim rate relief to be granted and the investment and expenses appropriate for
8 rate purposes.

9 Given the nature of Olympic's debt and its restrictions against additional
10 loans, given the lack of objective, written conditions under which Olympic may
11 access capital from its shareholders, and given Olympic's ongoing need for
12 capital to invest in pipe line facilities to serve the public, Staff's use of objective
13 financing criteria offers a reasonable solution to a difficult problem.

14 Staff's approach and recommendation in this case reflects an attempt to
15 craft a reasonable and practical solution, while capturing the essence of a more
16 traditional analysis under the PNB Test.

17

18 **Q. At the beginning of your testimony, you stated that any interim rate relief**
19 **should be collected subject to refund. What is the basis for this**
20 **recommendation?**

21 A. Olympic's original petition notified shippers that any amounts collected in the
22 interim proceeding would be subject to refund. Olympic's testimony now leaves
23 that issue to the Commission to determine.

1 I am also concerned about the issues surrounding the mismatch between
2 the Company's debt level and the amount of assets it has capitalized. Staff has
3 had insufficient time to determine whether these expenditures were properly
4 classified to plant accounts. This investigation, including an analysis of the
5 appropriate way for Olympic to finance its rate base, will be part of the general
6 rate case. Furthermore, as Mr. Colbo testifies, many of the projected test period
7 amounts for revenues and expenses have not been subject to a full audit.
8 Collecting interim rates subject to refund ensures that shippers will pay only for
9 proper investments in long-lived facilities. Indeed, the Commission in its 6th
10 Supplemental Order in the *Avista Utilities* case I discussed earlier relied upon the
11 subject-to-refund condition as a measure for protecting consumers in such
12 emergency cases.

13
14 **Q. Could you please summarize your testimony for this phase of the**
15 **proceeding?**

16 A. Yes. In recent periods, Olympic has reported operating losses. This loss is
17 caused primarily by sustained curtailments in the public's ability to use Olympic's
18 facilities (in whole or in part) to move petroleum products. The pipeline is now
19 operating at 80% pressure and 91% utilization, and Olympic's short-term
20 prospects show improved operating results. However, Olympic does face a need
21 to fund additional capital improvements. Staff's recommendation for interim rate
22 relief is within the spirit of the PNB test and provides an objective measure of the

1 amount of revenues reasonably necessary for the Company to access needed
2 capital for its 2002 construction program.

3

4 **Q. Does this conclude your testimony?**

5 **A. Yes.**