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BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

| | |
|----------------------------|-----------------------|
| WASHINGTON UTILITIES AND |)Docket No. TO-011472 |
| TRANSPORTATION COMMISSION, |)Volume IX |
| Complainant, |)Pages 766-951 |
| |) |
| v. |) |
| |) |
| OLYMPIC PIPELINE COMPANY, |) |
| INC., |) |
| Respondent. |) |
| _____ |) |

A hearing in the above matter was held on January 15, 2002, at 9:39 a.m., at 1300 Evergreen Park Drive Southwest, Olympia, Washington, before Administrative Law Judge ROBERT WALLIS, Chairwoman MARILYN SHOWALTER, Commissioner RICHARD HEMSTAD, and Commissioner PATRICK OSHIE.

The parties were present as follows:
OLYMPIC PIPE LINE COMPANY, INC., by Steve Marshall, Attorney at Law, One Bellevue Center, Suite 1800, 411 108th Avenue, N.E., Bellevue, Washington 98004, and Patrick W. Ryan, Attorney at Law, Perkins Coie, 1201 Third Avenue, Suite 4800, Seattle, Washington, 98101.

TESORO, by Robin Brena, Attorney at Law, 310 K Street, Suite 601, Anchorage, Alaska 99501.

TOSCO CORPORATION, by Edward A. Finklea, Attorney at Law, 526 N.W. 18th Avenue, Portland, Oregon 97209.

Barbara L. Nelson, CSR
Court Reporter

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1

THE COMMISSION, by Donald Trotter
and Lisa Watson, Assistant Attorneys General, 1400
Evergreen Park Drive, S.W., P.O. Box 40128, Olympia,
Washington 98504-0128.

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1 JUDGE WALLIS: The hearing will please come
2 to order. This is the Tuesday, January 15, 2002
3 session in the matter of Commission Docket Number
4 TO-011472. We're going to begin today's evidentiary
5 session by receiving the testimony of Mr. Hanley.
6 Whereupon,

7 FRANK J. HANLEY,
8 having been first duly sworn, was called as a witness
9 herein and was examined and testified as follows:

10 JUDGE WALLIS: Please be seated. Mr.
11 Brena.

12 MR. BRENA: Good morning, Chairwoman, good
13 morning, Commissioners, good morning, Your Honor.

14
15 D I R E C T E X A M I N A T I O N

16 BY MR. BRENA:

17 Q. Good morning, Mr. Hanley.

18 A. Good morning, sir.

19 Q. Do you sponsor testimony and a single
20 exhibit marked by this Commission as 111-T and 112-C,
21 FJH 111-T and FJH 112-C?

22 A. Yes, I did.

23 Q. And do you adopt that testimony as your
24 own?

25 A. I do.

00771

1 Q. Do you have any corrections or
2 modifications to it?

3 A. I do not.

4 CHAIRWOMAN SHOWALTER: You need to speak
5 either into the microphone or maybe turn it on.

6 JUDGE WALLIS: Let's be off the record for
7 just a minute.

8 (Discussion off the record.)

9 JUDGE WALLIS: Okay. Let's be back on the
10 record, please.

11 Q. Mr. Hanley, I believe that we've just
12 identified your testimony, that you've indicated that
13 there are no corrections that you have to make, and
14 you've just adopted it. Is that your understanding
15 of where we are right now?

16 A. Yes, sir, that's correct.

17 MR. BRENA: I tender Mr. Hanley for cross.

18 JUDGE WALLIS: Mr. Marshall.

19 MR. MARSHALL: Thank you,
20

21 C R O S S - E X A M I N A T I O N

22 BY MR. MARSHALL:

23 Q. Mr. Hanley, you've been retained by Tosco
24 and Tesoro in this matter?

25 A. Yes, sir.

00772

1 Q. And have you been retained for Tosco and
2 Tesoro in other matters over the years?

3 A. By Tesoro, but not for Tosco.

4 Q. And what -- how much work, approximately,
5 have you done for Tesoro over the years?

6 A. Measured how?

7 Q. Either by amount of your time or by fees
8 received or cases testified on?

9 A. The latter would be the easiest for me to
10 recall. I would say on three or four occasions.

11 Q. In the past couple of years?

12 A. In the past seven or eight years.

13 Q. And have you been retained by Tesoro with
14 regard to Olympic's FERC filing and tariff filing?

15 A. Yes.

16 Q. And you are preparing to oppose Olympic's
17 request for general rates at the FERC on behalf of
18 Tesoro; is that correct?

19 MR. BRENA: Objection, relevance.

20 JUDGE WALLIS: The witness may respond.

21 THE WITNESS: Well, I don't like to think
22 of it as oppose. I'm prepared to offer my
23 independent expert opinion as to the cost of capital.

24 Q. And is it going to be your position, as it
25 apparently is in your examination here, that the

00773

1 amounts that FERC has permitted to be awarded in
2 interim rates should be refunded entirely, based on
3 the testimony you're preparing before the FERC?

4 A. I'm presently --

5 MR. BRENA: Objection, Your Honor.

6 JUDGE WALLIS: Excuse me. Let's let Mr.

7 Brena have an opportunity to speak his --

8 MR. BRENA: Relevance objection.

9 JUDGE WALLIS: Mr. Marshall, what relevance
10 does that --

11 MR. MARSHALL: Tesoro has pointed out and
12 its witnesses have pointed out that Olympic is
13 entitled to rely on the interim rate relief received
14 by the FERC as a way of trying to address its
15 problems with funding. If these witnesses for Tesoro
16 are going to oppose the rates at the FERC, thereby
17 making the 13 million, \$14 million refundable, I
18 believe that is an issue that needs to be explored,
19 because it goes to the financial capability and
20 stability of Olympic.

21 MR. BRENA: Only -- they're only refundable
22 if they're above just and reasonable rates.

23 JUDGE WALLIS: Mr. Brena.

24 MR. BRENA: I said they were only
25 refundable if they're above just and reasonable

00774

1 rates.

2 JUDGE WALLIS: After hearing the parties'
3 views, I think that the question should be allowed.
4 The witness may respond. Do you have the question in
5 mind?

6 THE WITNESS: I do, Your Honor, yes. As I
7 said in response to a prior question, I will offer my
8 independent expert opinion as to the cost of capital.
9 To the extent that other witnesses have opinions with
10 regard to other issues, such as rate base, proper
11 level of expenses, and all those pieces are put
12 together in the regulatory paradigm, that will
13 determine, from Tesoro and Tosco's point of view,
14 what the proper increase should be.

15 If it happens to be more, equal to, or less
16 than the rates that are presently being collected
17 subject to refund on the FERC jurisdiction, then that
18 will be what it is. But, frankly, as an independent
19 expert, I have no predetermined disposition as to how
20 that will come out.

21 Q. Have you done any work so far on that
22 particular case before the FERC, any preliminary
23 studies?

24 A. No, sir, I have not.

25 Q. Would you agree that if there is a refund

00775

1 from the FERC of the interim rates, that would have
2 an impact on Olympic's financial condition?

3 A. Well, from Olympic's point of view, it will
4 certainly have an impact, just as though they -- they
5 would change upward perhaps, who knows. That's
6 another issue. But any change would have an impact.
7 The question is is the impact within the context of
8 the regulatory paradigm appropriate. Just because
9 something is less than what the company desires,
10 certainly, I'm sure you would agree, does not mean
11 that it is inappropriate.

12 Q. Have you at all analyzed what the financial
13 impact to Olympic would be if the rates allowed by
14 FERC in the interim rate relief granted in September
15 would have to be refunded?

16 A. No, it's not within the scope of my
17 assignment, and as I've indicated, I've not done any
18 studies with regard to the FERC matter.

19 Q. I see. Now, with regard to tariffs on file
20 here in the state of Washington for Olympic, have you
21 gone back to find and review the prior tariffs that
22 Olympic has had in place since 1983 to the present as
23 part of any of your background work?

24 A. No, I have not, because it really has no
25 direct bearing on the conclusions that I have drawn

00776

1 that are set forth in Exhibit FJH-111-T.

2 Q. Okay. Are you aware of what those rates
3 have been in the past?

4 A. No, and I'm usually -- almost always not.
5 I think that's true of most financial experts, from a
6 cost of capital viewpoint, going to look more at the
7 larger picture, not the rates or, if you will, how
8 one slices up the pie to get the total level of
9 revenues.

10 Q. Are you aware that there have ever been any
11 interventions by any shippers in any prior case
12 taking any of the positions that you're now taking in
13 your testimony in the past here in Washington State
14 with regard to Olympic?

15 A. Well, I heard Mr. Batch's representations
16 yesterday, but it's my understanding, notwithstanding
17 his representations, that there hasn't really been
18 what I would consider to be a rate case where parties
19 have an opportunity to come through, put forth
20 testimony, have a set of hearings, have opportunities
21 to cross-examine opposition witnesses and so forth.
22 So I guess we have a different idea as to what that
23 perceived acquiescence on Olympic's part really
24 means.

25 Q. So it's your understanding that no

00777

1 intervenor had any opportunity with regard to any of
2 the rates previously filed for approval by the
3 Commission by Olympic, they had no opportunity to
4 intervene and be heard in a hearing; is that your
5 testimony?

6 A. My testimony is is that I don't believe
7 there have been what I would consider to be a rate
8 case, rate cases such as you have now in the general
9 rate filing before this Commission.

10 Q. And how did you obtain that understanding?

11 A. In discussion with counsel for Tesoro and
12 Tosco and with other consultants who are working on
13 this assignment with me in this particular instance.

14 Q. Now, not talking about your discussions
15 with your attorneys or the attorneys for Tosco or
16 Tesoro, in your discussion with other witnesses for
17 Tosco and Tesoro, and that's Mr. Grasso and Mr.
18 Brown, are you stating that you have had discussions
19 with those two individuals?

20 A. Yes, I have, but I would add this, that --

21 Q. That's my only question. Let me ask the
22 next question.

23 MR. BRENA: Please allow the witness to
24 fully answer the question, and then, if there's a
25 problem with his response, it can be addressed

00778

1 properly. I do not want my witness cut off.

2 JUDGE WALLIS: The witness may offer a
3 brief explanation of his answer, but I would caution
4 the witness not to answer a question that has not
5 been asked. The question, as I recall it, was have
6 you had discussions. I'm not sure what explanation
7 would be required about that.

8 MR. BRENA: Your Honor, if I may, that
9 would be the reason to allow him to finish his
10 answer.

11 JUDGE WALLIS: That's -- I'm giving him
12 that opportunity, with that caution.

13 THE WITNESS: What I wanted to add, I don't
14 know if Your Honor thinks it's appropriate or not,
15 it's certainly not a dissertation, but simply wanted
16 to add that regardless of the past, those instances
17 would have no bearing on the testimony that I have
18 set forth in this proceeding.

19 JUDGE WALLIS: Mr. Marshall.

20 Q. Okay. In your discussions with Mr. Brown
21 and Mr. Grasso, have they given their opinion to you
22 that they will take the position at the FERC that all
23 of the interim rates allowed by the FERC should be
24 refunded?

25 A. No, I think that the -- I can't speak for

00779

1 them unequivocally, but my impression is is that
2 they've yet to do much in that regard, as well, and I
3 think the outcome needs -- remains to be determined.

4 Q. So your testimony is you had no discussions
5 about the issue of whether the rate filing at the
6 FERC by Olympic, in which you've been retained, will
7 prompt any of the three of you to take a position
8 contrary to that rate filing; is that your testimony?

9 A. Sir, I believe you're putting words in my
10 mouth. What I said prior, and I will say again,
11 hopefully clearly to others in the room, that studies
12 have not been made yet, the outcome has yet to be
13 determined. Whether that will be equal to or less
14 than what Olympic has filed for at the FERC is
15 something yet to be determined. I don't know how I
16 can state it more clearly than that.

17 Q. Now, have you been retained to give expert
18 testimony in this case in the general rate case phase
19 of the proceeding?

20 A. I have, yes.

21 Q. By Tosco and Tesoro both?

22 A. Yes, sir.

23 Q. Okay. Have you done work on that?

24 A. No. Frankly, there's been little time,
25 because of the emergency filing. And about the only

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1 thing I've done so far is I have suggested certain
2 areas for discovery, which are under counsel's
3 consideration, is my understanding at this point in
4 time, but that's all.

5 Q. Okay. Now, are you familiar with Mr.
6 George Schink?

7 A. Yes, sir.

8 Q. He's a witness that is considered to be an
9 expert on tariff matters?

10 MR. BRENA: Objection. Perhaps he could
11 direct me to the part of this witness' testimony to
12 which he's cross-examining on.

13 MR. MARSHALL: I'll withdraw that question.

14 JUDGE WALLIS: Maybe Mr. Marshall can
15 revise the question.

16 Q. Sure. Have you reviewed Mr. Schink's
17 testimony in this case?

18 A. I have, yes.

19 Q. And you mention Mr. Schink in your
20 testimony, don't you?

21 A. Yes.

22 Q. Okay. Is Mr. Schink well regarded as an
23 expert in this area?

24 A. Well, when you say this area, I address it
25 from the financial area. To my knowledge, Mr. Schink

00781

1 is a fine person and a fine economist. Whether he is
2 a financial expert is something that the regulators
3 in each individual instance will have to determine.

4 Q. Okay. Mr. Schink addresses many of the
5 same issues that you raise in your testimony; is that
6 correct?

7 A. Well, when you say he raises, are you
8 speaking about in a general rate case, or are you
9 talking about his rebuttal testimony in this portion
10 of the proceeding?

11 Q. In this portion of the proceeding, he
12 raises a number of the issues that you've addressed
13 in your testimony; is that a fair statement?

14 A. Well, I don't know what you mean. He talks
15 about ability to or inability, if you will, of
16 Olympic to raise capital. In that regard, we both
17 talk about the same thing, and we are diametrically
18 opposed in our conclusions.

19 MR. MARSHALL: Okay. Fair enough. That's
20 all the cross-examination I have.

21 JUDGE WALLIS: Mr. Trotter, do you have any
22 questions?

23 MR. TROTTER: No, Your Honor.

24 JUDGE WALLIS: Commissioners.

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E X A M I N A T I O N

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BY CHAIRWOMAN SHOWALTER:

Q. I just want to make clear, do you discuss in your testimony interest coverage ratio? I was just skimming to see, and I did not see that.

A. Your Honor, I do not.

JUDGE WALLIS: Any further questions?

Q. I'm sorry, I've got one more question. Can you turn to page 16 of your testimony? On line six, you have the sentence, I suggest this Commission request that OPL's owners properly capitalize OPL and achieve -- this could be accomplished by causing the equity ratio to become 50 percent of total capital.

And this is really, as I understand it, the summary conclusion of your testimony that precedes these lines. My question to you is supposing we agree with you and we say, Well, you are correct, there should be more -- a more balanced equity ratio, and we agree with you on a series of shoulds, and we say to the company, Well, we will treat you as if you were operating your company as Mr. Hanley has described, but then supposing they don't. In other words, if we grant an increase or not, but based on your suppositions, where will that get the company in terms of -- I'm not asking you to speak theoretically

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1 of what's appropriate or proper, but what is your
2 prediction of what will happen if we follow your
3 advice?

4 A. Well, I think it would be putting the
5 owners to the ultimate test of financial
6 responsibility. This is a company that is owned by
7 several of the largest petroleum companies in the
8 world who, for whatever reasons, have steadfastly
9 avoided putting equity capital into this company for
10 years on end. And my studies only went back to 1990,
11 but I know about even prior to that, but that's long
12 enough to be demonstrative of, frankly, as I stated
13 in my testimony, a shameful situation.

14 The wherewithal is there instantly.
15 Olympic could raise all the money it needs and then
16 some in the blink of an eye if the shareholders would
17 simply sign a little piece of paper that says, I
18 guarantee payment. That is such a common thing for
19 owner companies for subsidiary utility operations to
20 do that, for whatever reason. And in their minds,
21 they may have some reasons, although I have no idea
22 what they are. They could do that.

23 Another thing is that these debts, even
24 though they're disproportionate to any reasonable
25 assumption of rate base, in my opinion, from

00784

1 everything that I heard and know, much of it, if not
2 all of it, as far as the affiliated debts are
3 concerned, could go away in a heartbeat, just like
4 that. All they have to do is say -- give them a
5 piece of paper and say, We forgive this debt. They
6 would create instant equity, could bring the
7 capitalization into line with the industry standards.

8 Now, would that infuse new cash, no, but
9 \$20 million in cash to companies that have cash and
10 receivables of 30 or 40 billion dollars, it's
11 preposterous to think that they have no wherewithal
12 to fund and to do what needs to be done for this
13 company with these owners.

14 Q. Okay. But I've been listening to your
15 answer, and you have used could and would and
16 shoulds.

17 A. Okay, I'm --

18 Q. And I am saying, let's assume that, for
19 purposes of my question, that they could infuse, they
20 should, and the would was not will they, but, in your
21 answer, is that this would result. In other words,
22 what I'm trying to get you to focus on is either what
23 is their motivation to do what you say should be
24 done, and alternatively, if they don't, what is the
25 consequence?

00785

1 A. Well, I think --

2 Q. We can't order an infusion of equity, as I
3 understand it. We can set up some conditions, if
4 that's what we end up doing, but why -- the question
5 really is what is the motivation of the owners to
6 comply with the suggestion that you -- or the request
7 that you suggest that we make on page 16 of your
8 testimony?

9 A. Well, I'm not sure what their motivation
10 would be, other than they'd sort of be cutting off
11 their nose to spite their face if they let Olympic
12 literally go down the tubes. Because as you, Your
13 Honor, aptly perceived in your questioning yesterday,
14 they have a very vested interest themselves in this
15 pipeline for their own operations, aside from the
16 independent shippers, so they'd be cutting off their
17 nose to spite their face.

18 But I think what you can do -- they talked
19 about signals. Give them a signal that this is an
20 intolerable, insufferable, outrageous situation that
21 they refuse to put a dime of equity capital into this
22 company, and tell them to go away and prove a case in
23 the general rate case and give them absolutely zero
24 because -- now, in emergency relief, because,
25 frankly, if they got every penny they asked for right

00786

1 now, they couldn't attract flies in the capital
2 markets. With a hundred percent debt ratio right
3 now, if you gave them every penny they asked for in
4 emergency relief now, they couldn't attract any
5 capital in the marketplace. That's a joke.

6 The money needs to come in the form of
7 equity capital, they need it badly, they need a lot
8 of it, and it should come from the owners. Give them
9 the signal. Can you force them? No. But you
10 shouldn't be blackmailed, either.

11 CHAIRWOMAN SHOWALTER: Thank you.

12

13 E X A M I N A T I O N

14 BY COMMISSIONER HEMSTAD:

15 Q. On page three of your testimony, at line
16 five, beginning line four, you state that, Moreover,
17 OPL has, just from January 2000 to October 2001, paid
18 to BP almost \$22 million, including the 3.8 million
19 in transition costs and management fees. Of what is
20 the \$22 million composed?

21 A. Well, I could -- Your Honor, I couldn't
22 give you the details of that. It's presumably
23 whatever has to do with this transition. I mean, as
24 far as all the nitty-gritty breakdown, I've seen
25 nothing that gives that. Whether it's available, I

00787

1 don't know, but certainly it's a lot of money going
2 out, but no equity money coming in.

3 And as you, Your Honor, also aptly
4 perceived yesterday in your -- from your questions,
5 \$51.6 million in dividends have gone out to these
6 parents that have refused to put any money in. So
7 it's all going out, nothing going in, and they come
8 here and say, Gee, we can't raise any capital. Big
9 surprise. With a hundred percent debt, no equity,
10 who could raise capital on a situation like that?
11 The only way they can is the owners have to cough up.
12 They have to be responsible owners.

13 COMMISSIONER HEMSTAD: The Chairwoman
14 really explored the areas that I was going to pursue.
15 Thank you.

16

17 E X A M I N A T I O N

18 BY CHAIRWOMAN SHOWALTER:

19 Q. You know, I have one more question. I was
20 caught a little off guard, I didn't know you were
21 going to be here this morning, so I wasn't as
22 prepared as I should be.

23 A. I didn't know it either, Your Honor.

24 MR. MARSHALL: Nor did I.

25 Q. Remind me -- you have a Schedule One, I'm

00788

1 trying to skim it, but before you turn to it, my
2 question is do you compare the capital structures or
3 the capital structure of Olympic Pipe Line to other
4 pipeline companies?

5 A. I do, yes, and what's typical is in a
6 range. I say about 50 percent on average over time
7 is about where it ought to be. Could it be somewhere
8 in the range of 45 to 55 percent? Sure. I suggest
9 50 percent. I don't suggest that that's an absolute,
10 you know, etched-in-stone lock, but I think that's a
11 reasonable target that they ought to have.

12 Q. Okay. But is your comparison based on the
13 actual capital structures of those other companies?

14 A. Yes, it is, Your Honor.

15 Q. Okay. Can you point me to your exhibit?

16 A. Surely.

17 Q. Is it Schedule One?

18 A. Yes, it is.

19 Q. I had turned to that, but I'm just trying
20 to see where the companies are.

21 A. Okay. If you would look to what I'll call
22 the center section, it's just a tad below the exact
23 center of the page on pages one and two, it says
24 Proxy Group of Five Oil Pipeline Companies.

25 Q. Okay. And it's your note, note number one,

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1 that explains what those companies are; is that
2 right?

3 A. Right, their identities are there, and
4 they're also mentioned in the testimony itself. And
5 you can see on a yearly basis the capital structure
6 ratios, how they've ranged, and I've taken those from
7 page two, the far right-hand column, beginning with
8 1990, and working to your left across page two, the
9 yearly averages up through 1995, and then on -- back
10 flipping forward to page one, beginning with 1996 at
11 the right, moving to the left across to and including
12 the year 2000.

13 Q. All right. And what was your source for
14 finding these capital structures? Where did you go
15 to look for them?

16 A. We got this information directly from the
17 Standard and Poor's Compustat Services, the PC Plus
18 database.

19 Q. Okay. Thank you.

20 A. You're welcome.

21

22 E X A M I N A T I O N

23 BY COMMISSIONER HEMSTAD:

24 Q. I have a further question along that line.
25 Do you know the ownership structure of those five

00790

1 proxy companies? In other words, are the
2 shareholders of those companies analogous to Olympic
3 Pipe Line owned by upstream petroleum companies?

4 A. No, because their common stocks are
5 actively traded, so that they are not -- so they're
6 really, truly -- they meet the marketplace test, if
7 you will, as opposed to this situation, where it
8 could be whatever the owners want it to be, and
9 obviously they choose for it to be all debt.

10 Q. I think Mr. Batch testified yesterday, in
11 response to a question from me, that there are other
12 situations comparable to Olympic, with upstream
13 owners, like their situation. Do you know that for a
14 fact, or is Olympic unique?

15 A. I do not know it for a fact. I'd be real
16 curious as to who they are and I'd be even more
17 curious as to what the regulators, if they did, in
18 fact, do exist, think about it when they come in
19 asking for relief, such as in this case, crying
20 emergency when they're a hundred percent debt. I
21 know of no such instance. In fact, I guess in my
22 30-year career as a consultant and expert witness, in
23 my own personal experience, I've never encountered,
24 even as Your Honor, you apparently have one here, and
25 I think it was one that I picked up in searching your

00791

1 orders and mentioned it in my testimony as a guide,
2 but other than those, I don't know of any regulated
3 utility company of any type, energy company, water
4 company, telephone company at all that operates with
5 a hundred percent debt.

6 Q. Well, so I take it from that that the fact
7 of this upstream ownership here would not, in your
8 opinion, create any different circumstance that
9 would, from a regulator's perspective, make this
10 arrangement acceptable?

11 A. I'm not sure, Your Honor, I understand the
12 import of your question, so if I'm off-base in my
13 response, please, please stop me. So I want to
14 preface it by saying that. But clearly I believe
15 that they have the right to finance the company any
16 way they want, but regulators -- I think it's a
17 simple situation that they can do what they want.
18 Maybe you can't order them, but that's the whole
19 notion of hypothetical capital structures.

20 Their actual capital structure's a hundred
21 percent debt, they want to come in and suggest that
22 there's, on the one hand, when you get into the main
23 case or the general rate case, suggest that the
24 company is financed with approximately 83 percent
25 equity when they're running a hundred percent debt.

00792

1 Well, that's a situation where I say I don't think
2 the hypothetical capital structure works at all
3 unless they're willing to instantly achieve it.

4 How could that instantly be achieved, like
5 in the AWRI order. If they choose to, they could do
6 it quickly. You said in that order -- and when I
7 talk about these things, I'm going to make it very
8 clear from for the record, it's from a financial
9 expert. I have no legal background. The orders and
10 your intent and interpretations of them will be what
11 they are. I'll put that right up front.

12 But my impression, from a financial
13 expert's standpoint, is that if they can do something
14 and it's in their power to do it, you consider a
15 hypothetical capital structure ratio if they're
16 willing to do something where it can be accomplished
17 quickly. They could accomplish that quickly by
18 forgiving large portions of that debt that's payable
19 to the owner companies. It could be done just like
20 that, just like they could raise money just like that
21 by guaranteeing, if they choose.

22 But if they choose to continue to keep it a
23 hundred percent debt, what you can choose to do is
24 say, Go away, don't bother me for emergency relief.
25 Bring your case, try and make your case with us in

00793

1 the general rate case, and if you can't do that,
2 well, tough, the burden is on you. And if they still
3 want to go a hundred percent debt and don't want to
4 cough up the equity money, fine. Look at it as a
5 hundred percent debt. If they say their debt cost
6 rate is seven percent, that's what they get, seven
7 percent on the debt that finances the rate base, not
8 all of it.

9 JUDGE WALLIS: Anything further? Mr.
10 Brena.

11

12 R E D I R E C T E X A M I N A T I O N

13 BY MR. BRENA:

14 Q. I have a few areas. You were asked a
15 series of questions about Mr. Schink and whether or
16 not you've reviewed his testimony, whether you agree
17 or disagree with his conclusions. Do you recall that
18 line of questions?

19 A. Yes, sir.

20 Q. Why don't you agree with them?

21 MR. MARSHALL: Actually, that wasn't the
22 question. I asked whether this witness had reviewed
23 it and then whether Mr. Schink had addressed the same
24 issues, not whether he agreed or disagreed. He went
25 on to volunteer information about whether he agreed

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1 or disagreed, but I think it's beyond cross for his
2 redirect. I was very careful in the phrasing of the
3 question. The answer wasn't quite as careful.

4 MR. BRENA: First, my redirect goes to the
5 scope of the answers. He didn't raise the issue that
6 this witness exceeded the scope of his question.
7 Secondly, he went into the whole question about his
8 expert witness over my objection, and so he's raised
9 the issue, it was within the scope of the answer. I
10 want to know why he disagrees.

11 JUDGE WALLIS: Very well. Does the witness
12 have the question in mind?

13 THE WITNESS: I do, Your Honor. Well, I
14 disagree in this instance on -- especially on the
15 interest coverage point of view, which is why I
16 didn't mention it. Frankly, it's preposterous to
17 consider interest coverage, especially 2.6 times,
18 because those standards are for companies that have
19 reasonable proportions of equity in their capital
20 structure, debt equity ratios. To assume a 2.6 times
21 level of interest coverage, the median single-year
22 actual results that -- from which Mr. Schink cites
23 from Standard and Poor's related to companies that
24 have a BBB bond rating and that have about 57.5
25 percent as the median total debt ratio, which means

00795

1 that those companies have, on average, median, 42.5
2 percent equity in their capital structure.

3 So to talk about 2.6 times coverage for a
4 company that's with a hundred percent debt is just
5 totally off the mark. That's the reason I don't even
6 discuss it. Nobody gives standards for coverage with
7 a hundred percent debt ratio. Even indenture
8 coverage tests, such as 1.5 times, are not tests of
9 attraction; they're tests of protection, which is why
10 they're put in indentures and bond agreements.

11 And usually it's been my experience,
12 because I have raised capital, and I have privately
13 placed capital over the years on behalf of very small
14 water companies, but the principles apply. And I can
15 tell you this, that usually those tests, in addition
16 to being tests of protection for existing bond
17 holders or debt holders, also kick in and say if your
18 equity ratio gets below a certain point or if your
19 debt ratio is going to get above a certain point, and
20 that might be 60 percent or 66 percent or whatever
21 that's arbitrary in there, then you cannot issue
22 additional debt. But nobody addresses this issue of
23 a hundred percent debt, and certainly not the rating
24 agencies, such as Standard & Poor's.

25 Q. The entire issue of rating, are you aware

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1 of any rating agency anywhere that will rate a
2 company based on unaudited books?

3 A. No.

4 Q. So we have a situation where they're
5 applying standards in which there's no equity, but
6 which there's not audited books, and they're using
7 the ratios that would apply to companies that have a
8 significant percentage of capital and have audited
9 books.

10 MR. MARSHALL: This goes beyond the cross
11 entirely. These questions were not asked of the
12 witness. He's just leveraging on top of the prior
13 answer, to which I objected. I don't think this is
14 proper redirect at all.

15 MR. BRENA: He is correct that I'm asking
16 him to fully explain his last answer.

17 JUDGE WALLIS: The witness may respond.

18 THE WITNESS: Well, that is unheard of,
19 frankly, and what is even more unheard of, again, in
20 my career, and I think I've been personally involved
21 in something getting close to 300 rate cases, utility
22 rate cases in my career, I don't know of a single
23 instance where a company is financed with a hundred
24 percent debt, and not whether the regulators allowed,
25 but even had the audacity to suggest in a general

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1 rate case that the capital structure has 83 percent
2 equity in it, when, in fact, the owners don't have a
3 dime of their own equity money invested. It's
4 totally out of import.

5 It's true those owner companies have very
6 high credit ratings, and one can see why. The
7 largest companies in the world, AA bond ratings,
8 billions of dollars in cash and receivables, audited
9 financials, so with this kind of a contrast, I know
10 of absolutely no situation like that, where anybody
11 would lend money to a company with a hundred percent
12 debt, no audited books, and owners who are unwilling
13 to commit capital, either in the form of they won't
14 guarantee or they won't put equity directly into the
15 subsidiary.

16 Q. You mentioned, in response to Mr.
17 Marshall's questions, as well as in your last
18 response, that you've been involved in 300 rate cases
19 in which you've given expert testimony with regard to
20 capital structure and rate of return. Do you always
21 represent ratepayers?

22 A. No. As a matter of fact, most of my
23 testimony over the years, probably 95 percent of it,
24 I represent investor-owned utilities. I have, on a
25 few occasions, such as for Tesoro and now, in this

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1 instance, Tesoro and Tosco, and in a few instances I
2 have acted in the capacity, on an ad hoc basis, as
3 staff for Commissions such as Delaware and Arizona,
4 but almost overwhelmingly, my practice, my work, most
5 of the people that call me and say will you work for
6 me are investor-owned utilities.

7 Q. Chairwoman Showalter explained what would
8 be the owner's incentive in order to invest capital
9 in this company. I would like -- do you think that
10 operating -- their commitment to operate this company
11 safely would require an infusion of capital?

12 A. Well, I say that yes in two capacities.
13 One --

14 MR. MARSHALL: Well, Your Honor, I'd
15 object, because the issue of safety, this witness has
16 no credentials in the area of safety, and this is
17 beyond cross-examination. It also begins to be
18 leading questions. I understand Mr. Brena's desire
19 to get into these areas, but it's going to get us
20 into a whole bunch of areas where this witness has no
21 expertise.

22 MR. BRENA: The issue of what would be
23 their incentive was clearly raised. This question is
24 clearly within that scope. This witness is an expert
25 with regard to financial risk and capital structure

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1 in the way that impacts the ability of a company to
2 operate safely within the context of its financial
3 risk. We have a company with the owners who are
4 potentially threatening not to capitalize a company,
5 and what I intend to explore with him is what is the
6 financial risk to this company of doing that.

7 What if Whatcom Creek happened today?
8 Where would the money come from to respond? There is
9 huge financial risks with this company associated
10 with not having any equity in this company, and it's
11 perfectly within the scope of this incentive question
12 and this witness' expertise to address that financial
13 risk.

14 JUDGE WALLIS: The witness may address the
15 financial situation, but the issue of safety, as
16 such, is outside his stated area of expertise, and he
17 may not address that.

18 THE WITNESS: I understand, Your Honor, the
19 direction, although I will use the word safety in my
20 reply. I think it's necessary. Only in this sense
21 will I use it. That if the owners are indeed so
22 concerned about safety -- and that's the only way
23 I'll use it, because I don't know what it takes, and
24 I'll say that frankly, to make something safe or more
25 safe. That is beyond my expertise. But if there is

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1 this committed desire for safety, even above, as I
2 heard, some -- perhaps some notches above the norm or
3 the industry standards, that's fine, that's
4 admirable. And I, like anybody else, would be all
5 for it.

6 But if they're going to show that kind of a
7 commitment, it seems to me, not only from a financial
8 expert standpoint, but just from a common sense
9 standpoint, there needs to be the embracement of the
10 responsibility and commitment as owners to put in
11 some equity capital to make sure that that happens in
12 the most efficient way, and there's absolutely no
13 evidence to this very moment that there is that such
14 commitment, and there should be.

15 Q. Mr. Hanley, if there was a financial
16 emergency that arose for this company today that
17 required 25 or \$30 million of funds to respond, does
18 their decision not to fund this with equity impact
19 the way that they can manage that risk, and if so,
20 how?

21 A. Well, they would -- under such
22 circumstances, they would have no recourse. They
23 would be totally unable to do so without the
24 financial commitment from the owners, because, by
25 keeping it financed with a hundred percent debt, they

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1 could not attract any capital, which is certainly
2 true enough, but it's of their own making, their own
3 decision, their own choice to do so and to keep it
4 that way.

5 Well, that's fine, but when the moment of
6 truth comes and the capital is needed, they must do
7 it, they need to do it, it's their obligation to do
8 it. They talk -- I heard talk about signals
9 yesterday. Well, what signal? If they got -- and
10 I'll say it once again. In my opinion, if they got
11 every penny that they asked for in this emergency
12 proceeding, they couldn't attract any capital out in
13 the marketplace, not without a guarantee from the
14 parent or not without the owner companies coughing up
15 the money themselves.

16 So if they want to keep it a hundred
17 percent debt, they need to cough up the money. If
18 they want to put equity in to do it right, as
19 responsible owners, then cough in some equity
20 capital, don't call them notes that are payable in 45
21 or 90 days. That's preposterous, when the clear
22 inability to pay isn't there.

23 Q. Why does that financial risk exist today?

24 MR. MARSHALL: Your Honor, this is beyond
25 the scope of direct. And I can understand why Mr.

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1 Brena wants to go in and redo what he's done on
2 direct for his other witnesses, but this is well
3 beyond, and the witness' answers are becoming
4 repetitive, as even the witness acknowledges.

5 MR. BRENA: Well, with regard to the
6 witness' answers, it's typically that a repetitive
7 answer would be after the answer is given. I am
8 exploring with this witness their incentives as they
9 run this company like a shell company and now it's
10 time to put in some money, because some of the
11 financial risks they they've assumed because they've
12 bled it dry have been realized. And I'm exploring
13 whose financial risk, how that financial risk was
14 created, and who should be responsible for it when it
15 is realized.

16 I think that it goes right to the heart of
17 Chairwoman Showalter's questions about what kind of
18 incentives these people should have and how they
19 should act responsibly.

20 JUDGE WALLIS: Mr. Brena, would you restate
21 the question?

22 MR. BRENA: I will try. How was this
23 financial risk created?

24 JUDGE WALLIS: That appears to be beyond
25 the proper scope of questioning at this point, Mr.

00803

1 Brena.

2 MR. BRENA: Okay. Thank you, Your Honor.

3 Q. Mr. Hanley, is one potential incentive for
4 this company to put equity in commitments that
5 they've made to the Office of Pipeline Safety to make
6 these improvements?

7 MR. MARSHALL: Your Honor, I'd object.
8 This is leading now, and it's also beyond the scope
9 of cross.

10 MR. BRENA: I'll restate the question. I
11 agree that it was leading.

12 JUDGE WALLIS: I'm also concerned about the
13 scope and not sure what --

14 MR. BRENA: I'll address that, then, if I
15 may.

16 JUDGE WALLIS: Very well.

17 MR. BRENA: These companies, BP Pipelines
18 has stepped up and made representations to the Office
19 of Pipeline Safety that they're going to do what's
20 necessary to bring this pipeline up to speed and run
21 it safely. And yet, Olympic Pipe Line is here before
22 this Commission saying they need \$2 million or they
23 can't have their owners put any equity in to fund
24 necessary improvements.

25 Now, I think that BP Pipelines has an

00804

1 incentive to honor and stand behind this company and
2 their representations to the world that they're going
3 to make these improvements and they're going to come
4 into compliance with the compliance order for OPS and
5 not to come before this Commission and give a
6 completely contradictory signal that, yeah, Olympic
7 will do it, but Olympic needs to go get -- have it
8 funded by their shippers. Those are two entirely
9 different things, and I think go to the heart of
10 what's the owner's incentive to put some money in, so
11 --

12 JUDGE WALLIS: Well, I'm not sure at this
13 juncture whether that kind of incentive is directly
14 enough related to this proceeding that we should
15 entertain that line of questioning, at least for this
16 witness.

17 MR. BRENA: Thank you, Your Honor. I have
18 nothing further.

19 MR. TROTTER: Your Honor, I had one
20 question, and I'm happy to go after Mr. Marshall, but
21 if he wants to hear my question before he goes, I'm
22 happy.

23 MR. MARSHALL: Go ahead, Mr. Trotter.

24 JUDGE WALLIS: Mr. Trotter.

25 MR. TROTTER: I just have one area.

00805

1 C R O S S - E X A M I N A T I O N

2 BY MR. TROTTER:

3 Q. Mr. Hanley, in one of your responses to a
4 question I believe from your Counsel, you referred to
5 a 1.5 interest coverage ratio. Do you recall that?

6 A. Yes.

7 Q. Are you aware that Mr. Elgin used a 1.5
8 factor in his analysis?

9 A. Yes.

10 Q. Did you understand that he used that as an
11 indenture protection measure and not as a Standard &
12 Poor's coverage ratio measure?

13 A. I do. I believe I referred to that test,
14 of such 1.5, as being typically a test of protection,
15 yes.

16 MR. TROTTER: That's all I have. Thank
17 you.

18 CHAIRWOMAN SHOWALTER: May I ask some
19 clarifying questions?

20 MR. MARSHALL: Yes, absolutely.

21

22 E X A M I N A T I O N

23 BY CHAIRWOMAN SHOWALTER:

24 Q. And I am not as adept as the witness is on
25 these issues, obviously, so I don't actually

00806

1 understand your answer to Mr. Brena and now to Mr.
2 Trotter. In a question of Mr. Brena's, you said that
3 the 2.6 interest or coverage ratio would be
4 preposterous because it assumes a balanced capital
5 structure. You're just going to have to connect the
6 dots for me. Why might a 2.5 coverage ratio be
7 appropriate with a, quote, balanced structure, and
8 not be appropriate in a debt-financed structure?

9 A. Sure. Well, the rating agencies, and
10 particularly Standard & Poor's, they establish what
11 they call financial target ratios for given bond
12 ratings and perceived business risk. Within each
13 bond rating category, they have ten degrees, if you
14 will, of risk, with one being the least risky and ten
15 being the most risky. So that a company that has,
16 for example, bonds that are rated BBB, and that would
17 be three capital Bs in the S&P way of doing it, just
18 capital B three times, they wouldn't all be
19 necessarily created equal. BBB with a one risk
20 profile would be the least risky within that category
21 and ten would be the most risky.

22 And having said that, just taking an
23 average of all companies that have BBB rating, what
24 Mr. Schink referred to was the 2.6 times coverage
25 that was actually experienced by companies that had

00807

1 BBB rating during the 12 months ended June 30, 1999.

2 Well, that's not even necessarily a target.

3 That's what they achieve. That would happen to fall

4 within the range of what they think is appropriate.

5 Okay. Well, why is that okay for those companies?

6 Well, those companies only have -- the median was

7 57.5 percent debt. Well, clearly, as you have more

8 debt and you get up to a hundred percent debt, they

9 wouldn't be BBB any longer and those standards would
10 no longer apply.

11 In fact, when you got to a hundred percent

12 debt, they would be, frankly, if they had been

13 previously rated, they'd be downgraded to junk bonds.

14 They would be kind of a bond equivalent of Enron

15 common stock right now, is about where -- if you were

16 to make an analogy between a bond and a stock. Might

17 have been worth something up here, but when they got

18 to the hundred percent debt level, that would be

19 worth nothing, and you'd have a hard-pressed --

20 anybody paying any kind of value for that bond. So

21 that standard could no longer apply.

22 Why should you be able to have 2.6 times

23 coverage, which is a test of protection for

24 creditors? Creditors also want protection in the

25 form of equity, because they know -- just like -- I

00808

1 forget who, but somebody yesterday during hearing
2 talked about the home, when you're home, would you
3 have any -- can you go out and buy a home a hundred
4 percent without putting any money down or apply for a
5 home equity loan on a house if you have no equity in
6 it. Of course you're not going to do it.

7 You need to have that cushion, because
8 lenders, senior debt lenders know that when it comes
9 down, push comes to shove, if bankruptcy happens to
10 happen, it's the common owner, common stockholders
11 are the last in line in claim on assets and earnings
12 of the company. And so creditors want that
13 protection, they want that cushion underlying it.
14 That explains two things, why the 2.6 is not correct,
15 why there needs to be a reasonable proportion of
16 equity in the capital structure for that protection
17 and to provide the ability to attract external
18 capital, because they want that cushion under it.
19 That's why they can't attract any. It's not
20 surprising. But it also should not be to be able to
21 come in and say, okay, well, see, 2.6 is right, and
22 therefore, that justifies a certain level of increase
23 for emergency purposes.

24 Well, they wouldn't be BBB, and they don't
25 have 57 percent debt. They've got a hundred percent

00809

1 debt, and they would be junk bonds, not BBB. And yet
2 they presume out there in the case in chief yet to
3 come that, oh, we're just like a AA rated. We're
4 just like BP. We've got 83 percent equity. No, they
5 don't.

6 MR. BRENA: May I suggest, Chairwoman
7 Showalter, that perhaps Exhibits 64 and 66 illustrate
8 this risk of these ratios exactly.

9 CHAIRWOMAN SHOWALTER: All right. I'll
10 take a look at them.

11 Q. The other question I -- well, I'm now
12 confused by your answer to Mr. Trotter, in that I
13 don't understand the difference between a factor and
14 a coverage ratio, so can you explain what that
15 difference is?

16 A. Well, in effect, they may call it a factor
17 in some documents, but in effect, what it really is
18 is a coverage test. And existing creditors, because
19 they don't want to be in a situation or to find
20 themselves in a situation where there is no
21 reasonable equity cushion under them after they've
22 already committed their capital to the company, they
23 want to be sure that down the road, as the -- which
24 is sort of another matter, I don't want to sidetrack
25 it, but as companies invest and commit capital and

00810

1 then -- I'd like the record to show my emphasis on
2 the then -- and then go out and raise the money for
3 -- to fund it. They want to make sure that that
4 equity cushion doesn't disappear. One way to do that
5 is they say, Well, how can we do that. They put a
6 restriction on the company to say you cannot issue
7 more debt, even if you've gone out and built property
8 or done whatever you have if you're going to pull two
9 things. There's usually two kinds of tests, and they
10 usually work hand in hand. One is a capitalization
11 test that we won't allow you to pull your equity down
12 below, and I've seen -- they do vary all over the
13 place. Could be as little as 25 percent, my
14 experience, to 35 percent, or sometimes even more
15 equity. They don't want to go the absolute floor.

16 And also, we want to make sure you have a
17 level of earnings before interest and income taxes
18 that is at least, bare minimum, 1.5 times before you
19 can issue this debt. So they have to meet a couple
20 of tests.

21 Q. All right. Is a 1.5 factor the same or
22 different from a 1.5 times coverage ratio?

23 A. In essence, it's the same. The difference
24 being is that 1.5, as Mr. Trotter pointed out, and as
25 I acknowledge in my original response, and then also

00811

1 in response to his clarification, it is a test of
2 protection, not attraction.

3 CHAIRWOMAN SHOWALTER: I see. Thank you.

4 JUDGE WALLIS: Mr. Marshall.

5 MR. MARSHALL: Thank you.

6

7 C R O S S - E X A M I N A T I O N

8 BY MR. MARSHALL:

9 Q. Mr. Hanley, you mentioned how big oil
10 companies were who had shareholder interest in
11 Olympic. Remember that testimony? Very colorful.

12 MR. BRENA: Objection.

13 Q. Do you have that in mind?

14 MR. BRENA: I would appreciate it if he
15 would properly characterize this witness' -- and not
16 offer colloquy on it.

17 Q. Do you remember that testimony?

18 JUDGE WALLIS: I will ask both Counsel to
19 avoid characterizations.

20 Q. Do you remember that testimony?

21 A. I do. Yes, sir.

22 Q. Okay. Now, you're representing Tosco and
23 Tesoro. Tosco is now owned by what companies?

24 A. I believe that would be Chevron and Texaco.

25 Q. All right. Aren't you incorrect? Isn't

00812

1 Tosco owned by Conoco, and they now have a merger
2 with Phillips?

3 A. You're right. I'm sorry, I did misspeak.
4 Temporary mental block. I apologize to the client.

5 Q. Go ahead and correct it.

6 A. Yes.

7 Q. Correct what you now understand to be the
8 ownership of Tosco?

9 A. No, not what I understand; it's what I
10 misspoke.

11 Q. Okay. And how big is that company now in
12 the United States and worldwide in terms of its
13 ranking as an oil company?

14 A. Well, I would respond --

15 MR. BRENA: Objection.

16 THE WITNESS: I have to respond -- oh,
17 sorry.

18 MR. BRENA: Relevance. I can see that the
19 people who need to put the equity in, how big they
20 are has something to do with this case. I can't see
21 that the shippers' size has anything to do with this
22 case.

23 JUDGE WALLIS: Mr. Marshall, I'm not sure
24 that I see any relevance either.

25 MR. MARSHALL: I'm going to connect that

00813

1 up, Your Honor, in just a moment, if you bear with
2 me.

3 MR. BRENA: My objection --

4 JUDGE WALLIS: Very briefly.

5 Q. What size is Phillips Worldwide in the
6 United States, do you know?

7 A. Not off the top of the head, but not nearly
8 as large as BP and Shell, I can assure you of that.

9 Q. Isn't Phillips the sixth largest in the
10 world, third largest in the United States?

11 A. Perhaps. I don't know. But from a
12 ratepayer's viewpoint, the size -- if I made a
13 million dollars a year or \$20 million a year and I'm
14 a ratepayer of a utility --

15 Q. That's not --

16 A. -- and I'm a residential customer, it
17 shouldn't make any difference whether I make \$20
18 million a year or somebody that makes \$50,000 a year.

19 Q. That's not where I'm heading, Mr. Hanley.
20 I'll get there in just a moment. You said, in answer
21 to a question by Chairwoman Showalter, when she said,
22 We can't order them to make an infusion of equity,
23 what incentives do these owners have to do that. And
24 your response is, They won't cut off their nose to
25 spite their face. If they let Olympic go down the

00814

1 tubes, it's they who will be punished, words to that
2 effect. Do you remember that general statement, they
3 will cut off their nose to spite their face?

4 A. Generally, generally, yes.

5 Q. But BP/ARCO, one of the shareholders of
6 Olympic, owns a refinery here in Washington State;
7 correct?

8 A. Yes.

9 Q. And that's what you meant by that
10 statement, that they would want to keep that refinery
11 going and have access to the pipeline, so they would
12 not let Olympic, quote, go down the tubes; is that
13 what you meant?

14 A. Yes.

15 Q. Now, there are three other refineries in
16 Washington State, too, are there not?

17 A. Yes.

18 Q. Should they let Olympic go down the tubes
19 to spite their face?

20 A. Should the other refineries -- well, only
21 to the extent that the owners -- I think you get to
22 the situation where you shouldn't have ratepayers
23 funding capital of a company. Only owners should.

24 Q. Okay. My question was don't they have the
25 same interest, identical interest that BP/ARCO has in

00815

1 not wanting Olympic to go down the tubes?

2 A. Well, clearly they have an interest, but
3 they don't have the responsibility, and that's where
4 you're getting the disconnect, just like you've got a
5 disconnect between this emergency case and the
6 general rate case. There's a constant disconnect
7 about who should pay for what, and it's a situation
8 of here you've got a situation, the question is how
9 do you resolve it. Is it the responsibility of
10 shippers, the independent shippers, to fund capital
11 improvements and so forth when the owners refuse to
12 do so. And I don't think so, and I don't think I
13 have to say that as a financial expert. I think
14 that's common sense.

15 Q. Now, let's talk about infusion of equity.
16 Did you understand or do you understand that there
17 was another owner of Olympic, GATX, who owned 25
18 percent of the shares of Olympic up until the year
19 2000?

20 A. Yes.

21 Q. You've read that in Mr. Batch's testimony,
22 haven't you?

23 A. Are you suggesting that's the only reason I
24 know that?

25 Q. No, do you have --

00816

1 A. I don't understand the import of the
2 question.

3 Q. Wherever you read it, you agree that that's
4 correct?

5 A. I agree that that's correct.

6 Q. And wherever you found it, do you
7 understand that BP/ARCO paid \$7 million for that 25
8 percent share of GATX? Do you understand that?

9 A. I don't remember the exact number, but if
10 that's what you represent, that it was seven million,
11 I'll accept that.

12 Q. Does that sound about right?

13 A. Yes.

14 Q. I mean, you're familiar with that
15 transaction in general terms, maybe not specifically;
16 correct?

17 MR. BRENA: Objection.

18 THE WITNESS: I'm aware --

19 MR. BRENA: I don't see -- I think we're
20 into when a portion of the pipeline was purchased
21 five years ago. I'm sorry, I just don't remember any
22 question relating to that transaction whatsoever.

23 MR. MARSHALL: My next question will get to
24 that, Your Honor, if he answers this one.

25 JUDGE WALLIS: Very well.

00817

1 THE WITNESS: Well, your question, as I
2 recall it, suggested intimacy of the transaction. I
3 will say I'm aware that that transfer occurred. With
4 regard to intimacy of details of the transaction, no.

5 Q. If Tosco and Tesoro had the same refinery
6 interest, same interest in not letting Olympic go
7 down the tubes, was there any reason whatsoever that
8 either Tosco or Tesoro or both could not have
9 purchased the GATX shares?

10 MR. BRENA: Objection, relevance, and
11 beyond the scope. I -- what are we talking about
12 this for?

13 JUDGE WALLIS: I'm finding it difficult,
14 Mr. Marshall, to see what relevance this has to the
15 purpose of this proceeding.

16 MR. MARSHALL: This includes the
17 willingness of two other refineries, the ones that
18 are protesting here, to also invest equity and loans
19 and other things to keep this Olympic Pipe Line --
20 they're trying to insist that there be one refinery
21 that ought to keep this going for everybody, even
22 though it's a common carrier, even though there can't
23 be no discrimination. What we're trying to do here
24 is to show that the ultimate -- it's an issue here of
25 fundamental fairness in trying to figure out how you

00818

1 keep something that benefits all four refineries
2 equally when they've accused BP/ARCO of being
3 unwilling to put in equity, more equity, they want
4 BP/ARCO to forgive debt, but they've absolutely given
5 no indication as to why they won't buy shares, why
6 they won't make loans, why they won't step up to the
7 plate to share fairly the cost of trying to address
8 the series of problems that haven't been created by
9 Olympic, but are also before us.

10 MR. BRENA: I would like to address that
11 briefly, if I may.

12 JUDGE WALLIS: Mr. Marshall -- excuse me,
13 Mr. Brena, it may foreclose the need for your
14 comments. I believe that we are constrained by the
15 public service laws as we look at this situation, and
16 I'm not sure that the area you want to inquire into
17 is within the bounds of the public service laws that
18 govern this proceeding, so consequently, I don't
19 think this is an area that we should pursue any
20 further.

21 MR. BRENA: May I make just one comment
22 with regard to it? And I certainly agree with the
23 ruling, but I just want to make the point, Tesoro and
24 Tosco are not owners. They didn't distribute any
25 dividends for the last decade to us. We --

00819

1 JUDGE WALLIS: Mr. Brena, I believe that
2 that's a comment that has been earlier made, and I'm
3 not sure, also, that that adds to the record at this
4 point. So I'm going to ask Counsel to confine your
5 process at this point to the matters that this
6 Commission does have the authority to address.

7 Q. Now, Mr. Hanley, you said you testified in
8 about 300 cases, rate cases. What percentage of
9 those involve oil pipelines, approximately?

10 A. Just a handful.

11 Q. So what percentage, approximately, of the
12 300? Less than one percent?

13 A. Maybe two percent.

14 Q. You're saying that --

15 A. One or two percent. You know, I've been
16 involved four or five times.

17 Q. For Tosco and Tesoro or for any other
18 company except Tosco and Tesoro?

19 A. Just for -- well, I've already said that
20 these instances right now is the first time for
21 Tosco. The rest are for Tesoro.

22 Q. Okay. So you haven't done any oil pipeline
23 work except for Tosco and Tesoro; is that correct?

24 A. That's correct.

25 Q. Are you familiar at all with Continental

00820

1 Oil -- excuse me, Colonial Pipeline and Explorer
2 Pipeline? Are you familiar with those companies?

3 A. No, I've not done any specific studies
4 involving them.

5 Q. Isn't Colonial Pipelines one of the largest
6 pipelines in the United States, going from Texas to
7 New Jersey?

8 MR. BRENA: Objection.

9 Q. Thirty-six-inch pipeline?

10 MR. BRENA: Objection, scope.

11 JUDGE WALLIS: Mr. Marshall, I think the
12 witness has already indicated he hasn't any
13 familiarity with that firm.

14 Q. So if I represented to you that Colonial
15 Pipelines and Explorer Pipelines are funded with one
16 hundred percent debt, you wouldn't be able to say one
17 way or the other whether that's correct; is that
18 true?

19 A. That's true. I wouldn't know whether
20 you're correct in your representation.

21 MR. MARSHALL: Okay. No further questions.

22 JUDGE WALLIS: Are there further questions
23 from the Commission at this point? Mr. Brena.

24

25

R E D I R E C T E X A M I N A T I O N

00821

1 BY MR. BRENA:

2 Q. Mr. Hanley, is there any substantive
3 difference with regard to oil pipeline or gas oil
4 pipeline or a water pipeline or electric utility or
5 any regulated utility with regard to capital
6 structure, rate of return constructs?

7 A. No, the principles are the same regardless
8 of the type of industry.

9 Q. With regard to Mr. Marshall's
10 representation as to Colonial and Explorer Pipeline
11 -- well, first --

12 JUDGE WALLIS: Mr. Brena, I'm not sure --

13 MR. BRENA: I'll withdraw the question.

14 JUDGE WALLIS: -- that its representation
15 -- it's not evidence in the proceeding. We
16 instructed the witness not to respond to that, so I
17 would suggest we not get into that area.

18 Q. You were asked whether or not a ratepayer
19 and an owner had an identical interest in funding
20 capital to Olympic.

21 MR. MARSHALL: That was not the question.
22 I object to the assumption. That's not a fact in
23 evidence. That wasn't the question.

24 MR. BRENA: That's an exact quote. Mr.
25 Marshall said that isn't -- don't they have an

00822

1 identical interest in being sure that these
2 improvements get done, and explored for some time
3 with this the difference between an owner's position
4 and a ratepayer's position and the whole four
5 refiners in Washington and why aren't they sharing
6 equally in capital improvements, and I'd like to
7 redirect on it.

8 JUDGE WALLIS: We also, in terms of that
9 line of questioning, pointed out the limits of the
10 public service laws and the Commission's ability to
11 address some of those matters. You may inquire into
12 it, but not to the point that you exceed the
13 Commission's authority.

14 MR. BRENA: Thank you, Your Honor.

15 Q. Do you consider an owner and a ratepayer to
16 have an identical interest in capital contributions,
17 and if so, why, and if not, why not?

18 A. No, I think, frankly, the notion is
19 preposterous. Owners are owners and ratepayers are
20 ratepayers. Every time you had a little water
21 company or something, for instance, and they ran into
22 trouble, what's the solution? To have ratepayers
23 kick in and become owners? It's nonsense.

24 The owners need to take the responsibility
25 and do what it is that responsible owners do. Not

00823

1 try and foist it off on ratepayers, whether you call
2 them John and Suzy Smith or shippers such as Tesoro
3 and Tosco, who are not owners. They're still
4 ratepayers.

5 MR. BRENA: If I may just have a minute off
6 the record, Your Honor.

7 JUDGE WALLIS: Yes, Mr. Brena. Mr. Brena.

8 Q. You were explaining to Chairwoman Showalter
9 the different rating and risk adjustments. Are there
10 exhibits? Does Exhibit 64 illustrate that?

11 A. Yes, sir, it does.

12 Q. Do you have a copy of Exhibit 64?

13 A. I believe I do, yes, sir.

14 Q. And does Exhibit Number 66 also illustrate
15 the points that you were making?

16 A. Yes, it does.

17 Q. And do you have a copy of 66 with you?

18 A. I do.

19 Q. Would you please explain how Exhibits 64
20 and 66 illustrate your answer to the Chairwoman?

21 A. With regard to Exhibit 64, if we look at
22 the lower section that's entitled Total Debt to Total
23 Capitalization, we see here the target ratios for
24 utilities within the given bond ratings, as I was
25 talking about before. Now, these are the ratios that

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1 Standard and Poor's would like to see.

2 If you look down vertically, you'll see the
3 ten business risk profile categories within each bond
4 rating. And so, for example, if we looked in the BBB
5 column, if we just looked within the average, if we
6 just said, There's some company that's considered of
7 average risk profile, which would be a category five
8 or six, we can see that we're talking about 50 to 51
9 percent is the total level of debt they like to see,
10 which means that the complement, therefore, 49 to 50
11 percent, is what they really should have in terms of
12 equity.

13 And if you move across to the left under
14 the AA column, offhand, I don't know the business
15 risk profile of the parents, such as BP and so on,
16 but if we assume that they're relatively, you know,
17 average risk, that would imply somewhere -- you see
18 the total debt of 36 to 39 percent, which would mean
19 that they ought to have 61 to 64 percent. Now, I'm
20 saying that's not that they should have, as opposed
21 to what they do have, because I don't know their
22 exact category. I'm just meaning that illustratively
23 for the moment, not definitively. So that gives an
24 idea of within the target ratios.

25 Then, if we would turn to Exhibit Number

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1 66, if we look at the, again, the lower section under
2 Key Utility Financial Ratios, again, beginning with
3 the BBB column, we can see that the -- and the EBIT
4 on the top set of figures stands for earnings before
5 interest and income taxes, which is what we're
6 talking about for this interest coverage.

7 You can see the 2.6 times there. Well,
8 that's what the BBB electric utility during the 12
9 months ended June 30, 1999, actually earned, but if
10 we look down about the middle of those line items
11 there, there's a line that says Total
12 Debt/Capitalization, in other words, the ratio of
13 total debt to total capitalization, and these are all
14 medians, which means there's an equal number above
15 and an equal number below. This was 57.5 percent,
16 which one then could imply that there's roughly 42.5
17 percent equity at the median level.

18 Now, those numbers don't exactly add up
19 when you look at the preferred and the common stock
20 capitalization, and so I want to anticipate if the
21 Commissioners perhaps wonder why those three ratios
22 don't add to a hundred. And I think the simple
23 answer is is they necessarily -- all of them don't
24 necessarily have preferred stock, for example. And
25 so you're going to have different median levels for

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1 each different type of capital.

2 But we can generally say that there's a
3 substantial amount of percentage of equity to
4 generate that kind of interest coverage. And that's
5 why it would be not appropriate to make such an
6 assumption with regard to a company that has a
7 hundred percent debt.

8 Q. Mr. Hanley, Chairwoman Showalter also asked
9 you a series of questions to explain the difference
10 between different types of ratios and what they mean.
11 Does Exhibit Number 65 help illustrate your answer to
12 her, and if so, how?

13 A. Well, yes, it does. As I was indicating
14 previously that the information, for example, under
15 those key utility financial ratios on Exhibit 66 were
16 medians for one particular year, and while they are
17 of interest, to be sure, you can see on -- if you
18 would look on Exhibit Number 65, in the right-hand
19 column, the first complete paragraph that begins,
20 Ratio medians -- I won't read it, I think it speaks
21 for itself, but the import of it is is that they
22 basically say while this is of interest, it's not to
23 be indicative of what they really require of expected
24 future performance.

25 Those kinds of criteria would be as set

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1 forth in the -- for example, the total debt to
2 capitalization items shown on Exhibit Number 64
3 within the bond rating categories. So another
4 confirmation, over and above studying those five oil
5 pipeline companies and coming to the conclusion that
6 more or less of 50 percent equity ratio would be
7 appropriate, these financial targets, if you will, of
8 expected future performance by Standard & Poor's for
9 an average utility, average risk profile and a BBB
10 bond rating, which is the average bond rating of
11 those oil pipelines that have stocks that are
12 actively traded, would be in the area of about 50
13 percent.

14 Q. You mentioned the word benchmarks, and do
15 the last two paragraphs -- would you address if those
16 go to illustrate your response to the Chairwoman, as
17 well?

18 A. Well, they're -- yeah, the benchmarks
19 really are -- they are guidelines, they're not meant
20 to be precise, and the information on Exhibit Number
21 65 points that out. But they're intended to convey,
22 I think, the obvious, that while they're not etched
23 in stone, and these things can vary from time to
24 time, you know, they will accept that a ratio might
25 slip down. If the target is, for example, 50

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1 percent, they'll recognize that at times maybe they
2 have to have a little more debt temporarily until
3 they can bring the capitalization back into line.
4 It's not a static thing that it always has to be
5 this, but it's on average over time, and that's why I
6 looked why the historical performance has
7 considerable relevance here to make some
8 determinations as to a possible proper solution in
9 this instance, that that's not been the case at all
10 for this company going back as far as 1990.

11 And that's why, when you have a serious
12 consequence, a financial problem causes the sudden
13 expenditure of many millions of dollars if you don't
14 have a proper level of capital or equity capital in
15 the capitalization, you find yourself in a situation
16 like this, and that's why it would have been prudent
17 to, over the years, to maintain capitalization ratios
18 that are more in line with the industry and what's
19 expected.

20 Q. Mr. Hanley, in the circumstances of
21 Olympic, do you believe that the application of these
22 ratios can be used to illustrate whether or not
23 interim rate relief should be granted?

24 JUDGE WALLIS: Mr. Hanley, I'm going to ask
25 you to confine your answer to yes or no, and then

00829

1 we're going to go off the record for just a moment.

2 THE WITNESS: I don't like to do this to my
3 own counsel, but may I hear the question one more
4 time, please?

5 Q. I said in this circumstance, do you think
6 this type of ratio analysis can be used by Olympic to
7 illustrate their need for emergency financial relief?

8 A. No.

9 JUDGE WALLIS: Very well. Let's be off the
10 record.

11 (Recess taken.)

12 JUDGE WALLIS: Let's be back on the record,
13 please.

14 MR. BRENA: That completes my examination,
15 Your Honor.

16 JUDGE WALLIS: Very well, there is a
17 clarifying question from Chairwoman Showalter.

18

19 E X A M I N A T I O N

20 BY CHAIRWOMAN SHOWALTER:

21 Q. Yes, there is. Can you turn to Exhibit 66?

22 A. I have it.

23 Q. If you look at the top section, labeled
24 Adjusted Key Industrial Financial Ratios, there is a
25 -- the first row is labeled Interest Coverage Times,

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1 and runs along from a AAA to a CCC, and if you look
2 at the column under BBB, it says 3.7. Is that the
3 same figure as the BBB column in the bottom section,
4 which says 2.6, just for a different period of time,
5 or is this comparing something different?

6 A. It's comparing something different, but let
7 me explain, because I want to take away your
8 confusion totally. The top -- in the title in the
9 top portion, the key word there is industrial.

10 Q. Okay.

11 A. Okay. They're not utility companies. And
12 even more importantly than that, there are no -- the
13 kinds of target ratios that are set forth for
14 utilities on Exhibit Number 64, such targets do not
15 exist for industrials.

16 Q. All right. So for what we are looking at,
17 what caught my attention on this is that it actually
18 went down to a CCC.

19 A. Yeah.

20 Q. Whereas the Exhibit 64 only went to a B?

21 A. Yeah, because they assume that utilities,
22 with being regulated, and that the regulators would
23 make sure that, unlike unregulated industrial
24 companies, for the most part, would make sure that
25 there's a proper level of capitalization and not

00831

1 assume that they're going to become junk bond status,
2 which is what you've got when you get down into those
3 far right-hand extensions with regard to the
4 industrials.

5 CHAIRWOMAN SHOWALTER: All right. Thank
6 you for clarifying that. I've been educated enough.
7 Thank you.

8 JUDGE WALLIS: Is there anything further of
9 the witness?

10 MR. MARSHALL: No, Your Honor.

11 JUDGE WALLIS: It appears that there is
12 not. I thank you, Mr. Hanley, for appearing today.
13 You're excused from the stand at this time.

14 THE WITNESS: Thank you, Your Honor.

15 JUDGE WALLIS: We will take a 15-minute
16 recess.

17 (Recess taken.)

18 JUDGE WALLIS: Let's be back on the record,
19 please, following the morning recess. The
20 applicant's witness, Mr. Fox, is being presented at
21 this time. Mr. Fox, would you please stand and raise
22 your right hand?

23 MR. FOX: Sure.

24 Whereupon,

25 HOWARD B. FOX,

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1 having been first duly sworn, was called as a witness
2 herein, and was examined and testified as follows:

3 JUDGE WALLIS: Mr. Marshall.

4

5 D I R E C T E X A M I N A T I O N

6 BY MR. MARSHALL:

7 Q. Mr. Fox, do you have before you your
8 testimony, 81-T, and the exhibits, 82, 83, and your
9 supplemental rebuttal testimony, 84-T?

10 A. Yes, I do.

11 Q. Okay. Do you have any further additions or
12 corrections to make to bring your testimony
13 up-to-date?

14 A. Yes, I do have a couple of changes. The --
15 on page ten of my rebuttal testimony, towards the
16 end, on lines 14 and 15, the original -- these aren't
17 huge changes, but there was some slight changes in
18 the interim annual increase of \$9,410,559, should be
19 \$9,323,900, and the percentage change from 67.39
20 percent to 66.77 percent.

21 MR. BRENA: May I suggest that they just
22 submit an errata, to the degree they're
23 nonsubstantive changes?

24 JUDGE WALLIS: There may be some question
25 as to whether a change is substantive or not, but if

00833

1 the change is relatively minor in scope, we would be
2 very comfortable with an errata sheet.

3 Q. So with that in mind, do you have some
4 further changes?

5 A. No, I do not.

6 Q. Okay. If I were to ask you the same
7 questions that were included in your testimony, with
8 that one correction and the others in the errata
9 sheet, with those corrections, would you give the
10 same answers today under oath?

11 A. Yes, I would.

12 MR. MARSHALL: We offer his testimony and
13 exhibits into evidence and allow him to be
14 cross-examined.

15 JUDGE WALLIS: Very well. Is there
16 objection? Let the record show that there is none,
17 and 81-T, 82, 83, and 84-T are received. Let's begin
18 the examination with Mr. Brena.

19

20 C R O S S - E X A M I N A T I O N

21 BY MR. BRENA:

22 Q. Good morning, Mr. Fox.

23 A. Good morning.

24 Q. I'm going to refer to exhibits. If you
25 need -- Exhibit 18 is a copy of the audited

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1 financials, on page five of 15 is the auditor's
2 letter.

3 A. Yes.

4 Q. I'm going to ask you general questions. Do
5 you know -- would you explain the difference between
6 an unqualified and a qualified auditor's letter?

7 A. Sure. On an unqualified auditor's letter,
8 it represents, from an independent certified public
9 accounting firm, that the financials that they
10 audited conformed to all of the accounting
11 principles. A -- was your question qualified versus
12 unqualified?

13 Q. Yes.

14 A. Qualified would mean that there are certain
15 instances where auditors would want to make known
16 anything that was perhaps needing to be a caution for
17 investors.

18 Q. Now, is it fair for me to summarize this
19 difference by saying whether the books that the
20 company maintains represents the financial position
21 of the company according to GAAP?

22 JUDGE WALLIS: Excuse me, Mr. Brena,
23 according to what?

24 MR. BRENA: GAAP.

25 THE WITNESS: GAAP, generally accepted

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1 accounting principles.

2 JUDGE WALLIS: Thank you.

3 THE WITNESS: For this time period, yes.

4 Q. Okay. When is the last time that Olympic
5 received an unqualified audit opinion?

6 A. To the best of my knowledge, 1998.

7 Q. Is this it?

8 A. I suppose so. I -- BP took over as
9 operator in July of 2000, as you know, and I was not
10 around in 1998.

11 Q. Do you consider having an independent audit
12 an important thing for investors to review?

13 A. In general, the answer would be yes.

14 Q. Why do people have audits?

15 A. Well, there's several types of audits.
16 There are internal audits, external audits.

17 Q. An audit of the type that's presented here
18 by Arthur Andersen, a full audit of their books and
19 records?

20 A. There can be several reasons. I think the
21 primary reason here is it was required for the
22 company, but I don't know for sure.

23 Q. Required by whom and under what
24 circumstance?

25 A. I'm not aware of that. I haven't read the

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1 -- all of the documents associated with what Olympic
2 is required to do.

3 Q. Is it common for a lender to require
4 audited financial statements?

5 A. In most cases, yes.

6 Q. Okay. How many pipelines that BP manages
7 that are regulated have their books audited?

8 A. I wouldn't know the exact number. There
9 are several that I'm aware of.

10 Q. As a matter of practice, does BP Pipelines
11 have the books and records of the regulated common
12 carriers audited?

13 A. Without going into a big discussion about
14 audits between wholly-owned assets and joint venture
15 assets, it really depends on the covenants of
16 whatever agreements are in effect for the companies
17 that BP has an interest in.

18 Q. And -- I'm sorry.

19 A. So I mean, to answer your question
20 specifically, I don't know the whole audit schedule
21 and how many are audited and how often. If a joint
22 venture has a covenant that requires an audit, it
23 would be audited, and if it's a wholly-owned one,
24 it's probably covered by more of an umbrella audit by
25 our accounting firm.

00837

1 Q. Is Olympic in a joint venture?

2 A. Olympic is a joint venture, yes.

3 Q. Is there a requirement that the books and
4 records of Olympic be audited?

5 A. That's kind of a vague question, as
6 associated with what? I'm not sure what your
7 question is.

8 Q. I was asking you the circumstances under
9 which BP Pipelines performed third-party audits of
10 books and records, and you indicated joint ventures,
11 if it's a condition of the joint venture. Is it your
12 understanding that there is a condition of the joint
13 venture which requires Olympic's books and records to
14 be subject to an independent audit?

15 A. I don't know the answer to that. And I
16 think you stated that BP conducts an audit, and that
17 would be incorrect.

18 Q. Oh, yes. That BP authorizes that an audit
19 be done.

20 A. Right, yeah, that --

21 Q. Okay. Who within Olympic is responsible to
22 be sure that Olympic's books and records are audited
23 by a third party?

24 A. I believe that's the board of directors,
25 but I don't know for sure.

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1 Q. Has the board of directors directed that
2 Olympic's books and records be audited?

3 A. Yes, it has.

4 Q. Its full books and records?

5 A. I don't know if that was the specificity of
6 it, but I assume so.

7 Q. Did the board direct the Whatcom Creek
8 expenses to be subject to audit or did the board
9 direct that all of Olympic's books and records be
10 subject to audit?

11 A. I believe it was the latter, that it was --
12 it included several of the accounts, if you will, not
13 just Whatcom Creek.

14 Q. Okay. What is the status of that audit?

15 A. That audit is still in progress and has not
16 concluded.

17 Q. For what period is that audit?

18 A. For what period? I don't recall exactly,
19 but I -- I don't recall exactly.

20 Q. Do you know whether or not it's since the
21 last -- since the last time the books and records
22 were audited?

23 A. I believe it was even prior to that, and
24 what I don't recall is if we agreed to start it at
25 the end of when the last unqualified opinion

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1 occurred.

2 Q. So at least in the period from then, and
3 perhaps before. Did I correctly characterize your
4 testimony?

5 A. Could you restate that, please?

6 Q. At least from when the last audit occurred,
7 and perhaps before that point?

8 A. Yes.

9 Q. And when is it expected that this audit
10 would be completed?

11 A. I don't have an opinion on that.

12 Q. Who was initially engaged to perform this
13 audit?

14 A. PriceWaterhouseCoopers.

15 Q. Has there been a change of auditors since
16 the initial engagement?

17 A. Yes, there was.

18 Q. And why did Olympic change auditors in the
19 middle of an audit?

20 A. I'm not the appropriate person to address
21 this question to, primarily because -- I don't
22 remember, but I doubt that I was involved in the
23 discussions specifically that changed the auditors.

24 Q. Let me guess. Would Mr. Batch be the
25 appropriate person?

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1 A. Yes. Could I defer to him?

2 Q. I don't see why not. I'm sorry, I forgot.

3 Who was the initial auditor and who is the auditor

4 now?

5 A. You never asked the one.

6 PriceWaterhouseCoopers was the initial auditor, and

7 that was switched to Ernst and Young.

8 Q. Do you know why Arthur Andersen, the entity

9 that had been auditing it for years, wasn't engaged?

10 A. I don't recall specifically, but I know

11 that -- if I had to guess, and actually, I probably

12 shouldn't guess. I don't know specifically.

13 Q. Was Arthur Andersen contacted with regard

14 to updating its audit at all subsequent to 1998?

15 A. In what time period are you asking the

16 question for?

17 Q. Well, they did a complete audit in 1998;

18 correct?

19 A. Correct.

20 Q. Have there been -- have they been asked or

21 approached to do any other work for this company

22 since that audit?

23 A. If you don't mind, may I make a clarifying

24 statement --

25 Q. Certainly.

00841

1 A. -- to respond to that?

2 Q. Mm-hmm.

3 A. It should be pointed out that the
4 questions, and I'm not sure you prefaced it by asking
5 it this way, but the audit by PWC that changed to
6 Ernst and Young was not a -- what I would call a
7 financial audit. Andersen was the audit firm that
8 did the financial audit when Equilon was the operator
9 each year. The audit that was undertaken by PWC and
10 then by Ernst and Young was more of an internal
11 audit.

12 Q. So Olympic Pipe Line has not yet engaged
13 any accounting firm to do a -- to provide an audit
14 which would result in a unqualified audit letter?

15 A. To answer that question, I'm not sure if
16 you're asking me should we try to audit another year,
17 because, I mean, the primary focus is to get an
18 unqualified report for 1998. I mean, excuse me,
19 1999.

20 Q. Okay. So I'm confused by your
21 clarification, then. In 1998, you had an unqualified
22 opinion on the financial books and records of
23 Olympic; correct?

24 A. Correct.

25 Q. In 1999, I'm trying to clarify what efforts

00842

1 the company has gone through to try to get an
2 unqualified opinion with regard to the financial
3 books and records, specifically whether Arthur
4 Andersen was approached --

5 A. Yes.

6 Q. -- PriceWaterhouse or Ernst and Young?

7 A. Okay. Again, PriceWaterhouse, Ernst and
8 Young were handling an internal audit, which is a
9 separate activity. Andersen was approached on many
10 occasions, starting with Equilon and then with BP,
11 when they took over as operator, to attempt to get
12 those finalized.

13 Q. Okay. So let me state this as I understand
14 it. I'm just trying to understand. The company
15 contacted PriceWaterhouse and now Ernst and Young for
16 the purpose of doing internal audits, which then it
17 intended to turn over to Arthur Andersen to -- okay.

18 A. No.

19 Q. Okay.

20 A. They're unrelated. They're completely
21 unrelated.

22 Q. Okay. Is an internal audit -- when I think
23 about an internal audit, what I think about is
24 something from management decision-making. I don't
25 think about something for representation to the

00843

1 investor community. What type of audit -- is it
2 internal or is it -- what type of audit is ongoing?

3 A. An internal audit. And I need to clarify
4 what I said when I said unrelated. It is -- there is
5 a connection between that audit and the 1999
6 financial statements, but they're not the same thing.
7 I just wanted to clarify that you didn't think they
8 were the same thing.

9 Q. Okay, thank you. Now, clarify my
10 misunderstanding. If I think about an internal
11 audit, I think about an audit that does not come with
12 an auditor's letter that's qualified or unqualified.
13 When I think about an audit that comes with a
14 auditor's letter that's unqualified, I think about an
15 audit that is not for internal purposes, but is
16 intended to be used for external purposes for the
17 investment community. Okay. Is my understanding
18 correct?

19 A. In general, yes.

20 Q. Okay. The type of audit that's ongoing, is
21 it the type of audit that will result in an
22 unqualified letter -- that's intended to result in an
23 unqualified letter for representation to the
24 investment community?

25 A. No.

00844

1 Q. Why did you change auditors in the middle
2 of an internal audit?

3 A. I think you asked me that question
4 previously, and I said I wasn't the right one to
5 respond to that.

6 Q. Okay. Do you have any reason to believe
7 that one reason may be what the initial auditors
8 initially determined with regard to the books and
9 records of Olympic?

10 MR. MARSHALL: If the witness could confer
11 with Mr. Batch, we could answer that directly, and
12 probably cut some of the potential confusion.

13 MR. BRENA: If Mr. Batch is the witness --

14 MR. MARSHALL: I'm sorry, Mr. Beaver.

15 MR. BRENA: Mr. Beaver. If Mr. Beaver
16 would like to be the witness, I'd like to do that.

17 MR. BEAVER: I can be the witness, that's
18 fine.

19 MR. MARSHALL: On that issue, he could, if
20 you wanted. But I think that, you know, again, if
21 the real question is are we after a fact here, we
22 could cut through it and give a real fast, quick
23 answer on this.

24 MR. BRENA: A fast, quick answer as to why
25 they changed auditors in mid audit?

00845

1 MR. MARSHALL: Well, no, it wasn't mid
2 audit.

3 MR. BEAVER: No, there wasn't an audit --

4 JUDGE WALLIS: Okay. Let's be off the
5 record for just a moment, please.

6 (Discussion off the record.)

7 JUDGE WALLIS: Let's be back on the record.

8 Is the witness prepared to answer the question now?

9 THE WITNESS: Could you restate the
10 question, just because it's been about two minutes,
11 and I've lost it.

12 Q. I was trying to understand why there was a
13 -- I asked initially who was initially engaged, and
14 you indicated PriceWaterhouse, and that there was a
15 change to Ernst and Young, and my inquiry was why was
16 there a change?

17 A. Okay. And I think there was also an
18 implication that it was mid audit that the -- as I
19 recall, PWC had been on the audit for just a few
20 weeks, maybe not even a month, and there was a
21 concern from PWC, since I believe they also were the
22 audit firm for one of the shareholders, so there was
23 a conflict purely from that standpoint.

24 Q. Equilon?

25 A. I believe so.

00846

1 Q. So they undertook the engagement, worked on
2 it for about a month, and then brought forward a
3 conflict with Equilon and then, as a result of that,
4 there was a change?

5 A. Although I was indirectly involved in the
6 discussions, from what I understand, it had to do
7 with one office, being Chicago, not being in touch
8 with their Houston office.

9 Q. What is the purpose for the internal audit?

10 A. I'd have to characterize that as two
11 things. One, to just do a due diligence process on
12 the books and the records upon BP taking over
13 operatorship of the pipeline.

14 Q. Okay.

15 A. The second was to ensure the integrity of
16 all of the accounts.

17 Q. Has there been any efforts made to get an
18 unqualified letter on Olympic's books and records
19 since BP has been an operator?

20 A. Yes, there has.

21 Q. What was the effort?

22 A. I have personally -- I can only speak for
23 myself -- spoken to the Andersen audit partner
24 manager to try to ensure that we could get this
25 expedited.

00847

1 Q. When was that conversation?

2 A. I said there were several.

3 Q. When did they begin?

4 A. Shortly after BP took over as operator.

5 Q. Is Andersen currently engaged to do that?

6 A. I'm not sure I understand your question.

7 Engaged to do what?

8 Q. Have they been hired to do an audit
9 necessary to result in an unqualified letter on the
10 financial books and records of Olympic?

11 A. No, not to my knowledge.

12 Q. So they haven't been hired, they haven't
13 begun work?

14 A. I'm a little confused as to your question,
15 because Andersen, I mean, technically, is still under
16 hire to final the 1999 audit, so they're still
17 working on that audit. It's as though you asked me
18 were they hired for another activity, and that's what
19 I answered no to.

20 Q. They've been working on the 1999 audit for
21 three years?

22 A. It depends on how you define the term
23 working.

24 Q. Well, I'm just trying to know -- please
25 define it as you wish and answer the question.

00848

1 A. The activity level I would characterize as
2 being very low on it, to the extent that the audit,
3 the internal audit, has not been finalized.

4 Q. Have they given any indication at any time,
5 under any circumstances, that they may have
6 difficulty giving Olympic an unqualified letter?

7 A. They have indicated that certain events or
8 actions would have to take place before they would
9 give an unqualified opinion.

10 Q. What are those?

11 A. I really can't recall all of them, but the
12 -- there actually were -- as I recall, there were
13 three in total, and one or two of them were waived,
14 and I can't recall exactly what those were, but I
15 believe the primary one was the balances on the
16 balance sheet and in a particular partner agreement
17 on those. Or excuse me, a shareholder agreement on
18 those.

19 Q. What was the difficulty that they had with
20 the balances on the balance sheet?

21 A. BP, after taking over operatorship of the
22 pipeline, wanted to ensure that all of the spending,
23 as any owner would do, would want to ensure that all
24 of the balances were true and correct in all material
25 respects, and it's really part of a due diligence

00849

1 exercise. And to the extent that there were
2 questions on those balances, I believe was the
3 primary reason they haven't offered that opinion,
4 the unqualified opinion.

5 Q. My questions was what questions did they
6 have with regard to those balances?

7 A. They being Andersen?

8 Q. Yes.

9 A. Well, I didn't say they had a problem with
10 the balances; I said they had a problem with the
11 partners not in a total agreement in the balances or
12 potentially not being in agreement on that.

13 Q. What balances are the partners not in
14 agreement on?

15 A. I believe the exact title was payables to
16 affiliates.

17 Q. Do you have any loan conditions on your
18 existing conventional debt that require you to have
19 audited financials?

20 A. Yes, we do.

21 Q. Are you in default of those?

22 A. I'm not an attorney, so I couldn't give you
23 a legal answer, but -- I don't know if you want to
24 ask me as a non-attorney.

25 Q. Is the Prudential loan -- the Prudential

00850

1 loan is currently in default?

2 A. If one read the agreement and looked at the
3 covenants, particularly the affirmative covenants,
4 one would surmise that we are in default.

5 Q. Okay. Has Prudential taken the position
6 that you are in default?

7 A. The discussions with Prudential have not
8 been pleasant, and they started getting bad last year
9 and they've progressively gotten worse, so they may
10 not say default specifically. They -- we have every
11 reason to believe that they want out of this
12 situation.

13 Q. Has Prudential sent any letter -- has
14 Prudential sent any letter of default or notice of
15 default to Olympic?

16 A. I don't believe so.

17 Q. Is Olympic currently in compliance with all
18 of the payment terms of the Prudential debt?

19 A. I would say today, the answer is probably
20 no.

21 Q. Was it different yesterday?

22 A. Well, it would have been different six
23 months ago, and as you probably read in my testimony,
24 the rating from the National Association of Insurance
25 Commissioners has gone from the best rating to the

00851

1 worst rating, and we know that Prudential wants
2 approximately \$1,200 a day to keep them whole on
3 that.

4 Q. If I can isolate the rating issue, have you
5 made all your other payments under the Prudential
6 debt?

7 A. I believe so.

8 Q. Is the reason that the rating skipped was
9 because you don't have audited financial -- an
10 unqualified opinion?

11 A. I believe the answer to that is yes.

12 Q. Is that the only event of -- the specific
13 event of default that Prudential has brought forward,
14 is that you don't have audited financial books and
15 records and an unqualified opinion?

16 A. No, it is not.

17 Q. Are the others related to your failure to
18 pay this fee as a result of not having them?

19 A. Could you repeat the question, please?

20 Q. What other indications of specific default
21 -- well, let me phrase it the way that I did the
22 first time. I asked if not having audited books and
23 records was the only default that Prudential has set
24 forward to you. You said no; is that correct?

25 A. I'm not sure I said that, but if I did --

00852

1 no, I think what you asked was -- that was in
2 reference -- I answered that in reference to
3 basically are we current, are we paying everything.

4 Q. Okay.

5 A. And I said, No, there's this 1,200 a day.
6 I didn't say -- because that has nothing to -- that
7 is unrelated to the default, as far as I know.

8 Q. So let me summarize what I understand. The
9 Prudential note was current and not in default six
10 months ago, Prudential has taken the position that
11 the books and records need to be audited and they
12 need an unqualified opinion, and the lack of having
13 that has resulted in a rerating, and they have
14 imposed additional fines, which have not been paid.
15 Does that fairly summarize the situation?

16 A. No.

17 Q. Okay. Please summarize the situation.

18 A. And given the time constraints that I know
19 we're under, I'll try to clarify it as succinctly as
20 I can, but it is my understanding that if you just
21 read the -- and again, I'm not a lawyer, but if you
22 read the contract specifically, one could say that we
23 were in default 60 days after the end of 1999, so
24 when you said six months ago, I'd have to argue with
25 that, so I'd certainly clarify with that.

00853

1 Q. Okay. How you were in default in 1999 was
2 because of the failure to have an unqualified opinion
3 on your books and records; correct?

4 A. Correct.

5 Q. Has Prudential sent you any piece of paper
6 indicating that the Prudential debt is in default?

7 A. Does that include e-mails?

8 Q. Well, no, for the purposes of this answer.

9 A. I don't know the answer to that, because I
10 know some less-than-amicable mail traded hands as we
11 tried to get a waiver last year to put the ARCO loan
12 in effect, so I don't know -- I don't recall whether
13 there was anything either overtly or less discussed
14 in that exchange.

15 Q. Have you ever seen anything in which
16 Prudential has asserted -- a piece of paper in which
17 Prudential has asserted that its debt is in default?

18 A. I have not seen anything like that.

19 Q. Are you familiar with the notification of
20 default provisions in the underlying debt?

21 A. Is that -- what section is that? Is that
22 Seven?

23 Q. Well, I don't know.

24 A. I am aware of that. Again, I am not an
25 attorney, but I'm aware of that section, yes.

00854

1 Q. Does that section require written
2 notification?

3 A. I don't recall.

4 Q. Okay. You think it's Section Seven of the
5 note, of the --

6 A. I think it's under the section where it
7 talks about acceleration.

8 Q. Okay. Have you seen a piece of paper in
9 which Prudential has asserted that you have to pay
10 the \$1,200 and are not?

11 A. Again, excluding e-mails?

12 Q. Yes.

13 A. I have not seen a hard copy note on that,
14 no.

15 Q. Okay. They sent you an e-mail telling you
16 that you need to pay the \$1,200, or that you may have
17 to pay the 1,200 if you don't go get your books
18 audited?

19 A. Starting in September, it was, We have a
20 problem, we need to work on this, and I -- in
21 December, as I recall, calculations were even sent to
22 me. So if you're talking about written only, that's
23 what I can describe. If you want to talk about oral
24 discussions, that's another subject.

25 Q. Well, I understand that you're working with

00855

1 Prudential to try to resolve the issue associated
2 with having unaudited books. My question is have
3 they formally notified you of default, or have they
4 formally notified you that this \$1,200 is due, or
5 have they suggested that that will be due if you guys
6 don't get your books and records audited?

7 A. Not to be argumentative, but I deal with a
8 lot of third parties, and I don't need anything in
9 writing to know when a company wants out of a
10 situation, and that's how I would characterize it as.
11 In the last several discussions, particularly the
12 last discussion with Prudential, they -- this is one
13 of their least favorite loans, so there's no question
14 that they -- it has been a painful loan for them, and
15 frankly, it's been a painful loan for us.

16 Q. If you have \$20 million invested in someone
17 that can't get an audit done in three years, can you
18 understand why that would be kind of frustrating for
19 them?

20 MR. MARSHALL: Object as argumentative.

21 MR. BRENA: I withdraw the question.

22 Q. Okay. Does Olympic have any other third
23 party debt?

24 A. Yes, it does.

25 Q. And what debt is that? Well, excuse me.

00856

1 How much do you owe Prudential?
2 A. I believe -- I believe it's 14,500,000
3 subject to checking on it.
4 Q. Okay. And when's the next --
5 A. I believe it's fourteen-five.
6 Q. When's the next payment due under the
7 normal terms of the note?
8 A. I don't know the exact day, but I believe
9 it's in February.
10 Q. How much?
11 A. Principal or interest?
12 Q. Either.
13 A. Yeah, there's a principal and interest
14 payment due in February and another half a year on
15 the interest in -- I believe in August.
16 Q. Okay. Before we go to the next debt, I
17 want to just go back a minute to the problem with the
18 balance sheet on payables to affiliates. Is the
19 dispute -- excuse me, is the shareholder's
20 unwillingness to agree on that category based in the
21 \$43 million that Equilon had contributed into Olympic
22 that's characterized as debt in this case?
23 A. That is -- yes, I believe the answer is
24 yes.
25 Q. And is there a dispute between the

00857

1 shareholders over the amount of debt that is owed
2 Equilon?

3 A. Well, to the extent that the balance is
4 under audit would signify that there's some concern
5 about the ultimate number. However, I'd point out
6 that, and I'm not sure this has been documented, but
7 I would guess that we're talking, you know, five
8 percent variance to -- on the total amount, and not
9 something like, you know, half of it or whatever.
10 It's more of a what's the ultimate amount, rather
11 than is there a big chunk that should have been
12 excluded, et cetera, if that's what you're getting
13 at.

14 Q. The \$43 million, which is characterized as
15 Equilon debt, is currently under audit?

16 A. Yes, it is.

17 Q. Internal audit?

18 A. Yes.

19 Q. By whom?

20 A. Ernst and Young.

21 Q. Okay. When will their audit be completed?

22 A. I think you asked me that question before.

23 Q. Oh, that's the same internal audit we were
24 discussing before?

25 A. Yes.

00858

1 Q. Are they auditing things other than the
2 shareholder dispute?

3 A. Yes, as I mentioned before, the audit is
4 under -- was checking the balances that were turned
5 over from Equilon to BP.

6 Q. Does the audit extend beyond that scope at
7 all?

8 A. Not to my knowledge.

9 Q. Okay. Now, do you know -- you speculated
10 on the five percent. Do you know how much,
11 quantitatively, is in dispute between the
12 shareholders?

13 A. Specifically?

14 Q. Yes.

15 A. No, I don't know the exact amount.

16 Q. And you won't until the audit's complete;
17 is that correct?

18 A. That's correct.

19 Q. Okay. Have the shareholders agreed with
20 whatever Ernst and Young comes up with, that that
21 will be the amount used?

22 A. Again, I wasn't in the board meeting, which
23 I'm not even sure what meeting that was discussed,
24 but it may have been even a separate session in the
25 meeting. I didn't -- I wasn't around when that was

00859

1 discussed.
2 Q. Okay. Now, I want to go to the other third
3 party debt.
4 A. Okay.
5 Q. What is it?
6 A. It's a revolving note with Chase.
7 Q. Is it in default?
8 A. No, it is not.
9 Q. How much is it?
10 A. Thirty million dollars.
11 Q. What's the interest term of it?
12 A. The interest term? I don't know the exact
13 amount, but it was just rolled over in December. I
14 don't know the exact number.
15 Q. Was it rolled over -- were the parent
16 companies required to guarantee it in order to get
17 Chase to roll it over?
18 A. I can't answer that, because I don't know.
19 If you -- the term required concerns me a bit.
20 Q. Did they?
21 A. They did roll it over with parent
22 guarantees, yes.
23 Q. And when did that happen?
24 A. It was December -- I don't know the exact
25 date. I want to say 11th or 12th.

00860

1 Q. Okay. Are there any other disputes with
2 regard to Equilon's affiliated debt, other than what
3 we've discussed?

4 A. Not to my knowledge.

5 Q. What debt, other than -- other than
6 Equilon's \$43 million affiliated -- I'm sorry.
7 Sometimes the faster you go, the slower you get. Is
8 the entire Equilon debt subject to litigation now
9 between the shareholders?

10 A. I'm not involved in -- ask the question
11 again, if you don't mind.

12 Q. Is the entire amount of the Equilon debt
13 the substance of ongoing litigation currently?

14 A. I just -- I don't -- I don't know
15 specifically that that's the case. I'm not -- I'm,
16 one, not an attorney, and two, not involved in that
17 litigation.

18 Q. That's what I'm trying to explore, whether
19 there is litigation. Didn't Equilon sue for its 43
20 million back?

21 A. I don't have direct knowledge of that. I
22 do have a feeling that that's true, but I don't know
23 specifically. Again, I'm not heavily involved -- I'm
24 not involved at all in that litigation.

25 Q. What litigation?

00861

1 A. The litigation that you -- I think you said
2 -- you were the one that said litigation.

3 Q. Is there litigation concerning the \$43
4 million debt? Do you know that or not?

5 A. I don't know for sure.

6 Q. Please describe the other affiliated debt,
7 other than the Equilon debt.

8 A. It's approximately 52 million to ARCO.

9 Q. Had there been discussions -- and what were
10 the terms that that was lent under?

11 A. Are you asking interest rate?

12 Q. Interest rate, term of repayment?

13 A. Seven percent. I don't remember the
14 repayment date. They had varying repayment dates, as
15 I recall.

16 Q. Do you remember the range of the repayment?

17 A. Well, there probably ought to be a
18 distinction in the 52 million. There's -- I believe
19 42 million are promissory notes and 10 million is in
20 a different facility, but on the 42 million, I don't
21 know if it's 60 days or 75 days or 90 days. It's
22 somewhere in that area.

23 Q. Have you received any notification from
24 ARCO, any written piece of paper, have you seen a
25 written piece of paper that's indicated that Olympic

00862

1 is in default under the \$42 million notes?

2 A. I don't recall seeing anything like that.

3 Q. Have there been any legal actions by ARCO
4 to collect that debt, that you're aware of?

5 A. Not that I'm aware of.

6 Q. Are you aware the term provision under the
7 note, that if there is a default, it steps up the
8 interest rate from seven percent to 12 percent?

9 A. I don't recall that provision.

10 Q. Do you know whether or not Olympic is
11 accruing the seven percent or the 12 percent on its
12 books?

13 A. To the best of my knowledge, they are
14 accruing it on their books.

15 Q. At a rate of seven percent?

16 A. I believe it's seven percent.

17 Q. Has there -- have you seen anything in a
18 piece of paper that indicated that any rate
19 adjustment due to default provision of any of those
20 notes has been triggered?

21 A. Could you please restate the question?

22 Q. Have you seen any piece of paper that's
23 indicated that the rate adjustment provision of the
24 note, due to default, has been triggered?

25 A. Well, if I wasn't aware of it, obviously I

00863

1 wouldn't have seen that.
2 Q. So the answer is no?
3 A. The answer would be no.
4 Q. Thank you. I don't mean to ask silly
5 questions. Sometimes I can't help myself.
6 A. Just do them quick.
7 Q. If somebody owed you \$42 million and they
8 were in default, would you do something about it?
9 A. I don't know that I'm up here to answer a
10 question like that, to be honest with you.
11 Q. You mentioned the other \$10 million was
12 part of a different credit facility. That's the ARCO
13 revolving credit facility?
14 A. That's correct.
15 Q. And what is the total amount of that
16 facility?
17 A. Thirty million dollars.
18 Q. And so far Olympic has drawn down 10?
19 A. That's correct.
20 Q. So there is 20 remaining on that credit
21 facility?
22 A. That's correct.
23 Q. Has Olympic asked for any of that \$20
24 million?
25 A. Yes, they have.

00864

1 Q. When?

2 A. I would -- I don't have specific
3 recollection of the dates, but there's been several
4 occasions in the past month when bank balances have
5 gotten precariously low.

6 Q. Since the request for interim relief was
7 filed, the requests began?

8 A. I'm not aware of that date, so if you could
9 tell me that date, I could answer your question.

10 Q. Well, all of the requests for funds under
11 that facility occurred in the last month.

12 A. I believe so.

13 Q. And who requested the funds?

14 A. The financial analyst for Olympic.

15 Q. A person, please?

16 A. Cindy Hammer.

17 Q. And she requested them from whom?

18 CHAIRWOMAN SHOWALTER: Who's the them? I'm
19 lost here, the train of your questions.

20 Q. My understanding is that Cynthia Hammer
21 requested a drawdown on the ARCO revolving credit
22 facility within the last month, and I'm exploring who
23 she requested it from.

24 A. The answer is me.

25 Q. The answer is you?

00865

1 A. You asked who she requested it from.

2 Q. You have authority to grant \$20 million to
3 Olympic?

4 A. No. She requested it of me in terms of
5 starting the process to get ARCO to determine whether
6 they were willing to lend the money.

7 Q. Okay. So in the last month, Cynthia Hammer
8 has approached you and said we need some more cash,
9 would you start the process?

10 A. Correct.

11 Q. What is the process that you go through to
12 draw down on that credit facility?

13 A. Without, again, being argumentative, there
14 is not a real formal process for doing that. A lot
15 of what we've done involving Olympic has been,
16 frankly, what I'd probably characterize as dealing
17 with issues as quickly as we can so there is no
18 formal policy, is the way I'd probably answer that.
19 It would involve working with management to evaluate
20 the request and to determine the appropriateness of
21 offering those funds.

22 Q. Working with the management of ARCO?

23 A. Yes.

24 Q. Is that what you meant by management?

25 A. Yes.

00866

1 Q. Now, Olympic drew down \$10 million on this
2 credit facility; correct?

3 A. Correct.

4 Q. What was the process that Olympic went
5 through to draw down the \$10 million?

6 A. In terms of a request from Olympic to me,
7 where I took the request to the ARCO management; is
8 that -- I mean, that's essentially it. That was it.

9 Q. Okay. So the request came to you in your
10 capacity as assistant treasurer for Olympic?

11 A. I'd probably have to -- I'm going to have
12 to think about that question, because I wear a couple
13 of, at least, hats, so I'm not -- I really have to
14 think it through, rather than answer it quickly.

15 Q. Well, tell me all your hats.

16 A. The -- I mean, in terms of being an
17 assistant treasurer for Olympic, that probably is the
18 hat that would be worn at that time, but of course, I
19 also work for BP Pipelines.

20 Q. With what hat?

21 A. Supervise the planning group.

22 Q. And is Olympic Pipe Lines under the
23 planning group?

24 A. No, it is not.

25 Q. Okay. Do you have any other hats?

00867

1 A. None that are notable.

2 Q. Why would you be in -- I resemble that
3 remark. Then why would you be confused about what
4 hat you're wearing when the requests come to you?

5 A. It was a momentary lapse in thought.

6 Q. Okay, all right. So the request came for
7 the \$10 million. How did it get to you? Was it
8 Cynthia Hammer again?

9 A. I believe so.

10 Q. Okay. Do you remember specifically, or are
11 we guessing?

12 A. I'd be surprised if it was something else,
13 so more than likely, that was it.

14 Q. Okay. She came to you, and what did she
15 give you? Did she give you an analysis of financial
16 need? What did she give you that said, Go borrow \$10
17 million for us?

18 A. Well, when your bank account balance is
19 down to, you know, a very small amount of funds and
20 you've got a lot of operating cost, it doesn't take a
21 lot of analysis.

22 Q. What information did she provide?

23 A. She gave me the bank balance.

24 Q. Okay. And then you contacted whom?

25 A. I contacted, as I recall, Larry Peck.

00868

1 Q. How many times?

2 A. I don't recall.

3 Q. Was there any correspondence, or did you
4 just phone him up and say, Larry, our bank balance is
5 short, send us \$10 million?

6 A. I don't recall. I really don't.

7 Q. Did you fill out any sort of loan
8 application?

9 A. No, I did not.

10 Q. Did you provide any financial information
11 to Larry?

12 A. I would say that talking about the bank
13 balance is financial information, yeah.

14 Q. Is it fair to say, according to your best
15 recollection, that you phoned Larry up, conveyed to
16 him the information on bank balance, and then he
17 authorized it?

18 A. I wouldn't characterize it that way at all.

19 Q. Okay. What happened?

20 A. Again, I don't have specific memory of how
21 it took place, but I know there were discussions
22 about funding of Olympic and, you know, concerns
23 about how much money Olympic needed and, you know,
24 the need for additional analysis to determine level
25 of funding, et cetera.

00869

1 Q. Let's see. Could I refer you to Exhibit
2 46? Is this the ARCO revolving note?

3 A. Yes.

4 Q. Under paragraph six, the line of credit,
5 there is no requirement that the request even be in
6 writing, is there? It can be oral.

7 A. I'll say, once again, I'm not an attorney
8 to interpret the legal context of contracts, but --

9 Q. Well, I'm just -- advances under this note
10 may be required orally by borrower or as provided in
11 this paragraph. Lender may, but need not require
12 that all oral requests be confirmed in writing.

13 A. Okay.

14 Q. Did ARCO ask you to confirm in writing your
15 request?

16 A. Not with regard to the borrowing of the
17 funds, but certainly there would have to be the
18 appropriate signature on the request for a wire
19 transfer or whatever. I mean, there would have to be
20 a signature on that.

21 Q. Okay. And if you'd take a look at page
22 four of that exhibit.

23 A. Okay.

24 Q. The bank account that this came out of is
25 the ARCO miscellaneous bank account. That's in the

00870

1 middle of the page.

2 A. I don't see it.

3 Q. Page four of four?

4 A. I'm on page four.

5 Q. It says, Please send out Monday, June 25th,
6 2001, from ARCO miscellaneous bank account?

7 A. Okay. I'm there.

8 Q. So where this money comes from is the ARCO
9 miscellaneous bank account?

10 A. I assume that's the -- that's an account
11 name, rather than a characterization of the account,
12 if that's what you're getting at.

13 Q. Okay.

14 JUDGE WALLIS: Mr. Brena, I hate to risk
15 slowing things down by telling you that we are
16 pushing the envelope, but I want to give you that
17 warning.

18 MR. BRENA: Thank you for the warning.

19 JUDGE WALLIS: The time envelope.

20 MR. BRENA: Yes.

21 Q. Could I refer you to Exhibit Number 26?
22 Well, let me ask a few more questions with regard to
23 the ARCO one before we go to this draft resolution.
24 I apologize for the confusion.

25 With regard to where you're at now for

00871

1 additional funds, Mrs. Hammer has approached you to
2 say that it would be appropriate for you to request
3 additional sums under this revolving credit amount;
4 correct?

5 A. If you don't mind redoing that question,
6 because it sounded not like something I'd agree to,
7 so ask it again, if you don't mind.

8 Q. Okay. I'm just trying to understand, aside
9 from the \$10 million, which we've just explored --

10 A. Right.

11 Q. -- how that happened --

12 A. Right.

13 Q. -- subsequent to that, within the last
14 month, Mrs. Hammer has approached you suggesting that
15 you draw down additional sums under that line of
16 credit?

17 A. I wouldn't characterize it that way. I'd
18 probably use the verb asking, rather than suggesting.
19 I think it's more of a we're getting very close and
20 we need help, rather than -- I mean, and that may not
21 mean anything, but I just want to characterize it
22 that way.

23 Q. Have you phoned Mr. Peck and asked him for
24 money?

25 A. I have.

00872

1 Q. And what did you -- how much did you ask
2 him for?

3 A. Which time are you referring to? We've
4 done quite a few of these. Are you still under the
5 revolving note or --

6 Q. Yes, I am.

7 A. Okay. Because there are loans prior to
8 that. We've had discussions where I was the --
9 basically, the tenor of the discussion was I'm not
10 really inclined to do it.

11 Q. Okay. Have you asked Mr. Peck specifically
12 for a sum certain under the ARCO revolving note?

13 A. I don't recall if it was a specific amount.
14 It was certainly a protracted discussion about
15 they're going to need funds and they're going to need
16 it very soon, what are we going to do.

17 Q. Okay. And you said he was inclined. Did
18 he refuse?

19 A. He was what? Excuse me?

20 Q. I said did he refuse a specific request for
21 a sum certain drawdown on the remaining \$20 million
22 available under this credit facility?

23 A. Specifically, no.

24 Q. Okay. I'd like to draw your attention to
25 Exhibit 26. Now, in the interest of time, allow me

00873

1 to characterize this exhibit. It appears to be a
2 draft resolution and a revolving note for \$30 million
3 in June of this year that would be funded by BP
4 Pipelines, rather than ARCO. Are you familiar with
5 this draft resolution and note?

6 A. I am.

7 Q. Is this an additional \$30 million line of
8 credit?

9 A. No, it is not.

10 Q. Is this -- what is it?

11 A. The two BP Pipelines.

12 Q. Yes, I mean, there's a draft note here,
13 revolving note for \$30 million for BP Pipeline?

14 A. Obviously, that should be ARCO.

15 Q. When was the ARCO revolving note put in
16 effect?

17 A. I believe it was June 30th, but I'm not for
18 certain.

19 Q. Okay. June 22nd. So what you're saying is
20 is that, initially conceived, that it was going to be
21 BP Pipelines that was going to fund a \$30 million
22 credit facility, but then they substituted ARCO?

23 A. Once again, I am not a lawyer, so I don't
24 know legally what happened, but I know that they're
25 one and the same. They're corporate entities, if you

00874

1 will, that are the same.

2 Q. And by corporate entities, are you
3 referring to ARCO and BP Pipelines?

4 A. Yes, but, again, I -- to tell you I'd know
5 the legal structure would be a stretch.

6 Q. But your testimony is those weren't two
7 revolving lines of credits; those are just various
8 drafts of one revolving line of credit?

9 A. That's my understanding.

10 Q. Okay. Has there been any other
11 conversations about any other lines of credit with
12 anybody?

13 A. Since the beginning of time or --

14 Q. In the last year?

15 A. Not to my knowledge.

16 Q. Okay.

17 A. Can I add to that?

18 Q. Yeah, please.

19 A. I would -- I'd probably offer that --
20 that's not to say that we haven't had a lot of
21 analysis and discussion of what to do from a
22 financing standpoint.

23 Q. Would you please refer to Exhibit 49? Is
24 it your understanding that, to incur debt, that
25 Olympic has to ask this Commission for a public

00875

1 interest finding prior to incurring the debt?

2 A. I hate to be repetitive, but, again, I'm
3 not a lawyer, so I don't know specifically the codes
4 and statutes and the requirements for the state of
5 Washington, but I am aware -- vaguely aware of this
6 statute.

7 Q. Okay. And just for the purposes of our
8 conversation, I don't intend to ask you any legal
9 opinion whatsoever. I'm just asking for your
10 understanding.

11 A. Okay.

12 Q. So I'll just accept as a qualification on
13 every question that you're not offering legal advice.

14 A. Okay.

15 Q. Okay. Did Olympic come before this
16 Commission and request approval of any affiliated
17 debt?

18 MR. MARSHALL: That assumes an understanding
19 of the law that I don't believe is correct. I think
20 the law has been changed from seeking approval to
21 notification. And there's some doubt about what
22 notification is now for this particular time, so I
23 think the question is confusing and it's, as put, is
24 probably argumentative.

25 MR. BRENA: I'll rephrase the question.

00876

1 JUDGE WALLIS: Mr. Brena.

2 Q. With regard to the affiliated debt that's
3 been accumulated within Olympic over the last two
4 years -- and how much is that, in total?

5 A. Could you restate the question, please,
6 because I --

7 Q. How much affiliated debt has Olympic
8 acquired in the last two years? Would it be the 42,
9 plus the 10, or \$52 million?

10 A. No.

11 Q. It's more than that?

12 A. It's 97.

13 Q. Ninety-seven million dollars. So as far as
14 you're aware, did Olympic notify or contact this
15 Commission in any way prior to incurring that debt?

16 A. Bear in mind that probably -- I'm guessing
17 half was incurred prior to BP taking over as
18 operator, so I can't comment on the period before
19 that. I am not aware of anything after that date.

20 JUDGE WALLIS: Mr. Brena, just another
21 couple of minutes. What I'd like to do, then, is
22 take a very brief recess for an unrelated purpose,
23 then ask Mr. Trotter if he has any questions of the
24 witness that are very significant to the Staff case,
25 and then move to Commissioner questions.

00877

1 MR. BRENA: Okay. Thank you, Your Honor.
2 Is that five minutes? I mean, you said a few
3 minutes.

4 JUDGE WALLIS: I'd like to aim for a
5 quarter to, by the clock on the wall.

6 MR. BRENA: Okay. Thank you, sir.

7 Q. Are Olympic's \$30 million in receivables
8 available to Olympic to pay for capital improvements?

9 A. Absolutely not.

10 Q. Why not?

11 A. Because they're just receivables. That's
12 not cash in the company. Is that what you're asking?

13 Q. The definition of -- the definition of
14 receivables are current assets, correct, income?

15 A. That's correct.

16 Q. Okay. And current assets are assets
17 expected to be realized within the next 12-month
18 period under the FERC accounting; is that correct?

19 A. Under the what accounting rules?

20 Q. Under any accounting rules?

21 A. I thought you said FERC, but maybe I
22 misinterpreted what you said. Generally, that's
23 true.

24 Q. Okay. As these funds are realized, as
25 these receivables are realized within the 12 months,

00878

1 is that cash flow available for capital expenditures
2 to Olympic?

3 A. Well, but, unfortunately, the presumption
4 is that that balance will ever be realized in terms
5 of cash, and I think that's a very, very big stretch.

6 Q. Are you suggesting that the accounts
7 receivable on the balance statement is misstated?

8 A. I, to the best of my knowledge, there has
9 been an ongoing reconciliation. Bear in mind, this
10 is a very, very complex set of accounts, accounting,
11 compounded by the fact that a prior accounting system
12 handled all of the accounts and was turned over to
13 another company. That has all been under
14 reconciliation, but I think the heart of the question
15 is how much of that 30 million do you ever think
16 you're going to get back.

17 Q. Okay. Who is Olympic selling the Sea-Tac
18 terminal to?

19 A. I am not directly involved in the
20 negotiations, so I could speculate.

21 Q. Is it an affiliate?

22 A. I don't believe so. I don't know. I
23 thought it was somebody else, actually.

24 Q. Okay. Do you know when -- Mr. Batch
25 indicated that he expected a closing shortly. Is

00879

1 that your expectation?

2 A. You know, my main function is to get funds
3 for Olympic, and I'll do this quickly.

4 MR. BRENA: Excuse me, Your Honor. I asked
5 a yes or no question. I have about one minute. I
6 would appreciate a yes or no answer.

7 THE WITNESS: My expectation is no.

8 MR. BRENA: Okay. That's as far as I --

9 JUDGE WALLIS: Very well.

10 MR. BRENA: Not that I'm done.

11 JUDGE WALLIS: Yes, we understand that.
12 Let's be off the record for a moment.

13 (Recess taken.)

14 JUDGE WALLIS: Let's be back on the record,
15 please, and turn to Mr. Trotter.

16 MR. TROTTER: Thank you, and I'll try to be
17 concise.

18

19 C R O S S - E X A M I N A T I O N

20 BY MR. TROTTER:

21 Q. Mr. Fox, it appears there's no dispute that
22 the Prudential note prohibits any additional external
23 financing; is that right?

24 A. That's correct.

25 Q. Does it prevent any additional internal

00880

1 financing, any additional notes from the owners -- or
2 from Olympic to the owners?

3 A. I believe it does prevent that.

4 Q. Okay. So other than the ARCO revolving
5 credit line, the 20 million, that's the only capital
6 out there that Olympic could get and be consistent
7 with the Prudential note?

8 A. That's my understanding.

9 Q. Okay. Has Olympic asked Prudential to have
10 that condition waived?

11 A. Now, I'm going to try to be concise. There
12 was a considerable amount of effort to get Prudential
13 to allow the waiver to put the ARCO note in place in,
14 I believe, May of last year, so to ask them to waive
15 it again just doesn't make a lot of sense. It would
16 be sort of like, you know, boy, we really had to
17 fight to get this in. Oh, by the way, can we have a
18 waiver to that waiver. I mean, it just doesn't -- it
19 wouldn't -- they'd laugh at us.

20 Q. Okay. So you initially needed a waiver and
21 got one to issue the 30 million credit line, but
22 haven't asked for a waiver to permit any additional
23 financing internally, correct, because of the reason
24 you state?

25 A. Right, there's just no -- it's ludicrous.

00881

1 Q. A question was deferred to you regarding
2 the Equilon note that was issued in June of 2000, due
3 in August 2000. Are you familiar with that note?

4 A. Yes, I am.

5 Q. Is it correct that at no time in June,
6 July, or August of 2000, that Olympic had an ability
7 to pay off that note?

8 A. I believe the answer is no. Or yes, it did
9 not have the ability.

10 Q. You were referred some questions on
11 cross-subsidy. Let me see if I can ask you a
12 multi-part question to get to it. Do you agree that
13 none of the following events constitute a
14 cross-subsidy in Olympic's view. Number one, an
15 infusion of capital by its owners, a dividend from
16 Olympic to its owners --

17 JUDGE WALLIS: Do you want to take the
18 answers item-by-item?

19 THE WITNESS: Actually, frankly, I could
20 attempt to answer that, but I think Mr. Schink -- and
21 I don't want to start a litany of deferrals, but I
22 think it's probably best for him to talk about
23 cross-subsidization.

24 Q. I'll do that.

25 A. If you don't mind. Thanks.

00882

1 Q. Turn to your rebuttal testimony, Exhibit --
2 JUDGE WALLIS: 81-T.

3 Q. -- 81-T, page three, line ten.

4 A. Okay.

5 Q. Here you referred to this Commission
6 consistently holding that rates must be set at a
7 level sufficient to allow a regulated company to
8 attract sufficient capital and reasonable terms. Do
9 you see that?

10 A. Yes, I do.

11 Q. And in researching the Commission's
12 consistent holdings, did you find any case in which
13 the Commission permitted the company to recover cost
14 of capital in an amount that exceeded the amount that
15 the company had invested in net assets?

16 A. No, I did not.

17 Q. Did you find any order in which the
18 Commission had provided rate relief based on
19 liabilities that represented past losses?

20 A. In responding to that question, can I
21 clarify the previous question? I also didn't do any
22 research back into, you know, individual cases. My
23 primary concern, as I told Mr. Brena, was to secure
24 funds for Olympic, so the -- I didn't do that
25 research, just to clarify.

00883

1 Q. Well, just to clarify your testimony about
2 consistent holdings, did you read prior orders to
3 find out what those holdings were?

4 A. I read a couple, but I don't want to give
5 the impression that I went through, you know,
6 hundreds of them.

7 Q. Whatever review you did for support of your
8 testimony, you found none that provided recovery
9 related to liabilities that represented past losses;
10 correct?

11 A. I don't recall seeing any of --

12 Q. Turn to page four, line eight to nine. You
13 refer to none of the parties, in your view, seriously
14 disputing any of the items in Olympic's proposed
15 capital budget for 2002. Do you see that?

16 A. Yes, I do.

17 Q. Is that a general rate case issue, in your
18 opinion?

19 A. I really don't have a feeling one way or
20 another. I mean, I think it's just -- it stands on
21 its own merit, just --

22 Q. Well, in other respects, you criticize
23 parties for raising issues that are, in your belief,
24 more properly rate case issues. Do you recall that?

25 A. Yes.

00884

1 Q. Is this more properly a rate case issue?

2 It is, isn't it?

3 A. Probably.

4 Q. Turn to page seven of your same exhibit,
5 lines 18 to 21. You refer to the risk of Olympic,
6 and then the last phrase is -- and you refer to
7 higher risk, as recent events have shown. Do you see
8 that?

9 A. Which line was that, the last?

10 Q. Starts on line 18. The recent events have
11 shown is on line 21.

12 A. Oh, okay.

13 Q. Do you see that?

14 A. Yes.

15 Q. By recent events, are you referring to the
16 Whatcom Creek explosion?

17 A. I think it probably would cover a wide
18 range of things, including Whatcom Creek, but it
19 would also include operating environment in the state
20 of Washington. Not many states where we have an
21 interest in pipelines have earthquakes, landslides,
22 estuaries. But I think risk -- risk is a relative
23 term. I mean --

24 Q. And landslides and earthquakes affect other
25 regulated utilities in this state, do they not?

00885

1 A. I'm not aware of that.

2 Q. You didn't consider that when you were
3 relating it to other regulated companies?

4 A. I think what I was addressing was risk, in
5 terms of just risk isn't just -- I think, as the
6 Commission stated, the fact that the line was
7 pro-rated, that there's no risk on getting, you know,
8 the pipeline filled up. I think there's risk in
9 terms of what it costs to operate the pipeline.

10 Q. In any event, Olympic is proposing to
11 exclude the effect and impact of the Whatcom Creek
12 accident in its case, is it not?

13 A. I believe that is the case.

14 Q. Turn to page seven of your testimony, on
15 line nine. You refer, on line nine through 11, you
16 oppose Staff's 1.5 interest coverage ratio and say it
17 should be modified to adjust for federal income tax,
18 and you get to a 2.3 times ratio. Do you see that?

19 A. Yes, I do.

20 Q. And you calculated that by simply dividing
21 1.5 by one minus the federal income tax rate?

22 A. Correct.

23 Q. Federal income tax is a function of net
24 income; correct?

25 A. No, probably not correct. It's a function

00886

1 of taxable income, which is different than financial
2 book net income. It's more of a cash flow tax,
3 rather than -- or it's on cash flow, rather than
4 financial book net income. If you're talking about
5 actual taxes paid.

6 Q. If a company has taxable revenue equal to
7 taxable expense, it has no federal income tax
8 liability; correct?

9 A. That is correct, as long as you take
10 depreciation out of the equation, because financial
11 book depreciation and tax book depreciation are very,
12 very seldom the same.

13 Q. A company that -- are you saying that a
14 company that has interest expense that has taxable --
15 let me start over. A company that has taxable
16 expenses that equal its taxable revenues, does it pay
17 those taxable expenses out of pre-tax or after-tax
18 dollars?

19 A. I'm not sure what your question is, but I
20 think the answer is after-tax dollars.

21 Q. Even though it has no federal income tax,
22 because its taxable expenses and taxable revenues are
23 the same?

24 A. It -- I mean, it depends on the taxing
25 structure and --

00887

1 Q. Well, you refer to federal income tax, so
2 let's talk about that taxing structure. I'm asking
3 you to assume a company has taxable income and
4 taxable revenue -- excuse me, taxable expenses and
5 taxable revenue that are the same, and I'm asking you
6 to admit that that means that their federal income
7 tax is zero.

8 A. And in that specific example, again, I'd
9 preface that on saying that depreciation is very,
10 very seldom the same on financial book income as it
11 is on taxable income, but yeah, if you're talking
12 about tax book depreciation in that expense line,
13 I'll agree with you.

14 JUDGE WALLIS: Mr. Trotter, just a couple
15 more questions.

16 Q. Turn to page eight. You show -- line 12,
17 you talk about the company's salary expense, and the
18 7.38 million figure you show in line 14 is Olympic's
19 budget figure; is that correct?

20 A. I believe so, but I'd have to check that.

21 Q. Accept it subject to check?

22 A. Yes.

23 Q. And Mr. Colbo acknowledged that that was
24 the budget figure; he didn't acknowledge that it was
25 the correct level, did he?

00888

1 A. I'm not sure.

2 Q. Accept that, subject to your check?

3 A. Sure.

4 Q. On the government and public affairs issue,
5 starting on line 22, Olympic has not removed all
6 lobbying and image building expenses from its
7 expenses, whether related to Whatcom Creek or not,
8 has it?

9 A. Could you please repeat the question?

10 Q. Olympic has not removed from its operating
11 expenses all lobbying and image building expenses,
12 whether related to Whatcom Creek or not, has it?

13 A. I don't know the answer to that, but I know
14 that a lot of it is in the Whatcom Creek charges.

15 Q. Two other questions. On page nine, you
16 refer to your power -- the power expense adjustment,
17 and on line 17, you indicate that your adjustment
18 reflects intended rate increases filed by Puget Sound
19 Energy; is that correct?

20 A. Yes, it is.

21 Q. And those are subject to approval by this
22 Commission, are they not?

23 A. I would expect so.

24 Q. And then, finally, regarding the sale of
25 assets at Sea-Tac, the company is selling those at

00889

1 well above book value; correct?

2 A. I'm sorry, is that -- oh, is that on the
3 supplemental?

4 Q. This would be the supplemental rebuttal.

5 A. Okay. I don't know the answer to that
6 specifically.

7 Q. Are you aware of the policy of this
8 Commission that gains on sale of depreciable assets
9 belong to the ratepayers, not the shareholders?

10 A. Could you please repeat that?

11 Q. Are you aware of the policy of this
12 Commission that gains on sale of depreciable assets
13 belong to ratepayers, not shareholders?

14 A. No, I was not aware of that.

15 MR. TROTTER: Nothing further. Thank you.

16 JUDGE WALLIS: Very well. Let's turn to
17 questions from the Commissioners.

18

19 E X A M I N A T I O N

20 BY CHAIRWOMAN SHOWALTER:

21 Q. In your testimony, you say you were the
22 assistant treasurer of Olympic Pipe Line. Who was
23 the treasurer?

24 A. Louis Storino.

25 Q. I'm going to ask you a couple of questions

00890

1 that were deferred, and if, in the interest of time,
2 if someone else can address them later, just let me
3 know.

4 A. Thank you.

5 Q. Can you turn to Exhibit 69?

6 A. I could, except mine stops at 66. What is
7 69? Okay.

8 Q. I have two questions. One is, under
9 voluntary projects, it says 46.3 million. And the
10 question is how much of this 46.3 million is part of
11 the projected 2002 budget?

12 A. I don't know.

13 Q. Maybe another witness later can answer
14 that. If you don't know, that's fine.

15 A. I don't know.

16 Q. Just get to it later.

17 MR. MARSHALL: Actually, the exhibit was
18 withdrawn for that reason.

19 CHAIRWOMAN SHOWALTER: Oh.

20 MR. MARSHALL: There was some confusion.
21 It was going to be Exhibit 4 in Mr. Batch's initial
22 testimony. It was withdrawn because of the issue
23 about dates and so on.

24 CHAIRWOMAN SHOWALTER: All right. I'm
25 sorry.

00891

1 MR. MARSHALL: So we followed up with
2 another exhibit that goes through all the projects,
3 capital projects for 2002, and a detailed
4 spreadsheet.

5 CHAIRWOMAN SHOWALTER: That's fine. Sorry
6 for the confusion.

7 JUDGE WALLIS: What exhibit is that?

8 MR. MARSHALL: It's Exhibit Number 10, and
9 it's the response to Interrogatory Number Four and
10 testimony related to that.

11 JUDGE WALLIS: Thank you.

12 MR. MARSHALL: So I think the spreadsheet's
13 on the back end of that exhibit.

14 JUDGE WALLIS: Thank you.

15 Q. Okay. On page seven of your testimony, you
16 state that you believe Olympic is involved in a
17 higher risk or a riskier activity than maybe some
18 other regulated companies. If that's the case,
19 wouldn't a sound financial structure require more
20 equity, rather than less in a risky activity, all
21 other things being equal?

22 A. I don't know. I mean, I think that's --
23 people might have different perspectives on that. It
24 depends on -- I mean, just the common difference that
25 people have on how much to put down on a house or a

00892

1 car. I guess I'd say personally, if it was riskier,
2 I'd want to have less of my capital tied up in it,
3 but --

4 Q. Well, surely, from the owner's point of
5 view, but in terms of -- I mean, that would go
6 without saying.

7 A. Right.

8 Q. But from what is a sound financial
9 structure, and I suppose you'd have to be saying
10 really that would be from the point of view of either
11 an abstract financial or a financial adviser or
12 perhaps a lender, someone along those lines, wouldn't
13 you say that if a house was in an earthquake area,
14 you might want the owner to have more equity than the
15 same type of owner in a non-earthquake area?

16 A. I suppose you could say that, but, again, I
17 think it might vary.

18 Q. As assistant treasurer, do you think that
19 the capital structure of Olympic, with its absence of
20 equity, is a sound financial structure for Olympic to
21 have?

22 A. If you're asking my personal opinion, and I
23 should probably preface the answer by saying that,
24 again, we -- we being BP, took over as operator in
25 July of 2000, so a lot of what happened really

00893

1 happened prior to that.

2 If you're asking my -- you know, is this a
3 great result that we're at this level of debt, for
4 example, I'd say no, it's not. And I'd also say that
5 we are doing -- I mean, we are trying our hardest to
6 improve the financial integrity of this pipeline. I
7 mean, the sale of Sea-Tac, which, after hearing what
8 Mr. Trotter said, might scare me a little bit, but we
9 are doing whatever we can to bring this pipeline back
10 to what I probably would consider financial health.

11 Right now, it's really sick, and it's going
12 to need several things to happen, and we talked about
13 signals yesterday and there was discussions on
14 signals today and, you know, one of the things that's
15 going to happen is that we need clear and positive
16 signals that there will be substantial cash flows so
17 that we can bring it back to financial health.

18 My real feeling is that this -- there has
19 not been any dividends since 1997. A lot has been
20 talked about on the dividends. No dividends have
21 been paid since 1997. I've done a lot of ten-year
22 forecasts, forecasting on Olympic, and there won't be
23 any dividends forever. I'll be long gone when a
24 dividend could possibly be paid. So you know,
25 nobody's going to get any dividends by a tariff

00894

1 increase; it's going to go into the company, and
2 eventually there will be equity in this company.

3 Q. Okay. But if we were to look forward, say
4 two years from now, and posit a healthy company --
5 and I don't know and I'm not predicting how we might
6 get from here to there, but wouldn't you say that a
7 healthy company of this kind should have more equity
8 in it than it does today? Isn't that a part of the
9 picture?

10 A. If you had a way to both -- well, I think
11 the right word is probably entice, and maybe that's
12 not the right choice of words, but the -- you know,
13 somebody to put equity in there, that would be
14 phenomenal, but with the growth in cost and the
15 relative non-growth of revenues, it's not a good
16 investment. I mean, it's not -- would you put your
17 money in it, is kind of where you've got to come back
18 to. Is that something you'd invest in. That's part
19 of the problem. It's a lot about signals, frankly.

20 Q. Well, you're requesting a signal of a rate
21 increase. What if that signal were combined with a
22 condition that of X rate increase -- I'm not
23 predicting what it will be, if anything -- but X rate
24 increase on condition that there be more equity in
25 the company. Is that a -- does that send two

00895

1 signals?

2 A. It's an interesting question and one that
3 I've thought about a lot. I mean, and I can't speak
4 for the company, but to me that seems like a
5 potential outcome, something that the company should
6 seriously consider, but that's me speaking, rather
7 than the company.

8 Q. One last question. If there are other
9 similar utilities that operate on debt only, wouldn't
10 we expect to see that those owners are backing the
11 loans that -- are standing good for loans? In other
12 words, how --

13 A. Right.

14 Q. -- can we have it -- either equity's in the
15 company, so there's a vulnerability of the owners
16 there, or they are guaranteeing loans, so there's
17 some kind of vulnerability and --

18 A. Exposure.

19 Q. -- exposure, backup there. How can you
20 have a company that has no equity and no willingness
21 to back a loan if it becomes an entity that is
22 relying solely on either the expectation that
23 somebody else would loan the money or just rates from
24 the customers?

25 A. There's probably a couple things to say to

00896

1 that. I think it was mentioned earlier about
2 Colonial Pipeline, which is, I'm relatively sure, the
3 largest products pipeline in the United States. I
4 think it's about ten times as big as Olympic. And I
5 believe it's about roughly 90 percent debt.

6 Explorer Pipeline, another very, very large
7 pipeline in the United States, is 80-plus percent
8 debt. I think the difference is that in the products
9 pipeline industry, a lot of sort of the security is
10 in assuring cash flows through what's known as a
11 throughput and deficiency agreement, which I don't
12 know if you are familiar with that, but it basically
13 guarantees to a portion of the cash flow by having
14 shippers assure that those cash flows will be
15 available. So I think that's what might be unique
16 about this versus maybe other industries, and in
17 addition, it's throughput and deficiency, so
18 obviously if the shippers make up any differences,
19 but the real important part of that is volume on one
20 side and obviously tariff on the other, because it's
21 a revenue stream, and that's really what, generally,
22 in the industry, particularly in the products side,
23 people look to for kind of security.

24 And the differences between most pipelines
25 and Olympic is that the streams are pretty steady.

00897

1 Olympic's streams, obviously -- of cash flow are
2 steady. Olympic's is not.

3 Q. But I can follow your line of thinking for
4 a pipeline that keeps happily operating, but there is
5 risk in ownership. And if something goes wrong, such
6 as an explosion or poor management or whatever, how
7 does that throughput and deficiency arrangement
8 provide adequate coverage for the kind of risk that
9 an owner incurs?

10 A. Yeah, I don't know if that's better
11 deferred to Mr. Schink, but it probably is. But
12 yeah, that's -- it's a good question.

13 Q. I don't want to take any more of your time,
14 because I want to allow other Commissioners to ask
15 questions.

16 A. Thanks.

17

18 E X A M I N A T I O N

19 BY COMMISSIONER HEMSTAD:

20 Q. I believe you stated that you are not aware
21 of whether there is a lawsuit that has been brought
22 by Equilon against Olympic Pipe Line with respect to
23 its note. I find that rather surprising, that you
24 would not be aware of that, but apparently that's the
25 case.

00898

1 A. What I should have said is I'm not -- I
2 hope I said this -- that I'm not specifically aware
3 of it. You know, I've read the Seattle newspapers
4 and I've -- you know, actually, that's probably it.
5 I have not been -- and probably purposely -- involved
6 in it. And I've heard that, but I just didn't want
7 to say that I specifically knew that, because I
8 haven't read the -- I haven't read anything on it in
9 terms of the legal documents.

10 Q. Well, okay. Then, as assistant treasurer,
11 are you aware of the underlying dispute between
12 Olympic Pipe Line and Equilon?

13 A. I'm very aware of that, yes.

14 Q. Okay. And could you succinctly describe
15 that dispute?

16 A. Now, it depends on what you're talking
17 about. If you're talking about anything that has to
18 do with the -- in fact, I feel a little uncomfortable
19 discussing it, because my involvement is really on
20 the finance side of it and not anything else, so I
21 don't really -- I prefer not to get into anything
22 beyond the dispute over loans to Olympic. Is that
23 okay?

24 Q. Okay. But as -- well, as assistant
25 treasurer, wouldn't you have to have some sense of

00899

1 the company's exposure on that note?

2 A. Yes. No, I said I'll be glad to talk about
3 the note. I just -- the other issues that are
4 involved, I'm not specifically aware.

5 Q. In your opinion, is the note properly
6 payable?

7 A. Not -- no, not -- I couldn't give an
8 affirmative response to that till the audit is
9 completed.

10 Q. And does that issue go back to the nature
11 of Equilon's performance as manager?

12 A. I don't -- I wouldn't like to offer that.
13 I couldn't offer an opinion on that. It's purely --
14 I mean, you can get kind of dispassionate about it
15 and say what do the numbers show and what were they
16 for. I mean, it's really kind of an accounting
17 exercise, rather than an opinion of their management.

18 Q. Okay. Well, is it, then, the nature of
19 whether dollars are actually advanced from Equilon to
20 Olympic Pipe Line, and is it going to whether money
21 was actually delivered?

22 A. That would -- that's a part of it. I mean,
23 there would be -- that would be a piece of the audit.
24 I mean, certainly.

25 Q. So at some level, the response is that, oh,

00900

1 Olympic Pipe Line doesn't really owe \$43 million. Is
2 that the company's position?

3 A. I think the way I described it earlier was
4 it's -- it may not be 43. Actually, the number's
5 really 45, but --

6 Q. Sorry.

7 A. I would be very surprised if it varied more
8 than \$3 million, frankly.

9 Q. There was a lot of back and forth between
10 you and Mr. Brena about the ARCO credit line. And I
11 guess I'm trying to pin down, you wear a couple of
12 hats. You're paid by BP Pipeline, but in your
13 assistant treasurer role, you're representing Olympic
14 Pipe Line, and what goes on. You apparently have,
15 what, fairly continuous conversations with Mr. Peck
16 at BP Pipeline?

17 A. Yes.

18 Q. And who -- what is his position?

19 A. Larry also wears -- he actually wears many,
20 many hats, because he's in charge of quite a few of
21 our joint ventures, but he is the manager of the
22 products business line for BP Pipelines, he is also a
23 board member for Olympic Pipe Line, and I believe
24 he's also -- well, he's a director of Olympic Pipe
25 Line and I think he's the chairman -- I could check

00901

1 with folks here, but I believe he's the chairman of
2 the Olympic board.

3 Q. Is he the person --

4 A. Oh, excuse me, he's also an officer of
5 ARCO.

6 Q. All right. But is he the person who has
7 the authority to say yes, we will give you money, or
8 no, we won't?

9 A. He's one of those people, yes.

10 Q. And I'm trying to pin down, apparently the
11 conversations are fairly casual, back and forth. I
12 think you testified these conversations over the last
13 month, that you weren't very precise as to what was
14 being asked and answered. And again, I guess I want
15 to try to pin down, did you ask Mr. Peck for
16 additional money?

17 A. As I recall, I actually called him at home
18 during the Christmas holidays and I said, We're
19 getting really close, you know. What -- you know,
20 are we going to lend them the money. And Larry was
21 like, I'm -- you know, I'm not very inclined to do
22 it, but we need to look at and analyze the funding.
23 He was -- and frankly, there was no need to --
24 actually, I was looking for him to come in on his day
25 off to sign it, if he was willing to, but we were

00902

1 monitoring the bank account and it had gotten down to
2 a few hundred thousand, and the next day or the next
3 week, it was up to like a million-one, or something
4 like that, even though that's still pretty -- for an
5 operation like Olympic, that's pretty low.

6 Q. What, in your opinion, will happen if your
7 bank account approaches zero?

8 A. My -- I can't really say. I'll put it this
9 way. Early on, when BP took over, there was no
10 question that loans were going to be made and there
11 wasn't -- it wasn't a very onerous process. It has
12 increasingly gotten to the point where, you know,
13 it's like, basically, we need to really seriously
14 analyze it.

15 And I think part of the problem or the
16 condition that's changed is the scrutiny from our
17 central office in London is much greater on it,
18 whereas earlier it was more of a, okay, well, you
19 know, we bought ARCO, ARCO owned an interest in
20 Olympic, you know, that was part of the whole deal.

21 But as -- I think as the scrutiny has
22 become greater, the questions are more numerous and
23 more often, why are we loaning any more money to this
24 company.

25 Q. Okay. Let me approach it in a somewhat

00903

1 different way. Should Olympic Pipe Line reach the
2 point, the note payments aside, where it cannot pay
3 its accounts payable as they fall due, in your
4 opinion, would Olympic Pipe Line commence a
5 proceeding in bankruptcy?

6 A. In the -- I'm not sure if it was the
7 discovery documents or requests for production of
8 documents, but I'm on the Olympic finance committee
9 and I know that bankruptcy is something we discussed,
10 and we've looked at that as a -- as one potential
11 option. Would I say there's a high likelihood that
12 would occur? I don't think it's a high likelihood.
13 I think it's something that would probably be
14 considered.

15 Q. And I suppose one of the advantages of that
16 would be a way of minimizing the exposure on the
17 numerous lawsuits that are pending?

18 A. I have no comment on that. That wasn't one
19 of the considerations.

20 COMMISSIONER HEMSTAD: That's all I have.

21 CHAIRWOMAN SHOWALTER: I have just one
22 clarifying question.

23

24 E X A M I N A T I O N

25 BY CHAIRWOMAN SHOWALTER:

00904

1 Q. You said you had a conversation with Mr.
2 Peck in which your question was, Are we going to lend
3 them the money, and that was -- when you said we --

4 A. Right.

5 Q. Did you mean BP?

6 A. That, or ARCO. I mean, that's --

7 Q. ARCO?

8 A. Yeah.

9 Q. Okay. And then is OPL?

10 A. Correct.

11 Q. So you are identifying yourself with BP?

12 A. In that context, but if, you know, if the
13 context could have been different, I would have, you
14 know, addressed it as we being OPL, so --

15 CHAIRWOMAN SHOWALTER: Thank you.

16 JUDGE WALLIS: Mr. Marshall.

17 MR. MARSHALL: Thank you.

18

19 R E D I R E C T E X A M I N A T I O N

20 BY MR. MARSHALL:

21 Q. Part of the consideration in this is what's
22 going to happen --

23 COMMISSIONER HEMSTAD: I'm sorry. I have
24 one further question I probably should ask him before
25 you start.

00905

1 MR. MARSHALL: Please go ahead.

2

3 E X A M I N A T I O N

4 BY COMMISSIONER HEMSTAD:

5 Q. Is there any likelihood that -- at least a
6 reason why the parents here would not want to inject
7 equity into OPL is the fact of the pending lawsuits,
8 and that would then be available for access by those
9 plaintiffs if they are successful?

10 A. I can't speak for Equilon, because they're
11 another -- when you say parent, I think you mean
12 shareholder. I can't speak for them, but I don't --
13 there's certainly -- BP hasn't discussed that, to my
14 -- or ARCO, excuse me, has not discussed that. I
15 haven't heard that as a reason.

16 COMMISSIONER HEMSTAD: Okay. Thank you.

17

18 R E D I R E C T E X A M I N A T I O N

19 BY MR. MARSHALL:

20 Q. Just to follow-up on that, on all these
21 civil cases arising from Whatcom that are mentioned
22 in here, is it your understanding that Lloyds of
23 London is paying directly for all those defense
24 bills?

25 A. Yes, I'm not sure of the exact amount, but

00906

1 in a lot of the cases, they pay directly, and it does
2 not go through our emergency brokerage company.

3 Q. Now, are you aware that Tosco and Tesoro
4 have, earlier this past year, opposed Olympic's
5 effort to get interim rate relief from the FERC?

6 MR. BRENA: Objection, scope.

7 JUDGE WALLIS: The witness may respond.

8 THE WITNESS: Yes.

9 Q. And of course, they're opposing interim
10 rate relief here, as well. But is one of the factors
11 being considered in making further equity or loan
12 investments the likelihood of rate treatment at the
13 FERC or the WUTC level?

14 A. I know I'm not supposed to do this to my
15 own counsel, but could you repeat that, please?

16 Q. Sure. One of the considerations that has
17 to be considered is what, on a going-forward basis,
18 will be the rates set by the FERC and the UTC.

19 A. Yes.

20 Q. You mentioned throughput and deficiency
21 agreements when talking to Chairwoman Showalter and
22 you described a throughput agreement as being
23 something that securitizes, in effect, a future
24 stream of income that's produced by throughput times
25 the tariff revenue rate; is that correct?

00907

1 A. That's correct.

2 Q. And is that, in your understanding, the
3 most common way in the products pipeline field to
4 finance?

5 A. To the best of my knowledge, that's the
6 primary way, yeah.

7 Q. And if throughput goes down and rates don't
8 come up to give that same level of income, does that
9 have an effect on that financing mechanism?

10 A. Yes, it does.

11 Q. So the two things that need to be done to
12 respond to that situation are to increase throughput
13 and to increase tariff revenues or both?

14 MR. BRENA: Leading.

15 JUDGE WALLIS: In light of the time --

16 THE WITNESS: I actually said that earlier,
17 so I think it's probably okay. Well, I did.

18 MR. BRENA: Thank you, Mr. Fox.

19 Q. Before Whatcom Creek, there was equity in
20 Olympic; is that true?

21 A. That is true.

22 Q. And the question was asked earlier, if
23 there were another Whatcom Creek, that would create a
24 problem, because the equity has, in large part,
25 because of some of these issues with reduced

00908

1 throughput and so forth, have caused this financial
2 problem. What is the purpose of seeking the interim
3 relief here, as well as at the FERC?

4 A. I think the primary purpose is to bring
5 Olympic back to financial health to send a signal
6 that this is a decent place to invest, to lend funds
7 to. I think it's just primarily to get it to nurse
8 it back to health and insure that it's a financially,
9 you know, a reasonably financially attractive entity.

10 Q. If this Commission were to give the amount
11 of rate relief requested for this interim case, what
12 would be your recommendation to the people that you
13 make recommendations to on loans from ARCO to
14 Olympic?

15 A. Without a tariff increase?

16 Q. Assuming the interim rate relief is granted
17 in this proceeding in full?

18 A. Oh, I'm sorry.

19 Q. In full. What would your recommendation be
20 with respect to the remaining amounts of the ARCO
21 revolving credit?

22 A. I would -- I would recommend loaning enough
23 to get -- to get, certainly, the capital program
24 complete in 2002.

25 Q. If the Commission Staff's recommendation of

00909

1 a 20 percent rate increase is granted and nothing
2 more, what financial impact would that have on
3 Olympic?

4 MR. TROTTER: I'll object, Your Honor.
5 Beyond the scope.

6 JUDGE WALLIS: The witness may respond.

7 THE WITNESS: The 20 percent barely, as I
8 recall, barely covers the interest that Olympic must
9 pay, so we're still -- we still, you know, need \$24
10 million for 2002, or 23.8.

11 Further than that, we're really looking at
12 a long-term solution, at least from my sort of narrow
13 perspective. We're concerned -- I mean, I'm
14 concerned, in my position, for what does the long
15 term look like for Olympic Pipe Line. When I run the
16 numbers and when I even use conservative assumptions,
17 even with a 20 percent increase on both FERC and
18 Washington State, Olympic still needs a hundred
19 million dollars of something. It needs a hundred
20 million dollars over the next five to seven years.
21 No tariff increase, it needs like 180.

22 That's not something that makes me really,
23 really comfortable, and that's what I would present
24 to my management.

25 Q. Now, if rate requests, both the interim and

00910

1 general, are granted, what would be your
2 recommendation with regard to dividends from Olympic
3 to its shareholders?

4 MR. BRENA: Scope with regard to general.
5 We're not here to resolve the general rate case.

6 JUDGE WALLIS: The witness may respond.

7 THE WITNESS: Again, without discussing
8 this with other finance people, my personal
9 recommendation would be to not pay dividends until a
10 lot of the financial difficulties are overcome, which
11 is very long from now.

12 MR. MARSHALL: I have no further questions.

13 MR. BRENA: I have just a few, Your Honor.

14 JUDGE WALLIS: The witness really needs to
15 head for that airplane. What I'm going to suggest is
16 that perhaps one of the Olympic entourage might
17 rescue his sandwich from the back and the sandwich of
18 anybody else who's going to be in the car, and while
19 they're doing that, we have time for another couple
20 questions, Mr. Brena.

21

22 R E C R O S S - E X A M I N A T I O N

23 BY MR. BRENA:

24 Q. With regard to the throughput and
25 deficiency financing mechanism, isn't that typically

00911

1 something done by a shipper/owner?

2 A. Yes.

3 Q. Are you familiar with throughput and
4 deficiency agreements that are done by just shippers
5 and not shipper/owners?

6 A. No.

7 Q. With regard to -- he asked you a series of
8 questions about your recommendation. Do you make a
9 recommendation to BP, to ARCO, about whether or not
10 it advances funds or do you request them?

11 A. Advances funds or loans?

12 Q. Yeah, he asked what your recommendation
13 would be. That assumes that it's your role to
14 recommend to ARCO whether to lend or whether not to
15 lend?

16 A. Yeah, I understand your question.

17 Q. Is that your role?

18 A. You know, I've got a pretty fluid set of
19 roles, and I'm not sure there's one on a piece of
20 paper, but I am an opinionated person, so I will
21 provide my opinion when asked.

22 Q. Okay. But you do not recommend; you
23 provide your opinion?

24 A. I'm also on the Olympic finance committee.
25 Well, in terms of ARCO?

00912

1 Q. Yes.

2 A. Yes, I recommend.

3 Q. You were asked a question with regard to
4 the level of equity prior to Whatcom Creek. If I
5 were to represent that total shareholder equity in
6 this line in 1997 was \$6 million, do you have any
7 reason to disagree with that?

8 A. Subject to check. Well, I don't know. I
9 -- no, I don't know specifically.

10 Q. Okay. And if you'd like to check, Exhibit
11 Number 17, page two of four of column 1997, it has
12 it?

13 A. Page what, I'm sorry? Oh, I don't have 17.

14 Q. Nineteen.

15 JUDGE WALLIS: We're really pressed for
16 time.

17 MR. BRENA: One more question.

18 Q. Do I understand you correctly that the
19 person you asked for the loan, who has authority to
20 approve it, is the chairman of the board for Olympic?

21 A. I said I'm not positive what his role is.
22 I don't know if that's his -- I mean, the title or
23 his role. I think -- I said I thought that's what
24 his role was.

25 MR. BRENA: Thank you. Nothing further.

00913

1 JUDGE WALLIS: Very well.

2 MR. FINKLEA: Your Honor, one question was
3 sparked by his last answer.

4 JUDGE WALLIS: Mr. Finklea.

5

6 C R O S S - E X A M I N A T I O N

7 BY MR. FINKLEA:

8 Q. Mr. Fox, are you currently recommending
9 that ARCO not lend money to Olympic Pipe Line?

10 A. I believe that a number of things need to
11 occur to get Olympic healthy financially. I think
12 that we're doing whatever we can -- frankly, I mean,
13 it's -- we're trying really hard to do some sort of
14 nonconventional things. I think the sale of Sea-Tac
15 is one thing. I was able to get a five, I think,
16 point seven million dollar refund from the IRS on
17 taxes paid in previous years. We're not paying
18 dividends. We're doing a lot. And it's taken a lot
19 of, you know, frankly, a lot of pain to do it and to
20 turn over stones and look for ways to improve the
21 financials, but I think also there has to be some
22 assurance to BP that there's going to be a stream of
23 revenue out there that allows us to adequately cover
24 our cost.

25 I mean, just -- so to answer your question

00914

1 specifically, I'm sort of -- you know, on the Olympic
2 side, I'm kind of going, you know, Olympic really
3 needs funds, but on the BP side, I'm kind of going,
4 you know what, this isn't such a great investment.
5 So if you had to say which way do I sort of tend on
6 this subject, it's a little more to the no, don't,
7 don't loan funds. Does that answer your question?

8 MR. FINKLEA: Yes, it does.

9 JUDGE WALLIS: All right. With that, we're
10 going to excuse Mr. Fox --

11 THE WITNESS: Thank you.

12 JUDGE WALLIS: -- from the stand at this
13 time. And let's be off the record.

14 MR. MARSHALL: I do have one quick
15 clarification.

16

17 R E D I R E C T E X A M I N A T I O N

18 BY MR. MARSHALL:

19 Q. Do you know if there's a Tosco throughput
20 and deficiency agreement?

21 A. I'm not aware of one on the initial
22 building of Olympic, but I believe there was one
23 associated with Cross Cascades.

24 MR. MARSHALL: Thank you. I just wanted to
25 clarify the one question Mr. Brena had asked him.

00915

1 JUDGE WALLIS: Very well. We're off the
2 record now.

3 (Recess taken.)

4 JUDGE WALLIS: Let's be back on the record,
5 please. The next witness today is going to be Mr.
6 Kenneth Elgin, of the Commission Staff. Mr. Elgin,
7 would you please rise?
8 Whereupon,

9 KENNETH ELGIN,
10 having been first duly sworn, was called as a witness
11 herein and was examined and testified as follows:

12 JUDGE WALLIS: Please be seated. Mr.
13 Trotter.

14 MR. TROTTER: Thank you.

15

16 D I R E C T E X A M I N A T I O N

17 BY MR. TROTTER:

18 Q. Would you please state your name for the
19 record?

20 A. Kenneth L. Elgin, E-l-g-i-n.

21 Q. You're a witness for Commission Staff in
22 this case?

23 A. Yes.

24 Q. Have you caused to prepare testimony and
25 exhibits in this proceeding?

00916

1 A. Yes.

2 Q. Turning your attention to your Exhibit
3 131-T, is that your direct testimony?

4 A. Yes.

5 Q. If I asked you the questions shown there,
6 would you give the answers shown there?

7 A. Yes.

8 Q. In the course of that testimony, you refer
9 to Exhibits 132, 133, and 134, which you sponsor?

10 A. Yes.

11 Q. Were Exhibits 132 and 134 prepared by you
12 and are they true and correct?

13 A. Yes.

14 Q. Exhibit 133 is an excerpt from a company
15 document. Is that a correct excerpt, to your
16 understanding?

17 A. Yes.

18 MR. TROTTER: I move for the admission of
19 Exhibit 131-T and 132 through 134.

20 JUDGE WALLIS: Is there objection?

21 MR. MARSHALL: No objection.

22 JUDGE WALLIS: Let the record show that
23 there is no objection and those documents are
24 received.

25 MR. TROTTER: The witness is available for

00917

1 cross.

2 JUDGE WALLIS: Mr. Marshall.

3 MR. MARSHALL: Thank you.

4

5 C R O S S - E X A M I N A T I O N

6 BY MR. MARSHALL:

7 Q. Mr. Elgin, the Commission has a Pipeline
8 Safety Division now; correct?

9 A. Yes.

10 Q. Does it have any similar safety division
11 with regard to electric, gas, telecom?

12 A. No.

13 Q. And when the Commission was regulating
14 trucking, did it have anything relating to the safety
15 regulation of trucks in Washington State?

16 A. Yes.

17 Q. Okay. And that has been transferred over
18 now to what, the state patrol, or something like
19 that?

20 A. Yes.

21 Q. Now, there was a technical conference on
22 December 4th in this matter. Do you remember that?

23 A. Yes.

24 Q. And you attended that, along with Mr. Colbo
25 and Mr. Trotter and several other -- Mr. Twitchell, I

00918

1 believe, and maybe there's some others. I'm hoping
2 I'm not leaving anybody out.

3 A. From Staff?

4 Q. Yes.

5 A. Yes.

6 Q. And at that time, questions were asked
7 about a number of issues, including the capital
8 budget going forward for Olympic in 2002, and a lot
9 about notes and financial issues, but do you recall
10 some of the questions asked particularly of Mr.
11 Cummings and others about capital budget and other
12 issues?

13 A. Well, the questions were asked about the
14 figures and what was to be provided by the company in
15 terms of the numbers we wanted, but I think that was
16 the extent of the conversation.

17 Q. On 2002 capital budget?

18 A. Actually, the 2001, because at that time
19 there was still some question about what was actually
20 to be expended in 2001 and for 2002.

21 Q. Right. Now, at that technical conference,
22 did you feel that the company was responsive to the
23 questions, to the best of its ability then, and then
24 followed up with data requests that the UTC required
25 of the company?

00919

1 A. Well, I -- you know, my -- I guess the
2 question is to the best of its ability. I -- that's
3 for the company to say. I mean, the Staff did obtain
4 some data at that technical conference, which, at the
5 time, we were trying to basically get clarification
6 of the existing data responses that we had
7 outstanding. So that was our primary purpose, was to
8 understand what those figures were in response to
9 interrogatories and also get a better understanding
10 of the notes that were identified in Mr. Batch's
11 supplemental testimony in the interim case.

12 Q. Referring specifically to safety issues,
13 since BP Pipelines has taken over as operator of
14 Olympic in the summer of 2000, are you aware of any
15 complaints about whether Olympic is not investing the
16 amounts that it needs to with safety-related measures
17 in Washington State?

18 A. I'm not aware of any, but I wouldn't have
19 occasion to be privileged to that kind of
20 information, so I have no way of knowing.

21 Q. You haven't seen anything in writing from
22 anybody associated with a Pipeline Safety Division
23 that, since BP took over operations, it has not
24 invested what it should in safety; correct?

25 MR. BRENA: Objection. Perhaps he could

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1 direct me to the portion of this witness'
2 cross-examination that he is cross-examining on.

3 MR. MARSHALL: It relates to whether the
4 investments are essential and necessary, so forth, in
5 the 2002 budget.

6 MR. BRENA: The objection's withdrawn.

7 Q. Do you have the question in mind? Maybe I
8 could repeat it. The question is whether you
9 received anything in writing from the Pipeline Safety
10 Division here or any other means. You say you don't
11 have access, but have you seen anything in writing
12 indicating that since BP Pipelines took over in the
13 summer of 2000, that it hasn't invested what it needs
14 to in capital safety improvements for the pipeline?

15 A. I have not been provided any information,
16 and I don't know necessarily that even if the
17 Pipeline Safety Staff would receive that kind of
18 information, as well.

19 Q. Have you asked the Pipeline Safety Staff
20 for that information?

21 A. No, I have not.

22 Q. Have you asked them to do a review of the
23 2002 capital budget for Olympic?

24 A. No, I have not.

25 Q. Okay. I'm going to flip over a chart here,

00921

1 if I may, moving to a different topic. Get the
2 microphone here. If you turn to page 3-T of Mr.
3 Batch's testimony at page 16, I don't know if you
4 have that handy or not?

5 A. No, I don't.

6 Q. But assume for me, subject to check, that
7 at page 16 of Batch 3-T, the impact over the next six
8 months of a full allowance of a rate -- interim rates
9 by the Commission would result, based on the volumes
10 that Tosco and Tesoro have been sending down the
11 pipeline recently, would result in a payment by
12 Tesoro of \$633,000 for that period, and by Tosco of
13 \$527,000. Do you recall that, basically, from Mr.
14 Batch's testimony?

15 MR. BRENA: Your Honor, I'm going to object
16 to this. This has nothing to do with whether the
17 2002 capital budget is essential or not essential.

18 MR. MARSHALL: No, actually --

19 MR. BRENA: Excuse me. I'd like to
20 continue my objection. This goes to the financial
21 impact on Tesoro of the interim rate relief, which I
22 don't find relevant even when it's properly asked of
23 the proper witness. But when it's improperly asked
24 of the improper witness, it's completely
25 inappropriate.

00922

1 JUDGE WALLIS: I would repeat my admonition
2 to Counsel that you avoid characterizations. I don't
3 think it's necessary, I think it can get in our way.
4 Mr. Marshall, can you tell us what relevance this
5 question has, again, to the areas that the Commission
6 has jurisdiction over and to the questions that it
7 must answer legally, in responding to the request for
8 rates?

9 MR. MARSHALL: Yes, I'm trying to point out
10 that the Commission Staff recommendation, and I'll
11 get to that question in a minute, of approximately 20
12 percent interim rate case, produces these levels of
13 income from Tosco and Tesoro over this next six-month
14 period.

15 All I'm trying to do is just show the
16 relative impact of what's requested versus what would
17 be produced by the Staff's recommendation. I've
18 moved away from the capital budget, I'm finished with
19 that, because Mr. Elgin doesn't have any safety
20 information related to that from Pipeline Safety
21 Division.

22 JUDGE WALLIS: My understanding is that the
23 level of rates and the dollar impact is clear, and I
24 can't see the value to the record of identifying the
25 individual shippers' resulting obligations. Unless

00923

1 you can come up with something that demonstrates its
2 relevance, I'd prefer that we move on.

3 MR. MARSHALL: Okay. Well, the relevance
4 will be demonstrated in just a moment, when we talk
5 about the next item, which is the issue of
6 refundability, and I just wanted to set the stage for
7 how much would be refundable from each of the two
8 protesters, since no one else has protested.

9 MR. BRENA: And just to make my nature of
10 my objection clear, it's posed on relevancy, and I
11 don't see that this witness' exam -- testimony goes
12 to this issue at all.

13 MR. TROTTER: Your Honor, I would just add
14 that, on the issue of refundability, the fact that a
15 customer has not intervened would not preclude them
16 from getting a refund as a matter of law.

17 JUDGE WALLIS: And again, I still don't see
18 how breaking that down into individual customer terms
19 has any relevance. Perhaps the total amount of any
20 rate increase and the refundability of that amount
21 may be a proper subject of inquiry.

22 On review, we've determined that the area
23 may be inquired into. And does the witness have the
24 question in mind?

25 THE WITNESS: Please repeat it.

00924

1 Q. Okay. The question in mind is, assuming
2 that Mr. Batch's testimony is correct, if the full
3 rates were permitted at the rate that you recommended
4 be awarded for interim rates, which is approximately
5 31.7 percent of the 62.9 percent, would you agree,
6 subject to check, that Tesoro, over the next six
7 months, would pay \$200,000, approximately, and that
8 Tosco would pay \$167,000, approximately?

9 A. I'll accept that, subject to check.

10 Q. Now, you've mentioned in your testimony, at
11 page 23, lines 10 through 12, regarding the Avista
12 Utilities case and their Sixth Supplemental Order,
13 that you -- that was made subject to refund?

14 A. That's correct.

15 Q. And you make that recommendation here, as
16 well?

17 A. Yes.

18 Q. Okay. So if we proceed with this matter in
19 the general case, and in August, August 1st, it's
20 determined that the rates are proper that Olympic
21 asked for in full, there would be no refund?

22 A. Yes, under that hypothetical.

23 Q. Under that hypothetical. If we assume that
24 -- if we go from here to now in August, there is some
25 amount that's refunded, the maximum would be either

00925

1 of these two, assuming that the full amount or the 20
2 percent amount were awarded for interim rates; is
3 that fair?

4 A. The maximum amount would be the 633,000,
5 assuming that the Commission would find that existing
6 rates were fair, just and reasonable.

7 Q. Correct. And under both of those
8 conditions, the rates are fair, just and reasonable,
9 because either it's been found to be fair, just and
10 reasonable all along, or else it gets refunded back;
11 is that correct?

12 A. And there is the issue as to whether or not
13 existing rates are fair, just and reasonable.

14 Q. That may well be.

15 A. Yes.

16 Q. But apart from that. And then there's
17 always the possibility that no interim rate is
18 granted or a very reduced rate is granted, and at the
19 end of the period in August, we find that the company
20 has shown that it has proven its full rate request.
21 That's the third possibility; right?

22 A. That's correct.

23 Q. And that would result in the denial of this
24 period of time of rates, if we had set them today in
25 a general rate case, wouldn't be there, wouldn't have

00926

1 been granted?

2 A. Well, I don't know that I would agree with
3 the word a denial. It just would mean that during
4 the pendency of the rate case and under the statutory
5 provisions that the Commission has to process your
6 case, there's a seven-month statutory suspension
7 period, so we would -- as a matter of law, that's the
8 amount of time the Commission has to determine what
9 is a fair rate.

10 Q. Now, comparing this situation to Avista,
11 Avista, if it's ordered to make a refund, would have
12 to make a refund to several hundred thousand
13 customers; is that correct?

14 A. Yes.

15 Q. And here we're talking about 20, 30, 40
16 shippers?

17 A. My understanding is 70 shippers or -- is
18 the number.

19 Q. And we saw the relative percentages here
20 the other day in terms of who would have the most,
21 and the throughput records are fairly clear?

22 A. Yes, I've heard those figures from
23 yesterday's testimony.

24 Q. So is it fair to say that it would be
25 administratively much easier to give a rate subject

00927

1 to refund in this situation, with an oil pipeline
2 with a relatively few number of shippers, than
3 compared with the Avista case?

4 A. I don't know what you mean by relative
5 ease. I mean, there would be refunds to have to be
6 given, and there would be some sort of process to do
7 that. Considering the kind of technology that's
8 available today in the billing systems, I think, one
9 way or the other, they're both relatively easy to do.

10 Q. Now, you're aware, of course, of the fact
11 that the FERC has granted interim rate relief
12 beginning of September?

13 MR. BRENA: Well, objection. That
14 mischaracterizes what the FERC has done.

15 JUDGE WALLIS: You want to rephrase the
16 question?

17 Q. Yeah. What's your understanding of what
18 the FERC did on September 1st of this past year with
19 respect to a request for rates to go into effect
20 immediately?

21 A. Well, the FERC operates under a different
22 statutory standard. They put in rates subject to
23 refund. They have a minimum suspension period and
24 then the rates go into effect subject to refund and
25 then they decide the case. So it's not a question of

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1 interim or permanent rates; it's under the statutes
2 that provide for oil pipelines to make rates. It's
3 my understanding that the rates go into effect and
4 the Commission determines what is a fair rate and
5 then processes refunds.

6 Q. Right. That just happens automatically.
7 There's no such thing like this interim proceeding
8 that we're having here with regard to oil pipelines
9 before the FERC; true?

10 A. Yes, it's a different statutory scheme.

11 Q. Right. I mean, I'm not trying to argue
12 whether one is right or wrong; I'm just saying that
13 there is a difference between the two?

14 A. That's correct.

15 Q. And starting in September, under interstate
16 rates for this very same pipeline, additional amounts
17 of money have been coming to Olympic?

18 A. Yes.

19 Q. Those are subject to refund?

20 A. Yes.

21 Q. And do you know whether Tosco and Tesoro
22 are going to be asking for all or most of that back
23 in their general case? If you don't know, just say,
24 I don't know.

25 A. I don't know.

00929

1 Q. Okay. Now, in the Avista situation, where
2 Avista has been awarded rates subject to refund, can
3 they, either in an audited or unaudited fashion, book
4 those rates, accrue the revenues from the interim
5 rates, or are those rates too contingent to allow
6 them, under generally accepted accounting principles,
7 to put them into financial statements, or do you
8 know?

9 A. There is some -- the issue is more, as I
10 understand it, related to how they book the expenses
11 that gave rise to the interim rates. And there was a
12 material question about what the Commission -- what
13 they asked the Commission to do.

14 So my understanding -- and I have not
15 looked at their books since, so I'm not exactly sure
16 what kind of financial statements they're publishing
17 right now.

18 Q. If the rates Avista has been given in an
19 interim basis are subject to refund and if the
20 conditions aren't certain enough, are you aware of
21 the generally accepted accounting principle that
22 requires them not to be able to book that?

23 A. Well, as I mentioned, Mr. Marshall, that
24 was a serious issue in the Avista case, was how would
25 the company book the revenue under a subject to

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1 refund condition, because there was the substantial
2 issue about the amount that was deferred and, if they
3 got this increase, could they begin to amortize that
4 deferral and could they recognize those amounts that
5 they collected subject to refund as revenues. And as
6 I previously testified, I have not seen their books
7 and I don't know how they are recording their
8 revenues and accounting for that at this time.

9 Q. Are you familiar, in general, with those
10 accounting principals that allow you to book under
11 some conditions and not book under other conditions?

12 A. I'm -- this is getting beyond my comfort
13 level, and I would prefer that you would ask Mr.
14 Colbo that question.

15 Q. Sure, I'd be happy to. With regard to the
16 FERC rates that are subject to refund, do you have
17 any knowledge about whether that can be booked under
18 accounting principals, or should I ask Mr. Colbo that
19 one, too?

20 A. Please do.

21 MR. MARSHALL: Okay, will do. I don't have
22 any further questions.

23 JUDGE WALLIS: Mr. Finklea.

24 MR. FINKLEA: Thank you, Your Honor.

25

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1 C R O S S - E X A M I N A T I O N

2 BY MR. FINKLEA:

3 Q. Good afternoon, Mr. Elgin.

4 A. Good afternoon, Mr. Finklea.

5 Q. My first questions go to approximately the
6 first seven or eight pages of your testimony. Am I
7 correct that your understanding of this Commission's
8 precedent is that what we call the Pacific Northwest
9 Bell test is what is used to determine if interim
10 rate relief is granted to a utility in this state?

11 A. Yes.

12 Q. And that's the test that you are attempting
13 to apply in this case?

14 A. Yes, with some modifications.

15 Q. And am I correct that one part of that
16 analysis is a recognition that this is an
17 extraordinary remedy in Washington?

18 A. Yes.

19 Q. So unlike at the FERC, this is something
20 that's unusual, rather than the practice?

21 A. Yes.

22 Q. And is part of what we'll call the PNB
23 test, the Pacific Northwest Bell test, that an actual
24 emergency must exist?

25 A. Yes, that is -- turn to page -- let me find

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1 it here in my testimony -- page eight. And those six
2 criteria are listed and laid out in that testimony,
3 Mr. Finklea.

4 Q. And do you agree that, based on the
5 testimony in evidence that Olympic has put forward in
6 this case, that they have not met the burden of
7 showing that, absent the relief, that it would have
8 such an effect on the financial demands of the
9 company as to substantially affect the public
10 interest?

11 A. Yes, I have testified to that on page 10,
12 lines 18 through 20.

13 Q. In your opinion, in an inquiry over interim
14 rates, is a relevant aspect of determining whether
15 they should be granted to determine how the company
16 got into the financial crisis that it is presenting
17 to the Commission as the rationale for the interim
18 relief?

19 MR. MARSHALL: I would object. This isn't
20 true cross. I mean, this is -- Mr. Elgin has already
21 testified to this, and he's just trying to basically
22 repeat much of what Mr. Elgin has said, and the last
23 three questions have been repetitious of direct
24 testimony. This one is, as well.

25 MR. FINKLEA: Well, Your Honor --

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1 JUDGE WALLIS: Mr. Finklea, this isn't
2 approaching what we might call friendly cross, is it?

3 MR. FINKLEA: Well, no, Your Honor, because
4 the witness does recommend an interim rate increase,
5 and my clients are opposing the interim request.
6 What I'm trying to delve into is what standard,
7 ultimately, the witness is using for the basis of his
8 recommendation.

9 JUDGE WALLIS: And I certainly think that's
10 an appropriate area for you to inquire into, but
11 there is probably little need to get the witness to
12 repeat the testimony that he's provided.

13 MR. FINKLEA: Well, this question, I do not
14 think he has touched on in his direct, as to whether
15 the circumstances giving rise to the financial crisis
16 should be taken into consideration.

17 JUDGE WALLIS: Very well.

18 THE WITNESS: Could you repeat the
19 question, please?

20 Q. Yeah. In your opinion, is it relevant to
21 the inquiry whether interim rates should be granted
22 to determine how the company got into the financial
23 crisis that it is presenting to the Commission as the
24 basis for its request?

25 A. Yes, and that's what my analysis was an

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1 attempt to do.

2 Q. Can you explain what you mean by -- can you
3 elaborate on that answer?

4 A. Well, what I did is, if you turn to page
5 eight of my testimony, bullet six says, The
6 Commission must reach its conclusion with its
7 statutory charge to regulate in the public interest.
8 And so what my analysis did is basically looked at
9 their direct case and see if they really met the
10 standards that were before it, before the Commission
11 in the U-8111 Washington Natural Gas cause, and my
12 conclusion was no, it did not.

13 But I took it one step further and I said,
14 Well, what is facing this company. And I looked at
15 the testimony of Mr. Batch and the circumstances,
16 that the company was asserting that it was in default
17 and that it was planning to spend additional money
18 for its ongoing safety and operation and maintenance
19 of the facility, and it needed to raise additional
20 capital. And so I said, What kind of a natural
21 analysis could I do to see, within the spirit of the
22 PNB test, could lead me to some kind of
23 recommendation for rates to solve this problem.

24 And so that's how I approached it, and that
25 analysis appears later in my testimony, is where I

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1 looked at the facilities that could reasonably be
2 expected to be in service and providing service to
3 the shippers in 2001, and then provided a level of
4 interest payment coverage that would reasonably be
5 expected under a protection clause under a first
6 mortgage indenture or some kind of preferred equity
7 covenant, and then calculate a level of pre-tax
8 interest coverage that would be necessary to have
9 that minimum level of earnings so that the company
10 could possibly put together a pro forma income
11 statement and take it to a lender and borrow
12 additional money. That was my approach.

13 Q. So it's fair to characterize that as you
14 had to make some kind of leap of logic for the
15 company, because if you had stopped at simply did the
16 company's case meet the PNB test, your answer would
17 have been no; is that correct?

18 A. Yes.

19 MR. FINKLEA: Your Honor, we tendered a
20 data request based on Mr. Elgin's testimony, and we
21 received the answer this morning. I have the proper
22 number of copies, so I need to have marked for
23 identification the next exhibit in order.

24 MR. MARSHALL: Your Honor, we haven't been
25 provided with any copy of that.

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1 MR. TROTTER: Counsel, I left two copies on
2 your table this morning.

3 MR. MARSHALL: Okay. I wasn't aware. My
4 table is --

5 JUDGE WALLIS: Let's be off the record for
6 a moment.

7 (Discussion off the record.)

8 JUDGE WALLIS: Let's be back on the record,
9 please. A document has been distributed that I am
10 marking for identification as Exhibit 138-C, and
11 that's because it has a couple of yellow pages
12 attached to it, which indicate potential
13 confidentiality. I'm going to ask Mr. Finklea to
14 tell us about the mechanics of this and the nature of
15 the potential confidentiality issue without revealing
16 any confidential or potentially confidential
17 information. Mr. Finklea.

18 MR. FINKLEA: Your Honor, we tendered to
19 Staff a data request asking how would Staff's
20 recommended level of interim rate relief be adjusted
21 if the Bayview terminal investment was taken out of
22 Staff's calculation. I was provided the answer this
23 morning, and what I have marked for identification as
24 Exhibit 138-C is a single page that has an answer,
25 and then two pages of financial information that

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1 tracks with the information that is included in
2 Robert Colbo's testimony and recalculates the
3 recommended level if you take -- if you make one
4 assumption, which is that you take out the Bayview
5 terminal investment from the Staff calculation, much
6 in the same manner as the Cross Cascade project
7 investment was removed.

8 And I am offering this as a
9 cross-examination exhibit to explore -- first, I can
10 simply explore without this exhibit the question
11 about Bayview, but then, if we're going to assist the
12 Commission in determining what would be the impact of
13 changing the recommended level of interim increase,
14 we thought it would be helpful to actually know what
15 the figure would be.

16 JUDGE WALLIS: Very well. Now, Mr.
17 Marshall, you have some problems with this; is that
18 correct?

19 MR. MARSHALL: My objection may come too
20 late, but I was going to ask that it not be
21 distributed or reviewed by anybody until we could
22 make the objection. The reason is we have no real
23 ability to respond to this in this time period.
24 There was no mention of this as being a potential
25 exhibit on Friday or on Monday when we gathered, no

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1 notice to Olympic that this was going to be brought
2 forward as an exhibit or used in any way.

3 There are a lot of good responses to the
4 Bayview issue and we can go into that detail,
5 including the fact that this Bayview facility was the
6 subject of a prior rate hearing, but without being
7 able to develop that record and then mark exhibits
8 and to find the people to testify, including others
9 who may not even be available anymore, I find that
10 this is going to be very difficult to respond to at
11 this late stage.

12 It would have been different if we'd been
13 notified that something like this might be used, and
14 then we could have been given an estimate of what the
15 impact might be and this was going to be important.

16 But this would be a significant issue now.
17 It would reduce Staff's recommendation by a
18 significant percentage. So I have objections on just
19 the procedural grounds of not being able to
20 thoroughly respond.

21 JUDGE WALLIS: Mr. Finklea, what's your
22 response to that?

23 MR. FINKLEA: Your Honor, we served this
24 data request on all parties when we made the request.
25 The answer didn't come until today. I didn't know

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1 what the answer was going to look like until I got
2 the answer. As I understand it from Staff Counsel,
3 it wasn't -- the answer wasn't only distributed to
4 me; it was distributed to Olympic's Counsel this
5 morning.

6 The questions about how to treat Bayview
7 could certainly be done with or without this exhibit.
8 I think it's a fair area of cross-examination. I
9 would think that, in the process of exploring
10 something like this, that we'd want to try to get to
11 as accurate an answer as possible in terms of what
12 effect it would have on the recommended level of
13 interim rate increase, and that was the reason the
14 question was asked.

15 The fact that the answer has come today is
16 why it is only today that we are able to identify
17 this as a potential exhibit.

18 JUDGE WALLIS: Mr. Trotter, do you have any
19 views to offer on this subject?

20 MR. TROTTER: Well, let me say this. The
21 request does not -- Staff is not changing its
22 recommendation. This is purely a calculation on the
23 assumption that's been given to us, so that is what
24 we did.

25 The Bayview terminal issue has been

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1 addressed in various testimony, I believe mostly in
2 the intervenors' direct case, so it's already been
3 subject to rebuttal opportunity, and it was discussed
4 during cross-examination, but this is just -- it's
5 almost a subject to check, if you removed Bayview,
6 what would the number change to, and that's how we
7 took it, that's how we responded to it, so that's
8 what it is. We're not offering it, so I'd just offer
9 that for your consideration.

10 MR. MARSHALL: One final point to make is
11 that this relates -- this was a data request on
12 testimony that was filed some time ago. This wasn't
13 rebuttal testimony, but testimony that I believe Mr.
14 Elgin gave on January 4th, according to the date on
15 this, so there's no real good reason for why the data
16 request came this late in this proceeding as it did.

17 JUDGE WALLIS: It appears that the document
18 in question merely puts some numbers on topics that
19 really have been explored earlier in the
20 cross-examination that are set out as issues in the
21 prefiled testimony. The company has ample
22 opportunity to cross-examine on the origin of the
23 information. The issue, because it addresses and
24 merely puts numbers on issues that have previously
25 been a topic is information that could be elicited on

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1 cross-examination. It doesn't appear to pose any due
2 process concerns, and consequently, we will deny the
3 objection.

4 We do want to inquire as to the potential
5 confidential nature of the information. Is it true,
6 now that you have taken a look at it, that the
7 information that is in this document is similar in
8 direction and scope and character to information that
9 the company has waived confidentiality on, or should
10 we treat it as confidential for purposes of the
11 discussion?

12 MR. TROTTER: Your Honor, I would just
13 contribute that the reason that I designated this as
14 confidential was that, at that time, the Bayview
15 figure, which is shown on the last page, line six,
16 had been provided under a confidentiality
17 designation, and that has since, as I understand it,
18 been removed. The only other adjustment was an
19 adjustment to cumulated depreciation, so that's why
20 it was designated.

21 MR. MARSHALL: I don't see an issue of
22 confidentiality here with this exhibit, because it
23 does reflect the similar type of exhibit from before
24 that we had removed the confidentiality on.

25 JUDGE WALLIS: Thank you, Mr. Marshall.

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1 Mr. Finklea, you may proceed. I would like to let
2 you know that, because we need to conclude in about
3 25 minutes, I will, if you haven't concluded your
4 examination by then, I'm going to break in in about
5 ten minutes and allow Commissioner Hemstad to ask any
6 questions that he may have of the witness at that
7 point.

8 Then, when we get to the appointed hour,
9 we'll break and we'll resume tomorrow morning at the
10 point where we have left off.

11 MR. FINKLEA: Thank you, Your Honor. I'll
12 endeavor to be done that quickly, but we'll just have
13 to see how it goes.

14 JUDGE WALLIS: I would urge you to talk
15 twice as fast, except it is a harrowing time for our
16 court reporter. She's -- Mr. Finklea, was I clear
17 that we would be able to continue tomorrow morning at
18 whatever point you stopped?

19 MR. FINKLEA: Yes, Your Honor. I will try
20 to get through this topic in the time allowed, but I
21 understand that sometimes it's like when you hit the
22 accelerator on ice so fast, the slower it gets.

23 Q. Mr. Elgin, if you could turn to page 17 of
24 your testimony. In your calculation of what I'll
25 call an alternative way to come up with an interim

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1 rate number, you removed the Cross Cascades project;
2 is that correct?

3 A. Yes, it is.

4 Q. And why did you remove Cross Cascades?

5 A. Cross Cascades is classified as
6 construction work in progress, or CWIP, and it's not
7 providing service to the public, so therefore, it
8 needed to be removed from my calculation of net plant
9 that would be reasonably available to provide service
10 to the public.

11 Q. Now, what is your understanding regarding
12 the status of the Bayview terminal investment?

13 MR. MARSHALL: I don't think it's been
14 established that this witness has the foundation to
15 know, from personal knowledge, the status of the
16 Bayview terminal.

17 JUDGE WALLIS: Well, let's let the witness
18 respond, and see what the answer is.

19 THE WITNESS: My understanding is that the
20 Bayview terminal was a facility that was placed in
21 service previously, so it's in the plant accounts,
22 the company has been taking depreciation on that
23 facility, and subsequent to the incident at Whatcom
24 Creek for operational purposes, that the facility's
25 been bypassed, and we had testimony yesterday

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1 regarding what that means, and so right now it's --
2 there are questions as to whether or not that
3 facility is serving the public or not serving the
4 public, and we have not made a determination yet as
5 to whether or not -- what's the appropriate treatment
6 at that facility, but I have included it, because it
7 is in net plan accounts and it has been depreciated.

8 JUDGE WALLIS: Mr. Marshall, do you need to
9 voir dire?

10 MR. MARSHALL: No I believe he indicated
11 his knowledge is only from prior testimony of Mr.
12 Batch.

13 JUDGE WALLIS: Thank you.

14 Q. So Mr. Elgin, in your expert opinion, is
15 the Bayview terminal used and useful property that's
16 serving customers of Olympic today?

17 MR. MARSHALL: Again, I would have to
18 object, because I think it has been established that
19 he only has that knowledge from testimony of Mr.
20 Batch.

21 JUDGE WALLIS: I do think the witness
22 already answered that question, Mr. Finklea.

23 MR. FINKLEA: Could I have the answer
24 repeated, because I -- I wasn't certain that I got an
25 answer to it.

00945

1 JUDGE WALLIS: Mr. Elgin?

2 THE WITNESS: My understanding is that it
3 was placed in service, it was providing service, but,
4 after the incident, it was bypassed. And so whether
5 that means it's serving the public or not, I'm not
6 sure, and Staff has not made a decision yet about
7 that, and that's a general rate case issue.

8 Q. So that would be a topic of debate if this
9 was a general rate case?

10 A. That's correct.

11 Q. Can I ask you to now turn to Exhibit 138-C?

12 JUDGE WALLIS: I think we've established
13 that it is not information that the company wishes to
14 protect as confidential, and we can just call it 138.

15 MR. FINKLEA: Thank you, Your Honor.

16 Q. Am I correct that Tosco asked you the
17 question of how would Staff's 2.7, approximately,
18 million or 19.48 recommended level of interim rate
19 relief be adjusted if the Bayview terminal investment
20 is taken out of the calculation, and what Exhibit 138
21 is is that question, plus the Staff's answer in an
22 actual spreadsheet that shows how you derived the
23 answer?

24 A. Yes, that's correct.

25 Q. And am I correct that the answer is that if

00946

1 the Bayview terminal investment is treated the same
2 as you treated Cross Cascades, that the level of
3 interim relief would be 11.97, rather than 19.48?

4 A. Correct.

5 Q. And are you changing your recommendation in
6 this case based on this, or is it your testimony that
7 you simply haven't concluded how to treat Bayview for
8 this?

9 A. The latter.

10 MR. MARSHALL: I thought it was Mr.
11 Trotter's statement that Staff's recommendation would
12 not be changed with regard to this.

13 MR. TROTTER: That's what he just said.

14 MR. MARSHALL: Okay.

15 MR. TROTTER: The latter was --

16 MR. MARSHALL: Okay, I'm sorry. I
17 apologize.

18 Q. Mr. Elgin, on the revenue side of your
19 calculation, how did you treat the revenue that
20 Olympic is receiving as a result of the
21 subject-to-refund rate increase granted by the
22 Federal Energy Regulatory Commission in September?

23 A. I'm not providing that treatment. That
24 question, I would ask you to pursue that with Mr.
25 Colbo.

00947

1 Q. Mr. Elgin, would you agree that, in
2 addition to the Cross Cascades project, that Olympic
3 has approximately 11 and a half million dollars of
4 construction work in progress that was remaining at
5 year end 2000 that supported plant additions in 2001?

6 A. I'm not aware of that figure. I would ask
7 that -- Mr. Colbo would be the one to pursue that, in
8 terms of the exact plant amounts and what isn't
9 construction work in progress, but the only
10 adjustment I made to those net of plant accounts is
11 the investment for Cross Cascade, because of the
12 nature of those facilities and the investments that
13 the company made for those projects.

14 Q. Would it be consistent with the theory
15 you're putting forward for the interim relief to
16 remove all construction work in progress from the
17 calculation, if it could be determined how much that
18 amount is?

19 A. No, it wouldn't.

20 Q. And why would that be?

21 A. As a general matter, the companies who have
22 construction work in progress need to be able to fund
23 that, and the theory of my calculation is that, to
24 the extent that the company is making expenditures
25 and it hasn't been classified to plant accounts still

00948

1 doesn't mean that the company doesn't need enough
2 revenue to generate earnings to provide debt service,
3 and particularly the way that this company is
4 capitalized and the way that I calculated the
5 interest coverage test, based on a hundred percent
6 debt or fully-financed with debt.

7 So that's my theory, that the Cross Cascade
8 is clearly a project that kind of stands up on its
9 own, that -- where the company made the investment,
10 it doesn't look like it's going anywhere, and it's
11 not going to provide service to customers, and it
12 should be removed.

13 Q. Mr. Elgin, based on your knowledge of
14 energy utility financing in operations in the state
15 of Washington, is a one hundred percent debt capital
16 structure prudent for a utility?

17 A. No.

18 MR. FINKLEA: Your Honor, probably in the
19 interest of time, I do have probably a few more
20 questions for tomorrow, but I could break at this
21 point.

22 JUDGE WALLIS: Very well. Commissioner
23 Hemstad.

24 MR. FINKLEA: Your Honor, I do offer
25 Exhibit 138.

00949

1 MR. MARSHALL: We'd renew our objection,
2 but --

3 JUDGE WALLIS: Very well, and the response
4 would be the same, and the exhibit is received.

5 MR. FINKLEA: Thank you, Your Honor.

6 COMMISSIONER HEMSTAD: I currently don't
7 have any questions, so if you want to simply continue
8 with your cross.

9 MR. FINKLEA: Very good. Thank you.

10 Q. Mr. Elgin, from a policy perspective, are
11 you concerned with the precedent of allowing Olympic
12 an interim rate increase under these circumstances of
13 a company that is so under-capitalized, both from the
14 perspective of precedent with this company in the
15 future and precedent with other utilities in the
16 state?

17 A. No, and in fact, my recommendation was
18 mindful of what I thought would be a reasonable
19 recommendation for the ultimate outcome of this case,
20 to recognize that at some point this company needed
21 to build up its equity and provide, on an ongoing
22 basis, to balance the interest between how it's
23 actually financed and at some point move the company
24 towards a balanced capital structure.

25 So that's what I attempted to do. And

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1 given the circumstances surrounding this case, I
2 think this is a very unique case. This is, in my
3 estimation, a one-time and one-and-only circumstance,
4 and we're responding accordingly.

5 Q. Mr. Elgin, do you think it matters how many
6 customers a utility has in terms of determining
7 whether interim relief is appropriate or
8 inappropriate?

9 A. It's an irrelevant consideration.

10 Q. And am I correct that had Olympic not
11 withdrawn the case that it filed last summer, that
12 the suspension period would already have run and
13 there would be final rates by now?

14 A. Yes.

15 MR. FINKLEA: That's all I have, Your
16 Honor.

17 JUDGE WALLIS: Mr. Brena, do you want to
18 start now and then complete your examination in the
19 morning, or perhaps conclude now?

20 MR. BRENA: I would prefer to -- what are
21 my choices? I'd just as soon go home. Is that an
22 option?

23 MR. MARSHALL: Yes.

24 MR. BRENA: Bring it back in the morning.

25 JUDGE WALLIS: Under some circumstances.

00951

1 MR. BRENA: Can we take it up in the
2 morning?
3 JUDGE WALLIS: I believe that would be
4 appropriate. Let's be off the record at this
5 juncture.
6 (Discussion off the record.)
7 (Proceedings adjourned at 2:50 p.m.)
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