

Agenda Date: November 16, 2001
Item Number: 3A

Docket: TO-011472

Company: Olympic Pipeline Company, Inc.

Staff: Gene Eckhardt, Assistant Director of Water and Transportation
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Recommendations:

1. Suspend the tariff revisions filed under Tariff No. 23 by Olympic Pipeline Company, Inc., (Olympic) in Docket TO-011472. Consider the merits of the matter in the proceeding scheduled for prehearing conference on November 21, 2001.
2. Defer consideration of the merits of the Petition of Olympic Pipeline Company for an Order Authorizing an Immediate Rate Increase Subject to Refund to the Commission's November 28, 2001, Open Meeting.
3. Consider the merits of the Petition of Olympic Pipeline Company for a Policy Statement and Order Clarifying Oil Pipeline Rate Methodology in the proceeding scheduled for prehearing conference on November 21, 2001.

Discussion:

Olympic Pipeline runs from refineries in Whatcom and Skagit Counties in the north along the eastern edge of Puget Sound to Portland, Oregon, in the south. In July, 2000, operation and ownership of Olympic was taken over by BP Pipelines of North America (BP).

Last summer, Olympic filed a 76 percent rate increase in Docket TO-010792 (WUTC Tariff No. 22). No interim relief was requested. That filing was suspended. By Commission order dated July 11, 2001, that filing was permitted to be withdrawn at Olympic's request. Olympic indicated to Staff that it intended to work with Staff and customers to resolve differences before Olympic refiled its rate case. No discussions with Staff took place.

On October 31, 2001, Olympic filed a 62% rate increase. A notice of prehearing conference and notice of declaratory ruling in this docket was issued Tuesday, November 13, 2001. The proceeding is scheduled to begin by way of prehearing conference on November 21, 2001. That

notice contains a note that if the Commission does not suspend the tariffs in this matter, the notice may be withdrawn.

As of the time this memo was filed, the Commission had received letters from Tosco Corporation and Tesoro Northwest Company, both major pipeline customers, protesting the rate application and request for interim rate relief.

Olympic's 62% General Rate Increase Request

On October 31, 2001, Olympic filed new tariff WUTC No. 23, canceling WUTC No. 21 and naming increased transportation rates for petroleum products in Washington. Present rates have been in effect since February 1, 1999.

The stated impact of the filing is 62 a percent rate increase - \$8.74 million on intrastate Washington traffic and \$14.12 million on interstate traffic.

The letter of transmittal accompanying the current, 62% general rate increase filing alleges that the proposed tariff is in response to "... increased costs and safety investments including system enhancements, an aggressive, state-of-the-art internal inspection and repair program, new and more stringent regulatory and more rigorous internal safety rules and procedures." The material submitted in support of the general rate increase application is prepared using Federal Energy Regulatory Commission (FERC) cost-of-service methodologies. FERC methods differ from the proforma income statement/rate of return on investment analysis traditionally used by this Commission to set rates. Although in the past, the Commission has allowed rates to go into effect that were supported by a FERC methodology, the Commission has never approved the FERC methodology. No customer appeared before the Commission to object to those past rate changes.

Olympic represents that all fines and penalties, and all other costs directly associated with the Whatcom Creek explosion, have been removed from the underlying data in support of its 62% general rate increase application.

Staff has begun its review of Olympic's 62% general rate increase application. That review is not complete.

Accordingly, Staff recommends the Commission suspend the tariff filing of Olympic Pipeline Company, Inc., in Docket TO-011472. The Commission should consider the merits of the matter in the proceeding scheduled for prehearing conference on November 21, 2001.

Olympic's Petition for Interim Relief

On October 31, 2001, as part of its 62% general rate increase application, Olympic filed a Petition of Olympic Pipeline Company for an Order Authorizing an Immediate Rate Increase Subject to Refund (hereafter "Petition for Interim Relief"). In this petition, Olympic proposes

that the 62% rate increase be placed into effect on December 1, 2001, subject to refund. Olympic does not propose a specific interest rate for calculating refunds.

The Commission has discretion to allow rates to go into effect on a temporary basis, based on reasonable terms and conditions. When it comes to interim rate relief for transportation companies, the Commission has in the past stated that "...the Commission adheres to its prior determinations that an interim rate increase is an extraordinary remedy which should be granted only when an actual emergency exists or when relief is necessary to prevent gross hardship or gross inequity." *WUTC v. Skamania County Sanitary Service, Inc.*, Cause No. TG-2108 (1st Supp. Order, October 6, 1987). In that case, the Commission granted interim rates before hearing, based on a Staff recommendation. In prior and subsequent interim rate matters in cases involving utility companies, the Commission has required a hearing.

The Staff has met with company representatives and has submitted a detailed list of questions that will help Staff to analyze the Petition for Interim Relief, including a review of the actual results for 2000, actual results through September 2001, and forecasted results for the last three months of 2001. The Company met with Staff on November 14 to discuss answers to these questions. Additional information was requested. Staff's overall analysis of Olympic's Petition for Interim Relief is not yet complete.

FERC Methodology The Company's forecast results, on which it bases its request for interim relief, are based on actual results for 2000 through September 2001 and forecasted results for the last three months of 2001. These results do include the fines and penalties, and other costs directly associated with the Whatcom Creek explosion. In addition, the Company forecasts its rate base at around \$112 million, which reflects a FERC methodology. An historical cost less depreciation rate base would amount to approximately \$78 million. The Company also uses a 82.92 percent equity ratio, which the Company states reflects the actual combined capital structure of the two owner companies. This equity ratio is significantly higher than the level traditionally used by the Commission for other regulated companies. There are also significant differences between the Company's forecast results supporting its interim case, and the pro forma results supporting its permanent rate case. Staff has not had time to fully explore these differences.

Staff has conducted some preliminary analyses of Olympic's proposed FERC-based Total Company 2001 Forecast. Attachment No. 1 shows Olympic would require a temporary rate increase of 33.39 percent, subject to refund, to achieve a projected 9.235 percent Rate of Return. Column (a), titled "Olympic Total Company 2001 Forecast," reflects the data filed by Olympic in its rate case. Column (b), titled "Preliminary Staff Adjustments," reflects the adjustments that Staff has identified at this time. Each adjustment is numbered and an explanation of the adjustment is shown at the bottom of Attachment No. 1. Also, as shown in Columns (b) and (c), Staff used a 50 percent equity ratio instead of Olympic's proposed 82.92 percent equity ratio. Staff uses the Company's proposed equity return of 11.73 percent. Column (c), Titled "Adjusted 2001 Forecast," shows the effect of the adjustments in Column (b). Column (d), titled "Effect of Interim Rates," shows the additional revenue needed to achieve the target 9.235 percent Rate of

Return. Column (e), titled "Adjusted Forecast With Interim Rates," shows the combined effect of Column (c) and Column (d).

Staff does not recommend the Commission adopt the results of this analysis for the following reasons:

1. Staff does not recommend the Commission approve any rates based on the FERC methodology. The appropriate methodology to use in setting rates will be an important element of this proceeding and is the subject of a petition filed by the Company.
2. The analysis is preliminary. Staff has not reviewed the underlying data. Staff has requested additional information from the Company. The Company has promised to file additional information, but has not yet done so.
3. Interested shippers have not had sufficient time to review this information and submit comments. Shippers may provide additional information that the Commission will find useful in considering whether or not to approve temporary rates, subject to refund, and if so, the level of rates.

Original Cost Methodology: Staff has also done a preliminary analysis of the filing using the traditional original cost minus depreciation rate base / rate of return methodology that the Commission uses in setting rates for other utilities. This preliminary analysis of Olympic's proposed FERC based 2001 forecast, adjusted to reflect original cost minus depreciation rate base / rate of return methodology shows that Olympic would require a temporary rate increase of 19.86 percent, subject to refund, to achieve a projected 9.37 Rate of Return. Attachment No. 1 shows Staff's preliminary analysis of Olympic's proposed FERC based Total Company 2001 Forecast adjusted for the Original Cost methodology. Column (f), titled "Adjustments to FERC Methodology," shows an adjustment to rate base to reflect the actual, original cost minus depreciation rate base. The only other adjustment in this simplified analysis is to adjust return on equity to 12.0 percent. Column (g), titled "Adjusted Original Cost With Interim Rates," reflects the effect of Column (e) and Column (f).

Staff does not recommend the Commission adopt the results of this analysis for the following reasons:

1. The analysis is preliminary. Staff has not reviewed the underlying data. Staff has requested additional information from the Company. The Company has promised to file additional information, but has not yet done so.
2. Interested shippers have not had sufficient time to review this information and submit comments. Shippers may provide additional information that the Commission will find useful in considering whether or not to approve temporary rates, subject to refund, and if so, the level of rates.

Olympic asked the Commission to approve temporary rates to become effective December 1, 2001. The next scheduled Open Meeting for the Commission will be held on November 28, 2001. We apologize for the lateness of our memo, which was not posted until this morning. Today is the first time Olympic and the customers have seen staff's analysis. Staff's analysis today is very preliminary. We need additional time and information to make a more informed analysis and recommendation. We expect that both Olympic and the customers will provide

additional information that will allow Staff to fine tune our analysis and allow the Commission to make a better informed decision.

So there are significant issues related to the request for interim relief that still need to be analyzed and addressed. Staff is committed to doing that expeditiously, but more time is required. In sum, the Company has not yet demonstrated that the proposed or interim rates are fair, just, reasonable or sufficient.

Accordingly, Staff recommends the Commission defer consideration of the merits of the Petition for Interim Relief to the Commission's November 28, 2001, Open Meeting.

Olympic's Petition for Policy Statement

On October 31, 2001, in conjunction with its 62% rate increase application, Olympic filed a Petition of Olympic Pipeline Company for a Policy Statement and Order Clarifying Oil Pipeline Rate Methodology (hereafter "Petition for Policy Statement"). Specifically, Olympic requests the Commission issue a policy statement under WAC 480-09-240, or in the alternative, a declaratory order under WAC 480-09-230.

In this petition, Olympic requests the Commission to rule that the "ICC/FERC methodology" should be adopted for use in oil pipeline rate proceedings. The petition contains many factual and legal arguments purporting to support this request.

WAC 480-09-230 requires that within 15 days of receipt of a petition for declaratory order, the Commission must give notice to interested persons. The notice issued Tuesday, November 13, 2001, for the November 21, 2001 prehearing conference, contained a notice for the declaratory order. That notice indicates that a determination had yet to be made whether the petition would be treated as a request for a declaratory order.

Staff has not had time to complete its analysis of the Petition for Policy Statement. And if the Commission decides to handle this matter as a request for declaratory order, notice is required.

Accordingly, Staff recommends the Commission consider the merits of the Petition for Policy Statement in the proceeding to begin November 21, 2001.