PREPARED DIRECT AND ANSWERING TESTIMONY OF JOHN F. BROWN

I INTRODUCTION

Q. Please state your name, business address and occupation.

A0 My name is John F. Brown. My business address is 9525 Katy Freeway, Suite 420, Houston, Texas 77024. I am a consultant with and Chairman of the consulting firm Brown, Williams, Moorhead & Quinn, Inc.

Q. Please state your personal qualifications.

A0 My personal vita, which is attached as Appendix A, contains the details of my experience since my initial employment in the energy industry in 1955. More particularly, for more than forty-five years, I have been involved in rate and regulatory matters before the Federal Energy Regulatory Commission and its predecessor the Federal Power Commission (hereinafter referred to jointly as the AFERC@), as well as numerous state regulatory agencies. I have presented testimony on many occasions before the FERC and various state regulatory agencies on matters of cost of service, including direct cost assignment and rate design. In addition, I have testified numerous times in court and arbitration proceedings on matters of contracts, regulation, costs of service, and rate design. As to my educational training, I received a Bachelor of Science-Business Administration degree, with a major in accounting and a minor in economics, from Washington University in St. Louis, Missouri, in June 1953; and a Juris Doctor degree from St. Louis

University School of Law in St. Louis, Missouri, in December 1971. I hold a non-resident law licence from the State of Missouri.

2. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony in this proceeding?

A0 I have been retained by Tesoro Refining and Marketing Company (ATesoro@) to evaluate and comment on Olympic Pipe Line Company=s (AOlympic@) request for a 62% increase in rates. In particular, I have been asked to set forth the regulatory policies and principles appropriate to be utilized by the Washington Utilities & Transportation Commission (AWUTC@) when evaluating Olympic=s rate filing.

II SUMMARY OF TESTIMONY

Q. Please summarize your testimony.

A0 In general, Olympic has operated quite profitably for over a decade. Between 1990 and 1997 inclusive, Olympic=s average return on equity was 188.5%, and during the period 1982-1997 it paid $106.4 million in dividends to its owners. Moreover, between 1983 and 1999 the rates Olympic charged its customers resulted in an overcollection of $116 million when compared with the rates Olympic should have charged under the WUTC=s traditional depreciated original cost (ADOC@) methodology. In addition, as recently as February 1, 1999, Olympic filed a rate increase that went into full effect without investigation, protest, or hearing resulting in even further overcollections.

Olympic=s request for a rate increase is not driven by safety concerns. The rates and rate structure I have recommended allow Olympic to recover all of its prudently incurred operating costs, including significant increases in several operating costs areas, such as Management Fees, Salaries, Fuel and Power, and Insurance. The rates and rate structure I have recommended also allow Olympic to recover every dollar it has invested into every capital project it has identified as necessary to comply with the Office of Pipeline Safety=s (AOPS@) and Department of Environmental Conservation's (ADEC@) safety requirements as well as every capital project Olympic has identified as necessary for any reason to continue to operate the pipeline. This is no small matter given that Olympic is adding approximately 24% to its total gross plant in service in only three years. The rates and rate structure I have recommended will provide an apparently needed incentive for Olympic to more expeditiously comply with OPS=s safety requirements and return its pipeline to normal operations.

It simply is unacceptable that Olympic will take five years or more to comply with the safety requirements necessary to operate under normal conditions. The capital structure and conditions Tesoro witness Hanley recommends and I endorse will provide an apparently needed incentive for Olympic and its owners to operate a prudently capitalized company, instead of continuing to operate a petroleum products line without equity or access to the equity capital necessary to properly manage the risks of ownership. In short, the rates and rate structure I have recommended will provide just, fair, reasonable and sufficient (Ajust and reasonable@) rates for Olympic and its shippers.

Instead of being driven by safety, Olympic=s request for a rate increase is driven by the improper manipulation of the rate setting process. To reach any rate increase, Olympic=s direct case has had to (1) improperly use higher budgeted and unspent costs in place of its actual costs, (2) characterize one-time expenses as recurring expenses, (3) characterize expenses unrelated to providing service as recurring expenses, (4) characterize its capital structure as 83% equity when it has no equity whatsoever, (5) overstate its return on equity, (6) include a hypothetical calculation of deferred return for prior periods in which it, in fact, dramatically overcollected its total return, (7) include a transition rate base write-up for the purposes of recovering a return and income tax allowance on investment it did not make, and (8) request rates be set based on a restricted throughput when the restricted throughput is the consequence of its own imprudent operations and should have been returned to normal operations well before now. In sum, none of the factors which truly drive Olympic=s rate increase justify higher rates be borne by its ratepayers.

Olympic has collected rates far greater than just and reasonable from its ratepayers for years. Accordingly, Olympic=s current financial distress is not the result of the undercollection of revenue from its ratepayers, but from its own imprudent operation of the pipeline and its own failed investments. Olympic has paid out all of its net income to its owners for over a decade. Olympic invested approximately $21.5 million in a flawed and now abandoned project (ACross-Cascades project@). Olympic had a catastrophic incident at Whatcom Creek in Bellingham, Washington, where gasoline was spilled and three young people were killed

(AWhatcom Creek incident@). Atlantic Richfield was purchased by BP and, as a result of that purchase and Atlantic Richfield=s subsequent purchase of GATX, Inc.=s interest in Olympic, Atlantic Richfield became a majority owner of Olympic. As a result of this change in majority ownership, BP Pipeline Company, a new affiliated company to Atlantic Richfield, was named the new operator for Olympic effective on July 1, 2000. Taken together, these events have resulted in financial distress for Olympic, but these events do not form a justification for higher rates to be charged its ratepayers.

Shippers may only be expected to pay just and reasonable rates based on Olympic=s prudently incurred costs of providing the service they receive. Just and reasonable rates will not and should not eliminate the risks of ownership associated with failed projects or catastrophic events.

Just and reasonable rates do, however, fully and fairly compensate Olympic for assuming the reasonable risks of ownership. Olympic=s shippers have fairly and fully compensated Olympic for assuming the reasonable risks of ownership through paying rates which included the recovery of a risk-adjusted rate of return on equity, expenses associated with operating a safe pipeline, expenses associated with maintaining the insurance necessary to reasonably manage such risks, and the recovery of capital expenditures with return and income tax allowance for all capital projects associated with operating a safe pipeline.

Beyond this point, Olympic or its owners will have to assume the reasonable risks of ownership and not expect that their ownership losses may be <u>shifted</u> to Olympic=s ratepayers.

Olympic=s shippers should not be made to compensate Olympic for the reasonable risks of ownership then also be made to pay for such risks when they are realized. Olympic=s shippers have, in fact, overpaid their rates for years. It is now time for Olympic and its owners to step up and be responsible for the financial distress which has arisen from matters beyond the reasonable costs of providing service to its ratepayers.

My testimony is organized in three basic parts: (1) regulatory standards; (2) Olympic=s rate filing; and (3) Olympic=s rates. The first basic part of my testimony concerning regulatory standards is further organized into three subparts: (1) proper rate filings; (2) just and reasonable rates; and (3) burden of proof. The third and last basic part of my testimony concerning Olympic's rates is also further organized into five subparts: (1) rate base methodology; (2) rate base; (3) return on rate base; (4) operating costs; and (5) throughput.

III REGULATORY STANDARDS

A0 PROPER RATE FILING

Q. Please explain what procedural standards must be met by a rate filing.

A0 A proper filing for an increase in rates begins with the selection of a period during which actual costs are incurred. Adjustments to the actual costs for the selected period are made as appropriate in order to establish the costs to be used in setting the proposed rates. The test period costs must be provided in a format that shows a cost of service and throughput for the test period. Statements supporting the cost of service must be provided to show the details of operating and maintenance costs, overall return on rate base, income taxes, rate base, and

allowance for funds used during construction (AAFUDC@). In addition to the cost of service and supporting statements, the applicant must provide detailed support for its original rate filing in the form of direct testimony.

B0 JUST AND REASONABLE RATES

Q. Please explain what substantive standards the Commission applies in evaluating a filing for increased cost-based rates.

A0 The WUTC applies the standard that rates must be just, fair, reasonable, and sufficient pursuant to its statute, RCW 81.28.010, which mandates that:

> All charges made for any service rendered or to be rendered in the transportation of persons or property, or in connection therewith, by any common carrier, or by any two or more common carriers, shall be just, fair, reasonable and sufficient.

In the State of Washington, as well as in virtually every other state and federal jurisdiction, such statutory standards have been applied to set rates which strike a balance between both the regulated company and its ratepayers based upon the regulated company=s prudent costs of providing the service to its ratepayers. See, e.g., Washington Util. and Transp. Comm=n v. Avista Corp., UE-991606 (Sept. 29, 2000) (AThe ultimate determination to be made by the Commission in this matter is whether the rates and charges proposed in the revised tariffs are fair, just, reasonable, and sufficient, pursuant to RCW 80.28.020.@ This Commission=s mandate to establish just and reasonable rates for common carriers pursuant to 81.28.010 is

substantially similar to its mandate to establish just and reasonable rates for utilities pursuant to 80.28.010 and 80.28.020.)

In a seminal case, the D.C. Circuit Court of Appeals summarized the nature of the balance which should be struck in meeting the Ajust and reasonable@ standard. In Farmers Union Central Exchange, Inc., et al. v. FERC, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (AFarmers Union II@), it stated:

> We begin from this basic principle, well established by decades of judicial review of agency determinations of Ajust and reasonable@ rates: an agency may issue, and courts are without authority to invalidate, rate orders that fall within a Azone of reasonableness,@ where rates are neither Aless than compensatory@ nor Aexcessive.@ (citations omitted)

Regulatory agencies and the courts have found over the years that the way to meet these twin criteria is to allow the regulated company to recover through rates its prudently incurred operating expenses, capital investment, and a reasonable return on its unrecovered capital investment. Wash. Util. & Transp. Comm=n. v. Puget Sound Power and Light Co., 147 PUR 4th 80, 50 (Sept. 21, 1993), *citing* Bluefield Water Works Improvement Co. v. PSC of West Virginia, 262 U.S. 679 (1923); and FPC v. Hope Natural Gas Co., 320 U.S. 592 (1944).

Q. Please explain what regulatory standards are normally applied to evaluate whether a pipeline carrier=s costs are to be included within just and reasonable rates.

A0 The normal ratemaking practice is to base rates for future periods on a normal and representative cost level which can be reasonably expected to occur in the future. In practice, this means that the actual costs for a recent 12-month period of actual experience are adjusted so as to be representative of the future costs. The adjustment to actual costs during the actual cost period generally consists of adjustments to ensure that the costs are prudently incurred, related to the service provided to the shipper, no higher than necessary to provide the service needed for the shipper, and representative of the pipeline carrier=s future operations.

Thus, to be included within future rates, costs must be related to the service actually provided. A pipeline may incur actual costs which are not related to the service actually provided to the ratepayers. For example, a pipeline may incur costs associated with facilities which are not facilities used or useful for providing service for the ratepayers. In such a case, those costs unrelated to the service provided are not properly included within future rates.

To be included within future rates, costs must be prudently incurred. A pipeline carrier may incur costs resulting from its own imprudent actions. For example, a pipeline carrier=s imprudent operation of the pipeline may result or contribute to an explosion or product spill. In such a case, those costs related to the pipeline carrier=s imprudence are not properly included within future rates.

To be included within future rates, costs must represent the lowest, reasonable cost available in providing service to ratepayers. A pipeline may incur actual costs which are greater than the lowest reasonable cost of the service provided to the ratepayers. For example, a

pipeline may incur greater costs than the lowest prudent alternative in building new or unnecessary facilities. In such a case, those higher additional costs are not properly included within future rates.

To be included within future rates, actual base period costs must be representative of a normalized level of recurring costs expected to occur into the future. A pipeline may incur actual costs which are one-time extraordinary or one-time costs. For example, a pipeline may incur costs which are unusually high due to extraordinary circumstances or which may fluctuate from year to year due to any number of circumstances. In such a case, those nonrecurring costs are not properly included within future rates.

The actual adjusted costs may be further adjusted to take into consideration future events which are known and measurable and which may be quantified with a reasonable degree of certainty. This means generally that there must be some basis for the expectation that the projected costs will be incurred, and there must also be a basis for quantifying the impact associated with the occurrence.

C0 BURDEN OF PROOF

Q. Please describe who has the burden to demonstrate the justness and reasonableness of a rate increase.

A0 The pipeline carrier has the burden to demonstrate the justness and reasonableness of its filed rates. RCW 81.04.130 clearly states, AAt any hearing involving any change in any schedule, classification rule, or regulation, the effect of which is to increase any rate, fare, charge, rental, or toll theretofore charged, the burden of proof to show that such increase is just and reasonable is upon the public service company.@ Moreover, when a pipeline carrier engages in transactions with its affiliated companies, the pipeline carrier has a unique burden to demonstrate the reasonableness of those affiliated transactions, and the WUTC will carefully scrutinize all such affiliated transactions. See RCW 81.16.020-.090.

IV OLYMPIC=S RATE FILINGS

Q. In general, do Olympic=s cost-of-service presentations filed in support of its revised rates meet the regulatory standards for proper rate filings?

A0 No. In general, Olympic=s cost-of-service presentations do not meet the regulatory standards for proper rate filings. As noted above, a pipeline carrier proposing a change in its rates must provide the actual costs it incurred for the most recent 12 consecutive months for which a balance sheet and income statement are readily available. This period is known as the pipeline=s test period. From these actual test period costs, necessary adjustments must be made to eliminate nonrecurring items. Nonrecurring items are those items of cost which were incurred during the base period but which will not occur during the test period. After elimination of all nonrecurring costs, the carrier may include normalizing adjustments to provide for items of cost, *i.e.,* a payroll increase, which were not in effect throughout each of the 12

months of the base period. In addition, adjustments may be made for changes in revenues and costs which are known and measurable with reasonable accuracy. Stated in other words, the starting point for development of a test period cost of service is the actual costs experienced in the test period adjusted as required and necessary to reflect expected future costs.

Olympic=s rate filing fails to meet these simple, clear standards for four basic reasons: (1) Olympic=s cost-of-service support is not based on Olympic=s actual costs during the test period, but is instead based on budgeted costs for the year 2002; (2) Olympic has advanced alternative test periods; (3) Olympic has not made nonrecurring cost adjustments or other required adjustments to test-period costs necessary to properly reflect the future costs of providing service; and (4) Olympic=s direct case contradicts in several significant respects its own cost-of-service information it filed with its initial tariff filing.

Q. Please comment briefly on the failure of Olympic=s rate filing to set forth proper cost-of-service information.

A0 A pipeline carrier has the burden to support any rate request filing it makes. This requirement to support any rate change is particularly appropriate when there is a contested proceeding, such as the instant proceeding involving the 62% rate increase request filed by Olympic. In short, the WUTC requires that a filing in support of a rate increase be based upon actual test period costs, adjusted as appropriate. Olympic does not use actual test period costs in the direct case it has filed in support of its rate filing. Instead, it relies upon budgeted costs. Budgeted costs simply do not provide a proper basis for development of test period costs because those costs

are not based on the actual costs incurred during the test period. Olympic=s obligation was to advance and support the costs claimed by it in its October 31, 2001, rate filing. Budgeted costs do not meet the regulatory standards required by this Commission.[1]

Q. Please comment briefly on the failure of Olympic to set forth a proper test period.

A0 While this Commission may allow some deviation from the generally accepted test period concept, that does not mean that a pipeline carrier is free simply to put on alternative and contradicting test periods in an effort to support its filed cost of service. In that regard, Olympic has advanced two alternative and contradicting test periods. It is further not appropriate for a pipeline carrier to come in with a contradictory approach to the cost of service it originally submitted in support of its rate increase filing.

In this proceeding, Olympic has filed the testimony it filed with the FERC in support of the rate increase filing it made at that Commission. In such testimony, Olympic noted that it intends to rely upon its Case 2 base period and test period. Based on Olympic=s representations, I have chosen to focus my testimony on Olympic=s Case 2 presentation. To the degree Olympic is suggesting that Case 2 should be used because it reflects the most recent cost experience for its pipeline, I agree with that principle and am recommending that the Case 2 period of October 1, 2000, through September 30, 2001, be used for rate setting purposes.

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[1] See, e.g., WUTC v. Tenino Tele. Co., U-83-62 at 26 (May 14, 1984).

Q. Please comment briefly on the failure of Olympic to set forth the necessary and required adjustments to its actual test period information.

A0 While I will discuss this in greater detail within my comments on Olympic=s operating costs, Olympic in general has not made the adjustments to its test period costs which are required to be made. For example, adjustments to test period costs must be made to eliminate nonrecurring items. In several major categories of costs, Olympic neither supports its costs nor adjusts them to eliminate nonrecurring items.

Q. Please comment briefly on the manner in which Olympic=s direct case contradicts rather than supports the cost-of-service information provided in support of its original tariff filing.

A0 Olympic=s original tariff filing with a 62% increase in rates was based on the cost-of-service information Olympic filed at the time it made its rate increase request. The purpose for a direct case is to provide additional and detailed narrative and support of the cost-of-service information filed with a tariff filing. Olympic=s direct case contradicts the cost-of-service information filed with its original tariff in several significant respects. In other words, Olympic has not submitted testimony in support of the test period cost of service it provided with its October 2001 rate filing.

To be more specific, Olympic used in its rate filing a different throughput level, a lower rate of return, a lower AFUDC calculation, and a lower level of operating and maintenance costs than it now advances through its direct case. In essence, Olympic has presented in its

direct case entirely different elements of its cost-of-service and throughput than it had used in its original tariff filing. Instead of filing a direct case which reflected the higher throughput and, therefore, a lower than 62% increase in rates, Olympic filed a direct case which offset its higher throughput by increasing its operating and maintenance costs, return and AFUDC--resulting in the same 62% increase. The purpose of a direct case is to provide additional support for the cost-of-service information filed by a carrier with its rate increase. It is not supposed to be an opportunity for the carrier to shift cost-of-service information and thereby present a substantially different basis for the increased rates than that which it used when it filed its increased rates.

Olympic=s efforts to buttress its rate filing by making numerous changes to the data it filed in support of its increased rates is like the shifting sands in a wind storm. This Commission should not allow such disregard for the tried and proven procedures it has consistently followed in setting rates subject to its jurisdiction.

V OLYMPIC=S RATES

Q. Please explain the context in which it is helpful to understand Olympic=s 62% rate increase.

A0 Olympic has operated quite profitably for over a decade, and from 1983 through 1999, inclusive, Olympic overcollected by $116 million the revenue requirement it would have been permitted if its rates during that period had been determined under this Commissions= traditional DOC methodology. In addition, from 1982 through 1997, Olympic paid $106.4 million in dividends to its owners. Moreover, Olympic increased its rates just three years ago and received its entire requested increase.

Beginning in about 1997, however, Olympic invested in a failed project and a few major events occurred. First, Olympic invested approximately $21.5 million in a flawed and now abandoned Cross-Cascades project. None of the funds expended on the failed Cross-Cascades project are recoverable from Olympic=s shippers, and to Olympic=s credit it has tried to exclude those costs from its revenue requirement. Second, Olympic had the Whatcom Creek incident. Olympic and certain of its former employees have been criminally charged, and there are over 20 lawsuits pending as the result of their role in the Whatcom Creek incident. None of the funds expended on the Whatcom Creek incident are recoverable from Olympic=s shippers, and to Olympic=s credit it has tried to exclude the direct (but not indirect) costs from its revenue requirement. Olympic has also come under greater regulatory scrutiny and has not been permitted to operate its pipeline at its normal operating pressure until it complies with certain OPS safety requirements. The costs associated with such compliance are recoverable from its shippers provided they meet the other regulatory standards for inclusion in rates. And, third, Atlantic Richfield was purchased by BP and, as a result of that purchase and Atlantic

Richfield=s subsequent purchase of GATX, Inc.'s interest in Olympic, Atlantic Richfield has become a majority owner of Olympic. This change in majority ownership resulted in the new affiliate of Atlantic Richfield, BP Pipeline Company, being named the operator for Olympic beginning in July of 2000. None of the costs of changing operators as the result of a change in the majority ownership are recoverable from Olympic=s shippers.

In sum, there has been no fundamental shift in Olympic=s financial position which should be borne through higher rates from its shippers. The rate impact from the costs associated with increased regulatory compliance, which may be collected from Olympic=s shippers, is less than the amount of overcollections Olympic was previously recovering. In fact, when taken as a whole, Olympic=s existing permanent rates are higher than may be justified.

Q. In general, does Olympic=s direct case support the justness and reasonableness of its proposed 62% rate increase?

A0 Definitely not. In that regard, to be deemed just and reasonable, rates should allow a pipeline carrier like Olympic to recover its reasonable operating costs, its original and additional investment through depreciation, and a reasonable return on its unrecovered investment. Olympic=s direct case, however, would allow the collection of unjust and unreasonable rates from its shippers.

Q. Please describe the major areas in which Olympic=s rate filing fails to support its proposed 62% rate increase.

A0 There are four major areas in which Olympic=s test period cost of service fails to support its request for a 62% rate increase. These areas are as follows: (1) Olympic has based its rate base and return allowance on the FERC=s method of setting rates rather than the traditional DOC methodology followed by this Commission and, even under the FERC methodology, it has overstated its rate base; (2) Olympic has substantially overstated its operating costs; (3) based on Tesoro=s witness Hanley=s testimony, Olympic has substantially overstated its return, and, therefore, its tax allowance as well; and (4) Olympic has substantially understated the likely throughput which will be achieved under its future rates. Following is a discussion of these major areas.

A0 RATE BASE METHODOLOGY

Q. Please briefly describe the meaning of the term "rate base."

A0 The Glossary for the Gas Industry published by the American Gas Association (AGA) defines "rate base" as: "The investment value established by a regulatory authority upon which a utility is permitted to earn a specified rate of return."[2] As it pertains to Olympic in this proceeding, it would apply to the unrecovered investment relevant to the test year used for determining just and reasonable rates.

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[2] The Glossary of Terms attached to the NARUC 1990 Report defines "Rate Base" as "Investment in operating plant, less depreciation, upon which a regulated utility is entitled to earn profit."

Q. Please briefly describe the three basic methodologies which are discussed below in your testimony.

A0 The methodologies discussed below are (1) the DOC methodology, (2) the valuation methodology as was set forth in FERC=s Opinion No. 154 (AFERC=s 154 methodology), and (3) the trended original cost (ATOC@) methodology with a transition rate base as was set forth in FERC=s Opinion No. 154-B (AFERC=s 154-B methodology).

DOC Methodology

The most common method employed by regulatory agencies (federal and state) is the DOC methodology. Under the DOC approach, the net undepreciated investment is determined by subtracting the accumulated depreciation reserve from the original cost of the facilities. To that undepreciated investment is added an allowance for working capital to account for funds tied-up on a continuing basis in materials and supplies and prepaid expenses. Deducted from the balance are accumulated deferred taxes as well as other deferrals where the ratepayers have contributed the funds. The DOC methodology results in cost-based rates which are designed to compensate investors for the use of funds actually made available to the regulated company. The FERC and virtually all state regulatory agencies use the DOC methodology for establishing the rate base to be used to determine gas and electric rates. Moreover, every state regulatory agency to have considered the issue has adopted the DOC methodology for the regulation of petroleum pipelines.

FERC Opinion No. 154 Methodology (Valuation Methodology)

The methodology set forth in FERC Opinion No. 154 was the valuation methodology previously employed by the Interstate Commerce Commission (AICC@) for regulating interstate common carrier pipelines. The valuation rate base consists of a weighted combination of original cost and an element called "cost of reproduction new" reduced for depreciation by an element called "condition percent" and inflated by a value for "going concern" to which is added working capital and the present value of lands and rights of way. In effect, FERC=s 154 methodology determines return based upon valuation concepts rather than on the actual net investment associated with providing service. As such, the FERC=s 154 methodology has been rejected as an inappropriate methodology for establishing cost-based rates.

FERC Opinion No. 154-B Methodology (Trended Original Cost With a Transition Rate Base Methodology)

FERC=s 154-B methodology is a deferral methodology whereby the pipeline defers a portion of its costs in the earlier years in exchange for the recovery of that deferred portion in the later years. In general terms, this deferral aspect of FERC=s 154-B methodology, as well as similar deferral methodologies, are referred to as trended original cost methodologies (ATOC@). As set forth in FERC Opinion No. 154-B, the inflation portion of the nominal equity return is deferred and amortized over the life of the facilities.

While the deferral aspect of FERC=s 154-B methodology is a TOC methodology, FERC=s 154-B methodology does deviate from a TOC methodology in one significant respect. It allows a pipeline carrier a starting or transition rate base <u>unrelated</u> to actual investment. In

determining the transition rate base, the FERC used the valuations that were prepared for the year ending December 31, 1983, which included figures for both original cost and reproduction cost new. This is, in effect, the blending of a valuation methodology with a cost-based methodology. The debt ratio was applied to net depreciated original cost to determine the debt portion of rate base. The equity ratio was applied to the reproduction cost new value to determine the equity portion of rate base. The effect of this is to permit earnings on an equity rate base which is written up above the regulated pipeline=s actual net investment.

Q. Please describe what rate base methodology would be appropriate to apply to determine the rate base for Olympic.

A. The DOC methodology is the appropriate methodology to use in determining rate base for Olympic. The DOC methodology results in cost-based rates which are designed to compensate regulated companies for their actual unrecovered investment in plant. The DOC methodology is the most common method employed by regulatory agencies (federal and state) for determining the rate base for regulated companies.

At the federal level, the DOC is the methodology used by the FERC for the regulation of interstate natural gas pipelines and interstate electrical transmission systems. Moreover, even though the FERC has principally relied upon a different methodology for the regulation of interstate crude oil and petroleum products lines, it has consistently acknowledged the

advantages of the DOC methodology even when considering the regulation of those crude oil and petroleum products pipelines.[3]

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[3] In Williams Pipe Line Co., 21 FERC & 61,260 (1982) (FERC Opinion No. 154), the FERC failed to adopt the DOC methodology, but noted its "not inconsiderable virtues" of simplicity and objectivity. Id. at & 61,616. The FERC also noted that the "oil pipeline industry acknowledges the utility and the validity of original cost measurements." Id. In Williams Pipe Line Co., 31 FERC & 61,377 (1985) (FERC Opinion No. 154-B), the FERC adopted a preference for the TOC methodology over the DOC methodology for reasons irrelevant to this proceeding. In doing so, however, the FERC did not question the validity of the DOC methodology, but described the TOC methodology as an "acceptable cost-based alternative" to the DOC methodology. Id. at & 61,834 (emphasis added). Subsequent to the FERC Opinion No. 154-B and notwithstanding the FERC's apparent preference for the TOC methodology, Administrative Law Judge Zimmet adopted the DOC methodology for use by the Endicott Pipeline Company. In doing so, he held that FERC Opinion No. 154-B does not establish complete or absolute guidelines, but invites alternative and innovative solutions based on the facts of each case. Endicott Pipeline Co., 55 FERC & 63,028 at 65,141 ("Thus, in place of TOC, the Commission invited alternative innovative solutions= to be presented to it in a given case.").

At the state level, the DOC is the rate base methodology used for the regulation of natural gas pipelines, crude oil pipelines, petroleum products lines, electrical and other utilities. So far as I am aware, every state to have adjudicated the issue of the appropriate rate base methodology for the regulation of crude oil and petroleum products lines has adopted the DOC methodology. For example, the Alaska Public Utilities Commission in Kenai Pipeline Co., 12 APUC 425, Order No. P-91-2 (11) (12/1/92) rejected similar arguments advanced by Olympic and applied the DOC methodology. In Kenai Pipeline at 438, the Alaska Commission reasoned:

> Present cost-based rates include a reasonable return only on capital actually invested in the enterprise. Cost-based rates cannot include a return on capital that has previously been recovered by the carrier. Thus, a carrier would be restricted each year to earning a return only on the remaining rate base not yet recovered in rates through depreciation or amortization, i.e., the depreciated original cost of its property, that return deficiency could legitimately be treated as though it had been reinvested in the enterprise.
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> The Commission will use the depreciated original cost of KPL=s property in service as its rate base. The Commission will apply its traditional DOC methodology to determine rates for KPL in this proceeding and in future rate cases.

To cite another example, the Wyoming Public Service Commission has ruled that a DOC methodology is the appropriate methodology when setting intrastate rates. Wyoming was also presented with arguments similar to the arguments made by Olympic in this proceeding, that intrastate rates should be set identical to FERC rates and that those rates should be established applying a TOC methodology with a transition rate base. Wyoming also rejected

these arguments. Amoco Pipeline Co., Docket No. 50001-PT-92-1 (Wyo. Pub. Service Comm=n. 1993). In Amoco at 19, the Wyoming Commission held

> The Commission has uniformly ruled: that the depreciated original cost rate base is the most appropriate rate base determination methodology that complies with the >used and useful= mandate.

Importantly, the DOC methodology is the rate base methodology used by the WUTC to establish the rate base for regulated utilities and public service companies within the State of Washington.

Q. Please explain why the DOC methodology is the most commonly used rate base methodology.

A0 The DOC methodology is so common because it works to fulfill the fundamental regulatory goal associated with setting rates for a regulated company. The DOC methodology bases the calculation of return on the actual unrecovered investment employed to provide the current service to ratepayers, and therefore strikes the proper regulatory balance between the regulated company and its ratepayers.

Aside from fulfilling this fundamental regulatory goal, the DOC methodology (1) is simple and accurate, (2) avoids complex accounting and litigation issues, (3) is inexpensive to determine, (4) is easy to administer, (5) does not run the risk of overcollections due to improperly derived inflationary factors, and (6) is the most reliable and equitable methodology available.

Q. Please describe what rate base methodology Olympic purported to use to determine Olympic=s rate base for setting intrastate rates.

A0 Olympic=s direct case suggests it used the FERC=s 154-B methodology; however, as I explain below, Olympic has misapplied that methodology in determining the rate base it is proposing. The FERC=s 154-B methodology was adopted to replace the valuation methodology initially adopted by the FERC through Opinion No. 154 (Nov. 30, 1982) after FERC=s 154 methodology was rejected by the D.C. Circuit Court of Appeals in Farmers Union II.

Q. Please briefly explain and comment on the primary differences between the DOC methodology you have recommended and the FERC=s 154-B methodology.

A0 There are two primary differences: (1) the amortization of and inclusion in rate base of a calculation of an inflation portion of the nominal equity return from 1983 to date (Adeferred returns@); and (2) the starting or transition rate base write-up (Atransition rate base@). Essentially, through its version of the FERC=s 154-B methodology, Olympic is attempting to recover deferred returns it never deferred and a return on investment it never made.

Q. Please comment specifically on whether Olympic should be allowed to use a rate base methodology which includes deferred returns from prior periods in current rates.

A0 Olympic should not be allowed to use a rate base methodology which includes deferred returns from prior periods for several reasons. First, Olympic has not demonstrated that it actually deferred returns from prior periods. To allow unsupported deferred returns from prior periods to be included within current rates, Olympic should have to clearly demonstrate that it forewent those returns during the prior periods. Olympic has made no such showing.

Second, Olympic did not, in fact, defer any return from prior periods, but has substantially overcollected any reasonable calculation of its total cost of service during those prior periods. Tesoro witness Grasso has compared Olympic=s actual, prior revenues from 1983 through 1999 against the total cost of service under a DOC methodology for the same period. Exhibit No. ____(GG-7). His analysis used the capital structure and rate of return Olympic itself has advanced for these same prior periods in its direct case and used Olympic=s FERC Form No. 6 expenses to calculate the total cost of service. His analysis demonstrates that Olympic overcollected its total cost of service under a DOC methodology by $116 million during the 1983 through 1999 period.

Tesoro witness Grasso has also compared Olympic=s actual, prior revenues from 1983 through 1999 against the total cost of service under FERC=s 154-B methodology for the same period. Exhibit No. ____(GG-4). His analysis again used the capital structure and rate of return Olympic itself has advanced for these same prior periods in its direct case and used

Olympic=s FERC Form No. 6 expenses to calculate the total cost of service. For the purposes of this calculation, he also accepted Olympic=s position with regard to the calculation of deferred returns under FERC=s 154-B methodologyBan issue in dispute in this proceeding. His analysis demonstrates that Olympic overcollected its total cost of service even under Olympic=s version of FERC=s 154-B methodology during the 1983 through 1999 period.

These staggering overcollections during prior periods when compared with the total cost of service calculated under both the DOC methodology and Olympic=s version of FERC=s 154-B methodology should come as no surprise. Olympic, in fact, collected rates under the FERC=s 154 (not 154-B) methodology prior to 1996.

As noted briefly above, FERC=s 154 methodology was not a cost-based methodology, but was the Avaluation methodology@ previously used by the ICC. This valuation methodology resulted in huge overcollections when compared with any cost-based methodology. It was rejected as an appropriate methodology for setting rates as early as 1978. The D.C. Circuit Court of Appeals referred to the valuation methodology as Aweak and outmoded@ and an artifact of a Abygone era.@ Farmers Union I 584 F.2d at 416-18. Similarly, the D.C. Circuit Court of Appeals again rejected the underlying valuation methodology in 1984 and held that FERC=s continued reliance upon the valuation methodology in its Opinion No. 154 was Aarbitrary and capricious.@ Farmers Union II, 734 F.2d at 1490. By 1985, the FERC, the last bastion for the outdated valuation methodology, adopted FERC=s 154-B methodology (which

continues to this day to use vestiges of the valuation methodology through the transition rate base).

Notwithstanding the clear and complete rejection of the underlying valuation methodology embodied in FERC=s 154 methodology once in 1978 and again in 1984, Olympic continued to collect rates based on FERC=s 154 methodology from 1983 through 1995. The result of Olympic=s years of continued collections under FERC=s discredited 154 methodology was Awindfall@ revenues. After having collected Awindfall@ revenues during these prior periods, for Olympic to now advance a methodology which includes a hypothetical calculation of deferred earnings from these prior periods for the purposes of setting current rates is simply not credible.

Q. Setting aside Olympic=s overcollections from prior periods, please explain whether a deferral methodology would be in the public interest to adopt for Olympic.

Adopting a deferral methodology under the circumstances of Olympic is not in the public interest and would not result in rational cost-based rate regulation. The basic concept behind any deferral methodology is to lower initial rates to more normalized levels by shifting the deferred cost or return component into later years. The primary reason the FERC adopted such an approach was to aid new pipelines in their efforts to compete with older more fully depreciated pipelines and with other alternative forms of transportation.

While the logic supporting the use of deferral methodologies may hold together when setting a new pipeline=s rates in a competitive marketplace, it makes no sense when setting an

older pipeline=s rates in a noncompetitive marketplace. Olympic is not a new pipeline. Olympic is the only pipeline which may serve the four refineries manufacturing petroleum products within the State of Washington. Olympic has no apparent competition for the services it provides and, in fact, has been an overnominated pipeline system for the past decade. In fact, Olympic has recently increased its interstate rates by 62% and its intrastate rates by 24.3% and continues to be overnominated. Under these circumstances, the logic underlying the use of a deferral methodology as a necessary means to achieve lower and more competitive rates is not persuasive.

In addition, the application of the deferred methodology, as Olympic has presented it, will not work toward the normalization of its rates, but will simply work to increase its rates throughout the remainder of its economic life. Under the circumstances of Olympic, Olympic=s ratepayers have not realized the theoretical benefit under a deferral methodology of having lower normalized rates in the earlier years. During the earlier years, Olympic=s ratepayers paid rates based on FERC=s 154 methodology which permitted the collection of higher rates than any nondeferred, cost-based methodology. To now force Olympic=s ratepayers to pay higher rates in the later years under the concept of a deferral methodology when they have already actually paid rates in the earlier years which are higher than any nondeferred, cost-based methodology would not be rational cost-based regulation.

Finally, there is no reason to add the complexity and potential risk of improper collections inherent in the adoption of a deferral methodology under the circumstances of

Olympic. The calculation of the deferred return, its amortization, and the inflation factors are all unnecessary complexities which may result in future rates deviating substantially from a proper cost-based rate. As a general regulatory matching principle, current rates should reflect the current costs of providing the service. Whenever costs or return from prior periods are included in current rates, the result is to skew this general regulatory matching principle by introducing the risk of intergenerational inequities. While certain circumstances may justify the application of such deferral concepts, Olympic does not present those circumstances.

Q. Please comment specifically on whether Olympic should be allowed to use a rate base methodology which includes a rate base write-up unrelated to its actual investment.

A0 Olympic should not be allowed to use a rate base methodology which includes a rate base write-up beyond its actual investment for several reasons. First, Olympic has not provided any support for why it should be allowed to write-up its rate base beyond its actual investment. Absent the clear demonstration of why it is entitled to write-up its rate base beyond its actual investment, its position should not even be considered.

Second, there is no basis to allow the write-up to the rate base set forth under the transition rate base calculation. Olympic should not, as the most basic principle of cost-based regulation, be permitted a return on investment it did not make. In contradiction to this basic principle, the transition rate base allows Olympic to recover a return for investment it did not make. No cost-based regulatory justification is possible for Olympic=s position.

Finally, every court or state regulatory agency to consider the issue of whether a transition rate base may be justified under similar circumstances has rejected it outright. In Farmers Union II the D.C. Circuit Court of Appeals rejected the need for a transition rate base to compensate for the change from an ICC valuation methodology to an original cost methodology. In so holding, the D.C. Circuit Court of Appeals stated:

> FERC failed to give a reasoned basis for its assumption that A[t]ransitional rate bases would have to be constructed@ at all. Regulated industries have no vested interest in any particular method of rate base calculation. See Federal Power Comm'n v. Natural Gas Pipeline Co., 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942). Accordingly, as FERC acknowledged, a switch to a new rate base formula would not disrupt protected pipeline property. So long as the resulting rates are reasonable, the oil pipeline companies should have no difficulty maintaining their financial integrity. We are therefore at a loss to understand FERC=s trepidation about a change in its regulatory method. Similarly, when this court granted FERC's request to remand this case Aso that it may begin its regulatory duties in this areas with a clean slate,@ Farmers Union I, 584, F.2d at 421, we specifically advised that the pipelines= reliance on an outdated rate base formula should not justify a continuation of the error. Rather, Athe solution is not to perpetuate that reliance but to end it prospectively, without allowing reparations based on its occurrence in the past.@ Id. at 419. We still adhere to that principle today.

Farmers Union II, 734 F.2d at 1517-18 (footnote omitted). See e.g., Cook Inlet Pipe Line Co. v. Alaska Pub. Util. Comm=n., 836 P.2d 343, 350 (Alaska 1992) (AEven if the APUC=s regulatory scheme has a detrimental effect on CIPL=s earnings, CIPL has made no showing that the scheme threatens CIPL=s financial integrity. See Farmer=s Union II, 734 F.2d at 1517-18. We conclude that the APUC=s application of an original cost rate methodology without a

transition rate base does not constitute an unconstitutional taking of CIPL=s property.@Cook Inlet Pipeline Co. v. Alaska Pub. Util. Comm=n., 836 P.2d 343, 350 (Alaska 1992)).

Q. Does Olympic provide substantive or conceptual support in its direct case for either the use of a deferral methodology or the use of a transition rate base write-up?

A. No. Olympic=s witnesses simply mechanically applied their version of FERC=s 154-B methodology and have provided no substantive or conceptual support for the Commission=s adoption of either a deferred methodology or a transition rate base write-up.

Olympic=s only argument in support of either the use of hypothetical deferred returns or a transition rate base seems to be that because the Commission has allowed Olympic=s rates to go into effect without investigation or hearing in the past, the Commission should be obligated to simply adopt whatever methodology underlay those rates when adjudicating rates in the future. Simply stated, the failure to adjudicate the issue of rate base methodology in the past does not justify the application of an improper methodology into the future. The issue in this proceeding is what is the proper methodology for setting future rates. This is an issue of first impression and should not be treated as though it has previously been adjudicated in the past when it has not.

Moreover, if the Commission starts down this road, it quickly ends in confusion created by Olympic because it has filed rates based on more than one methodology and more than one version of each methodology. Even in seeking its rate increases in the past year, Olympic has filed three different versions of FERC=s 154-B methodology and apparently intends to file a

fourth soon. None of the various methodologies Olympic has used in the past are correctly calculated or even consistent with each other.

Finally, even assuming the Commission had adjudicated the issue of a proper rate base methodology in the past and had decided to apply one of the various approaches Olympic has utilized in the past, the Commission still would not be bound to continue to use the prior methodology. It is a well settled principle of regulation that a regulated facility has no vested interest in any particular regulatory methodology.[4]

Q. Does Olympic=s direct case set forth a proper calculation of its rate base under FERC=s 154-B methodology?

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[4] This has been established law for decades. E.g., Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944) (Hope) (a public regulatory commission "was not bound to the use of any single formula or combination or formula[s]" in setting a rate base; Federal Power Comm'n v. Natural Gas Pipeline Co., 315 U.S. 575, 586 (1942); ("The designation of a single theory of rate making as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors."); Farmers Union II, 734 F.2d at 1517 ("Regulated industries have no vested interest in any particular method of rate base calculation.").

A. No. Olympic=s calculated rate base is substantially overstated under FERC=s 154-B methodology for two major reasons: (1) Olympic=s rate base is overstated by the amount of its calculation of the deferral of the nominal return on equity from the 1983 through 1995 period when, in fact, the rates it collected during that same period included not only a full return but overcollections; and (2) Olympic=s rate base is overstated by an unsupported and erroneous calculation of AFUDC.

Q. Please explain why Olympic=s inclusion of the deferral of the nominal return on equity in rate base is improper under the FERC=s 154-B methodology.

A. As noted above, through FERC Opinion No. 154-B, the FERC established its basic approach to regulating oil pipelines. In relevant part, FERC=s 154-B methodology was used to establish rates for those pipeline carriers who had open rate cases, but FERC did not require pipeline carriers with existing final rates to file new rates based on its new methodology. In Olympic=s case, at the time FERC adopted its 154-B methodology, Olympic had rates in effect. It did not file rates under its version of FERC=s new 154-B methodology (TOC with a transition rate base) until 1996. Accordingly, prior to 1996, Olympic=s rates could not possibly have contained any deferral of the nominal portion of the equity return as would have been otherwise required under the FERC=s 154-B methodology. Setting aside the conceptual contradiction in attempting to collect the nominal portion of the equity return twice, Olympic has cumulatively overcollected any total cost of service based on any cost-based approach to setting rates.

Q. Please explain why Olympic=s calculation of AFUDC under the FERC=s 154-B methodology is unsupported and erroneous.

A. Olympic=s calculation of AFUDC in its direct case is unsupported, erroneous, and inconsistent with its own initial tariff filing. Tesoro witness Grasso details the errors in Olympic=s own calculation. Essentially, Olympic included an abandoned project in the Construction Work In Progress (ACWIP@) costs in its July 30, 2001, filing. This had the effect of overstating Olympic=s rate base, its overall return allowance, its income taxes, and the rates Olympic placed in effect on September 1, 2001. In Olympic=s direct case, Olympic removed the abandoned-project costs from its CWIP; however, to date, Olympic has not modified its presently effective rates to remove the overstated costs included in those rates.[5] Also, Olympic has changed its Ain service@ ratio of AFUDC from its original tariff filing of 50% to its direct case filing of 100%. This change is completely unsupported.

B. RATE BASE

Q. Aside from the methodology issues you have discussed above, are there other potential rate base issues the Commission may need to decide?

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[5] Olympic=s intrastate rates have been suspended until September 1, 2002. Hence, if the filed rates are permitted to become effective at that time, they will be overstated because of the inclusion of this abandoned project in CWIP and the resulting AFUDC.

A. Yes. Olympic=s direct case includes the Bayview terminal as property in service. The Bayview terminal was intended to be a batching terminal which, when in service, would increase Olympic=s throughput from 35-40,000 barrels per day (ABPD@). Even though Olympic has and is continuing to treat the Bayview terminal as property in service, the Bayview terminal was only substantially utilized for a few months prior to the Whatcom Creek incident and is currently out of service. As it stands today, Olympic is treating the Bayview terminal as plant in service, but is not including the throughput which Olympic has represented will be available when the Bayview terminal is in service. Olympic cannot be allowed to have it both ways. Either the Bayview terminal should be treated as plant in service and its represented throughput should be included in the rate calculation, or the Bayview terminal should not be treated as plant in service and its represented throughput should not be included in the rate calculation. Given Olympic=s representations that the Bayview terminal may be put in service in the near future, my recommendation is to allow Olympic to continue to treat the Bayview terminal as plant in service provided that the represented throughput is also included in the rate calculation.

C. RETURN ON RATE BASE

Q. Please explain your position as to Olympic=s calculation of return.

A. Tesoro=s witness Hanley is a rate of return expert, and I would defer to his testimony on this matter. That being said, there is a point brought forward by Mr. Hanley that I believe one does not have to be a rate of return expert to express and is important to emphasize--Olympic should not be rewarded for financial imprudence.

A pipeline carrier should maintain sufficient equity (or have owners willing to invest additional equity as may be needed) to attract capital and to respond when the risks of transporting petroleum products are realized. Olympic put itself unnecessarily at financial risk by imprudently adopting a dividend policy of 100% of net income for the past decade while also investing $21.5 million in the failed and now abandoned Cross-Cascades project. When Olympic distributes its equity to its owners and then takes substantial ownership risks without the safety of additional equity and when Olympic=s owners refuse to reinvest equity when needed, the result is an undercapitalized company without access to the equity capital necessary to manage the risks of ownership. The Whatcom Creek incident simply realized Olympic=s imprudently taken financial risk of operating an undercapitalized pipeline carrier.

In the case of Olympic, its undercapitalization is an owner issue not a ratepayer issue. The shippers may only be expected to pay just and reasonable rates based on Olympic=s prudently incurred costs of providing the service they receive. Just and reasonable rates will not and should not eliminate the risks of ownership which are associated with failed projects, such as the Cross-Cascades Project, or catastrophic events caused, in part, by operator imprudence, such as the Whatcom Creek incident. Beyond the point of just and reasonable rates, Olympic or its owners will have to assume the risks of ownership and not expect that their ownership losses may be shifted to their ratepayers through asking for rates based on equity capital they are unwilling to maintain or invest.

Q. Please explain what steps the Commission should take to ensure that Olympic is properly capitalized.

A. Tesoro witness Hanley has recommended that Olympic=s owners invest additional capital and forgive much of the debt they have burdened Olympic with as the result of their unwillingness to realize the losses from the Whatcom Creek incident. He has also suggested that the Commission set rates based on Olympic=s actual capital structure unless it is recapitalized prudently. He has also suggested limiting the payment of dividends. Again, I agree with his recommendations and believe that proper regulation of Olympic mandates such steps be taken.

D. OPERATING COSTS

Q. Please explain what base and test year periods are appropriate for setting rates in this proceeding.

A. Olympic has indicated that it will rely upon its Case 2 base and test periods. For simplicity of comparison in this proceeding, I recommend Olympic=s Case 2 base period of October 1, 2000, through September 30, 2001, be used. With regard to the test period, I believe Olympic=s proposed test period provides helpful guidance but should be applied flexibly when good cause requires.

Q. Please explain whether you are concerned with Olympic=s inability to provide information as to its actual costs which have been subject to a proper external audit.

A. I am very concerned with Olympic=s inability to provide audited financial books and records. Typically a regulated common carrier has its financial books and records audited each year and

will have an unqualified audit letter issued by an independent accountant that states that the company=s financial books and records accurately reflect the company=s actual financial condition. The lack of an audit and the lack of an unqualified auditor=s letter is a very real concern under normal circumstances. Absent an unqualified audit letter, there is no assurance that the financial information Olympic has provided in support of its rate increase or to the parties through discovery accurately reflects its actual financial condition.

Under the conditions of this proceeding, however, there is even more reason for concern. This proceeding concerns a 62% rate increase--an extraordinary request from a pipeline carrier who was allowed its full requested rate increase just three years ago. Also, during every prior rate request of which I am aware, Olympic has provided the Commission with financial information based upon financial books and records which have been subject to audit and upon which an unqualified audit letter has been issued. The fact is that Olympic has been unable to get its 1999, 2000, or 2001 audits completed or an unqualified audit letter issued notwithstanding its efforts to do so over the last three years. Olympic has also had three changes in its basic accounting system in as many years. Its former operator used one accounting system and was discharged in June of 2000. Its current operator started using a second accounting system when it was retained in July of 2000, and then changed its accounting system to a third accounting system in May of 2001. Tesoro, through difficult discovery, has taken the extraordinary step of requesting Olympic=s auditors= workpapers so that it could independently review the causes for the delay.

Finally, Olympic has continually represented that obtaining its audit and getting an unqualified audit letter would not take very long or be a major problem. When this Commission raised its concern with the lack of audited financial information during the interim proceeding, Olympic minimized the issue and indicated that it would have the audit complete in time for its general rate case. Specifically, the exchange was as follows:

> COMMISSIONER HEMSTAD: I have one question for Mr. Marshall. Would the company be able to have available for the general rate case, in an appropriate time frame, an audit of the books?
>
> MR. MARSHALL: I spoke to Mr. Fox yesterday about this very issue. I said, Well, help me understand what this real issue is. He said it=s actually a fairly minor issue about amounts on books, and he thinks that that can be resolved here in a relatively short time. But he=s gone back to the auditors and said, Look, this has created an issue. So I believe I can represent to you, Commissioner Hemstad, that that will be resolved and we will have audited financial statements.
>
> And it's only because '99 is hung up that the others get hung up. You know, you hang up one and then it stacks up, like the freeway. <u>So not only can we get you audited statements here, I believe in the next couple weeks, certainly before -- much before the end of the general rate case, before, I think, Commission Staff has to put on their rate case, but we can get you the closing numbers for the 2001 year</u>, which unfortunately are nowhere near as rosy as the predictions were when we made them in November, unfortunately. But we will be amending and providing additional data.

WUTC Interim Hearing, Closing Argument, Tr. Vol. 11, Jan. 24, 2002, p. 1303, l. 25, through p. 1304, l. 25 (underscore added).

Olympic has not completed its audit as it represented it would. Under these circumstances, neither this Commission nor I may have any confidence that the operating cost

information that Olympic has provided in support of its rate case accurately reflects its actual financial condition. This is very troubling.

Q. Please briefly explain the importance of the proper rate treatment for base period costs so they may reflect expected future cost performance.

A. It is very important to assure that future rates most accurately reflect future costs. To give an example, if Olympic were not to remove a $100 one-time expense from its base period, then Olympic would collect the $100 expense as a recurring expense each and every year the rates were in place, when, in fact, it only incurred a $100 nonrecurring expense under its prior rates in a prior period. Assuming the rates were in effect for five years, then, under this first example, Olympic would collect $500 when its true expense during the period the future rates were in effect would be $0. Similarly, if Olympic were to inadvertently characterize a $100 capital expense as a recurring expense in its base period, then again it would collect the $100 expense as a recurring expense each and every year the rates were in place, when, in fact, it should have added only $100 to its rate base and recovered it through a depreciated expense with return and a tax component over the life of the pipeline. As may be seen, the proper adjustments to base period expenses are very important when establishing rates for future periods.

Q. Please identify the major areas in this proceeding in which Olympic has substantially overstated its operating costs.

A. Based upon my review, Olympic has failed to support its test period adjustments or has substantially overstated its costs in the following five major cost categories: (1) Outside

Services; (2) Other Expenses; (3) Materials and Supplies; (4) Rentals; and (5) Operating Fuel and Power. Importantly, except as set forth in the testimony below, I accept Olympic=s Case 2 test period operating costs. My acceptance is, however, conditional upon my further review of the prefiled testimony of the other parties to this proceeding. Following is a discussion of the reasons why Olympic=s Case 2 test period operating costs are not acceptable for rate setting purposes with a recommendation as to what operating costs would be appropriate.

Q. Please explain how Olympic has overstated or failed to support its Case 2 Outside Services costs.

A. In Exhibit No. ____ (CAH-4), Schedule 21.5, ln. 16, Olympic requested approximately $9.3 million in test period adjusted costs for Outside Services. Through this request, Olympic has overstated or failed to support these costs by improperly including (1) $5.6 million in one-time maintenance costs, (2) $1.2 million in remediation costs, (3) an unamortized $1 million in regulatory expenses for legal and consulting services; and (4) $455 thousand in operator-transitional costs. When properly adjusted, Olympic=s test period costs for Outside Service should be approximately $1.2 million.

Q. Please explain why $5.6 million in one-time maintenance costs should not be included in Outside Services costs.

A. Olympic has adjusted its base period costs for Outside Services upward by $5.6 million to reflect budgeted one-time maintenance costs for 2002. Future rates should not include one-time maintenance items from either the base period or the test period. When setting future

rates, the base period actual costs may not be adjusted upward based on some future budget for one-time expenses. By their very nature, one-time expenses may not be expected to recur during the future periods in which the future rates are to be collected. Also, $4.3 million of this $5.6 million is included in Olympic=s books as a carry-over expense. Thus, the expense is not only a one-time expense, but an expense for an item which should have already been completed. Accordingly, I recommend one-time maintenance costs of $5.6 million be excluded from Outside Services.

While Olympic did not provide support for any alternative rate treatment for any of the items within this $5.6 million, one-time maintenance category, it may well be that a portion of this $5.6 million is associated with capital items and not expense items. For example, within this $5.6 million is $455,000 for lowering the pipeline over the East Creek. Clearly, this is not a recurring expense, but it may well be a capital expense which should have been added to Olympic=s rate base. At any rate, Olympic is not entitled to adjust its base period costs for Outside Services upward to include one-time maintenance items as recurring expenses.

Q. Please explain why $1.2 million in remediation costs should not be included in Outside Services costs.

A. Olympic accrued $6.4 million for remediation by December of 2000 and estimated that, of this $6.4 million, $1.2 million would be spent for remediation in 2001. The $1.2 million should not be permitted for rate purposes. There is no support that Olympic actually spent or will spend any remediation funds during either the base or test period. A revenue requirement is based on

actual, not estimated expenses. Olympic has not demonstrated that it has or will incur any actual costs associated with its estimated remediation. Additionally, it appears that the $6.4 million includes estimated remediation expenses for both Bellingham and Sea Tac. The Bellingham estimate is related to the Whatcom Creek incident and the Sea Tac estimate is related to a facility Olympic no longer owns. Neither of these is proper to include within rates. As to the remediation of the oil spilled during the Whatcom Creek incident, Olympic has represented that the direct costs associated with the Whatcom Creek incident should not be included within its rates. Notwithstanding making this representation, Olympic has improperly included the projected costs associated with the remediation of the petroleum products spilled during the Whatcom Creek incident. Finally, there is no evidence that Olympic=s remediation costs will be recurring or will even be spent and so should not be permitted in future rates. Accordingly, I recommend Olympic=s estimated $1.2 million in remediation cost not be permitted for rate purposes.

Q. Please explain why an unamortized $1 million in regulatory expenses for legal and consulting services costs should not be included in Outside Services costs.

A. Olympic has adjusted its base period costs to include approximately $1 million in regulatory expenses for legal and consulting services. Again, Olympic has not supported its estimated spending. Moreover, the $1 million expense reflects unusual circumstances for Olympic which will not recur each year. Olympic has two full rate cases as well as compliance requirements imposed upon it by OPS and DEC. This heightened level of regulatory activity may not be

expected to continue. Typically, under such circumstances, the regulatory expense would be amortized over a period of time to reflect a normalized level for these expenses. Accordingly, I recommend that the $1 million be amortized over a five-year period to normalize the expense.

Q. Please explain why $455,000 in operator transitional costs should not be included in Outside Services costs.

A. Olympic has included $455,000 in costs for changing from one operator to another. This $455,000 is based on a five year amortization of $2.3 million in total transitional costs purportedly charged Olympic by BP for becoming Olympic's new operator on July 1, 2000. First, this expense is related to an event which occurred prior to the base period of October 1, 2000, through September 30, 2001. Hence, there is no basis for inclusion of such cost in the test period cost of service.

Second, the change from one operator to another is not related to the service provided to the shippers. Olympic has not advanced any reason related to the service it provides to its shippers to support the need for a change from one operator to another. In fact, Olympic has asserted that the pipeline was operated safely by its prior operator. Moreover, to the degree Olympic could have had any concern with the safe operation of the line, it could have imposed new or different operating standards on its prior operator rather than changing operators.

Finally, and just as importantly, the change of operators seems to have arisen as a direct result of a change in the majority ownership of Olympic. The new majority owner decided, for unsubstantiated reasons, that it would prefer to have an affiliated entity operating

Olympic. While the new majority owner may choose to have its affiliate operate Olympic, the change was not for the benefit of Olympic=s shippers and they should not be required to pay for the transition costs associated with the change of operators. Accordingly, I recommend the $455,000 be excluded from Outside Services costs.

Q. Please explain how Olympic has overstated or failed to support its Case 2 Other Expense costs.

A. In Exhibit No. ____ (CAH-4) Schedule 21.8 lns. 1 & 2, Olympic has indicated its adjusted test period expenses for Other Costs were $3.2 million while its actual base period expenses for Other Costs were $2.3 million. Olympic=s request represents a test period adjustment of approximately $900,000. This $900,000 test period adjustment is entirely unsupported. It appears to be based upon an amount which was initially budgeted in 2000 for the year 2002 based on the estimates in the management contract with the new operator. Stated differently, the $900,000 represents the additional amount Olympic initially budgeted; however, Olympic has not presented any evidence that the additional has been, or will be, spent. In other words, there is no basis for including in Olympic's test period costs an amount which was budgeted two years ago. Accordingly, I recommend that the amount actually incurred by Olympic during the base period be included in the test period costs. This means that $900,000 should be excluded from Other Expenses costs.

Q. Please explain how Olympic has overstated or failed to support its Case 2 Materials and Supplies costs.

A. In Exhibit No. ____ (CAH-4) Schedule 21.4 lns. 1 & 2, Olympic has indicated its adjusted test period expenses for Material and Supplies were $1.9 million while its actual base period expenses for Material and Supplies were $1.3 million. Olympic=s request represents a test period adjustment of approximately $600,000. This $600,000 test period adjustment is entirely unsupported. In fact, based on the testimony of Olympic=s witness Hammer, the amount proposed by Olympic for Materials and Supplies is the budgeted amount for 2002. In view of the complete lack of support for the amount proposed by Olympic, the amount which should be included for rate setting purposes is the actual expenses during the base period and not the amount which was previously budgeted to be spent during that period. Accordingly, I recommend that the adjustment proposed by Olympic of approximately $600,000 be excluded from Materials-and-Supplies costs.

Q. Please explain how Olympic has overstated or failed to support its Case 2 Rental costs.

A. In Exhibit No. ____ (CAH-4) Schedule 21.9 lns. 1 & 2, Olympic has indicated its adjusted test period expenses for Rental were $712,000 while its actual base period expenses for Rental were $540,000. Olympic=s request represents a test period adjustment of approximately $172,000. This $172,000 test period adjustment is entirely unsupported. As with Other Expenses and Materials and Supplies, the greater amount proposed by Olympic, per the

testimony of witness Hammer, is the amount budgeted for the year 2002. In view of the failure to support the proposed amount, the amount which should be included for rate-setting purposes is the actual expenses during the base period. Accordingly, I recommend that the adjustment of $172,000 be excluded from Rental costs.

Q. Please explain how Olympic has overstated or failed to support its Case 2 Fuel and Power Costs.

A. In Exhibit No. ____ (CAH-4), Schedule 21.6, lns.1 & 4, Olympic has indicated its adjusted test period expenses for Fuel and Power Costs were $9.4 million while its actual base period expenses for Fuel and Power Costs were $4.8 million. Olympic=s request represents a test period adjustment of approximately $4.6 million. This adjustment is supported by a schedule which determines the test period unit price for electrical power based on the highest rather than the average electrical rate during the test period. This calculation skews the Fuel and Power Costs significantly upward and does not reflect the likely electric rates during the period in which the rates at issue in this proceeding will be in effect. Tesoro=s witness Grasso has recalculated the Fuel and Power Costs based on the more likely rates and has determined that $8.2 million is an appropriate level for those expenses. Accordingly, I recommend $1.2 million be excluded from Fuel and Power Costs.

It is important to note that this fuel calculation by Tesoro witness Grasso is based on the likely cost of electricity for transporting a barrel of product multiplied by the total number of barrels expected to be transported. As such, the $8.2 million is the cost of Fuel and Power for

transporting 121,349,000 barrels per year (ABPY@) and not the 105,897,000 BPY Olympic is using as the basis for its revised rates. Accordingly, the $8.2 million would be substantially overstated for Fuel and Power costs if Olympic=s estimate of 105,897,000 BPY were to be used.

Q. In making recommendations as to the level of operating costs to be included in rates, have you taken into consideration whether the costs you are recommending will allow Olympic to operate safely?

A. Yes, I certainly have taken safety into consideration. It is in everyone=s best interest that Olympic operate the pipeline safely in the future. The long-term costs and potential disruptions to business caused by the unsafe operation of Olympic are far greater than the costs of operating safely.

The rates I have recommended allow Olympic to recover <u>every</u> dollar it has invested into every capital project Olympic has identified as necessary to comply with OPS=s and DEC=s safety requirements as well as every capital project Olympic has identified as necessary for any reason to continue to operate the pipeline. This is no small matter given that Olympic is adding approximately 24.3% total gross plant in service in only three years. The rates also allow Olympic <u>significant increases</u> in several operating costs areas such as Management Fees, Salaries, and Insurance. The rate structure I have recommended will provide an apparently needed incentive for Olympic to more expeditiously comply with OPS=s safety requirements and return its pipeline to normal operating pressure. It should be simply unacceptable that

Olympic will take five years or more to comply with the safety requirements necessary to operate at normal operating pressures. Finally, the capital structure and return recommendations by Tesoro=s Witness Hanley, which I endorse, will provide another apparently needed incentive for Olympic and its owners to operate a prudently capitalized company, instead of continuing to operate a petroleum products line without the equity or access to equity capital to properly manage the risks of ownership. In short, the rates and rate structure I have recommended will provide needed improvements to the safety performance of Olympic.

I would like to emphasize one point regarding safety--the largest single risk to Olympic=s safe operation of the pipeline is its imprudent capitalization. Equity capital is necessary to prudently manage the risks of ownership. Moreover, Olympic=s decisions to distribute all its equity capital to its owners, to invest heavily in failed projects, and to imprudently operate the pipeline are the reasons Olympic is undercapitalized. Stated differently, the reason Olympic is undercapitalized is not Olympic=s under recovery of its proper costs from its ratepayers. In fact, as Tesoro=s witness Grasso demonstrates, Olympic has overcollected rates from its ratepayers in prior years.

E. THROUGHPUT

Q. Please explain the importance in this proceeding of properly determining a representative level of throughput for the years in which the rates at issue will be collected.

A. Once a revenue requirement is determined, the revenue requirement is divided by expected annual throughput to determine just and reasonable rates for the future. To the degree Olympic is able to understate throughput for rate setting purposes but achieve higher throughput in future operations, it will realize a Awindfall@ profit. In this proceeding throughput is a substantial issue. It is also a difficult issue to estimate with a high degree of certainty.

Olympic has based its direct case on a throughput estimate of 105,897,000 BPY or 290,000 BPD. My recommendation, which I believe understates likely actual throughput in future periods, is to base rates on 121,349,000 BPY or 332,500 BPD. Thus, my recommendation is approximately 15,452,000 BPY or 42,500 BPD greater than Olympic=s recommended throughput. As one can tell, the resolution of the throughput issue may substantially impact rates.

Q. You have indicated that Olympic has substantially understated its throughput for rate setting purposes. Please explain.

A. To begin, Olympic has advanced an unsupported and erroneous calculation of its expected throughput. Olympic=s calculation assumes that its throughput during the period future rates are collected will be 105,897,000 BPY or 290,000 BPD. Olympic=s calculation of throughput (1)

improperly excludes throughput attributable to the pressure restriction imposed by OPS as the result of Olympic=s imprudent operation of the pipeline; (2) fails to take into consideration the throughput impact from the downtime and disruptions associated with Olympic=s unusually high level of capital and major maintenance projects during the test period; (3) fails to take into consideration the throughput impact from the Bayview terminal; and (4) fails to take into consideration the increased throughput resulting from Olympic=s new batching and throughput control procedures, systems, and software.

Q. Your first reason Olympic understated throughput was that Olympic did not calculate throughput at normal operating pressures. Please explain further.

A. On June 18, 1999, OPS limited Olympic to operating its pipeline system at 80% of its normal operating pressure. This pressure restriction substantially reduced the amount of throughput which may be shipped through Olympic=s pipeline system. Olympic has assumed that this pressure restriction and the lower level of throughput will continue during the future periods when its rates may reasonably be expected to be collected.

There are four reasons why Olympic=s rates should be set based on its throughput at a normal operating pressure in this proceeding: (1) the pressure restriction is the result of Olympic=s imprudent operation of its own pipeline, and the economic consequences for its imprudent operation should be borne by Olympic and its owners and not by its ratepayers; (2) the pressure restriction was imposed approximately three years ago, and Olympic should have prudently taken the necessary steps to comply with OPS=s safety requirements to have the

pressure restriction lifted well before now; (3) the pressure restriction is likely to be lifted within the near future assuming Olympic=s prudent operation of the pipeline; (4) setting rates based on full operating pressure will serve as a reasonable and apparently needed incentive for Olympic to expeditiously comply with the regulatory and safety requirements of OPS as may be necessary to bring the system into full operation. Under these circumstances, Olympic=s rates should be set based on its throughput at normal rather than restricted operating pressure.

Q. Please explain why the pressure restriction is the result of Olympic=s imprudent operation of its pipeline.

A. Olympic=s pressure restriction is a regulatory restraint which was imposed on its system as the result of OPS=s heightened regulatory oversight of the pipeline. OPS=s heightened regulatory oversight resulted directly from the Whatcom Creek incident of June 10, 1999. As such, the financial impact from the imposition of the pressure restriction arose out of Olympic=s imprudent operation of the pipeline and should be borne by Olympic and its owners and not by its ratepayers.

The Whatcom Creek incident resulted in the deaths of three young people due to the escapement into Whatcom Creek and subsequent explosion of gasoline being transported through the pipeline by Olympic. Criminal charges have been brought against Olympic and certain of its employees for their role in the Whatcom Creek incident. There are currently over 20 civil lawsuits to which Olympic has been named a party for its role in the Whatcom Creek incident. OPS imposed the largest fine in its history ($7 million) on Olympic as the result of

Olympic=s role in the Whatcom Creek incident. It would be hard to imagine a clearer case of imprudent operation of a pipeline. Under such circumstances, the direct and indirect financial impacts of Olympic=s imprudent operation of the pipeline should be borne by Olympic and its owners and <u>not</u> by Olympic=s ratepayers.

For its part, even Olympic has agreed that the <u>direct</u> costs associated with the Whatcom Creek incident should not be recovered from its ratepayers, and it has asserted in its direct case that it has removed all of the <u>direct</u> costs associated with the Whatcom Creek incident from its rate filings. What Olympic has not done is remove the <u>indirect</u> costs associated with the Whatcom Creek incident from its rate filings. As to the indirect costs, Olympic has, by judicial admission, acknowledged that it has not even accounted for or tracked the indirect costs associated with the Whatcom Creek incident.

With regard to the pressure restriction, the pressure restriction is but one of many consequences resulting from Olympic=s imprudent operation of the pipeline. As such, the financial impact resulting from the pressure restriction should be borne by Olympic and its owners and not by its ratepayers through understated throughput and consequently higher rates.

Q. Please explain why the prudent operation of the pipeline would have resulted in compliance with OPS=s safety requirements for lifting the pressure restriction before now.

A. Olympic is operated by BP Pipelines, and prior to its operation by BP Pipelines it was operated by Equilon. BP and Equilon are both large, capable operators. Olympic is owned by Atlantic Richfield (ARCO) and Equilon. Olympic=s owners have billions of dollars in cash assets. Its current operator, BP Pipelines, is the second largest liquids pipeline company in the United States. BP Pipelines transports over 450 million barrel miles of liquids each day or 9 percent of the entire United States= liquids pipeline market. Given this vast network of resources, Olympic has no excuse for not having yet fully complied with OPS=s safety requirements to operate its system at normal operating pressures.

Notwithstanding the availability of such resources, three years is more than an adequate time to have complied with the safety requirements of OPS necessary to operate the pipeline at normal operating pressure. In my opinion, the prudent operation of the pipeline would dictate that the safety requirements to operate at normal operating pressure would be the highest priority for Olympic. Instead, it appears that Olympic has devoted resources to other projects. Olympic=s ongoing failure to comply with OPS=s safety requirements necessary to operate the pipeline at normal operating pressure should be a major regulatory concern. At any rate, even if imposition of the pressure restriction was not the result of Olympic=s imprudence (which it appears to be), Olympic should be expected to act in a prudent and efficient manner to comply

with OPS=s safety requirement as may be necessary to operate its system at its normal operating pressure. To date, it has been almost three years since the Whatcom Creek incident and Olympic has yet to even complete the testing of its pipeline system necessary to evaluate any outstanding safety issues. This simply should be unacceptable.

Q. Please explain why the pressure restriction is likely to be lifted within the near future.

A. Olympic seems operationally capable of complying with OPS=s safety requirements in order to operate its system at normal operating pressure within the very near future. As noted above, Olympic has already had more than enough time to comply with those safety requirements. Instead of making compliance with OPS=s safety requirements a priority, however, Olympic has apparently chosen to complete unrelated projects. While Olympic may argue it should be able to operate as it chooses, its ratepayers should not be required to pay for the imprudent choice of failing to promptly comply with OPS=s corrective action order.

Q. Please explain why setting the rates based on Olympic=s throughput at full operating pressure will operate as an incentive for Olympic to more expeditiously comply with the OPS=s safety requirements.

A. Olympic apparently needs an economic incentive to more promptly comply with the OPS=s safety requirements and bring its system up to normal operating pressures. Olympic has advanced a direct case which assumes that the OPS=s safety requirements may not be fulfilled until 2004--five years after the events resulting in the safety requirements being imposed on

Olympic. This is a wholly unreasonable assumption under the circumstances, and seems designed to ensure its rates are set based on artificially constrained throughput levels.

It is of note that Olympic=s estimates of when the pressure restriction may be lifted have substantially changed throughout the course of this proceeding. It originally estimated it would have the pressure restriction lifted by 2003. Now, it is estimating that the pressure restriction will not be removed until 2004 or possibly in 2005.

Allowing Olympic to recover its full revenue requirement at artificially lowered throughput levels would remove any incentive Olympic may have to comply with OPS=s safety requirements, at least during the period in which its rates are contested. In short, Olympic has no incentive to operate its system at normal throughput levels or at normal operating pressure during the period in which its rates are in dispute. Olympic=s rates should be set based on its throughput at normal operating pressures to provide a long overdue incentive for Olympic to fully and expeditiously comply with OPS=s safety requirements.

Q. Your second reason Olympic understated throughput was that Olympic did not take into consideration unusually high levels of down time. Please explain further.

A. One of the most important constraints to a pipeline=s throughput during a particular period is the amount of downtime for the system. Olympic=s throughput estimate as well as its recent actual throughput performance does not take into consideration what may be expected to be an unusual and nonrepresentative amount of downtime for the system as the result of the historic levels of capital and major maintenance projects Olympic has recently undertaken.

Q. Your third reason Olympic understated throughput was that Olympic did not take into consideration the additional throughput from the Bayview terminal. Please explain further.

A. In 1998, Olympic had filed for and received a full rate increase which was allowed to go into effect without a rate proceeding. The basis for its rate increase was its representations that the increase was necessary to bring the Bayview terminal on line. The Bayview terminal is a batching terminal which, when operating, will allow Olympic to increase throughput on the pipeline system from 35-40,000 BPD[6]. Olympic has collected increased rates to reflect the Bayview terminal costs and has depreciated this terminal as though the terminal were in service for over three years.

It now is apparent that the Bayview terminal was only substantially used as a batching terminal for a few months prior to the Whatcom Creek incident. It is very clear that the Bayview terminal is not in service today and has not been in service since it was bypassed after the Whatcom Creek incident.

Olympic has not advanced any reason which adequately explains why the Bayview terminal continues to be out of service. Moreover, there is no reason to believe the Bayview

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[6] In its filing to increase its rates to reflect the Bayview Terminal costs, Olympic stated that the terminal would enable to increase in throughput of 35-40,000 BPD.

terminal will continue to be out of service during the period in which the rates at issue will be in effect. Under these circumstances, there is a choice. Either the Bayview terminal should be taken out of the rate base because it is not in service or the Bayview terminal should be allowed to remain in the rate base and its represented throughput should be considered when setting future rates. My recommendation is to allow the Bayview terminal to continue to be included in rate base and to also include its represented throughput when setting future rates.

Q. Your fourth reason Olympic understated throughput was that Olympic did not take into consideration the increased throughput resulting from Olympic=s new batching and throughput control procedures, systems, and software. Please explain further.

A. Beginning in 2000, Olympic has implemented new batching and throughput management procedures, systems, and software. The import of these new procedures is to enhance the throughput capacity of Olympic=s system. In effect, Olympic is able to run longer batches of similar products through the pipeline to minimize the inefficiencies associated with shifting among batches.

Q. Given the flaws you have pointed out in Olympic=s estimate of throughput, please explain your recommendation as to how throughput should be determined for rate setting purposes.

A. When filing for its rate increase for the Bayview terminal, Olympic represented that once the Bayview terminal was on line, its pipeline system would operate at 121,349,000 BPY or 332,500 BPD. Olympic=s representations are the most recent and only estimates as to

Olympic=s throughput capacity with the Bayview terminal in service and with the pipeline operating at normal operating pressures.

Stated differently, the 121,349,000 BPY capacity is also the throughput which Olympic used when calculating its current final rates, the rates it has filed to revise through its rate filings initiating this proceeding. In effect, Olympic is attempting to reduce the throughput underlying its own current final rates from 121,349,000 BPY to 105,897,000 BPY. Olympic has not met its burden of proof necessary to establish that its proposed throughput is representative of its likely future throughput. Olympic=s attempt to reduce the throughput basis for its underlying rates by 15,452,000 BPY or approximately 13% in an attempt to justify its presently proposed rates is simply unsupported by any reasonable estimate of the throughput likely to be transported during the period in which the rates at issue will be in place.

It is important to note that Olympic=s representations as to its own capacity underlying its current final rates represent a <u>minimum</u> throughput level for the Olympic pipeline system during the future. I suggest this is a minimum level of throughput for the fully operational system because Olympic=s estimated throughput at the time of its Bayview filings did not reflect several changes subsequent to the filing that would increase Olympic=s throughput capacity beyond the represented level. To cite one example, Olympic has adopted new batching and throughput control procedures, systems, and software. The effect of these changes has been to allow Olympic to operate with larger batches of similar product and therefore attain higher levels of throughput than under previous operating procedures.

To cite a second example, even though Olympic represented that the operation of the Bayview terminal would increase throughput 35-40,000 BPD, Olympic actually only increased throughput by approximately 13,000 BPD above the actual throughput for 1998 (the year immediately prior to the time the terminal was placed in service) when it established its current final rates. Hence, once the Bayview terminal is brought back on line, Olympic's throughput may reasonably be expected to exceed the 121,349,000 barrels I have recommend be used for setting rates.

VI. CONCLUSION

Q. Please state the conclusion you have reached.

A. Olympic=s direct case does not support a rate increase. Olympic wants its cost of service to be based on one-time expenses when they may not be expected to recur, a very high level of equity when it has no equity at all, a hypothetical calculation of deferred earnings from a period when it actually overcollected its return, a return for investment when it never made the investment, and throughput at artificially constrained levels when it may be expected to operate normally in the future. Simply stated, Olympic should not be allowed, through any method, to shift its prior ownership losses due to failed investments, imprudent operations, and extraordinary events onto its shippers through these various ratemaking contrivances.

Q. Does this conclude your testimony?

A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that on May 13, 2002, a true and correct copy of the foregoing document was hand delivered to the following at the WUTC settlement proceedings:

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Exhibit No. _____ (JFB-1T)
Docket No. TO-011472
Witness: John F. Brown

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION	)	
	)	**DOCKET NO. TO-011472**
Complainant,	)	
	)	
v.	)	
	)	
OLYMPIC PIPE LINE COMPANY, INC.	)	
	)	
Respondent.	)	
______________________________________	)	

GENERAL RATE CASE

Prepared Direct and Answering Testimony of

JOHN F. BROWN
Brown, Williams, Moorhead & Quinn, Inc.

on Behalf of Intervenor
Tesoro Refining and Marketing Company

May 13, 2002

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TESTIMONY OF JOHN F. BROWN

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Appendix A: Resume