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Exhibit No. T ___ (MLT-1T)
Docket No. TO-011472
Witness: Maurice L. Twitchell

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

TESTIMONY OF
MAURICE L. TWITCHELL

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

MAY 24, 2002

WUTC DOCKET NO. TO-011472
190 IT
ADMIT W/D ☐ REJECT ☐

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TO
TESTIMONY OF MAURICE L. TWITCHELL

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Maurice L. Twitchell. My business address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington 98504-7250.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Consultant.

I. QUALIFICATIONS

Q. WHAT ARE YOUR EDUCATION AND EXPERIENCE QUALIFICATIONS?

A. I am a graduate of Brigham Young University, holding a Bachelor of Science degree with a major in Accounting and a minor in Business Administration and Economics, having graduated in June 1970. While in the employment of the Commission, I have participated in or been in charge of numerous Staff studies and accounting examinations, including telephone cases involving QWEST (US WEST, Pacific Northwest Bell Company), VERIZON (General Telephone Company of the Northwest, Inc.), Sprint (United Telephone Company of the Northwest), Pacific Telecom, Inc., and many of the other Local Exchange Companies. I have also participated in examinations of Avista Corporation (The Washington Water Power Company), Puget Sound Energy (Washington Natural Gas Company and Puget Sound Power and Light), and Pacific Power & Light Company. I have also participated in examinations of several water and transportation companies.

In addition, I was the Accounting Advisor to the WUTC Commissioners for eight years over the period 1981 to 1989.

II. RESPONSIBILITIES

Q. WHAT ARE YOUR RESPONSIBILITIES IN DEVELOPING COMMISSION STAFF'S RECOMMENDATIONS IN THE OLYMPIC PIPE LINE RATE CASE, DOCKET NO. TO-011472?

A. I have been assigned to address the issues of Federal Income Taxes and the appropriate Rate Base. I assisted in the audit of Olympic Pipe Line's (Olympic) records, and I address several problems with Olympic's accounting records. I explain the differences between Olympic's presentation of the FERC methodology and the WUTC methodology. I also discuss the allocation of Olympic's Total Company Results of Operations between Interstate and Washington Intrastate operations.

III. SUMMARY OF RECOMMENDATIONS

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. Staff recommends that the interim rates approved February 2002, be terminated, and the Company be allowed to file tariffs designed to provide the Company the opportunity to collect total revenues of $14,641,838 for the state of Washington. This is an increase in permanent rates of $78,614. or 0.54 per cent. The Commission should not require the Company to refund revenues collected because the Company has not overearned while interim rates have been in effect.

To set intrastate rates Staff recommends the Commission adopt the rate base/rate of return methodology the Commission traditionally uses. The Commission should reject the FERC methodology for setting intrastate rates. The Commission should use the separated results of operations for the state of Washington as presented by the Company and Staff (Exhibit No. ___(MLT-3), for setting intrastate Washington tariff rates. To set intrastate rates, the Commission should use an annual throughput of 58,188,628 barrels.

IV. EXHIBITS SPONSORED BY MR. TWITCHELL

Q. WHAT EXHIBITS DO YOU SPONSOR IN THIS CASE?

A. I sponsor Exhibit No. ___ (MLT-2), which compares the FERC and WUTC methodologies; Exhibit No.____ (MLT-3), which provides total Company operations and allocated Washington intrastate operations; Exhibit No. ___(MLT-4), which provides the summary of the restating actual and pro forma results of operation for the twelve months ending December 31, 2001; Exhibit No. ___(MLT-5), which provides each restating actual adjustment for total Company operations; Exhibit No. ___(MLT-6), which provides each pro forma adjustment for total Company operations; Exhibit No. ___(MLT-7), which provides the summary of the restating actual and pro forma results of operations for intrastate Washington; Exhibit No. ___(MLT-8), which provides each restating actual adjustment for intrastate Washington operations; Exhibit No. ___(MLT-9), which provides each pro forma adjustment for intrastate Washington operations; and Exhibit No. ___(MLT-10), which provides the achieved rate of return for Olympic Pipe Line Company from 1984 to 1999. My Exhibit No. ____(MLT-11), is produced for illustrative purposes for calculating the pro forma interest adjustment. The last exhibits I sponsor are Exhibit Nos. ___(MLT-12 through ___(MLT-15), which contain portions of the deposition testimony of Olympic witnesses Talley, Hammer, Collins and Omohundro.

V. AUDIT PROBLEMS

Q. WAS STAFF PRESENTED WITH ANY PROBLEMS IN AUDITING THE COMPANY'S RESULTS OF OPERATIONS IN THIS CASE?

A. Yes.

Q. PLEASE DESCRIBE THOSE PROBLEMS.

A. First, the operator of Olympic Pipe Line changed in July 2000. BP Pipelines Company replaced Equilon as the pipeline operator. Equilon did not provide Olympic with accounting records for periods before July 2000. The result was that accounting records for periods before July 2000 were not available to Staff. That made it impossible for Staff to consistently track Olympic's financial records by account.

Staff has used Olympic's FERC Form 6 Reports for years prior to 2000 to evaluate the Company, but the Company's income statements, balance sheets, and supporting accounting records for those years are not available.

Olympic has used prior year information contained in Exhibit No. ____(OPL-31, CAH-4). Mr. Brett Collins, a consultant used by Olympic in the current rate filing and prior Olympic rate filings, provided the Company the financial data prior to 2000. Olympic informed Staff that Mr. Collins' data could not be supported by the financial records of Olympic. For example, the Company's FERC Form 6 Report does not contain details of the accounts for verifying calculations, such as AFUDC, Deferred Return, and

Net Write-Up of Starting Rate Base. These calculations are only contained in Mr. Collins workpapers and are not recorded on the books and records of Olympic.

The second problem stems from the fact that Olympic changed its accounting system in May 2001. This has made it difficult for Staff to compare current data with data prior to May 2001, because all the accounts have different numbers and titles.

Third, Olympic has not responded in a timely manner to Staff data requests. These ongoing delays have made it almost impossible for Staff to complete the audit, provide detailed calculations of adjustments, and make recommendations to the Commission concerning Olympic's revenue requirements.

Fourth, Staff has been unable to confirm that all the costs associated with the Cross Cascade construction project have been removed from the year 2001 results of operations. The Company testified it has some ongoing expenses related to this project that apparently have not been removed from test year results. Expenses are not identified as such. See Exhibit No. ___(MLT12) Deposition of Mr. Talley at Tr. 8 lines 25 to Tr. 9, line 5..

Fifth, Olympic does not book any amounts for Allowance for Funds Used During Construction (AFUDC), or the amortization of this AFUDC. BP Pipeline Company does book AFUDC for its other affiliates, as it should. The calculation of AFUDC per the records of BP Pipeline Company is different than the calculation of AFUDC per Exhibit No. ____(OPL-31, CAH-4). Staff had BP Pipeline Company's calculation for AFUDC while auditing the books of the Company, but this document was taken from the Staff and not returned.

Sixth, the Company has not actually provided results of operations per books, or any fully restated actual and pro formed results of operations for this case. While Olympic has provided operating expense by accounts per books, restated actual and pro forma adjusted. Olympic has not provided revenues per books, restated and pro formed, nor has Olympic provided the rate base per books, restated and pro formed. What Olympic has provided is its calculation of a Total Cost of Service, assuming the Commission accepts all adjustments to expenses, restated revenues, restated rate base, rate of return, and FERC methodology. The information Olympic has provided is insufficient for the Commission to determine whether Olympic's earnings are fair, just, reasonable, and sufficient because most of the information provided to support the Company's restating actual and pro forma adjustments reflects budgeted results. Budgeted results are not known and measurable and are not appropriate to support adjustments using objective and rational ratemaking methodology. The Company agrees that budgeted results are not known and measurable. See Exhibit No. ___(MLT-13), Deposition of Ms. Hammer at Tr. 25, lines, 16 through 19, and Tr. 52, lines 18 through 21 Olympic's proposed adjustments are therefore unauditable.

Seventh, the Company has provided no calculation of Federal Income Taxes for any year from 1983 to 2001, except in response to WUTC Staff Request No. 319. The only figure for Federal Income Taxes the Company provides in its direct case is shown on Exhibit No. ___(OPL-31, CAH-4), Schedule 4. This Federal Income Tax figure is after a 62 percent increase in revenues, assuming full approval by both the FERC and WUTC. The Company's figure of Federal Income tax is incorrect in that the Company misstates adjustments to taxable income, known as Schedule "M" adjustments, by $6.1 million.

Eighth, a serious problem with this case is that the Company has not had unqualified outside audits of its financial records since 1998. In an unqualified audit finding, an independent auditor states that the Company's financial records fairly present the Company's financial position, and that the results of its operations and the changes in financial position conform with generally accepted accounting principles' applied on a consistent basis. Without such a finding, Olympic cannot testify that its financial records for 2001 fairly represent its financial position. This renders its financial records unreliable.

Staff is unable to verify that Olympic's financial records fairly present the financial position of the Company. Thus, the Commission has the difficult task of determining the appropriate revenue requirement from the doubtful accuracy of Olympic's financial records. Staff witness Mr. Kermode addresses this issue as well.

Ninth, the Company has not provided a witness to support the FERC ratemaking methodology it proposes. Company witness Ms. Hammer provided Mr. Collins the data to present a rate case based on the FERC methodology. See Exhibit No. ___(MLT-13). deposition of Ms. Hammer at Tr. 8, lines 16 and 17, and Tr. 11. Ms. Hammer testified that she did not understand the FERC methodology. *Id.* at Tr. 21, lines 4-6. Mr. Collins provided the calculations using his interpretation of the FERC methodology, but he did not present testimony that the FERC methodology should be used for setting fair, just and reasonable rates. Essentially, the Company instructed Mr. Collins to base his analysis on the FERC Methodology (See Exhibit No. ___ (MLT-14), Deposition of Mr. Collins at Tr.

82, line 5, through Tr. 83, line 5.) The Company offered Ms. Omohundo's testimony that the FERC methodology should be used, but she admitted she was not an expert on the FERC methodology. See Exhibit No. ___(MLT-15) Deposition of Ms. Omohundo at Tr. 6, lines 20 through 22.

Finally, because the Company does not possess financial records for the years 1983 through June 2000, the Company cannot establish that it correctly applied the FERC methodology.

VI. THE APPROPRIATE RATEMAKING METHODOLOGY FOR SETTING WASHINGTON INTRASTATE RATES

Q. PLEASE EXPLAIN THE RATEMAKING METHODOLOGY THAT SHOULD BE USED FOR SETTING WASHINGTON INTRASTATE RATES FOR OLYMPIC PIPE LINE COMPANY.

A. A regulated company deserves to recover the normal costs of providing services, as long as they are prudently incurred, plus a fair return on the investment the Company has devoted to serving the public. This return should be competitive enough to allow the company to attract sufficient external capital at reasonable terms to meet its obligation to provide services. However, this return should not be so excessive as to impose an unfair and unreasonable burden on the ratepayers. The primary objective of ratemaking is therefore to determine for each regulated company a set of rates that are just, fair, reasonable, and sufficient. These rates, in addition to covering all the company's operating expenses, including depreciation and taxes, also provide the company with an opportunity to earn a fair return on its investment. These rates are determined at the end of a rate case, to be applied to the future and cannot be retroactively applied to any period in the past. Ratemaking is therefore prospective in nature.

Q. PLEASE EXPLAIN WHAT THE COMMISSION SHOULD CONSIDER IN DETERMINING RATES THAT ARE FAIR, JUST, REASONABLE AND SUFFICIENT.

A. The ultimate determination to be made by the Commission in this matter regarding the Company's rates and charges is what tariffed rates should be charged that are fair, just, reasonable and sufficient. This determination is made establishing the fair value of the Company's property in-service for intrastate service in the State of Washington, and determining the Washington intrastate adjusted results of operations during a test year, the proper rate of return permitted on that property, the number of annual units transported and then ascertaining the rates charged per unit to customers to recover that return.

Q. PLEASE EXPLAIN HOW THE COMMISSION CAN DETERMINE THESE RATES.

A. First, the Commission establishes an appropriate test period. An appropriate test period is defined as the most recent 12-month period for which income statements and balance sheets are reasonably available. These income statements and balance sheets must be certified by the Company as fairly representing the Company's financial position. This can be done if the Company has an unqualified financial statement from an outside auditor. The Commission uses the test period to determine fair, just, reasonable, and sufficient rates based on the Company's operations.

Second, the Commission must determine the Company's results of operations for the test period. The results of operations must be adjusted for restated actual and pro forma adjustments. Restating actual adjustments adjust the test year operating results for items that distort the test period earnings. The test period should reflect only those revenues, expenses, taxes, and plant transactions relating to the test period and were used to provide the regulated service. Pro forma adjustments adjust the test period results of operations for known and reasonably measurable charges, to the extent the charges are not offset by other factors. Pro forma adjustments only adjust the results of operations for known and measurable factors affecting the revenues, expenses, taxes, and plant transactions that are used to provide the regulated service.

Third, the Commission must determine the appropriate rate base, which is derived from the Company's balance sheets for the test period. The rate base is the net book value of assets acquired with investor's funds that are used and useful in providing the regulated service.

Fourth, the Commission determines the authorized rate of return. The authorized rate of return is the weighted cost of debt and equity the Company needs the opportunity to earn.

Fifth, the Commission compares the appropriate rate of return the Company is authorized to earn with the Company's achieved rate of return. The achieved rate of return is derived from the adjusted test period results of operations by dividing the net operating income by the rate base.

Sixth, the Commission determines the Company's revenue requirement. The revenue requirement is the adjusted rate base times the authorized rate of return plus the adjusted operating expenses and taxes. The difference between the adjusted operating revenues and the revenue requirement is the amount the Company will need in rates to be given the opportunity to earn a fair, just, reasonable and sufficient return. This amount is known as the revenue deficiency or revenue excess.

Seventh, the Commission determines the pro forma throughput units on which rates are to be charged. The revenue excess or revenue deficiency and throughput are then used to develop rate design.

Finally, the Commission determines the rate design. Rate design determines the specific tariff rates to be charged customers for transporting property from point of receipt to point of delivery.

Q. PLEASE DESCRIBE THE METHODOLOGY STAFF RECOMMENDS THE COMMISSION USE TO SET WASHINGTON INTRASTATE RATES FOR OLYMPIC'S PIPELINE TRANSPORTATION SERVICES.

A. Staff recommends the Commission use the methodology it usually uses to set rates for public service companies in this state. That is, restated, pro forma results of operations, including a return on a rate base calculated based on historical cost less depreciation.

Q. COMPANY WITNESS MR. COLLINS EXPLAINS THE TRADITIONAL COST-OF-SERVICE METHODOLOGY THAT HAS BEEN USED BY THIS COMMISSION IN HIS TESTIMONY EXHIBIT NO. ___(BAC-2) PAGE 3, LINE

17 THROUGH PAGE 6, LINE 14. IS THAT A FAIR DESCRIPTION OF THE METHODOLOGY YOU RECOMMEND?

A. Yes. This methodology requires the Commission to set rates that will provide the company the opportunity to earn revenues sufficient to recover (1) a reasonable level of operating expenses and taxes, (2) a return *of* the investment used to provide the regulated service, and (3) a return *on* the investment used to provide the regulated service. The operating expenses, taxes, investment and return on investment must correspond to the same time period to satisfy the matching principle of accounting.

Under this methodology, if the Company over-earns in a given year, the Commission may bring a complaint to determine the appropriate level of rates. If the Company under-earns or experiences a loss, the Company has the responsibility to file for a rate increase. The stockholders of the Company absorb the loss until such time as rate relief is granted. In hardship cases, the Commission may grant interim rate relief.

Q. UNDER THE RATEMAKING METHODOLOGY STAFF RECOMMENDS, HOW ARE OPERATING EXPENSES DEFINED?

A. Operating expenses are the costs, including income taxes, of operating and maintaining the assets that provide the regulated services. Operating expenses that are costs unrelated to operating and maintaining the assets that provide the regulated services should not be allowed for ratemaking purposes.

Q. DOES OLYMPIC PROVIDE A DEFINITION OF OPERATING EXPENSES THAT IS CONSISTENT WITH THE DEFINITION YOU PROVIDE?

A. Yes. See Exhibit No.____(BAC-2) page 4.

Q. UNDER THE RATEMAKING METHODOLOGY STAFF RECOMMENDS, HOW IS RETURN *OF* INVESTMENT DEFINED?

A. Return *of* investment is the recovery of investment through depreciation and amortization over the useful life of plant used to provide the regulated service. The calculation of depreciation and amortization expense is derived through a study using the useful life, cost of removal, and the salvage value at the time of retirement. Depreciation or amortization of amounts that are not invested in plant in service and do not provide regulated services should not be allowed for ratemaking purposes.

Q. DOES OLYMPIC PROVIDE A DEFINITION OF RETURN *ON* INVESTMENT THAT IS CONSISTENT WITH THE DEFINITION YOU PROVIDE?

A. Yes. See Exhibit No. ___(BAC-2) page 4.

Q. UNDER THE RATEMAKING METHODOLOGY STAFF RECOMMENDS, HOW IS RETURN *ON* INVESTMENT DEFINED?

A. The investment on which a return is allowed is the investment recorded on the Company's balance sheet that has been used to construct or purchase assets that are used and useful in providing the regulated service. This investment of assets is referred to as the Rate Base. This Rate Base is computed on an average monthly average (AMA) basis for each account included in the Rate Base. The reason for using this AMA amount is to match the revenues, expenses and taxes with the Rate Base. The revenues, expenses and taxes are taken from the income statement for the test period. The income statement records the revenues, expenses and the taxes for the twelve months of the test period. The balance sheet is for a point in time. To match the revenues, expenses and taxes with the Rate Base, the Rate Base has to be calculated using the twelve balance sheets for each of the months represented in the income statement. The return is the weighted cost of the investments used to provide service.

Q. SHOULD ACCUMULATED DEFERRED INCOME TAXES (ADIT) BE INCLUDED IN THE RATE BASE?

A. Yes. Historically the Commission has agreed that ADIT should be included in the rate base at an end of test period amount. ADIT reduces the Rate Base, since this account represents an interest-free loan from the ratepayers. Since these are funds provided by ratepayers, not investors, the balance of this account as of the end of the test period best represents the funds provided by ratepayers.

Q. DOES OLYMPIC AGREE THAT ADIT REPRESENTS AN INTEREST-FREE LOAN FROM RATEPAYERS?

A. Yes. See Exhibit No. ____(BAC-2) page 6.

VII. FERC RATEMAKING METHODOLOGY VERSUS THE HISTORICAL COST LESS DEPRECIATION, RATE OF RETURN METHODOLOGY

Q. PLEASE PROVIDE AN OVERVIEW OF THE FERC METHODOLOGY OLYMPIC PURPORTS TO USE IN ITS DIRECT CASE TO JUSTIFY A RATE INCREASE.

A. Olympic provided me a statement summarizing the methodology it used. According to that statement, Olympic based its filing on its interpretation of the methodology in FERC Opinion No 154-B. According to Olympic, FERC:

(1) adopted net depreciated trended original cost (TOC) as the form of rate base and stated that only the equity portion thereof would be trended;

(2) concluded that rate of return should be determined on a case-by-case basis by the usual approach of using embedded debt costs and setting a risk-related equity rate of return;

(3) stated that as a general policy the proper capital structure to use was the pipeline's or its parent's capital structure, depending on how capital was raised;

(4) adopted a starting rate base for existing assets consisting of the sum of a pipeline's debt ratio times book net depreciated original cost and the equity ratio times the reproduction cost portion of the valuation rate base depreciated by the same percentage as the book original cost rate base has been depreciated;

(5) ruled that oil pipelines should use their actual interest expense in computing their income tax allowance in their cost-of-service;

(6) adopted normalization as the proper treatment for book and tax timing differences in the recognition of certain expenses and noted that oil pipelines must exclude all deferred tax amounts from their rate bases; and

(7) removed the previously imposed limitations on the suspension of unprotested oil pipeline rate filings and on the participation of Commission staff in oil pipeline rate case.

Q. HAVE YOU PREPARED AN EXHIBIT THAT PORTRAYS THE DIFFERENCES BETWEEN THE FERC METHODOLOGY AS PRESENTED BY OLYMPIC IN THIS CASE, AND THE TRADITIONAL HISTORICAL COST LESS DEPRECIATION RATE BASE, RATE OF RETURN METHODOLOGY STAFF RECOMMENDS?

A. Yes. I prepared Exhibit No. ___(MLT-2), entitled "Olympic Pipe Line Company, Comparison of FERC and WUTC Methods, Adjusted Results of Operations for the Twelve Months Ending September 30, 2001", to show the differences between the FERC methodology of regulation (as presented by Olympic) and the WUTC methodology. The data for this exhibit are taken from Company Exhibit No.___(OPL-31, CAH-4), which is Olympic's proposed results of operations for total Company after all adjustments, and after applying the 62% increase in revenues the Company is requesting from FERC and the WUTC. In its testimony, Olympic states that its case is based on the federal oil pipeline methodology. (Exhibit No. ___(CAO-3), page 3, lines 8 and 9.)

Q. PLEASE EXPLAIN THE FORMAT OF EXHIBIT NO. ___(MLT-2).

A. The first Column of this exhibit shows the line numbers, to make it easier to discuss the exhibit.

Column (A) provides the "Description" for each line. These line descriptions are the same for the expenses as the Company provided in Exhibit No. ___(OPL-31, CAH-4), Schedule 21.

Column (B) is derived from Company Exhibit No. ____(OPL-31, CAH-4). This Column depicts the Company's proposed total cost of service after all adjustments, as well as a 62% increase in revenues the Company is requesting. This Column reflects the only complete results of operations provided by Olympic in an exhibit in Olympic's direct case.

Column (C) lists the sources from Exhibit No. ___(OPL-31, CAH-4) for each line of Column (B).

Column (D) adjusts Column (B) (The FERC Methodology as presented by Olympic) to arrive at Column (F) (WUTC Methodology).

Column (E) references each adjustment by number. The amounts in Column (B) for Adjustments 1, 2, and 4 are not recorded on the books and records of Olympic. Olympic has not provided a witness to support or explain these adjustments in this docket. Olympic has included these adjustments as if they were recorded on the Company's financial records. All of the numbered adjustments are explained at the bottom of page 2 of the exhibit.

Column (F) displays the results of the WUTC Methodology after adjustments to the FERC methodology (as presented by Olympic). In the WUTC methodology column, the revenues are held constant, and the change flows to the rate of return on line 42.

Page 2 of this exhibit, lines 1 through 19, contains the Federal Income Tax calculation for Columns (B), (D), and (F). This is the federal income tax calculation used by Olympic in Exhibit Nos._____(BAC-2) and _____(OPL-31, CAH-4). This federal income tax calculation is not consistent with the federal income tax calculation for the year 2001 as provided in response to WUTC Staff Data Request No. 319. The differences are: 1) interest expense, 2) the FERC expenses not recorded on Olympic's books, and 3) the Schedule "M" adds and deductions. The Company misstates the Schedule "M" adds and deductions by $6.1 million.

Notes at the bottom of page 2 provide a brief explanation of each of the adjustments made to the Olympic results or the adjustments in Column (D).

Q. PLEASE PROVIDE AN EXPLANATION FOR EACH OF THE ADJUSTMENTS YOU HAVE MADE IN COLUMN (D).

A. My first adjustment is the "Amortized Deferred Return." It is shown on line 21 of my Exhibit No. ___(MLT-2), page 1. The Company has calculated this adjustment using the FERC methodology as stated in Opinion No 154-B, item number (2) concerning the risk-related equity rate of return. Adjustment 1 removes the $848,000 of Amortized Deferred Return from the FERC method calculation of revenue requirement. This is the amount the Company used to calculate the Total Cost of Service per Exhibit No. ___(OPL-31, CAH-4), Schedule 1, line 6. This is the amortization of Net Deferred Return included in the FERC Rate Base.

Q. DOES THIS DEFERRED RETURN REPRESENT AN OPERATING EXPENSE OR TAX, OR A RETURN *OF* INVESTMENT, OR A RETURN *ON* INVESTMENT USED BY OLYMPIC TO PROVIDE INTRASTATE SERVICES?

A. No. This Amortized Deferred Return is not an operating expense or tax that is necessary to provide service. It is not a return *of* an investment used to provide the regulated service. It is not a return *on* the investment used to provide the regulated service. It is the amortized amount of the deferred risk-related equity rate of return as calculated under FERC Opinion 154-B.

Under the FERC methodology, pipelines are permitted to amortize an amount of return that FERC assumes has not been collected in prior years. When setting rates, FERC assumes pipelines are not allowed the opportunity to collect these revenues, known as "Deferred Return." FERC allows the Company to collect an amortized portion of these assumed uncollected revenues through rates set in the current rate case.

Later, I will explain the Deferred Return and how the Company has actually collected these "uncollected" revenues, when I address Olympic's proposal to include the Deferred Return as a component of the Rate Base.

Q. IS RECOVERY OF THE DEFERRED RETURN CONSISTENT WITH THE MATCHING PRINCIPLE OF ACCOUNTING?

A. No. The matching principal of accounting requires that the revenues collected should be collected in the time frame the expenses, taxes, and rate base provided the service.

The Company's calculation of this Amortized Deferred Return is provided in Exhibit No.____(OPL-31, CAH-4), Schedule 6, page 2 of 2, line 17. The Company has not provided testimony to support this as an appropriate operating expense for ratemaking under either FERC or WUTC methodologies.

Q. ARE YOU AWARE OF ANY ACCOUNTING ORDER ISSUED BY THE WUTC THAT PERMITS OLYMPIC TO DEFER ANY PORTION OF ITS RETURN?

A. No.

Q. DID OLYMPIC ACTUALLY DEFER ON ITS BOOKS ANY PORTION OF ITS RETURN?

A. No.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT 2 "AMORTIZED AFUDC."

A. Adjustment 2, "Amortized AFUDC" reduces operating expenses by $124,661. The Company has calculated AFUDC using items 2 and 3 of FERC methodology: (2) the risk-related equity rate of return, and (3) Olympic's interpretation of the proper capital structure to use.

The amortization of AFUDC is a necessary expense for the Company to receive the return of the cost of capital of construction projects. The reason this account had to be adjusted was because the Company calculated AFUDC incorrectly. Since the AFUDC is incorrect, the amortization of AFUDC is also incorrect. I will discuss the calculation of AFUDC under my adjustments addressing the rate base.

The Company's calculation of this amortization of AFUDC is shown on Exhibit No. ___(OPL-31, CAH-4), Schedule 8, page 2 of 2, lines 5 and 12 for the Test Period. The Company has not provided testimony to support this as an appropriate operating expense for ratemaking under either FERC or WUTC methodologies.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT 3, "INCOME TAXES - FEDERAL," SHOWN ON LINE 23 OF EXHIBIT NO. ___(MLT-2), PAGE 1.

A. Adjustment 3, "Income Taxes – Federal " reduces federal income taxes by $1,399,722. The Company has calculated income taxes using the FERC methodology per item number 5 from FERC Opinion No. 154-B; (5) use actual interest expense in computing income tax, plus adjustment (1) Amortized Deferral and (2) Amortized AFUDC discussed above.

This adjustment to Federal Income Taxes reflects the tax effect of (1) the interest expense, (2) Amortized Deferred Return, (3) Amortization of AFUDC, and (4) Amortization of AFUDC Equity. I have not adjusted the Federal Income taxes in this exhibit for the calculation error made by the Company regarding Schedule "M" adds and deducts.

Interest expense is correctly included in the calculation of federal income taxes. In its calculation of federal income taxes, the Company is using $647,000 of interest expense. Yet Olympic's financial records report interest expense for the year 2001 as $8,642,656. (WUTC Staff Data Request No. 303). The $647,000 interest expense is the pro forma interest expense per the Company's case. Olympic calculates this pro forma interest expense by multiplying the weighted cost of capital of its parent BP, by the original cost rate base of Olympic. Olympic calculates BP's weighted cost of debt at 0.88 per cent.

The $8,642,656 interest expense is the actual interest expense Olympic records on its books. The FERC method, per FERC Opinion No. 154-B, item (5), states that actual interest expense is to be used in computing income tax. In this case, Olympic has presented this case as the FERC method, yet Olympic's calculation of income taxes does not use actual interest expense. The FERC methodology using Opinion No. 154-B would use $8,642,656, not $647,000 of interest expense in the calculation of income taxes. There is also an issue whether $8,642,656 is Olympic's actual interest expense. Without audited results of operations, the Staff is unable to determine what amount should have been booked.

By calculating income taxes using $647,000 interest expense, Olympic substantially increases the amount of revenue requirement in this case. This causes a mismatch of revenues, expense, taxes and rate base, which is not consistent with generally accepted accounting principles. It is also inconsistent with accounting theory, in that it determines tax levels on the basis of interest expense using less debt than the Company has used to construct or purchase the plant it has placed in service. The Company's approach shifts risks away from the Company's management and its stockholders onto ratepayers.

The Company has not provided testimony to support this as an appropriate adjustment for ratemaking under either the FERC or WUTC methodologies.

I have calculated the interest expense for purposes of this exhibit using the debt ratio of 100 per cent, as Olympic claimed in its interim case. My adjustment increases the Company pro forma interest to $4,686,206. I have multiplied the weighted cost of debt of 6.74 per cent times the rate base as shown on line 41 Column (F) page 1 of 2 of this exhibit.

Adjustments to the federal income taxes for purposes of Exhibit No. ___(MLT-2) page 2, lines 2, 6 and 7, Column (D) are consistent with the adjustments I made to results of operations for AFUDC and Deferred Return.

The Company's calculation of Federal Income Taxes is shown on Exhibit No. ___(OPL-31, CAH-4), Schedule 4, line 11 for the Test Period.

Q. PLEASE EXPLAIN YOUR ADJUSTMENTS TO THE RATE BASE, STARTING WITH ADJUSTMENT NUMBER 4, "AFUDC (AVERAGE)," ON LINE 29, COLUMN (D) OF EXHIBIT NO. ___(MLT-2), PAGE 1.

A. This adjustment reduces the amount of AFUDC included in the rate base by $3,740,191. The Company has calculated AFUDC using the FERC methodology from FERC Opinion No. 154-B, items number (2) the risk-related equity rate of return, and (3) Olympic's interpretation of the proper capital structure to use.

The Company does not account for AFUDC on its books of account. The Company provided a calculation for AFUDC in Exhibit No.____(CAH-4), Schedule 7. But neither Mr. Collins nor Ms. Hammer claim in testimony that this calculation and adjustment are correct for ratemaking purposes. The Company's calculation uses the FERC regulatory method, which according to Olympic, allows the Company to use its parent's weighted cost of capital. Olympic also uses the FERC high risk-related equity rate of return. It is proper for Olympic to record AFUDC on its books, at least a side record which can be audited. This recording should be made every six months or at least once a year.

The calculation of AFUDC for ratemaking purposes is necessary so investors are allowed a return of the cost of debt and equity while the Company builds plant that will be used and useful in providing pipeline services. Olympic's calculation of AFUDC is flawed because it uses the risk-related equity rate of return and capital structure of BP.

Also, the cost of equity for each year from 1984 to present is assumed to be the same cost of equity the Company is proposing for purposes of setting rates in this case. The weighted cost of capital of BP, and used by Olympic, is 13.89 per cent, derived as follows:

	Ratio	Cost	Weighted Cost
Debt	.1708	.0674	.0115
Equity	.8292	.1536	.1274
Total weighted cost of capital			.1389

The actual weighted cost of capital for Olympic is 6.74 percent.

	Ratio	Cost	Weighted Cost
Debt	1.0000	.0674	.0674
Equity	.0000	.1536	.0000
Total weighted cost of capital			.0674

The problem becomes apparent by the following example. If you assume Olympic has $10,000 of CWIP, using BP's weighted cost of capital will produce $1,389 of AFUDC ($10,000 times .1389 equals $1,389). But using Olympic's actual weighted cost of capital will produce only $674 of AFUDC ($10,000 times .0674 equals $674). By using BP's weighted cost of capital to calculate AFUDC, Olympic has overstated AFUDC and the amortization of AFUDC. This overstated AFUDC is the product of calculating AFUDC each year from 1984 to present, and then including the sum total amount in the rate base.

This miscalculation increases Olympic's revenue requirement. The resulting AFUDC included as an expense and in rate base is overstated. This causes a mismatching of revenues, expense, taxes and rate base inconsistent with generally accepted accounting principles. The Company's AFUDC calculation is inconsistent with accounting theory, in that it determines AFUDC levels on the basis of capital costs based on less debt and more equity than the Company actually used to construct or purchase rate base. It shifts risks away from the Company's management and its stockholders and places it on ratepayers. To the extent that AFUDC is a part of the cost of providing service and subject to a rate of return requirement from the utility customers, the revenue requirement is overstated.

For this adjustment, I have adjusted the results of operation from the FERC methodology to the WUTC methodology. I have calculated the AFUDC using Olympic's actual cost of capital, that is, 100 percent debt. I then calculated the lesser amount of AFUDC to be amortized. This adjustment reduces the Amortized AFUDC line 22 of this exhibit from $204,000 to $79,339. It also reduces the AFUDC line 29 of this exhibit from $8,802,500 to $5,062,309.

The Company's calculation of AFUDC is shown on Exhibit No. ___(OPL-31, CAH-4), Schedule 8, lines 2 and 9, average of Columns Base Period and Test Period. The amortization of AFUDC is shown on Schedule 8, lines 5 and 12. The Company has not provided testimony to support this as an appropriate adjustment for ratemaking under either the FERC or WUTC methodologies.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT 5, "NET WRITE-UP OF SRB (AVERAGE)," SHOWN ON LINE 30, COLUMN (D) OF EXHIBIT NO. ___(MLT-2), PAGE 1.

A. I have removed from the rate base $9,124,500 of "Net Write-Up of SRB". The Company has calculated this amount using the FERC methodology FERC Opinion No. 154-B, item number (4): adopted a starting rate base. Part of the FERC methodology allows Olympic to recover a return on what is called "Starting Rate Base" or "SRB." SRB is a rate base component using a methodology FERC adopted from the Interstate Commerce Commission (ICC)

Q. HOW DID OLYMPIC COMPUTE "STARTING RATE BASE?"

A. The "starting rate base" (SRB) amount is the average of the amounts shown on Exhibit No.____(OPL-31, CAH-4), Schedule 5, line 16, Columns "Base Period" and "Test Period." In 1983, the SRB was $37,510,000. This amount has been amortized since 1983 using an amortization life of 24 years. By the end of 2002, the remaining SRB will be $6,390,000.

Q. WHAT IS "STARTING RATE BASE"?

A. Starting Rate Base, or SRB is the equity portion of the Cost of Reproduction New (CRN), less the accumulated depreciation less the Net Plant in Service. CRN of Olympic's facilities was calculated in 1983 to be $139,798,000. The accumulated depreciation of CRN was calculated in 1983 to be $50,177,000. The Net Plant in Service was $35,169,000 in 1983. This leaves the debt and equity portion of SRB to be $54,452,000. The equity ratio was shown to be 68.89 per cent in 1983. Thus, the equity portion of Olympic's SRB is $37,510,000.

CRN is the estimated cost of replacing an asset at current market prices. The accumulated depreciation of the CRN is the amount that was determined to have been depreciated by 1983. The Net Plant in Service is the actual cost of plant providing service less accumulated depreciation.

Q. DOES OLYMPIC RECORD ANY AMOUNT OF "STARTING RATE BASE" ON ITS BOOKS OF ACCOUNT?

A. No.

Q. WHY HAVE YOU MADE AN ADJUSTMENT TO THE RATE BASE TO REMOVE THE FERC-ALLOWED "STARTING RATE BASE?"

A. I removed this "Starting Rate Base" from the rate base because it does not reflect the amount of plant built with investor funds, nor does it reflect plant that is used and useful in providing the regulated pipeline service.

In particular, the Net Write-Up of SRB represents the equity amount of investment that the Company did not actually invest to build plant to provide service to customers. The FERC method allows the company a return on this non-investment. The FERC method then amortizes this non-investment over 24 years, but FERC does not allow the amortization as an operating expense. Thus, the FERC methodology does not allow the Company a return of this non-investment. This is inconsistent and is not rational rate making theory.

By including Net Write-Up of SRB in the rate base, Olympic has increased the amount of the revenue requirement in this case. The resulting revenue requirement provides for a return on this non-investment by overstating the rate base. This causes a mismatching of revenues, expense, taxes and rate base which is not consistent with generally accepted accounting principles. The Company's calculation of rate base including SRB is inconsistent with accounting theory, in that it determines the rate base on the basis of non-investor supplied funds. It shifts risks away from the Company's management and its stockholders to ratepayers. The FERC method is inconsistent and is not rational ratemaking theory.

The rate base the Company is requesting in this case is the average of the amounts as shown on Exhibit No. ___(OPL-31, CAH-4), Schedule 5, line 14, Original Cost Rate Base, line 15, Net Deferred Return, and line 16, Net Write-Up of SRB.

Olympic's calculation of this Net Write-Up of SRB is shown on Exhibit No.____(OPL-31, CAH-4), Schedule 10. The Company has not provided testimony to support this as an appropriate adjustment for ratemaking under either the FERC or WUTC methodologies.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT 6, "NET DEFERRED RETURN (AVERAGE)," SHOWN ON LINE 31, COLUMN (D), IN EXHIBIT NO. ____(MLT-2) PAGE 1.

A. I have removed from the rate base $24,871,500, entitled "Net Deferred Return." The Company has calculated this adjustment using the FERC methodology as stated in Opinion No 154-B, item number 2) concerning the risk-related equity rate of return.

The Net Deferred Return amount is the average of the amounts shown on Exhibit No.____(OPL-31, CAH-4), Schedule 5, page 2 of 2, line 14, Columns "Base Period" and

"Test Period." The calculation of Net Deferred Return is provided by Olympic on Exhibit No.____(OPL-31, CAH-4), Schedule 6.

As shown on Exhibit No.____(OPL-31, CAH-4), Schedule 6, lines 18, 19 and 20, the Net Deferred Return is Accumulated Net Deferred Return less Accumulated Amortization of Deferred Return.

The Net Deferred Return is the accumulation of the assumed uncollected revenue less any accumulated amortization of this assumed uncollected revenue. The calculation of this Deferred Return is based on the assumption that Olympic has not received the revenue requirement found to be fair, just and reasonable using a "Nominal Equity Rate of Return."

This calculation makes it necessary for FERC to authorize two different returns on equity; 1) "Nominal Equity Rate of Return" and 2) "Real Equity Rate of Return." The FERC adds an inflation factor to the "Real Equity Rate of Return" to derive the "Nominal Equity Rate of Return." When FERC allows a rate increase to become effective, the revenue requirement is determined using the "Real Equity Rate of Return," even though the FERC finds that the company is entitled to a revenue requirement using the "Nominal Equity Rate of Return." Olympic accumulates the assumed uncollected revenue requirement associated with this inflation factor. This uncollected revenue requirement is then added to the accumulated amount each year making the accumulated amount increase over time. This deferred account is amortized each year. It is this amortized amount of this deferred return that is included on line 21 of my Exhibit No. ___(MLT – 2). So FERC allows the company a return "of" and "on" this deferred amount.

Q. DOES THE AMOUNT OF DEFERRED RETURN OLYMPIC SEEKS TO RECOVER IN RATES IN THIS CASE REPRESENT INVESTOR SUPPLIED FUNDS, AND DOES IT REPRESENT PROPERTY USED AND USEFUL IN PROVIDING SERVICE?

A. My answer is no to both questions for two reasons. First, the Company actually collected revenues for the years 1984 through 1998 that were greater than those that would be justified using a rate of return using the "Nominal Equity Rate of Return." Second, the deferred return is calculated using a rate base that is neither used and useful nor provided by investors, and should not be collected for that independent reason.

Q. HAVE YOU PREPARED AN EXHIBIT THAT DEMONSTRATES THAT OLYMPIC ACTUALLY EARNED IN EXCESS OF THE NOMINAL RATE OF RETURN?

A. Yes, my Exhibit No. ____(MLT-10) shows that Olympic actually earned a rate of return for the years 1984 through 1998 that was greater than a rate of return calculated using the "Nominal Equity Rate of Return."

Q. PLEASE EXPLAIN YOUR EXHIBIT NO. ___ (MLT- 10).

A. Exhibit No. ____(MLT- 10) is entitled "Olympic Pipe Line Company, Realized Rate of Return from 1984 to 2001."

Line 1 shows the Operating Revenues for each year. The source of these revenues is the response to WUTC Staff Data Request No. 41.

Line 2 is the Operating Expenses for each year. The source of this expense is the response to WUTC Staff Data Request No. 41.

Line 3 shows the Depreciation Expense for each year. The source of this depreciation is Exhibit No. _____(OPL-31, CAH-4), Schedule 11, line 7.

Line 4 is the Operating Taxes for each year, which are calculated by subtracting the expenses and depreciation from the revenues and multiplying the results by the tax rate of 35 percent.

Line 5 shows the Net Operating Income for each year.

Line 6 is the Rate Base (Original Cost) for each year. The source of this rate base is Exhibit No. ___(OPL-31, CAH – 4), Schedule 5, line 18.

Line 7 is the Achieved Rate of Return each year (line 10 divided by line 11).

Lines 8 through 12 provide the calculation of the Rate of Return Olympic claims it needs to recover its "Nominal Equity Rate of Return."

Line 8 shows the Equity Ratio provided by Olympic. The source of this equity ratio is Exhibit No. ___(OPL-31, CAH-4), Schedule 7, line 1.

Line 9 is the Debt Ratio provided by Olympic. The source of this debt ratio is Exhibit No. ___(OPL-31, CAH-4), Schedule 7, line 2.

Line 10 is the Nominal Cost of Equity Rate of Return provided by Olympic. The source of this equity rate of return is Exhibit No. ____(OPL-31, CAH-4), Schedule 7, line 3. This cost of equity includes the inflation factor for each year. This is the Cost of Equity used by Olympic for each year of 13.23 per cent plus the inflation factor for each year.

Line 11 shows the Cost of Debt provided by Olympic. The source of this debt cost is Exhibit No. ___(OPL-31, CAH-4), Schedule 7, line 4.

Line 12 is the Rate of Return Requirement using the above capital ratios and costs.

By comparing line 7 with line 12, it is readily apparent that Olympic actually earned in excess of the Nominal Rate of Return (Rate of Return Requirement) until the time of the Whatcom Creek explosion in June 1999.

Since Olympic Pipe Line Company has earned greater than its Nominal Equity Rate of Return, there is no need to calculate any "Deferred Return." Moreover, the Company, has not deferred any earnings on its books of account. Since there is no actual Deferred Return, there is no need to amortize this Deferred Return. The Amortized Deferred Return simply is not a proper expense for ratemaking purposes.

Q. HAS THE COMMISSION REJECTED ATTEMPTS BY OTHER COMPANIES TO RECOVER COSTS DEFERRED FROM PRIOR PERIODS WITHOUT A COMMISSION ORDER APPROVING THE DEFERRAL?

A. Yes. In its Eleventh Supplemental Order in Docket No. UE-920433, UE-920499 and UE-921262 (September 21, 1993), the Commission dealt with Puget Power Company's unilateral election to defer certain costs for later recovery through rates. At page 53 of its Order, the Commission ordered the company to stop that practice:

> The Commission orders the company to immediately cease creating unauthorized deferral accounts. If the company believes it has cause for creating a reserve deficit, it is well aware of its obligation to petition the Commission for an accounting order authorizing such action.

In its Fourth Supplemental Order in Cause Nos. U-82-12 and U-82-35 (February 1, 1983), at pages 23-243, the Commission rejected Pacific Power & Light Company's attempt to defer costs without prior approval.

> The company in recent years has engaged in the practice of recording depreciation and other expenses only partly as expenses. To the extent that the company fails to achieve its authorized rate of return, it has been in some instances booking a proportionate amount of expense items into capital accounts as deferred expenses....
>
> This accounting procedure is not shown to be a generally accepted accounting principle. It is inconsistent with accounting theory, in that it determines expense levels on the basis of income, rather than expenses. It shifts risks away from the company's management and its stockholders. To the extent that income is deemed insufficient to support expenses, the expenses are deemed to become assets and subject to a rate of return requirement from the utility customers. The practice is not acceptable to this commission and the company is ordered to cease the practice.

The Commission should not allow Olympic to defer earnings as "unearned" when in fact they have been earned. I also recommend that this Commission not allow Olympic to amortize these unearned earnings which have, in fact, been earned. Olympic was not permitted to defer any portion of its return on its books of account, and it did not do so.

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Please note that the Company has not provided testimony to support this as an appropriate adjustment for ratemaking under either the FERC or WUTC methodologies.

Q. YOU STATED EARLIER THAT THIS DEFERRED RETURN SHOULD NOT BE INCLUDED AS A COMPONENT OF THE RATE BASE BECAUSE IT IS CALCULATED USING A RATE BASE THAT IS NEITHER USED AND USEFUL NOR PROVIDED BY INVESTORS. PLEASE EXPLAIN.

A. Net Deferred Return is the inflation factor of the return on equity times the "Trended Rate Base." The "Trended Rate Base" is the sum of (1) Equity portion of Original Cost Rate Base, (2) Unamortized SRB, and (3) Accumulated Net Deferred Return.

The Original Cost Rate Base element of Trended Rate Base is Plant in Service, Land and AFUDC; less Accumulated Depreciation and Accumulated Amortization plus working capital; less Accumulated Deferred Income Taxes. This is basically the Rate Base that is recognized for ratemaking purposes by this Commission. Under the FERC method, the equity portion of this rate base is then derived because the deferred return is only the equity return and does not include the debt return.

The Unamortized SRB element of Trended Rate Base is the Net Write-Up of SRB. These are not investor-supplied funds, as explained in my testimony earlier.

I have already explained that this return on equity for the inflation factor should not be collected because the Company has already collected it. To now calculate this return on the "Equity portion of Original Cost Rate Base" will allow the Company to earn the inflation factor twice on the equity portion of the original cost rate base. This accounting procedure does not reflect generally accepted accounting principles. It is inconsistent with accounting theory in that it allows double return on investment. It shifts risks away from the company's management and its stockholders to ratepayers. The FERC methodology is inconsistent and is not rational ratemaking theory in this respect.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT NUMBER 2 " ACCUMULATED AMORTIZATION AFUDC (AVERAGE)," SHOWN ON LINE 38, COLUMN (D) OF EXHIBIT NO. ___(MLT-2), PAGE 1.

A. I have reduced the amount of Accumulated Amortization AFUDC by $550,474. I also reduced the amount of AFUDC by $3,740,191, on line 29 of this Exhibit No. ____(MLT-2). This reduction in Accumulated Amortization AFUDC flows directly from that adjustment of AFUDC.

Q. PLEASE EXPLAIN YOUR LAST ADJUSTMENT TO THE FERC METHOD OF RATEMAKING, ADJUSTMENT NUMBER 5, "ACCUMULATED DEFERRED INCOME TAXES," SHOWN ON LINE 39, COLUMN (D) OF EXHIBIT NO. ___(MLT-2) PAGE 1.

A. The FERC methodology correctly removes the Accumulated Deferred Income Taxes from the Rate Base. The Accumulated Deferred Income Taxes represent an interest-free loan from the ratepayers. The interest-free loan is the amount paid by ratepayers during the twelve months of the test period. However, the FERC methodology uses the average amount collected, while the Commission methodology uses the total amount collected. The FERC methodology understates the amount of the interest-free loan recorded on the income statement.

Q. WHAT IS THE EFFECT OF USING THE FERC METHODOLOGY VERSUS THE WUTC METHODOLOGY?

A. My Exhibit No. ____(MLT-2), page 1, line 42, shows the effect after adjusting the results of operation under the FERC methodology, removing only the FERC-related adjustments. I have not adjusted this exhibit for restating actual and pro forma adjustments. My Exhibit No. ____(MLT-4) presents my proposed restated and pro forma results of operations. This exhibit (MLT-2) shows the effect on rate of return if only the FERC related items are removed from the results of operations. The realized rate of return increases from 12.38% to 22.54%.

VIII. FULLY ALLOCATED JURISDICTIONAL RESULTS OF OPERATIONS

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING THE METHOD YOU USED TO ALLOCATE COST OF SERVICE BETWEEN FERC JURISDICTION AND WASHINGTON INTRASTATE JURISDICTION?

A. Yes. My Exhibit No. ____ (MLT-3) is entitled "Olympic Pipe Line Company, Actual and Allocated Results of Operations, Twelve Months Ending December 31, 2001."

Column (A) is the description of each line. Column (B) contains the results of operation for Olympic Pipe Line per its books and records. The source for the amounts on each line is shown in Column (C). The allocation factor applied to the total Company results of operations to determine the Washington Intrastate results of operations is shown in Column (D). The Washington jurisdictional results of operations are shown in Column (E).

Q. DOES YOUR PRESENTATION OF WASHINGTON STATE JURISDICTIONAL ALLOCATION FACTORS DIFFER FROM THAT SHOWN IN OLYMPIC'S EXHIBIT NO. ____(BAC-2) AT PAGES 17 AND 18, AND EXHIBIT NO. ___(OPL-32, CAH-4)?

A. No.

Q. DO THE ALLOCATIONS YOU SHOW IN YOUR EXHIBIT NO. ____(MLT-3) FAIRLY SEPARATE OLYMPIC'S RESULTS OF OPERATIONS BETWEEN THE FEDERAL AND STATE JURISDICTIONS?

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A. Yes.

Q. ARE SUCH ALLOCATIONS COMMON IN REGULATION OF MULTI-JURISDICTIONAL COMPANIES?

A. Yes.

Q. PLEASE EXPLAIN WHY THE TAX CALCULATION ON PAGE 2, LINE 20, COLUMN (B) DOES NOT AGREE WITH THE TAXES ON PAGE 1, LINE 28 COLUMN (B).

A. The tax amount of $(7,599,170) on page 1, line 28 includes $(65,547) of state income taxes which are not included in the federal income tax on page 2.

Q. PLEASE EXPLAIN THE SOURCE OF THE ALLOCATION FACTORS USED IN EXHIBIT NO. ___(MLT – 3).

A. Allocation factors are shown on page 2 of 2 of this exhibit, lines 21 through 24. The source of these factors is Exhibit No. ____(OPL-32, CAH-4). I have provided the source for each factor in Column (C).

IX. RESULTS OF OPERATIONS FOR TOTAL COMPANY AND WASHINGTON INTRASTATE

Q. PLEASE EXPLAIN YOUR EXHIBIT NOS. ____ AND ___(MLT – 4, AND MLT – 7).

A. These two exhibits are organized using the same format. The only difference is that Exhibit No.____(MLT-4) is for Total Company, and Exhibit No.____(MLT- 7) is for the state of Washington jurisdiction.

The two exhibits are Olympic Pipe Line Company, Actual and Pro Forma Results of Operations for the twelve months ending December 31, 2001.

The first Column provides the line numbers to help in reading and explaining the exhibits.

Column (A) is the description of each line.

Column (B) for Exhibit No.____(MLT - 4) is the Total Company results of operations, while for Exhibit No.____(MLT - 7), it is the Washington results of operations.

Column (C) for both exhibits is the total of all the restating actual adjustments taken from Exhibits Nos.______(MLT-5) and______(MLT-8).

Column (D) for both exhibits is the results of operations after the restating actual adjustments.

Column (E) for both exhibits is the total of all pro forma adjustments taken from Exhibits Nos.____(MLT-6) and____(MLT-9).

Column (F) for both exhibits is the results of operations after the pro forma adjustments.

Column (G) for both exhibits provides the necessary increase (or decrease) in revenues for the Company to have an opportunity to realize a rate of return of 7.40 percent.

Column (H) for both exhibits is the results of operations after the increase (or decrease) in revenues.

Page 1 of 2 of these exhibits provide the results of operations, that is revenues, expenses, taxes, and rate base with the rate of return calculation in Columns (B), (D), (F) and (H).

Page 2 of 2 of these exhibits is the Federal Income Tax calculation for each Column.

Q. PLEASE EXPLAIN EXHIBITS NOS. ___(MLT-5) AND ___(MLT-8).

A. These two exhibits list each of the restating actual adjustments the Staff has made to the results of operations. Exhibit No. ___(MLT-5) is for Total Operations and Exhibit No. ___(MLT-8) is for Washington jurisdiction.

Column (A) is the same description of each of the lines as was used in Exhibit No.____(MLT-4).

Column (B) for each exhibit is the total of all the adjustments listed in the rest of the Columns.

I will explain the adjustment in Column (G) RA-5 "Correct AMA Rate Base," and Column (J), RA-8 "AFUDC," and the federal income tax calculation for each adjustment. Staff witness Mr. Colbo is responsible for the rest of the restating actual adjustments shown on Exhibits Nos.____(MLT-5) and ___(MLT-8).

Q. PLEASE EXPLAIN EXHIBITS NOS.____(MLT-6) AND ___(MLT-9).

A. These two exhibits list each of the pro forma adjustments the staff has made to the results of operations. Exhibit No.____(MLT-6) is for Total Operations and Exhibit No.____(MLT-9) is for Washington jurisdiction.

Column (A) is the same description of each of the lines as was used in Exhibit No.____(MLT-4).

Column (B) for each exhibit is the total of all the adjustments listed in the rest of the Columns.

I am responsible for the adjustments in Columns (K), (M), (N), (O) and the federal income tax calculation for each adjustment. Staff witness Mr. Colbo is responsible for the rest of the pro forma adjustments.

X. RESTATING ACTUAL ADJUSTMENTS TOTAL COMPANY AND WASHINGTON JURISDICTION

Q. PLEASE TURN TO EXHIBIT NO. ____(MLT-5), COLUMN (G), AND EXPLAIN THE ADJUSTMENT RA-5 "CORRECT AMA RATE BASE".

A. This adjustment reduces the AMA Rate Base by $7,759,280 for errors recorded on the Olympic's Balance Sheets during the test year. The Company's response to Staff WUTC Data Request No. 303, Schedule 303 A, has a December 31, 2000, amount for Plant in Service of $134,642,919 and an amount for Construction Work in Progress of $10,173,365. The Company informed the Staff that these numbers were in error. The Plant in Service amount should have been $111,815,761 and the Construction Work in Progress amount should have been $32,970,554. Corrections to the these accounts were recorded in March and April of 2001. These corrections corrected the accounts as of that date but did not correct the accounts for calculating the Average Monthly Average to be included as Rate Base or to calculate AFUDC.

In December 2001, the Company also informed Staff that $21,500,000 of CWIP was transferred to Plant in Service. This $21,500,000 was the Company's investment in the Cross Cascade Project. This was an error, as explained by Olympic. The Cross Cascade Project is not in service and should be recorded as CWIP, not Plant in Service.

Adjustment "Correct AMA Rate Base" corrects the balance sheet amounts as if they had been booked correctly and then calculates the correct AMA Plant in Service amount. The depreciation expense also needed to be adjusted, because Olympic had booked depreciation expense for the Cross Cascade Project. These corrections also affected the Accumulated Depreciation amounts, which I also corrected.

Q. TURN TO EXHIBIT NO. ___(MLT-5), COLUMN (J), AND PLEASE EXPLAIN THE ADJUSTMENT RA-8 "AFUDC."

A. This adjustment increases the rate base by $4,092,976, and increases operating expenses for Amortized AFUDC by $80,913. The adjustment has three parts: (1) calculate the AFUDC from 1984 to present, (2) calculate the amount of the Amortized AFUDC, and (3) calculate the amount of the Accumulated Amortized AFUDC.

The calculation of AFUDC for ratemaking purposes is necessary so investors are allowed a return *on* and *of* the debt and equity cost of funds used while construction projects are in process and not yet included in the rate base. This cost is known as

Allowance for Funds Used During Construction (AFUDC). This amount is usually calculated every six months or each year and is recorded at that time as an increase to plant in service and non-operating income. AFUDC does not need to be amortized because when it is recorded correctly, it is included in the calculation of the depreciation expense on plant in service. The Company's AFUDC calculation for this rate case is improper retroactive ratemaking. The Company made no adjustment to AFUDC nor did it present testimony concerning AFUDC. Olympic presented the AFUDC as booked each year since 1984 when in fact Olympic has not booked this AFUDC. Olympic makes not statement concerning AFUDC before 1984. The Company has not had an unqualified outside audit since 1998, so the recording of this AFUDC is unclear. In the spirit of fairness, Staff has calculated the AFUDC using the workpapers contained in Exhibit No. ____(OPL-31, CAH-4) Schedules 6, 7 and 8. For this calculation for 2001, Staff used the weighted cost of capital provided by Staff witness Mr. Wilson in his Exhibit No. ___(JWW-9). For the years 1984 to 2000, the Staff has used Staff witness Mr. Wilson's weighted cost of equity. For the weighted cost of debt for these years, the Staff used Mr. Wilson's debt ratio and the Company-provided cost of debt.

The Company did not provide a witness to support or explain this AFUDC. Olympic just included AFUDC as if it recorded it on the its books as AFUDC and Amortized AFUDC.

XI. PRO FORMA ADJUSTMENTS TOTAL COMPANY AND WASHINGTON JURISDICTION

Q. TURN TO EXHIBIT NO. ____(MLT-6), COLUMN (K). WILL YOU NOW EXPLAIN YOUR ADJUSTMENT P-9 "PLANT IN SERVICE 2001 – NRP."

A. This adjustment "Plant in Service 2001 – NRP" increases the rate base by $6,759,343. "NRP" means "Non-Revenue Producing." This adjustment increases the rate base to the end-of-period level by increasing (1) Plant in Service by $8,197,866, (2) Accumulated Depreciation by $1,438,523 and (3) Depreciation Expense by $185,617. By this adjustment, the Staff has adjusted the Average Monthly Average (AMA) level to the end-of-period rate base level. To accurately measure revenues and expenses during a test year, the properties that produce those revenues and cause the expenses must be matched as the revenues are generated and the expenses incurred. Otherwise, a "mismatch" of revenue and expenses will result. Staff strongly supports the AMA method of calculating rate base for ratemaking purposes, unless extenuating circumstances exist. The Commission has allowed end-of-period rate base to be used if circumstances justify the departure from the AMA.

In its Third Supplemental Order in Cause No U-80-111 (September 24, 1981), a rate case involving Washington Natural Gas Company, at page 6, the Commission stated the following conclusions concerning end-of-period rate base:

(1) Average rate base is the most favored.
(2) Year-end rate base is an appropriate regulatory tool under one or more of the following conditions:
(a) Abnormal growth in plant
(b) Inflation and /or attrition
(c) As a means to mitigate regulatory lag
(d) Failure of utility to earn its authorized rate of return over an historical period.

Condition (2)(a), "Abnormal growth in plant," applies here. The Company is experiencing "abnormal growth in plant" in that the Company has experienced a sizeable increase in additions to plant since the 1999 Whatcom Creek explosion. The plant additions are replacements of existing plant made for reasons of maintenance, safety, or reliability, or are entirely unrelated to capacity or revenues.

Condition (2)(c) above: "a means to mitigate regulatory lag," also applies to Olympic. The plant built and placed in service during the last few months of the test year will not generate additional revenues until the pipeline is restored to 100% pressure. The AMA rate base only includes a weighted portion of the plant placed in service these last few months of the test period. Thus, if the rate base is not adjusted to include this plant the Company will experience regulatory lag. The revenue requirement for this case will be understated if this non-revenue producing plant is not included in the rate base. If this adjustment is not made, the Company will need to file another rate case to have a reasonable opportunity to earn a fair return on this non-revenue producing plant.

Condition (2)(d) above, "failure of utility to earn its authorized rate of return over an historical period," also applies to Olympic. Since the Whatcom Creek explosion, the Company has not earned a fair, just, reasonable and sufficient rate of return.

In the Third Supplemental Order in Cause No. U-77-53, Washington Water Power Company (March 24, 1978), at page 9, the Commission stated the following regarding adjusting the rate base to include non-revenue producing plant:

> … that these items do not add capacity, and they do not, therefore, produce additional revenue. That they are either replacements of existing plant made for reasons of maintenance or reliability or that they are entirely unrelated to capacity or revenues.
>
> We believe that allowance of pro forming in this matter is consistent with our treatment in Cause No U-76-6 and U-75-10, and that the basic nature of these items is of such a non-revenue nature that connection between the items and their revenues effect is not direct. Consequently we will allow the adjustment …

In its Third Supplemental Order in Cause No. U-79-10, regarding the Washington Water Power Company (October 9, 1979), at page 6, the Commission further discussed when adjustments are acceptable for non-revenue producing plant;

> "In its presentation, the company included as rate base items certain investments of a sort which has been accepted by the Commission in prior proceedings under the term "non-revenue items." The staff witness that testified in regard to this adjustment recognized the Commission's consistent treatment and neither proposed a specific adjustment to deal with the subject nor provided an itemized list of projects. He recommended, however, that the Commission reexamine its approach to this subject.
>
> We have examined the recommendation, and believe that the reasoning and the treatment which we have utilized in prior cases remain appropriate for treatment of this subject in this proceeding; consequently, we will allow the affected items as a proper addition to the respondent's rate base."

My adjustment is necessary because the plant placed in service the last few months of 2001, is non-revenue producing.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT P-11 "REMOVE SEA-TAC AND IMPACTS," SHOWN IN COLUMN (M) ON PAGE 3 OF EXHIBIT NO. ___ (MLT-6).

A. This adjustment removes $9,688,897 from the rate base because of Olympic's sale of its Sea-Tac facility. The adjustment has three parts: (1) remove the facility from the books, (2) increase the accumulated depreciation by the gain on the sale; and (3) adjust the ADIT for the taxes associated with removing the facility from the books.

On February 12, 2002, Olympic Pipe Line Company filed an application requesting approval to transfer the Sea-Tac Terminal Facility to the Port of Seattle. The Commission approved this transfer of property. The book value of this facility at the time of the transfer was $6,814,365. The accumulated Depreciation on the facility was $2,617,774. Thus, the net book value of the Sea-Tac Terminal Facility at the time of the sale or transfer was $4,196,591. The entire proceeds of the sale of the facility is $11,000,000. Thus, there was a gain on the sale of the facility of $6,803,409

Since this facility will no longer be in service, all operating expenses, taxes, and rate base associated with this facility must be removed from the results of operations for this rate case. Staff witness, Mr. Colbo, will address the operating expenses associated with this facility recorded in the test period ending December 31, 2001. I address the removal of the facility from the rate base and the accounting of the gain from the sale.

Q. WHAT ADJUSTMENT DO YOU RECOMMEND TO REMOVE THE SEA-TAC FACILITY FROM THE RATE BASE?

A. I recommend that the booked value of this facility, $6,814,365, be removed from the Plant in Service account. I also recommend the accumulated depreciation account be reduced by $2,617,774. This will remove the facility from the rate base for the test year ending December 31, 2001.

Q. DID OLYMPIC ALSO REMOVE THE SEA-TAC FACILITY FROM THE RATE BASE IN ITS DIRECT CASE?

A. Yes, though the Company's adjustment contains some errors. The Company removed $3,645,000 from both the plant in service account and the accumulated depreciation account. This is in error. The Company also increased the accumulated depreciation account by $10,000,000. For both items, see Exhibit No. ___(OPL-31, CAH-4), Schedule 14, page 3 of 4, lines 9, 16, and 17). The net effect of these adjustments is to decrease the Rate Base by $10,000,000. The problem with these entries is that they overstate plant in service and understate accumulated depreciation. Even though this makes the net book value of the facility after the sale the correct amount, the Company's adjustment does not reflect correct accounting. It should also be noted that the sale of the Sea-Tac Facility was $11 million, not $10 million.

Q. DOES THE NET EFFECT OF THE COMPANY'S AND STAFF'S ADJUSTMENT PASS THE GAIN OF THE SALE OF THE SEA-TAC FACILITY TO RATE PAYERS?

A. Yes.

Q. DOES THE STAFF AGREE THIS TREATMENT IS APPROPRIATE?

A. Yes. Regulation in this state has historically and correctly allowed companies a return *of* and *on* the investment used to provide the regulated service. In effect, this passes the risk of owning the plant in service to the ratepayer. Because the ratepayers carry the risk, the gain on sale of a facility should be given to the ratepayers.

Q. HOW DO YOU RECOMMEND THE SALE OF THE SEA-TAC FACILITY BE RECORDED TO PASS THE GAIN TO RATEPAYERS?

A. I have already explained the accounting for the plant and accumulated depreciation. This removes the facility from the books. I recommend the gain on the sale increase the accumulated depreciation account.

The gain on the sale is the sale value of $11,000,000 less the net book value of the facility of $4,196,591, or $6,803,408. By increasing the accumulated depreciation by the net gain of the sale, the effect is to passed the gain to the ratepayers.

The net effect of the gain of sale and removing the facility will increase accumulated depreciation account by $4,185,635. ($6,803,408 less $2,617,773).

Q. HAVE YOU ALSO ADJUSTED THE ACCUMULATED DEFERRED INCOME TAX (ADIT) RELATED TO THE SALE OF THE SEA-TAC FACILITY?

A. Yes. The Company's Sea-Tac facility has been depreciated for tax purpose faster than it has been depreciated for book purposes. The difference in tax and book depreciation effects the tax calculation. The tax timing differences causes the calculation of "current" tax and "deferred" tax. The Company pays "current" tax based on tax depreciation while the "deferred" tax collected in rates from ratepayers are based on book depreciation. The difference in the tax paid is recorded as ADIT, an interest-free loan from the ratepayer. Now that the Sea-Tac facility has been sold the Company will have to pay this deferred tax. Because this tax must be paid, the tax is no longer an interest-free loan from the ratepayer. Thus, I have reduced the ADIT amount included in the rate base for the deferred tax associated with the Sea Tac facility in the amount of $1,311,103.

Q. WILL THE COMPANY BE REQUIRED TO PAY TAX ON THE GAIN OF THE SEA-TAC FACILITY?

A. No. The Company will not pay any tax because the benefit of the sale has been passed to the ratepayers. Therefore, there is no gain on the sale to the Company. The tax on the gain of the sale will be paid in the future. The Company will book less depreciation in the future because of the increase in accumulated depreciation by the amount of the gain. By booking or expensing less depreciation, the ratepayer will be required to pay the tax on the gain in the future.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT P-12, "PRO FORMA INTEREST EXPENSE," SHOWN IN COLUMN (N) OF EXHIBIT NO. ___(MLT-6), PAGE 3.

A. This adjustment reduces Net Operating Income by $1,416,882. The reason for this adjustment is to recognize the tax effect of changes in the cost of debt to be consistent with the authorized rate of return.

Q. WHY IS AN ADJUSTMENT GIVING EFFECT TO THE INCOME TAX EFFECT OF PRO FORMA DEBT COSTS PROPER?

A. If any recommended rate of return applied to the test period reflects higher or lower interest costs than those incurred during the test year, then test year income taxes should also be adjusted for the higher or lower interest costs to be consistent.

Q. IS INTEREST EXPENSE A DEDUCTION FOR FEDERAL INCOME TAX PURPOSES?

A. Yes. Interest costs, like operating expenses, are deductible in determining taxable income. An increase in interest cost will reduce income taxes because of a larger interest deduction for tax purposes. This is very similar to the way rate increases are handled. Because the revenues are increased, the Federal Income Tax is also increased.

Q. FOR RATE MAKING PURPOSES, SHOULD THE TAX EFFECT OF INTEREST COSTS BE TREATED IN THE SAME MANNER AS THE TAX EFFECT OF OPERATING EXPENSES?

A. Yes. In ratemaking, the need for revenue is determined based on the full cost of rendering service. Simply stated, the cost of service is the sum of all operating expenses including depreciation, taxes, and a rate of return on the property rendering the service. Interest expense is allowed for and recovered through the rate of return, as the weighted cost of debt is multiplied by the rate base. Interest expense is not a direct deduction from revenues. The interest component of the rate of return is just as real and measurable as any operating expense.

Q. HAVE YOU PREPARED AN EXHIBIT WHICH DEMONSTRATES YOUR PRO FORMA INTEREST CALCULATION?

A. Yes. Exhibit No. ___(MLT-11) is entitled "Olympic Pipe Line Company, Tax Benefit on Pro Forma Interest, Twelve Months Ending December 31, 2001." Column (A) is the Description for each of the lines. Column (B) is the Total Company amounts and Column (C) is the Intrastate Washington amounts. Line 1 is the Rate Base amount taken from Exhibit No. ___(MLT-4), line 38, Column (H). The Rate Base has been adjusted for Restating Actual and Pro Forma Adjustments. These adjustments increased the Rate Base for the investments of investors for the end of period amounts for CWIP and Plant in Service, as I explained earlier. For purposes of calculating the Pro Forma Interest, the adjusted Rate Base must now be increased for the Bayview Terminal investments, since

Bayview was constructed using investor funds and AFUDC will be charged to the Bayview Terminal Investment. Line 2 is the Bayview investment that reduced the Rate Base in Adjustment P- 2.

Line 3 is the Total Investment used for calculating the Pro Forma Interest Expense. Lines 4, 5, and 6 were provided by Mr. Wilson on Exhibit No. ___(JWW-9). Line 7 is the product of line 6 times line 3, and calculates the Pro Forma Interest Expense. Line 8 is the Interest Expense recorded on Olympic's books per Exhibit No. ___(MLT-4) page 2 of 2, Column (B), line 3. Line 9 is line 7 less line 8, which is the adjustment necessary to synchronize the Rate of Return and the interest expense. Line 10 is the 35 per cent federal income tax rate. Line 11 is the federal income tax effect of the change in interest expense.

Q. **PLEASE EXPLAIN YOUR ADJUSTMENT P-13 "PLANT IN SERVICE 2002 NRP," ON EXHIBIT NO. ___(MLT-6), PAGE 3, COLUMN O.**

A. My adjustment "Plant in Service 2002 – NRP" increases the rate base by $23,017,097. "NRP" means "Non-Revenue Producing." The plant in service is being adjusted for the amount of Construction Work in Progress (CWIP) at the test period year-end amount excluding Cross Cascade investment. This CWIP will not be placed in service until some time in 2002. This adjustment increases: (1) Plant in Service by $23,550,326, (2) Accumulated Depreciation by $533,229, and (3) Depreciation Expense by $533,229. By this adjustment, the Staff has not only adjusted the AMA to the level end-of-period rate base, but it has also included in the rate base construction projects that are not in service by December 31, 2001. In order to accurately measure revenues and expenses during a test year, the properties that produce those revenues and cause the expenses must be matched as the revenues are generated and the expenses incurred. Otherwise a "mismatch" of revenue and expenses will result. As I stated earlier, Staff strongly supports the AMA rate base for ratemaking purposes unless extenuating circumstance exist. But the Commission has allowed CWIP as a rate base component if circumstance justify the departure from the AMA.

Olympic is experiencing a phenomenon related to demands for new plant. This is demonstrated by the fact that the Company has experienced a sizeable increase in additions to plant since the Whatcom Creek explosion in 1999. The delivered throughput during the last two years has been less than that delivered in the years before the explosion.

In its Third Supplemental Order in Cause No. U-80-13 and U-80-14, (January 26, 1981) concerning The Washington Water Power Company, at page 6, the Commission addressed the issue of including CWIP in the rate base:

> . . . CWIP is becoming an increasingly large percentage of net utility plant and in 1980 has exceeded 25% of net utility plant....
>
> It is the Commission's opinion that an inclusion in rate base of CWIP at 20% of total average electric CWIP without an AFUDC offset would be appropriate under the circumstances in view of Respondent's critical need for cash and the large percentage relationship of total CWIP to total net utility plant.

Olympic has experienced a sizeable increase in additions to plant since the Whatcom Creek explosion. Olympic's delivered throughput during the same time has been less than that delivered in the years before the explosion. This contributes to Olympic's need for cash. Staff recommends that because Olympic has experienced a loss of revenues and has had sizeable increases in plant additions, the end-of-period 2001 CWIP balance, representing plant that will go into service in 2002, should be included in the rate base.

XII. FEDERAL INCOME TAXES

Q. PLEASE TURN TO YOUR EXHIBIT NO. ___(MLT-3) PAGE 2 OF 2, AND EXPLAIN YOUR FEDERAL INCOME TAX CALCULATION.

A. I have presented Olympic's tax calculation in my Exhibit No. ___(MLT-2), per the Company's case. This is the calculation shown on Company Exhibit No. ___ (OPL-31, CAH-4). I have also presented Olympic's tax calculation on my Exhibit No. ___(MLT-3), per the Company's books. There are several differences between these two calculations of Federal income taxes.

The first difference is interest expense. Per the Company's books, interest expense for the 12 months ended December 31, 2001 was $8,642,656, while for the Company's case as presented per Exhibit No.____(OPL-31, CAH-4) Schedule 4, line 5, Column "Test Period," interest expense is only $647,000. The Company has not provided an adjustment to the interest expense. I have provided an adjustment in my Exhibit No. ___(MLT-3). I started with the booked interest expense and then made an adjustment to this amount for Adjustment P-12, "Pro Forma Interest Expense." I discussed this adjustment earlier.

The second difference is the Schedule "M" adds. The Company has not explained Schedule "M" adds of $3,987,000 Company Exhibit No.____(OPL-31, CAH-4), (Schedule 2, line 13 shows the book depreciation, Schedule 6, line 17 shows the

Amortized Deferred Return, and Schedule 8, line 5 shows the Amortization of AFUDC Equity). These three items make up the $3,987,000 of Schedule "M" adds. The Company did provide a response to WUTC Staff Data Request No. 319, which asked for support for the Schedule "M" adds that I have used in my Exhibit No. ___(MLT-3). The Company's response to WUTC Staff Data Request No. 319 listed the Schedule "M" adds as $6,820,303, not $3,987,000.

The third difference is tax depreciation. The tax depreciation per Exhibit No.___(OPL-31, CAH-4) is $5,676,000. The tax depreciation as provided by the Company in response to WUTC Staff Data Request No. 319 is $7,063,201. I have used as the correct amount of tax depreciation the $7,063,201 as presented by Olympic per WUTC Staff Request No. 319.

The fourth difference is the miscellaneous Schedule "M" deduct. This Schedule "M" deduct item is not included in Exhibit No. ___(OPL-31, CAH-4). I have used as the correct amount for this miscellaneous Schedule "M" deduct the $824,373 as provided by the Company in response to WUTC Staff Data request No. 319.

I recommend that the Commission use the federal income tax calculation shown on Exhibit No. ___(MLT-3) Column B, page 2 of 2. I have consistently used this calculation in all restating actual and pro forma adjustments in the Staff's case.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.