Exhibit No. ______ (HBF-6T)

OLYMPIC PIPE LINE COMPANY

REBUTTAL TESTIMONY OF HOWARD B. FOX

I. Name and Qualifications

Q. Please state your name.

A. My name is Howard B. Fox. I am Assistant Treasurer for Olympic Pipe Line Company and supervise the Planning Group for BP Pipelines (North America) Inc. My business address is 801 Warrenville Road, Suite 7033, Lisle, Illinois 60532.

Q. Please describe your educational and professional background qualifications.

A. I received my degree in 1981 from the University of Kansas, majoring in Accounting and Finance. My experience includes 20 years in varied assignments in the oil and gas industry including upstream (exploration and production), chemicals, and pipelines. I have provided testimony and support for litigation and disputes in the states of Alaska, Colorado, New Mexico, Wyoming, and Washington.

II. Summary of Testimony

Q. Have you presented previous testimony in this docket, No. TO-011472?

A. I testified before in this docket in favor of Olympic's request for interim rates. (Exhibit T – ______ (HBF-1T)

Q. Please summarize your testimony.

A. First, I will respond to the questions the Commission asked at Paragraph 10 of the Supplemental Order in this docket. In those responses I will note the recommendations of Staff and Intervenors and generally describe the financial consequences of their recommendations. As Larry Peck also testifies, without an increase in tariff revenues there will be little hope of additional loans or capital placed at risk by Olympic's owners or others. Without additional tariff revenues or loans, Olympic will be unable to finance the $66,000,000 of capital expenditures that Bobby Talley will describe Olympic needs over the next three years.

In my responses I will also address arguments presented by Staff witness, Ken Elgin. As I will show, Mr. Elgin obviously is not familiar with normal pipeline practices in the United States and attempts to paint a picture of Olympic as having poor financial management in the past. He does not acknowledge that Olympic stopped paying dividends in 1997, that it aggressively applied for and received a refund of Federal income taxes in 2001, or that it sold its Sea-Tac facilities to raise cash for necessary capital projects. He also fails to understand that Olympic has very limited options: Either Olympic receives increased tariffs to cover needed capital projects or these projects will need to be canceled or deferred.

Collectively, Staff and Intervenors make recommendations that will require Olympic to refund well beyond all of Olympic's current cash on hand. This potential refund liability will total an estimated $17 million at the FERC and WUTC by September. Olympic does not have the financial resources to cover both (1) the summer capital budget projects and (2) this enormous potential refund liability created by Intervenors and Staff.

The impact of the Staff’s recommended increase of 0.54% is disastrous to Olympic and the citizens of the State of Washington. Such a trivial increase will require over $100 million of new capital for Olympic. As Larry Peck testifies: There is little hope that BP/ARCO will provide additional loans or equity on top of the $53 million already loaned to Olympic. Simply stated: 0.54% is not going to benefit anyone in this case. (Exhibit No. ____ (LP-1T).

Olympic cannot cut dividends because it has already reduced dividends to zero. Olympic cannot suspend interest payments on the loans from its parents because it has already suspended interest payments. There is nothing major left to cut except capital expenditures.

III. Issues Identified by the Commission in Paragraph 10 of the Commission's Third Supplemental Order Granting Interim Rates in Part

Q. Please state the issues you will discuss, which the Commission identified in paragraph 10 of its Third Supplemental Order in this docket.

A. Staff's witness, Mr. Elgin, identified eight questions that the Commission requested the parties to address in the general rate case. Exhibit T ____ (KLE-5T). I will address each one and respond to Mr. Elgin's testimony on those questions, which are as follows:

1. "How the Company came to this situation, what regulatory consequences should flow from the Company's actions, and what the Company should do in the future…"
2. "Questions exist with regard to the Company's financial structure, its plans for the future, and its ability to operate soundly."
3. "Questions exist with regard to the Company's cash flow, its lack of

audited financial reports, its failure to notify the Commission of its debt financing, its ability to secure capital in a rational manner to assure its future operations, its ability to shed the ghosts of its past, its owners' willingness to support--or share in the support of--its long-term financial needs."

4. "Questions exist with regard to the status of its investments in the Bayview Terminal and the Cross-Cascade Pipeline."

5. "Whether a firm with a more traditional capital structure would have fared better than Olympic through its recent circumstances?"

6. "How to gauge the effect of capital structure in determining long-term fair, just, and reasonable rates."

7. "The level of current management fees and whether the management contract may have required prior approval."

8. "How to account for the Bayview Terminal, the investment in the Cross-Cascade Pipeline, and the Whatcom Creek expenses for ratemaking purposes."

Q. Regarding the first issue identified by the Commission, how did the Company come to its current financial situation?

A. My answer is in two parts. In the first part, I describe Olympic's current financial situation following BP/ARCO's $53 million in loans starting in the Summer of 2000 and the effect BP Pipelines had when it took over as operator of Olympic in July 2000. In the second part, I describe how Olympic came to the financial situation BP found it in the Summer of 2000.

First, BP/ARCO essentially rescued Olympic in the Summer of 2000. Olympic is in operation today because starting in the Summer of 2000, BP/ARCO voluntarily loaned Olympic $53 million that Olympic had no other means of obtaining. BP/ARCO also guaranteed nearly $19 million of loans by JPMorgan Chase to Olympic.

Also, in June of 2000, BP Pipelines, Inc. was successful in its bid to replace Equilon as the pipeline operator and manager for Olympic Pipeline.

Following the BP/ARCO loans, Olympic was able to invest over $36 million in capital improvement projects that enabled Olympic to restart all of the pipeline segments by June 2001 and for other capital projects. BP/ARCO loans necessarily were used for capital improvement projects, because without those loans there would have been no other funds to pay for those capital improvement projects. By this time, Olympic was not paying any dividends and was not paying interest on debt owed to its owners.

In short, BP/ARCO and BP Pipelines came to a critical situation voluntarily. BP Pipelines placed its expertise and reputation in the service of making sure the pipeline could continue to operate. Olympic's current financial situation would have been far worse if not for BP/ARCO and BP Pipelines.

Q. What was the financial situation Olympic faced in the Summer of 2000 when BP/ARCO and BP Pipelines came in?

A. Olympic's financial situation as of June 2000 when BP Pipelines came in was the result of three factors:

(1) a dramatic decline in throughput volumes resulting first from the June 10, 1999 Whatcom Creek incident and then from pressure restrictions on Olympic's entire system following a September 18, 1999 hydrotest failure of a ERW steel

pipe seam. (See the direct and rebuttal testimony of Bob Batch, Bobby Talley and Bill Beaver regarding the ERW steel pipe issues.) This ERW related restriction reduced Olympic's tariff revenues by over $50 million from September 1999 to December 2001 based on the expected throughput levels in the current tariff at the FERC and the WUTC.

(2) a significant increase in expenses for capital projects and O&M expenses necessary among other things to address the ERW pipe issue and later to comply with new federal pipeline regulations on Integrity Management Programs in High Consequence Areas and other regulations (see the direct and rebuttal testimony of Bob Batch, Bobby Talley, Dan Cummings and Tom Wicklund); and

(3) Olympic's decision not to come in for an immediate rate increase due to the lower throughput and higher expenses. If Olympic had come in for rate relief earlier, Olympic would have had an approximately $50 million in additional revenues to adjust for a decline in throughput and for increased costs and added capital, all other things being equal.

Q. What does Staff say caused the Company's financial situation?

A. Staff attributes the Company's dire financial situation on management's "aggressive financial policies and pursuit of high returns and cash flows." Mr. Elgin adds that "the Company's dividend policy, the investment decisions and its financing decisions were extremely aggressive." Exhibit T ___ (KLE-5T).

Q. How do you respond?

A. As Dr. Schink and Leon Smith, former Chief of Oil Pipeline Regulation at the FERC and ICC, testify, Olympic's financial structure and policies were consistent with oil pipeline industry practice and standards. Olympic's policies were not aggressive for this unique industry. Many oil pipeline companies in the United States are wholly-owned by large integrated oil companies, where most or all of the debt is owed to the parents or is guaranteed by the parents. This is a crucial distinction.

Mr. Elgin does not compare Olympic to other oil pipeline companies. He also does not make a distinction between debt owed to oil pipeline company parents compared to the type of regulated utility debt he is familiar with – that is, debt that is owed to third parties.

Leon Smith provides the historical and regulatory background that have made oil pipeline companies unique. Dr. Schink compares Olympic to other oil pipeline companies, where the debt is owed to or guaranteed by the parents.

They disagree with Mr. Elgin that Olympic's capital structure or financial policies were "aggressive" compared to other oil pipeline companies, as do I.

Q. Do you have a specific response to Mr. Elgin's claim that Olympic's dividend policies were aggressive?

A Mr. Elgin's discussion of payout ratios does not make any comparisons to oil pipeline companies. If he would have looked at the most recent database of FERC Form 6 filings, he would see that high payout ratios are the norm rather than the exception.

As Dr. Schink testifies, it is not unusual for oil pipeline companies like Olympic to pay out all profits as dividends:

> Further, it is not unusual for pipelines, like Olympic, to routinely pay all their profits to their parents as dividends. The parents, as

> member of the pipeline's board, then determine which investment projects to pursue. These investment projects are funded by equity infusions, by guarantees in loans to the pipeline by others, or by direct loans from the parents to the pipeline.

Exhibit No. ___ (GRS-4T) at 35.

By contrast, Olympic's average dividend payout from 1992-1997 was 91%. And most of that dividend payout was reinvested in Olympic, as Dr. Schink suggests is usual.

Tesoro's witness, Mr. Hanley, uses five oil pipeline companies in the oil pipeline proxy group that had an average dividend payout ratio in the year 2000 of 119.33%, according to Dr. Schink. Exhibit No. ___ (GRS-4T) at 35. This oil pipeline proxy group has had an average payout ratio of close to 100% since 1997. (Id.)

I have examined the average dividend payout ratios for the top ten joint venture oil pipeline companies. For the year 2000, those companies (including Colonial, Buckeye, Plantation, Kaneb, Explorer, Dixie, Wolverine, Seminole, Trans Montagne and Westshore) had an average payout ratio of over 92%.

Q. Do you have a specific response to Mr. Elgin's testimony regarding Debt/Equity Ratios?

A. Olympic's capital structure is neither unusual nor aggressive compared to oil pipeline industry practices, as Dr. Schink and Leon Smith also agree.

Mr. Elgin does not compare Olympic's capital structure to that of other oil pipeline companies. He does not refer to the unique historical and regulatory circumstances that led to the capital structure common for oil pipeline companies.

The amount of debt owed to the parents is capital at risk. In Olympic's case, all but a small percentage (less than 10%) of Olympic's total debt is owed to the parents or guaranteed by the parents.

Most of the "debt" in the oil pipeline industry is owed to the owners instead of third parties, and the debt owed to third parties is usually guaranteed by the owners. That is true in Olympic's case as well. This situation is a significantly different than the debt that regulated utilities usually have, which is debt owed to third parties instead of their parent-owners. Mr. Elgin makes no distinction between the type of debt regulated utilities have compared to the type of debt owed by a pipeline company to parents. But this is a crucial distinction.

In my experience, many joint venture pipeline companies have a capital structure similar to Olympic’s. Dr. Schink has also testified in the interim case and here in the direct case that it is not unusual for oil pipeline companies to have a capital structure similar to Olympic's.

Leon Smith, former Chief of Oil Pipeline Regulation at the FERC and ICC, describes the unique and historical and regulatory circumstances that have produced the capital structures used by oil pipeline companies. Exhibit No. ___ (LPS-1T). Olympic's capital structure is neither unusual nor aggressive. He points out that FERC had long addressed the regulatory consequences of the capital structure used by joint venture oil pipelines and FERC often uses the parent's capital structure where the debt is mostly owed to or guaranteed by the parent.

Q. Did Olympic's capital structure or past dividend policies cause Olympic's current financial situation?

A. No. The reason Olympic faces a financial emergency results from the dramatic drop in throughput and associated revenues since 1999, and increased costs, including the costs of ERW pipe testing, repair and replacement, and costs from new HCA regulations. In fact, Olympic’s expenses increased at a compounded annual growth rate of 10% per year between 1992 and 1997, and revenues increased less than 6% in the same time period. It should be pointed out that this disparity was already in place before the Whatcom Creek incident

As Dr. Schink points out, it is not unusual for a pipeline like Olympic that is wholly-owned by several large integrated oil companies to have an almost all debt capital structure. As shown in Exhibit No. _____ (GRS – 4T), there were at least four other such pipelines during the 1999 to 2000 period. The four pipelines are all financially healthy pipelines. As Dr. Schink testifies, "what dramatically distinguished Olympic from other financially strong pipelines is Olympic's cash flow crisis." Exhibit No. _____ (GRS-___) Olympic's revenues in 2000 covered only 54.1% of its operating and maintenance expenses. The other four pipeline companies' revenues are 165.4% to 248.8% of their operating and maintenance expenses. Olympic's cash flow crisis is a post-1999 phenomena. In 1998, its last year of full operation, Olympic's revenues were 185.5% of O&M expenses and Olympic was a financially healthy pipeline company. Exhibit No. _____ (GRS-4T)at 34. As Dr. Schink has testified, in order to make Olympic a financially sound company, it needs more revenues from operations which, given its dramatic decline in throughput, requires a higher tariff rate for Olympic.

Q. What regulatory consequences should flow from the Company's actions?

A. My answer is in two parts. First, there should be no adverse regulatory consequences. Because Olympic's policies are similar to most joint venture oil pipeline companies in the United States, this question has been considered and addressed by the FERC over the years as Leon Smith testifies. Exhibit No. ______ (LPS-1T). The FERC does not believe these policies are unusual and does not impose adverse regulatory consequences for those policies. Instead, FERC accepts the oil pipeline industry financial practices and often uses the capital structure of the oil pipeline parents in order to recognize the character of the debt owed to the parent companies. George Schink and Leon Smith also testify that Olympic's financial policies were consistent with oil pipeline industry practices and standards. In summary, they agree there should be no adverse regulatory consequences from Olympic's prior policies. Leon Smith recommends FERC's approach to this unique industry because FERC has had reason to carefully consider it and oil pipeline companies have come to rely on it. Id.

As Mr. Smith said:

"In Opinion No. 154-B the FERC stated that in recent gas pipeline cases it had expressed a preference for actual capital structures rather than hypothetical capital structures. Specifically the FERC stated:

> The actual capital structure could be the actual capital structure of either the pipeline or is parent. The Commission concludes that a pipeline which has issued no long-term debt or which issues long-term debt to its parent or which issues long-term debt guaranteed by its parent to outside investors should sue its parent’s actual capital structure. However, a pipeline which issues long-term debt to outside investors without any parent guarantee should use it’s

> (the pipeline's) own capital structure. (31 FERC ¶ 61,377 at 61,836)

Id. at 12-13

Mr. Smith adds: "The basic reason the FERC expressed a preference for actual capital structures is that it realized these structures would more accurately reflect the risks of the specific company for which the capital structure was being employed. If parent companies guaranteed the debt of their subsidiaries, these parent companies were in essence assuming the risk of their affiliates and the FERC determined it was more appropriate to use the parent company capital structures." Id, at 13.

Overall, Mr. Smith's testimony presents a considered response to the Commission's question on regulatory consequences:

> My testimony will largely concentrate on precedent and history at the FERC. My reason for this is not that I believe FERC precedent should override WUTC precedent. Rather, the WUTC has had little opportunity to consider the issues associated with oil pipeline ratemaking, which for reasons I will discuss below involves significantly different considerations form those associated with other public utilities. By contrast, the FERC has spent considerable time analyzing oil pipelines and developing a ratemaking methodology that most accurately reflects the unique circumstances of oil pipelines. In addition, it is my understanding that in many respects the WUTC has adopted elements of FERC's regulation with regard to oil pipelines, including requiring accounts to be kept according to the Uniform System of Accounts, and requiring pipelines to provide a copy of the FERC Form 6 to the WUTC. Id. at 3.

Second, the regulatory response to this situation should be appropriate for the current state of the pipeline and incorporate the expected fluctuations that will occur over the next several years. Intervenors and Staff have repeatedly acknowledged the extraordinary events and unusual circumstances surrounding this case. In the next breath, though, we hear how “traditional rate-making methodology” should be applied. This approach is neither appropriate nor in the best interest of Olympic, its shippers, or the general public of the state of Washington. Instead, the regulatory approach should be tailored to acknowledge the fluid nature of Olympic’s operation and should be crafted to ensure that the appropriate signal is sent to attract capital on reasonable terms and to ensure that a quality operator has enough incentive to manage the pipeline.

Third, this would be the wrong time for the Commission to formally adopt a capital structure, a methodology, or adjustments that differ from that used at the federal level. As Dr. Schink demonstrated, a properly-compensated switch from the federal approach (e.g., TOC) to the conventional methodology used by the Commission (e.g., DOC) would result in virtually the same revenues for Olympic as it would obtain under the federal approach. Given this fact and that Olympic must continue to adhere to the federal approach in the interstate regulatory arena, it is to no one's advantage to try to implement a methodology conversion at this juncture made the unique circumstances. The testimony of Leon Smith and Christy Omohundro also support this recommendation. Exhibit No. ____ (LPS-1T); Exhibit No. ___ (CAO-5T).

Q. What is Olympic's recommendation with respect to what the Company should do in the future?

First, for the Company’s part, upon receiving a fair, just, and reasonable tariff**,** it should continue to move forward with necessary safety projects and to improve the pipeline throughput by getting back to 100% pressure. The Company will not be in a position to provide dividends to its shareholders for many years and will only be able to repay a portion of loans to Equilon and BP/ARCO. With the requested tariff increase, the Company would recommend to its shareholders to convert a certain amount of debt to equity. The Company is not asking to make an exorbitant return. Also, the Company would be required to adjust rates to the extent of major changes in operations such as much lower future capital spending or much greater volumes than anticipated.

For example, Dr. George Schink has also testified that Olympic's capital structure should be consistent with federal precedent for pipeline companies like Olympic that do not independently issue debt. Under those circumstances, FERC precedent allows Olympic a capital structure based on the capital structures of its parents. Olympic's equity share of capital is set equal to the ownership share weighted equity shares of capital for its parents. Based on the most current data, Olympic's equity share of capital is 86.85%.

Second, Olympic recommends a collaborative process to adopt an automatic adjustment mechanism to tariff rates for throughput changes. If Olympic had an automatic tracking mechanism for throughput, Olympic would have had an additional $50 million of revenues between September 1999 and December 2001.

Finally, Olympic recommends a collaborative process to draft a memorandum for immediately adding new capital spending to rate base as those expenditures being made and to reduce regulatory lag.

Q. What is your response to Staff recommendations with respect to what the company should do in the future?

A. Staff recommends that the company should "develop a financial plan to build equity in the company through retaining its earnings in equity investments." But, as Dr. Schink has pointed out, "the fact that Olympic's own capital structure contains largely or even exclusively debt is irrelevant because Olympic does not issue stock and Olympic's actual potential creditors look to Olympic's parents for loan guarantees." Exhibit ____ (GRS-4T)at 89. As Dr. Schink has noted, the "creditors" concern is not with Olympic's capital structure but with Olympic's cash flow. The only capital structures of concern to Olympic's creditors are those of Olympic's parents. The WUTC cases cited by Staff's witness, Dr. Wilson, where the WUTC strongly requests that the regulated entity increase the equity share in its capital structure involved stand-alone, regulated entities that issued stock to the public. For such stand-alone companies, capital structure does matter to creditors, but Olympic is not a stand-alone, regulated entity. Further, Mr. Elgin says in his testimony that "I recommend that the Commission provide an incentive to the Company to move, over time, to more sound financial footing". There are no details of this "incentive". Instead, the Staff mechanically follows its regulatory model and opts to penalize Olympic on virtually every issue on which it could apply discretion. Again, a 0.54% increase will only result in a further downward spiral of debt for Olympic and increase its odds for bankruptcy

Q. Do you agree with Dr. Schink that cash flow is the paramount concern for Olympic's parents in deciding whether to make or guarantee additional loans to Olympic?

A. Yes. As I have also explained, cash flow is the significant concern in terms of Olympic's ability to attract capital from its parents, who have loaned most of the capital directly or guaranteed those loans. I reviewed what cash flows are produced by a series of different rate levels. For example, the interim rate level of 24.3% would not produce cash flow sufficient to attract capital. At that 24.3% level, the cash flows produced do not cover ongoing O&M and capital needs or repay existing debt. In fact, they would require an additional amount to be borrowed of $52 million.

Q. What is Olympic's long-term financial plan?

A. My answer is in three parts. First, as Bob Batch has testified, when BP Pipelines took over as the operator for Olympic Pipe Line in the Summer of 2000, the first priority was to stabilize revenues that had dramatically declined due to a drop in throughput. The focus was to bring back onto line those segments not in service, which was done by June 2001--although the pipeline system is still under an 80% pressure restriction until it completes its ERW testing, evaluation and any needed replacements or repairs.

In this initial period, BP/ARCO loaned Olympic $53 million, which enabled Olympic to spend approximately $36 million in capital improvement projects and the other needed increased expenditures. As part of its financial plan, Olympic has not paid any dividends since BP Pipelines has become the operator of Olympic, and Olympic has not paid any interest on loans from the owners.

Second, for the immediate term, Olympic's financial plan depends on obtaining a rate increase sufficient to enable Olympic to borrow further funds from BP/ARCO in order to complete the $66 million in capital projects needed over the next three years. When those projects are completed, it is anticipated that Olympic will be able to restore its system to 100% pressure, increasing throughput and associated revenues. As described above, Olympic's ability to attract capital in this unique industry depends to a significant degree on its cash flow.

Third, for the longer term, Olympic's financial plan will not differ from that of other joint venture oil pipeline companies in the United States. BP Pipelines operates pipelines around the United States and follows industry practices and policies. However, if an appropriate tariff is approved by the Commission, Olympic will endeavor to work with its shareholders to a compromise with the WUTC regarding capital structure and dividend payout policy. In any event, it appears certain that no dividends will be paid for the long-term foreseeable future.

One new proposal we have made that is not common and that will help moderate revenue fluctuations is an automatic throughput adjustment mechanism. This would protect shippers in the event of higher than predicted throughput and protect Olympic in the event of lower than expected throughput. It would mitigate the revenue impact of disruptions in flows due to earthquakes, third-party damage or other causes.

Another new proposal we have discussed with Staff is to add an automatic adjustment to rate base for capital additions and to avoid regulation log. We understand that Staff would incorporate that into its testimony, but we apparently misunderstood.

Q. What was the second issue identified by the Commission in its order?

A. "Questions exist with regard to the Company's financial structure, its plans for the future, and its ability to operate soundly."

Q. Please respond.

A. In the previous answers, I have addressed the Company's financial structure, its plans for the future and its ability to operate soundly. Larry Peck and Bobby Talley also discus the ability to operate soundly in the absence of new tariff revenues. In short, the tariff recommendations of Staff would compromise the sound operation of Olympic.

Q. What is the third issue identified by the Commission?

A. "Questions exist with regard to the Company's cash flow, its lack of audited financial reports, its failure to notify the Commission of its debt financing, its ability to secure capital in a rational manner to assure its future operations, its ability to shed the ghosts of its past, its owners' willingness to support -- or share in the support of -- its long-term financial needs."

Q. Please respond.

A. I discussed Olympic' cash flow prospects above. There are no questions regarding the cash flow of the pipeline. A substantial increase in the tariff is absolutely necessary to improve the cash flows of this company – regardless of the testimonies and rate-making assertions made by both Staff and Intervenors. Jim Mach addresses the audit issues. Without BP/ARCO loans Olympic would not have been able to make needed capital improvements.

Q. What is Staff's position regarding the Company's cash flow and financial statements?

A. As to cash flow, Staff states that:

> Over time, as the Company's cash flows improve with a return to normal operating pressure, the Company will be able to produce a credible financial plan and rational financial statements. Finally, an infusion of equity from Olympic's owners will accelerate the Company's prospects for returning to sound financial performance.

Exhibit No. T-___ (KLE-5T) at 11, lines 10-14.

Q. How do you respond?

A. Under Staff's recommendations there is no reasonable prospect that Olympic's cash flows will improve or that Olympic will be able to return to normal operating pressure. Mr. Elgin does not understand the financial structure and history of the oil pipeline industry and does not present a workable or credible financial plan. He assumes that Olympic's owners will provide "an infusion of equity." But, given Staff's rate recommendation, his assumption is unfounded. Staff shows a lack of basic understanding of oil pipeline financial practices and expectations as Dr. Schink, Leon Smith, and others detail.

Q. What is the fourth issue listed by the Commission in its Third Supplemental Order?

A. "Questions exist with regard to the status of [Olympic's] investments in the Bayview Terminal and the Cross-Cascade Pipeline."

Q. Please respond.

A. With regard to the Bayview Terminal, Bobby Talley has testified that the Bayview Terminal is used and useful for a number of current pipeline purposes, including an emergency overpressure relief system, staging areas for repairs, headquarters for the northern area maintenance team, storage for water for hydrotesting and diesel for smart pig operations, and for other purposes. As with the rest of Olympic' pipeline system, Bayview will provide additional services when the system is restored to 100% pressure, as Bobby Talley testifies. However, under Staff's recommendations, capital would not be available to restore the system to 100% pressure.

With regard to the Cross-Cascade pipeline, this project is on hold, and Olympic has not sought to include it in rate base. It was a projected supported by shippers, and it has not been abandoned but has been deferred as a lesser priority.

Q. What is Staff's position regarding the status of Olympic's investments in the Bayview Terminal and the Cross-Cascade Pipeline?

A. Staff recommends that Bayview be removed from results of operations, but that it be allowed to accrue AFUDC until it comes becomes operational. Staff does not address the Cross-Cascade Pipeline because Olympic has not sought to include it in rate base.

Q. How do you respond?

A. Bobby Talley's testimony responds to Staff's comments and recommendations on Bayview. Olympic agrees with Staff on the Cross Cascade pipeline.

Q. What is the fifth issue identified by the Commission?

A. "Whether a firm with a more traditional capital structure would have fared better than Olympic through its recent circumstances."

Q. Please respond.

A. Ironically, Olympic was very "traditional" in its capital structure when compared to most U.S. pipeline joint ventures. This issue assumes that Olympic should have adopted different financial practices in the past. In fact, if Olympic was financed with more equity, it would have been non-traditional compared to its peer group where the average debt/equity ratio is greater than 70%. In fact, at the end of 1998 (before the Whatcom Creek incident), Olympic's debt/equity ratio was exactly 70%.

Q. What is Staff's position regarding more "traditional" capital structure?

A. Staff criticizes Olympic's dividend policy from 1990 through 1999 as leaving Olympic "without any financial flexibility" and that "[i]f any event disrupted operations curtailing its cash flow, the Company was financially unable to respond." Exhibit No. T-___ (KLE-5T) at 17, lines 13-15. Staff contends that, if not for Olympic's dividend policy of the 1990s, "Olympic would have been able to produce a sound financial plan in order to restore operations, and it would have been able to provide assurances to lenders that it had the ability to pay off the new debt once operations were restored." Id. at 18, lines 5-8.

Q. How do you respond?

A. As I pointed out, Staff is simply ignoring common practices of U.S. pipelines and engaging in "Monday morning quarterbacking." Olympic, in fact, had a traditional capital structure for oil pipelines before Whatcom Creek.

The FERC website contains a database of hundreds of pipelines that must file FERC Form 6s. Again, the average payout ratio for all pipelines in 2000 was 92% for the largest joint venture pipelines.

Mr. Elgin's assertions are not based on oil pipeline management experience. He appears to suggest a program of self-insurance for risk of disruptions from everything from earthquakes, accidents, or sabotage. The proper response to disruptions of operations is to have insurance or to have an automatic throughput adjustment mechanism, or both. If equity investors or lenders are to also act as insurers, then the rate of return on equity loans must be increased for that risk.

Q. What is the sixth issue listed by the Commission in its Third Supplemental Order?

A. “How to gauge the effect of capital structure in determining long-term fair, just, and reasonable rates.”

Q. Please respond.

A. Less than 10% of the total debt is neither guaranteed by Olympic's shareholders nor are loans directly from the shareholders. In other words, Olympic's owners stand behind 90% of Olympic's debt. The capital structure should be more closely aligned to the credit of the shareholders, who are really the only parties keeping this pipeline afloat.

Q. How does Staff propose to gauge the effect of capital structure in determining long-term fair, just, and reasonable rates?

A. Staff proposes a "small equity cushion" as an incentive to the owners to restore the equity in the Company. Staff finds Olympic’s proposal “unreasonable” based on its assessment of Olympic’s pre-Whatcom Creek dividend policy.

Q. How do you respond?

A. Mr. Schink responds to the proper capital structure for joint venture oil pipeline companies.

Q. What is the seventh issue listed by the Commission?

A. "The level of current management fees and whether the management contract required prior Commission approval."

Q. What is the Staff's position regarding Olympic's current management fees and Olympic's failure to receive Commission pre-approval on management contracts?

A.. Staff criticizes Olympic's failure to receive Commission pre-approval on management contracts, but does not propose that the Commission penalize Olympic for this.

Q. Please respond.

A. Olympic agrees with Staff's decision not to penalize Olympic for any issue regarding Commission preapproval on management contracts.

I was personally responsible for the bid that BP developed in its efforts to take over operations of Olympic. I worked for several weeks with all of our departments to develop the management fee based on expected incremental cots for BP for such functions as Accounting, Engineering, Information Technology, and others. Quite frankly, we misjudged the support needed for Olympic. The Company is getting an absolute bargain at the current management fee rate, considering all of the resources devoted by BP's non-Olympic personnel. This additional effort is necessary because of Olympic's capital spending, audits, accounting, and systems activity. The tariff activity is another layer of activity – but the support is basically pro bono.

I am not a legal expert and therefore unable to determine whether the contract required Commission approval. However, I would hope that the Commission would have the wisdom to put safety before administration. If the Company failed to get approval required, it should remedy the situation.

Q. What is the last issue listed by the Commission in paragraph 10 of its Third Supplemental Order?

A. "How to account for the Bayview Terminal, the investment in the Cross-Cascade Pipeline, and the Whatcom Creek expenses for ratemaking purposes."

Q. Please respond.

A. We have addressed the treatment for the Bayview Terminal and the Cross-Cascades pipeline in previous answers. With regard to Whatcom Creek expenses, Olympic has not included the direct costs of Whatcom Creek expenses in its request for rates. Elsewhere, we have described in detail the difference between the ERW-weld issues and the Whatcom Creek issues, which Intervenors have confused. The ERW weld seam failures, which prompted the pressure restrictions on Olympic's entire system, were weld issues that involve pre-1970 ERW-weld steel pipe. All of the information regarding Whatcom Creek shows that the Whatcom Creek incident was not caused by an ERW-weld seam failure but, instead, was initiated by excavation damage by a third-party contractor not associated with Olympic.

Q. Does this conclude your present testimony?

A. Yes.

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