BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. OLYMPIC PIPE LINE COMPANY, INC., Respondent.	DOCKET NO. TO-011472 ANSWER ON BEHALF OF COMMISSION STAFF IN PARTIAL SUPPORT OF TESORO'S MOTION FOR SUMMARY DETERMINATION

This Answer is filed on behalf of Commission Staff. Staff requests the Commission issue an order granting Tesoro's Motion for Summary Determination ("Motion") in part.

In short, Olympic has not presented a *prima facie* direct case that the FERC formula presented by the Company in this case is appropriate. The consequence of granting Tesoro's Motion, to the extent Staff recommends, is dismissal of the filing. Without a direct case supporting the ratemaking methodology Olympic has offered, there is no direct case. Olympic should regroup, and refile an adequate direct case in another docket.

I. Legal Standards

At pages 3-10 of its Motion, Tesoro makes three basic legal points: 1) Olympic bears the burden of proving the rates it filed are fair, just, reasonable, and sufficient

(RCW 81.04.130); 2) Olympic must file a direct case establishing a *prima facie* case for the rates it has filed; and 3) Rebuttal is not the place for Olympic to make its *prima facie* case.

These points are well-established, and properly place the responsibility of producing an adequate direct case where it belongs: on the Company.

The Commission has recognized that the party with the burden of proof must establish a *prima facie* case in its direct case. In *GTE Northwest, Inc. v. Whidbey Telephone Co.*, Docket No. UT-950277, Fifth Supplemental Order (April 2, 1996), the Commission dismissed GTE's complaint because of its failure to present a *prima facie* case. *Id.* at 7. In doing so, the Commission stated:

> GTE chose to bring a complaint case under RCW 80.04.110. In making this choice, GTE assumed the burdens of the moving party in a complaint proceeding. It was the responsibility of GTE to analyze and determine what it believed to be the elements of a *prima facie* case. It was the responsibility of GTE to determine what proof would establish each of those elements, *and to proffer the requisite evidence in its direct case*.

Id. at 6 (emphasis added).

The purpose of rebuttal evidence is to answer new material presented by the opposing party. *State v. White*, 74 Wn.2d 386, 394, 444 P.2d 661 (1968) (citation omitted). Rebuttal evidence is not a reiteration of evidence in chief, but is evidence offered in reply to new matters. *Id.* See also, *W. E. Roche Fruit Co. v. Northern Pacific Railway Co.*, 184 Wn. 695, 698, 52 P.2d 325 (1935) (Rebuttal evidence is ordinarily limited to a reply to new points).

Evidence available to a party for its direct case is generally not proper rebuttal evidence. *Kremer v. Audette*, 35 Wn. App. 643, 648, 668 P.2d 1315 (1983). Although rebuttal evidence may overlap to some degree with the evidence presented in the direct case, the moving party may not withhold evidence supporting issues which it had the burden of proving in its direct case, only to present that evidence in rebuttal. *White*, 74 Wn.2d at 395.

Here, Olympic has the burden of proving the rate increase it seeks is just and reasonable. RCW 81.04.130. Olympic must meet its burden by presenting a *prima facie* case in its direct case. Olympic failed to produce a *prima facie* case on the FERC methodology, and summary determination of that issue is now appropriate. Olympic's attempt to provide a direct case through rebuttal should not be tolerated.

II. Olympic Knew it Needed to Defend the Ratemaking Methodology Supporting its Case

It is no surprise to Olympic that it needed to file a direct case on the propriety of the FERC methodology it proposes. Olympic knew this as early as July 2001.

The last Olympic tariff filing was in Docket No. TO-010792, a rate case initiated by Olympic seeking a 76% rate increase in general intrastate rates. That filing was suspended by the Commission, and later withdrawn on motion of Olympic. In its July 3, 2001 "Motion to Withdraw Tariff Filing and Cancel Pre-Hearing Conference" page 3 (Exhibit A to this Answer), Olympic stated in part:

> In light of the apparent rejection of the FERC methodology to support Olympic's tariff increase, Olympic believes it is in all parties' interest that its submission, predominantly based upon FERC methodology, be withdrawn and that it be provided additional time to understand the methodology which the Commission

will accept and to prepare a cost of service analysis that fully complies with the WUTC's methodology and requirements.

The Commission granted Olympic's motion by Order dated July 11, 2002.[1]

Nearly four months later, on October 31, 2001, Olympic filed tariffs initiating the instant case, Docket No. TO-011472, seeking a 62% rate increase. The same day, Olympic filed a "Petition of Olympic Pipe Line Company for a Policy Statement and Order Clarifying Oil Pipeline Rate Methodology" (October 31, 2001 Petition)(Exhibit B to this Answer, excluding attachments).

In its October 31, 2001 Petition, Olympic sought to have the Commission declare the FERC ratemaking methodology to be appropriate. Olympic acknowledged that there was "uncertainty regarding what methodology and filing requirements would be formally adopted by the Commission for oil pipeline rates…" (See October 31, 2001 Petition at page 5, ¶ 12, in Exhibit B to this Answer). Olympic also acknowledged: "It appears that the Commission has not made a formal policy determination on the appropriate methodology for intrastate pipeline rates." (*Id.* at page 5, ¶ 13).

On November 20, 2001, the Commission entered its "Complaint and Order Suspending Tariff Revisions and Instituting Investigation; Denying Request for Policy Statement or Declaratory Order" (Suspension Order). In its Suspension Order, the Commission denied Olympic's request for a policy statement or declaratory ruling on the appropriate ratemaking methodology "[b]ecause the Commission has determined to

[1] In its July 3, 2001 Motion, Olympic also committed to working with Staff and Intervenors prior to refiling its rate case. Olympic failed to meet this commitment.

address the question of applicable ratemaking methodology in the context of the adjudication…" Suspension Order at page 3, ordering ¶ 6.

More than three weeks later, on December 13, 2001, Olympic filed its direct testimony and exhibits in support of its case for general rate relief.

In sum, Olympic admitted last summer that the appropriate ratemaking methodology was an issue in this case. More than three weeks before filing its direct case in the instant docket, the Commission made clear the ratemaking methodology issue would be resolved in this docket. Olympic had ample time to provide a direct case on appropriate ratemaking methodology. It failed to do so.

III. Olympic Has Not Presented a Prima Facie Case Defending its Presentation of the FERC Methodology

Olympic's evidence justifying use of the FERC methodology is presented by Ms. Omohundro. No other Olympic witness defends the propriety of the FERC methodology. The points Tesoro makes in its Motion regarding Olympic's lack of a direct case, Ms. Omohundro's unfamiliarity with FERC methodology and Olympic's failure to support the FERC methodology, are well taken.

Ms. Omohundro summarizes Olympic's case on ratemaking methodology on page 3 of Exhibit No. ___ (CAO-3). The crux of Olympic's case is her factual assertion that "the Commission has never departed from the federal oil pipeline methodology for Olympic since 1983." She goes on to testify that "a decision to switch methodologies should be made in the context of regulatory history of the regulated company and with regard to the investment-backed expectations of the Company."

Ms. Omohundro also testifies that the WUTC methodology is appropriate "for public service companies providing essential services, with a duty to expand their systems to meet consumer demand." She contends the WUTC methodology "is not designed for and is not appropriate, however, for use in setting rates for an oil pipeline with no duty to expand capacity and which competes for capital worldwide for sources of capital." (Exhibit No. ___ (CAO-3) at page 3). The remainder of Ms. Omohundro's direct testimony reiterates these points.[2]

For the reasons stated below and in Tesoro's Motion, Exhibit No. ___ (CAO-3) should be stricken.

A. Ms. Omohundro Lacks Testimonial Knowledge of the Facts Necessary to Support Her Testimony, and She is Unqualified to Give the Legal Opinions Contained in Her Testimony

Ms. Omohundro lacks testimonial knowledge for the central point of Olympic's evidence: *i.e.*, that "the Commission has never departed from the federal oil pipeline methodology for Olympic since 1983." For example, when asked whether Olympic used the federal oil pipeline methodology in Olympic's 1996 Sea-Tac surcharge rate filing, Docket No. TO-961053, Ms. Omohundro testified she had no personal knowledge of that, and deferred the question to Mr. Collins. (Deposition of Ms. Omohundro at Tr. 33, line

[2] Mr. Batch summarizes Ms. Omohundro's testimony in his Exhibit No. ___ (BCB-8), page 7, lines 3-22. There, he introduces Ms. Omohundro as Olympic's witness who "will testify regarding this [methodology] issue." Mr. Batch is not providing direct testimony on this issue. Mr. Batch confirmed in his deposition that its was Ms. Omohundro who was Olympic's witness to respond to questions regarding this issue. (Batch Deposition, in Exhibit D. to this Answer. Tr. 13, line 15 to Tr. 14, line 9).

24 to Tr. 35 line 7, in Exhibit C to this Answer). Mr. Collins did not file direct testimony on the subject. [3]

Moreover, Olympic's direct case lacks any proof whatsoever that the *Commission* ever adopted any specific methodology for setting rates for Olympic. No Commission order is cited. No finding of fact or conclusion of law is offered.

Indeed, in Olympic's October 31, 2001 Petition, discussed earlier, the Company admitted the Commission had not adopted any specific ratemaking methodology for intrastate ratemaking: "It appears that the Commission has not made a formal policy determination on the appropriate methodology for intrastate pipeline rates." (See October 31, 2001 Petition at page 5, ¶ 13, which is in Exhibit B to this Answer).

At most, the Commission has allowed rates to go into effect as filed by Olympic. As a matter of law, absent a Commission order adopting a methodology, Olympic cannot support its testimony on what specific methodology the Commission "has never departed from."

The result is that Ms. Omohundro's assertions that the Commission in fact has "never departed from the federal oil pipeline methodology" are unsupported by her personal knowledge, and are unsupportable as a matter of law. That testimony should be stricken.

Also without factual foundation is the testimony Olympic offers to distinguish oil pipelines from those public service companies that provide "essential services." (Exhibit

[3] Staff has testified in deposition that Olympic's rate filings since 1983 have not all been based on FERC methodology. If this issue goes to hearing, and if Olympic presents a witness with knowledge, this point will be further established.

No. ___ (CAO-3) at page 4). While Ms. Omohundro testifies to the alleged fact that oil pipelines are distinguishable since they "compete for capital worldwide for sources of capital [stet]," she admitted in deposition that most public service companies, including those providing "essential services," compete worldwide for sources of capital. (Omohundro Deposition Tr. 47, lines 3-24, in Exhibit C to this Answer). Accordingly, Olympic provides no facts to support the distinction it advances.

Ms. Omohundro also lacks testimonial knowledge on Olympic's alleged "investment backed expectations" she refers to in her testimony. In her deposition, Ms. Omohundro admitted: "I am not the expert, nor did I study necessarily how Olympic made decisions on how to make its capital investments in this state." (Omohundro Deposition at Tr. 16, lines 1-7, in Exhibit E to this Answer).[4] If she does not know those facts, she cannot testify to those facts.

But even if Olympic actually made investments based on an "expectation" that a specific ratemaking methodology would continue, and some Olympic witness with knowledge was produced to testify to that, that testimony would be legally irrelevant. As a matter of law, a public service company has no legitimate expectation that a specific

[4] Ms. Omohundro deferred to the testimony of Mr. Talley and Mr. Batch regarding on what Olympic's expectations were when they constructed plant in this state before June 2000. (Omohundro deposition at Tr. 16, lines 1-17, in Exhibit E. to this Answer). Neither Mr. Batch nor Mr. Talley filed direct testimony on this issue, either. Moreover, Mr. Batch and Mr. Talley lacked personal knowledge in this area. Mr. Batch was asked, "Do you know what considerations or expectations Olympic actually had or applied before it elected to invest in the pipeline before that date [June 2000]?" He answered, "No." (Deposition of Mr. Batch at Tr. 28, line 22 to page 29, line 8, in Exhibit F to this Answer). Mr. Talley was asked, "So you simply don't know the considerations or expectations Olympic actually had or applied before it elected to invest capital in the pipeline before July 2000?" He answered: "I do not." (Deposition of Mr. Talley at Tr. 40, lines 8-12 in Exhibit G to this Answer).

form of regulation will continue. *Dusquesne Light Co. v. Barasch*, 488 U.S. 299, 316, 109 S. CT. 609, 102 L. Ed. 2d 646 (1989).

Finally, Ms. Omohundro offers to distinguish oil pipelines from other public service companies based on her legal opinion that oil pipelines have "no duty to expand capacity." (Exhibit No. ___ (CAO-3) at page 5). Ms. Omohundro admitted in her deposition that her filed testimony was not intended to supply legal opinions. (Ms. Omohundro Deposition at Tr. 6, lines 12-19, in Exhibit E. to this Answer). In any event, her legal opinion is wrong. Oil pipelines, as other common carriers, have a legal duty to provide adequate facilities to meet demand. RCW 81.28.010 states in pertinent part:

> Every common carrier shall construct, furnish, maintain and provide safe, adequate and sufficient facilities … to enable it to promptly, expeditiously, safely and properly receive, transport and deliver all … property offered to or received by it for transportation…

This obligation is enforceable by the Commission. RCW 81.28.240 states, in pertinent part:

> Whenever the Commission shall find, after such hearing, that the … facilities of any such common carrier in respect to the transportation of … property are … inadequate or insufficient, the Commission shall determine the … facilities … to be furnished [or] constructed … and fix the same by its order or rule.

In sum, Tesoro's Motion to strike the testimony of Ms. Omohundro should be granted. Ms. Omohundro has no knowledge of the ratemaking methodology actually used by Olympic in all of the Company's rate filings in this state since 1983. She relies on no Commission order in which the Commission established a ratemaking methodology for Olympic. The facts Olympic offers to distinguish oil pipelines from other public service companies are not factual distinctions at all. Ms. Omohundro has no

knowledge of Olympic's actual investment expectations. She offers improper and incorrect legal conclusions. And, much of her testimony lacks relevance.

Exhibit No. ___ (CAO-3) should be stricken in its entirety.

B. Olympic Has Not Offered Direct Evidence That its Use of Deferred Return in Calculating Rate Base is Appropriate. In Any Event, Recovery of Deferred Revenues is Improper Since Olympic Lacks an Accounting Order Permitting the Deferral

Since Olympic failed to justify its overall use of the FERC methodology in its direct case, it follows that Olympic also has provided no defense for any of the elements of that methodology. We focus on just two elements in this Answer: deferred return and Starting Rate Base.

Olympic's proposed rate base contains $25,287,000 in what it calls "deferred return." (See Olympic Exhibit No. ___ (CAH-4), Schedule 5). In simple form, Olympic seeks rates based on recovery of a portion of the overall return that was allegedly "deferred" from prior periods. This "deferred" return is capitalized, and amortized to rates over time. FERC apparently authorizes this as part of its methodology.[5]

Tesoro correctly points out in its Motion that Olympic provides no direct testimony that collection of this deferred return is appropriate. (Motion, Section 4.g, pages 30-33).

Moreover, Olympic seeks to collect these deferred revenues without having secured a Commission accounting order permitting Olympic to defer the revenues in the first place. Such an order is required.

For example, in its Eleventh Supplemental Order in Docket No. UE-920433, UE-920499 and UE-921262 (Sept. 23, 1993) at page 53, the Commission ruled that recovery of deferrals without an accounting order permitting such deferrals, would not be permitted:

> 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.

This is a regulatory principle of long standing. For example, in its Fourth Supplemental Order in Cause No. U-82-12 and U-82-35 (Feb. 1, 1983), the Commission rejected Pacific Power & Light's attempt to collect deferred amounts without an accounting order approving the deferral:

> 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.

Thus, there are two independent reasons for rejecting Olympic's use of the deferred return: 1) the lack of any direct case supporting the propriety of the deferred

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[5] A detailed explanation of deferred return is provided by Staff witness Mr. Twitchell in his Exhibit No. ___ (MLT-1T) at pages 18-20.

return, and 2) the lack of an accounting order from this Commission permitting the deferral in the first place.

C. Olympic Has Not Presented a Direct Case Defending its Use of the Net Write-Up of Starting Rate Base

Olympic also provided no direct case justifying its inclusion in rate base of $8,347,000, which the Company calls the net Write-Up for Starting Rate Base. (Exhibit No. ___ (CAH-4), Schedule 5). Tesoro's Motion is correct in this regard. (Motion, Section 4.h, pages 33-34).

In simple form, FERC apparently permits oil pipeline companies to increase their rate base by an amount related to a reproduction cost new methodology formerly used by the ICC (FERC's regulatory predecessor with respect to oil pipelines) and then initially used by FERC.[6] FERC initially justified its use of this method in part because it produced "handsome rate base write-ups" and "creamy returns on book equity." FERC Order 154, *Williams Pipe Line Company* (November 30, 1982)(as quoted by the court in *Mid-America Pipeline Co. v. United States*, 734 F.2d 1486, 1497 (D.C. Cir. 1984)(This court decision is often referred to as "*Farmer's Union II*").

FERC's initial use of reproduction cost new methodology was rejected by the federal court in *Farmer's Union II, supra.* Upon remand, FERC nonetheless permitted oil pipeline companies to write-off the balances related to this unlawful valuation method over time. FERC Order 154 B, *Williams Pipe Line Company* (June 28, 1985). This action by FERC has not been reviewed by any court.

In Washington, under Title 80 RCW, the Commission has the discretion to use "any method or combination of methods warranted by law." *See State ex rel. Pacific Tel. & Tel. Co. v. Department of Public Service,* 19 Wn.2d 200, 244 (1943). This case was decided under RCW 80.04.250, the Commission's valuation statute, which contains the term "fair value of property." It is an open question whether a reproduction cost new methodology would be valid under Title 81, which does not contain the term "fair value." In any event, the Commission has consistently used historical cost less depreciation rate base valuation for ratemaking purposes.

Given these circumstances, one would certainly expect Olympic to provide a detailed justification for using replacement cost new valuation in any form in this jurisdiction. Yet, Olympic provided no such defense in its direct case.

IV. Olympic's Lack of Audited Financial Statements

Tesoro correctly points out that Olympic's portrayal of its results of operations is not based on audited financial statements. (Motion, Section 3.a, pages 11-13). Staff also has concerns in this regard. (See, *e.g.* Exhibit No. ___ (MLT-1T), pages 5, 7 and 9). As the Commission is aware, this subject has arisen repeatedly in this case, and Olympic's promises of when it would receive audited financial statements have not been fulfilled.

The issue is: What are the consequences of this? After cautioning that Staff's analysis was based upon financial records of uncertain quality, Staff was able to make its

[6] A detailed explanation of Starting Rate Base is provided by Staff witness Mr. Twitchell in his Exhibit No. ___ (MLT-1T) at pages 25-28.

recommendation in spite of this problem. While this is far from the best case scenario, Staff does not believe that standing alone, it is a problem that justifies dismissal.

V. Other Issues Raised by Tesoro in its Motion

Tesoro also moves: to exclude Olympic's recovery of one-time maintenance costs (Motion, Section 3.b, page 13 and Section 4.e, page 27-28); to exclude Olympic's "Case 1" presentation (Motion, Section 4.a, page 17-18); and to exclude recovery of transition costs (Motion, Section 4.c, page 21); affiliated payments (Motion Section 4.d. page 23-27); and budgeted amounts of expenditures (Motion, Section 4.f, pages 28-30) .

With respect to Olympic's "Case 1" portrayal, Tesoro is correct that Olympic is not relying on "Case 1." It should be stricken.

With respect to transition costs and one-time maintenance costs, these are issues that should be resolved after full hearing, should there be a hearing. There are factual and policy issues whether recovery of these costs should be denied, or whether some form of amortization of some of the amounts over some period is appropriate. Tesoro's Motion should be denied on this issue.

With respect to affiliated payments, Tesoro is correct that Olympic has failed to supply the cost information required by RCW 81.16.030. That statute states the Commission "shall disallow the payment or compensation, in whole or in part, in the absence of satisfactory proof that it is reasonable in amount." The problem is determining the "whole or in part" amount. Had Olympic not paid for affiliated services, it would likely have performed similar services itself, or paid a non-affiliate to do them. Staff is

therefore concerned that elimination of the entire expense may be too severe a remedy. On the other hand, the requirements of the statute are clear and Olympic did not provide the information required in its direct case.

On balance, Staff believes the issue of the appropriate level of expenses for the affiliated services received should be resolved at hearing, if there is a hearing. If, in its rebuttal case, Olympic does not provide the cost records required by statute, then the Commission should consider rejecting the expense.

With respect to Olympic's use of budgeted expense items in its cost of service, Tesoro correctly cites Commission precedent rejecting the use of budgeted results, particularly in the absence of proof that budgeted amounts are reliable and sound. (Motion, Section 4.f, pages 28-30). Olympic provided no such proof. Budgeted results are not known and measurable and are thus unauditable. (Exhibit No. ___ (MLT-1), page 6). As a result, Olympic's direct case has not been adequately supported by use of budgeted amounts.

VI. The Commission Should Dismiss This Case for Want of An Adequate Direct Case

Should the Commission agree with the foregoing arguments of Staff, and grant the parts of Tesoro's Motion Staff recommends, the appropriate response to the Motion is dismissal. Olympic knew the issue of the appropriate ratemaking methodology was to be addressed in this case. Olympic failed to supply a direct case defending the ratemaking methodology it now advocates, by a witness possessing requisite testimonial knowledge.

Rebuttal is not the place for Olympic to present its direct case on ratemaking methodology.

Since Olympic has not supported the ratemaking methodology it uses, its direct case fails. The appropriate response to the Motion is dismissal of Olympic's case. Olympic can refile once it can offer the Commission and the parties an appropriate direct case.

DATED this 13th day of June, 2002.

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