

BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

Complainant,

v.

OLYMPIC PIPE LINE COMPANY, INC.,

Respondent.

DOCKET NO. TO-011472

OLYMPIC PIPE LINE COMPANY'S  
PREHEARING MEMORANDUM AND  
OUTLINE

**I. INTRODUCTION**

Pursuant to the Eleventh Supplemental Order ("Order"), issued by Administrative Law Judge Wallis ("ALJ"), and Washington Administrative Code § 480-09-420, Olympic Pipe Line Company ("Olympic") hereby submits this Pre-Hearing Memorandum. The Order requested that the parties each submit a memorandum and outline regarding the presentation of its case. Order at ¶ 9.

Pursuant to the Eleventh Supplemental Order, Olympic submits a summary of the testimony that it will present at the hearings.

**II. SUMMARY OF MAIN ISSUES**

Olympic is requesting a less than \$9 million dollar a year increase in interest intrastate oil pipeline rates, which is less than ¼cents a gallon. This increase is needed in order to enable Olympic to attract the \$66 million in capital over the next three years that it needs to improve its

system to enable it to return to 100% operating pressure and to meet increased costs of new federal regulations and other increased costs.

Oil pipelines have a unique regulatory history and a unique financial structure. Since it began operations in 1965, Olympic has submitted its rate filings to the WUTC using the same underlying data, the same capital structure, and the same oil pipeline methodology as at the federal level.

Olympic's rate filing here is identical in all material respects to the case it has presented at the FERC. Olympic has continued its practice of filing for a tariff revision at the WUTC on the same basis that it filed for a tariff revision at the FERC. Because of its unique regulatory history and methods of finance, oil pipeline rate methodologies differ in material respects from the rate methodology the WUTC applies public utilities. This fact was recognized in 1983 by Staff. Staff has known since 1983 that use of the federal methodology and capital structure assumptions consistently produced a higher rate than the state methodology in place at the time of each filing.

Olympic's witnesses show that the federal approach to oil pipeline rate regulation, including capital structure and rates of return, is well suited to the unique nature of joint venture oil pipeline companies.

Given the financial emergency faced by Olympic, this would be the wrong time to formerly adopt a methodology and approach that is known to produce lower financial end result than the one that has been the bases for Olympic's past tariff filings. It would also produce an inconsistency with interstate rates for the same system.

Olympic's witnesses also show that the decline of throughput brought about by the 80% restriction on Olympic's system is due to use of a type of pre-1970 steel pipe manufactured with electronic resistance welding (ERW) that was susceptible to a seam failure. In September 1999, during a hydro test, a section of Olympic's pipe failed along an ERW seam, prompting the 80%

restriction over Olympic's entire pipeline system. One fact is not disputed with respect to the Whatcom Creek incident – it was not caused by an ERW weld seam failure. The ultimate cause of the Whatcom Creek incident remains to be determined in other venues. Although there is speculation allegations regarding the Whatcom Creek incident, it is known for certainty that it was not caused by an ERW weld seam failure. Federal regulations have now been put into place that require special measures to be taken in high consequence areas.

The combination of reduced throughput due to the continued 80% restriction on Olympic's system and increased costs, including costs related to new regulations applicable to all pipeline companies, justify the rate increase Olympic seeks. Without such an increase, Olympic's ability to attract the \$66 million for needed capital projects over the next three years will be jeopardized.

### **III. OUTLINE OF OLYMPIC'S PRESENTATION**

#### **I. Introduction**

The following outline describes the general topics upon which Olympic's witnesses will generally testify. Not all of the testimony has been summarized below.

#### **II. Testimony on the Overall Rate Level**

- A. Rates Recommended by Staff and Intervenors Are Not Sufficient
  1. Not sufficient to attract capital necessary to return to 100% operating pressure (Bobby Talley, Howard Fox and Larry Peck)
  2. Not sufficient for compliance with new safety regulations (Bobby Talley, Tom Wicklund and Dan Cummings)
  3. Not sufficient for other capital projects (Howard Fox and Larry Peck)
- B. Staff incorrectly assumes that there will be an additional infusion of capital at risk from Olympic's owners even with a low rate increase.

1. Olympic needs an additional \$66 million over the next three years for capital projects. (Bobby Talley and Howard Fox)
  2. BP/ARCO is the only realistic potential source of new capital. Although BP/ARCO loaned \$53 million since 2000 in order to finance the needed capital projects, there is little hope that BP/ARCO will place additional capital at risk if Staff and Intervenors' recommendations are accepted.(Larry Peck and Howard Fox)
  3. The rates recommended by Staff and Intervenors compared to Olympic's risk profile will not result in the ability to attract capital. (George Schink)
- C. Rates Recommended by Staff and Intervenors are Not Fair, Just or Reasonable or Sufficient
1. Fair rates would take into account the end result test (George Ganz, Leon Smith, Christy Omohundro, George Schink, and Howard Fox)
  2. Fair rates would take into account the unique circumstances and dire financial emergency facing Olympic (Christy Omohundro, George Schink, Howard Fox)
  3. Under the unique circumstances present in this matter, fair rates requires discretion to allow certain costs instead of denying those same costs (George Schink, Leon Smith, George Ganz, Christy Omohundro and Brett Collins)
    - a. There is discretion on the treatment of \$5.6 million of so-called one-time costs. Staff and Intervenors take different views (Bobby Talley, Christy Omohundro, Brett Collins and George Schink)
    - b. There is discretion in whether to include Bayview in the rate base. Staff and Intervenors take different views (Bobby Talley, Christy Omohundro, Brett Collins and George Schink)

- c. There is discretion in deciding to adjust test year throughput volumes for known and measurable conditions. Staff and Intervenors have significantly different views; neither uses actual known recent throughput volumes (Bobby Talley, Cindy Hammer, Brett Collins and George Schink)
  - d. There is discretion on allowing the costs of community communication. Federal law requires certain communications and effective communication is also prudent and necessary to reduce the costs and potential operational delays. (Dan Cummings, Christy Omohundro, Brett Collins and George Schink)
  - e. There is discretion in determining the future higher level of operating costs due to new and more expensive federal safety regulations, particularly in High Consequence Areas (Bobby Talley, Dan Cummings, Tom Wicklund, Howard Fox, Christy Omohundro, Brett Collins and George Schink)
- 4. Fair rates in these circumstances would use the hypothetical capital structure and regulatory treatment common for oil pipelines in the United States (Leon Smith, George Ganz, George Schink, Christy Omohundro)
  - 5. Fair rates would take into account the risks (such as earthquakes, landslides, and operating in High Consequences Areas) facing Olympic and set a higher ROE to fairly reflect that risk. (George Schink, Howard Fox, Christy Omohundro)
  - 6. Fair rates in these unique circumstances would use Commission discretion to, at a minimum, delay formally adopting a rate method that it knows will significantly reduce Olympic's rate base and general rates (Christy Omohundro and George Schink)
    - a. Staff has known since at least 1983 that use of a state rate method instead of a federal rate method will produce significantly lower oil pipeline rates (Christy Omohundro and George Schink)

- b. The federal oil pipeline rate methods, including the allowed capital structure, used in the applications for state rates since 1983 produced rates that were fair, just, reasonable and sufficient (Christy Omohundro, Leon Smith and George Schink)
  - c. There was a rational basis for use of the federal TOC methodology as a transition from the ICC methodology that used a combination valuation including replacement cost and fair market value factors. (Leon Smith, George Ganz, George Schink)
  - d. Even if the Commission wishes to use a rate DOC method and capital structure for Olympic, it should delay a DOC method. Under the circumstances, this would be the worst time to make an immediate change (Christy Omohundro, Howard Fox, George Schink)
7. There is no evidence that Olympic's proposed rate increase of \$9 million a year for intrastate shipments would create rate shock or hardship for shippers or ultimate customers (Christy Omohundro, Brett Collins and George Schink)
- a. the oil pipeline transportation cost is an infinitesimal part of the cost of petroleum products
  - b. the increase in transportation rates is small compared to the costs to the public if the pipeline cannot continue to operate (Christy Omohundro, Brett Collins, and George Schink)
  - c. There is no evidence that any savings from lower rates to shippers would be passed on to citizens of the State of Washington (Christy Omohundro, Brett Collins and George Schink).
8. Olympic's costs have been rising faster over the last decade than its rates. The costs have significantly accelerated as national pipeline regulations and laws have been made more stringent. (Howard Fox, Dan Cummings, Bobby Talley, and Tom Wicklund)

- D. Rates Recommended by Staff and Intervenors Are Not in the Public Interest (Bobby Talley, Howard Fox, Christy Omohundro, Brett Collins and George Schink)
1. Staff and Intervenors fail to address and apply public interest factors. RCW 80.01.040 (incorporated through RCW 81.01.010). (Christy Omohundro and George Schink)
  2. The public interest is served by having a pipeline system that is safe and operated by an experienced, safe and reliable company (Bob Batch, Bobby Talley, Howard Fox, Christy Omohundro and George Schink)
  3. This is the first time the Commission's dual role to regulate and balance both rates and pipeline safety has been placed directly at issue. Staff and Intervenors fail to address the need to balance rates and the public interest in safety (Christy Omohundro)
  4. The public interest is served in having an operator who works with local communities and communicates effectively with state and local policy leaders (Bob Batch, Dan Cummings, Christy Omohundro and George Schink)
  5. The public interest is served by a pipeline that operates at 100% of capacity in order to reduce the need for tanker truck or barge transportation of oil products. (Dan Cummings)
    - a. Only half of the current refinery capacity from the four Washington State refineries can be moved by the pipeline at restricted pressure
    - b. Tanker trucks add traffic to a Washington State highway transportation system that is already suffering from undue traffic congestion
    - c. Tanker trucks are statistically less safe compared to oil pipeline transportation.

- d. Barges create the risk of oil spills in Puget Sound. Washington State public policy recognizes the potential cost of oil spills and enacted a spill tax that shippers must pay in recognition of the cost and risk of spills. More barge traffic carrying oil on Puget Sound is not in the public interest
- e. There are no sufficient alternatives to Sea Tac pipeline deliveries in the event of a pipeline shutdown.

**III. Response to Adjustments to Costs Made by Staff and Intervenors (Brett Collins, George Schink and George Ganz)**

**IV. Bayview is Used and Useful**

- A. Contrary to Staff's recommendation, Bayview is used and useful and should not be removed from rate base (Bobby Talley and George Schink)
  - 1. Bayview is a used and useful part of the Olympic pipeline system (Bobby Talley)
    - a. Bayview is an oil tank storage facility capable of storing 500,000 barrels of product
    - b. The Bayview Terminal continues to provide overpressure protection by being linked to the pipeline system. A Bayview tank and associated pressure valves acts as an emergency overpressure relief and protection system for the northern segment of Olympic's pipeline system, providing a valuable and useful service since December 1998. The overpressure relief feature of the Bayview Terminal has been in continuous use and useful operation from that time to the present (Bobby Talley)
    - c. Bayview is used as a staging area for pipeline repair and replacement projects on the northern end (Bobby Talley)



- d. Bayview has been essential in helping to restore other parts of the system by storing water for use in hydrotesting and storing diesel fuel for use in smart pig runs and serving as a staging area for northern area tests, replacements and repairs (Bobby Talley)
  - e. Bayview includes a multi-unit pump station (Bobby Talley)
  - f. Bayview has offices and maintenance shop space for the Northern Area Maintenance Team (Bobby Talley)
2. With Bayview on the system without the bypass option, it was not possible to run pipeline inspection tools through the Bayview facility due to its configuration. Thus, the bypass enabled the inspections tools necessary restore the system to 100% pressure to inspect both segments from Ferndale and Anacortes to Allen (Bobby Talley)
  3. Olympic used the Bayview Terminal during the test year for the following pipeline operations: over pressure protection for the northern segment described above, storing petroleum products, storing line fills related to repair work on the pipeline, storing water for use in hydro-testing and storing diesel fuel for use in "smart pig" runs that test the integrity of the pipeline system. These uses were essential to restarting the closed segment of the pipeline, ensuring the integrity of the pipeline system, and support restoration of all pipeline segments to 100% maximum operating pressure (Bobby Talley)
  4. Bayview continues to serve as a staging area for testing and repair work on the pipeline, as well as storage for emergency and spill response equipment and supplies. Also, the North Area Maintenance Team continues to use Bayview as their operations base and headquarters (Bobby Talley)
- B. Contrary to Tesoro's testimony, the Commission should not assume that Bayview will increase throughput by 35,000 to 40,000 bpd (Bobby Talley)
1. "capacity" compared to "throughput"

2. The calculations for the estimates for increased "capacity" in 1999 are unknown.
3. Bayview will increase throughput when the pipeline system returns to 100% pressure, that was estimated to be 12,000 bpd in the 1998 tariff filing

## **V. Capital Structure**

- A. The capital structure used for Olympic is consistent with other major U.S. oil pipelines. The unique history of oil pipelines led to the industry practice for capital structure and the use of the parents' capital structure for setting rates (George Schink, Leon Smith, Howard Fox)
- B. The percentage of equity directly depends on the choice of a rate base valuation methodology. Equity is value of the assets owned less debt. Higher value means higher equity (George Schink and Leon Smith)
- C. Since 1965 the Commission accepted tariffs using the capital structure of the parent companies -- which has been part of the federal oil pipeline approach (Leon Smith)
- D. The Commission is not required by law or public policy to use a state capital structure assumption at this time. Given Olympic's emergency financial situation, this would be the worst time to change capital structure assumptions. (Leon Smith, George Schink, Howard Fox, Christy Omohundro)

## **VI. Past Dividends**

- A. Staff and Intervenors focus on dividends paid by Olympic from 1990 to 1997. This is misleading, irrelevant and incorrect (George Schink, Leon Smith, Howard Fox)
  1. No dividends have been paid since 1997.
  2. Olympic' dividend policies are consistent with oil pipeline industry standards (George Schink, Leon Smith, Howard Fox)

3. No shipper objected to Olympic's dividends from 1990 to 1997, even though Olympic filed revised tariffs in that period. To raise the issue now is retroactive rate making
  4. Olympic's owners faced financial risks that were undercompensated by prior rates as the events of 1999 have proven. The uncompensated risks Olympic faced should be included in any retroactive review of dividends
- B. If granted in full, Olympic's proposed rate increase will not be sufficient to allow a dividend for years to come. (Howard Fox)

## **VII. Throughput and Volumes**

- A. According to Staff, test year throughput (from January 2001 to December 2001) was 83,761,308 barrels (Brett Collins)
- B. Olympic's initial direct testimony filings attempted to adjust the test year volumes for known and measurable changes to the test year's volumes (Cindy Hammer, Brett Collins, and Bobby Talley)
1. In August 2001 when Olympic filed its amended tariff at the FERC, Olympic had one month of actual throughput (July) from a system in which all segments were in operation.
  2. Olympic took the July 2001 volumes and tried to adjust that month's volumes to better reflect the actual conditions
  3. Olympic can no longer justify use of the July 2001 volumes to adjust for the test year volumes because we now know that actual throughput volumes for the last 10 months show that use of the adjusted July 2001 volumes do not represent known and measurable conditions
  4. Use of the average of the past 10 months of actual throughput and volumes is the only known and measurable data to adjust test year volumes

5. Staff and Intervenor's testimony on throughput is contradictory and based on assumptions and extrapolations that are incorrect. Their markedly divergent attempts to adjust test year throughput are not based on known and measurable conditions. The only uncontested known and measurable data showing actual conditions are the actual data for the last 10 months of throughput.
  6. It is not known when Olympic can restore its system to 100% operating pressure. It is certain, however, that with the rate recommendation of Staff and Intervenor's Olympic's system will not be restored to 100% pressure in the rate year or for years to come. Use of the last 10 months of actuals is appropriate when there is no certainty that volumes will ever be increased beyond that experienced in the past year.
- C. Olympic proposes an automatic adjustment mechanism for throughput that will lower the rate per barrel if volumes increase above the actual average for the last 10 months and will raise the rate per barrel if the volumes decrease. Olympic requests the Commission establish a collaborative process to create an automatic adjustment mechanism to resolve issues regarding throughput.
1. Staff supports an automatic adjustment mechanism that it calls a tracking mechanism, but does not provide details. RGC-1T, p.30.
  2. Olympic's automatic adjustment mechanism makes concerns about potential windfall profits moot. As Staff states, "A tracking mechanism would seem to resolve a very contentious issue in a way that would protect both Olympic and its customers."

**VIII. The ERW Seam Test Failures and Related Federal and State Regulations (Bobby Talley, Dan Cummings, and Tom Wicklund)**

- A. During hydrotesting in September 1999, Olympic raised the pressure in a segment of pipe that had been previously hydrotested at lower pressure. The result was a ERW seam failure.
- B. It is undisputed that the Whatcom Creek incident was not caused by an ERW seam failure. An ERW seam failure was a completely different issue than the cause

of the Whatcom Creek incident. Intervenors have attempted to confuse the two and lump them together.

- C. The pressure restrictions on Olympic from September 1999 to the present are the result of OPS restrictions imposed due to ERW seam failure issues.

**IX. Historic Basis for Oil Pipeline Rate Regulation (Leon Smith)**

**X. Answers to Questions Raised By the Commissioners in the Third Supplemental Order on Interim Rates (Howard Fox)**

**XI. The Status of the Independent Audit (James Mach)**

## OUTLINE OF POSTHEARING BRIEFS

Olympic recommends the following outline of issues for the parties' posthearing briefs:

- I. Introduction/Overview
- II. Legal Issues
  - A. The Public Interest Standard
  - B. The End Result Test
  - C. The Commission's Dual Role to Regulate Pipeline Rates and Safety
  - D. Nature of Oil Pipelines and History of Regulation
- III. Ratemaking Methodology Issues
  - A. The Commission's Discretion in Choosing a Methodology
  - B. Trended Original Cost v. Depreciated Original Cost
  - C. Capital Structure
- IV. Results of Operations
  - A. Test Year
  - B. Revenues
    1. Throughput
    2. Other
  - C. Rate Base
    1. Bayview Terminal

2. Cross-Cascades Project

E. Operating Expenses

1. ERW Testing and State and Federal Regulatory Costs

2. Continuing Maintenance Costs

F. Rate of Return

1. Methodologies

2. Summary of Witnesses' Proposals

3. Cost of Equity

4. Cost of Debt

5. Capital Structure

6. Other financial issues

G. Revenue Requirement Calculation

DATED this 13th day of June, 2002.

**Respectfully submitted,**

**PERKINS COIE LLP**

By \_\_\_\_\_

Steven C. Marshall, WSBA #5272

William R. Maurer, WSBA #25451