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1 BEFORE THE WASHINGTON UTILITIES AND
2 TRANSPORTATION COMMISSION
3 WASHINGTON UTILITIES AND)
4 TRANSPORTATION COMMISSION,)
5 Complainant,)
6)Docket No. TO 011472
7)Volume XXII
8)Pages 2207 to 2355
9 OLYMPIC PIPELINE COMPANY, INC.,)
10)
11)Respondent.)
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10 A prehearing conference in the above matter was held
11 on June 19, 2002 at 10:30 a.m., at 1300 South Evergreen Park
12 Drive Southwest, Room 206, Olympia, Washington, before
13 Administrative Law Judge ROBERT WALLIS.

14 The parties were present as follows:

15 THE WASHINGTON UTILITIES AND TRANSPORTATION
16 COMMISSION, by DONALD T. TROTTER, Senior Assistant
17 Attorney General, and LISA WATSON, Assistant Attorney
18 General, 1300 South Evergreen Park Drive Southwest,
19 Olympia, Washington 98504-0128, telephone
20 (360) 664-1189, Fax (360) 586-5522, E-mail,
21 dtrotter@wutc.wa.gov.

22 OLYMPIC PIPELINE COMPANY, INC., by STEVEN C.
23 MARSHALL, Attorney at Law, Perkins Coie, 411 108th
24 Avenue Northeast, Suite 1800, Bellevue, Washington
25 98004, Telephone, (425) 453-7314, Fax (425) 453-7350,
E-mail marss@perkinscoie.com, and WILLIAM H. BEAVER,
1201 3rd Avenue, Suite 2900, Seattle, Washington, 98101,
Telephone (206) 224-8054.

Deborah L. Cook
Court Reporter

1 TESORO REFINING AND MARKETING COMPANY,
2 by ROBIN O. BRENA, Attorney at Law, Brena Bell &
3 Clarkson, PC, 310 K Street, Suite 601, Anchorage,
4 Alaska, 99501, Telephone, (907) 258-2000, Fax,
5 (907) 258-2001, E-mail, rbrena@brenalaw.com.

6 TOSCO CORPORATION, by EDWARD A. FINKLEA,
7 Attorney at law, Energy Advocates, LLP, 526 Northwest
8 18th Avenue, Portland, Oregon 97209, Telephone,
9 (503) 721-9118, Fax (503) 721-9121, E-mail
10 efinklea@energyadvocates.com
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4 WITNESS:

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PROCEEDINGS

JUDGE WALLIS: Very well. Let's be on the record, please.

This is an evidentiary hearing in the matter of Commission docket TO 011472 which involves an application for a rate increase on the part of Olympic Pipeline Company.

This hearing is being held in Olympia, Washington, before the Commission, Chairwoman Marilyn Showalter, Commissioner Hemstad, Commissioner Patrick Oshie, and myself, Administrative Law Judge C. Robert Wallis.

The parties left us yesterday with a number of questions, and the Commission is prepared to rule, at least in part, on matters that were given to it yesterday.

The parties argued three groups of issues to the Commission yesterday. First, as to Olympic's motion for continuance, the Commission denies that motion. The parties are present. The bulk of the work has been done. The company continues to express its need for resolution of its rate proceeding, and we agree with the parties that there is a need for closure that the proposed continuance would challenge.

Second, the Commission denies Tesoro's motion

1 for summary determination. In doing so, we note that
2 Olympic's case, in retrospect, its original filing did
3 not fully articulate the matters that the Commission now
4 wants to consider in ruling on the cost rate proposal.
5 But the Commission observes that irrespective of how it
6 might have ruled upon such a motion at an earlier time,
7 the public interest does affect our view of the
8 proceeding, and the Commission's choices at the moment.

9 Third, there were a number of motions to strike
10 the testimony of certain witnesses. Commission is
11 prepared to rule on Mr. Schink's testimony today,
12 because he is the witness whom we will be hearing today,
13 and reserves until later today, or as early as possible,
14 ruling on the other motions to strike.

15 The Commission denies the motions to strike
16 portions of Mr. Schink's testimony. It believes that
17 most of his testimony does respond to the testimony of
18 other witnesses, or that it updates rather than totally
19 changes his earlier testimony.

20 As I noted, the Commission is not prepared at
21 this moment to rule on the other motions to strike.

22 It does have an observation and a qualification
23 that it addresses to the denial of the motion for
24 summary determination and the motion to strike. And
25 that is that the Commission is very conscious of the

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1 parties' concerns about their opportunity for discovery
2 and preparation.

3 If the parties need time to prepare for
4 Mr. Smith's examination, he is a witness whose
5 presentation is central to the analysis of FERC
6 processes, if they need time to prepare for that
7 examination, including the need for a deposition that
8 may be held on an evening or weekend.

9 And if the parties request a delay in his
10 appearance we will direct that he appear last in this
11 proceeding, or that an additional day of hearing be set
12 for his examination.

13 In addition, as to Mr. Schink and any other of
14 the witnesses, if the Commission denies the motions to
15 strike, we note that the parties have leave to state
16 their reasons, based on the record, why they may not
17 have had an opportunity for full exploration of relevant
18 issues, and they may file a motion for a continued
19 session, at which they may have the opportunity to
20 follow up.

21 Now, the Commission does plan to address the
22 rest of the motions to strike testimony and aspires to
23 have rulings on those at the beginning of the afternoon
24 session, or as soon thereafter as possible.

25 I earlier asked if there were any other

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1 preliminary matters, and the parties indicated that
2 there were none.

3 So are we ready at this time to hear the
4 testimony of Mr. Schink?

5 MR. MARSHALL: We are, Your Honor. One, I
6 guess, housekeeping matter. There is an updated exhibit
7 list that the Commission has. I understood there was
8 going to be an updated list made and handed out.

9 JUDGE WALLIS: I believe there is. I do not
10 have a copy of that with me.

11 MR. MARSHALL: I don't think it matters for
12 Dr. Schink, but I wasn't sure so I thought I would ask.

13 JUDGE WALLIS: It is our intention to have that
14 completed and provided to parties on the lunch break.
15 I will explore that and make sure that copies are
16 available.

17 MR. MARSHALL: Great. Again, I don't think it
18 has any bearing on Dr. Schink's testimony, because I
19 don't think anything was changed from the preliminary
20 exhibit list, but I thought I would inquire.

21 JUDGE WALLIS: Thank you, Mr. Marshall.

22 We do have some additional exhibits on
23 potential cross examination from Tesoro, and I will read
24 those into the record. Mr. Schink, please step forward
25 and make yourself comfortable.

2215

1 JUDGE WALLIS: Let's be off the record, please.

2 (Brief recess.)

3 JUDGE WALLIS: Let's be back on the record,
4 please.

5 Dr. Schink stepped forward and is ready to be
6 sworn in.

7
8 DR. SCHINK,
9 produced as a witness in behalf of the Company, having been
10 first duly sworn, was examined and testified as follows:

11

12 EXAMINATION

13 BY MR. MARSHALL:

14 Q Good morning, Dr. Schink.

15 A Good morning. Is this on?

16 JUDGE WALLIS: In conjunction with
17 Dr. Schink's appearance at a prehearing conference that
18 was held on Thursday, the 13th of June, a number of
19 documents were marked for identification for possible
20 use in this proceeding.

21 Those are Exhibits 201-T through 225-C, and
22 I will not further identify those other than to make
23 reference to the record of that prehearing conference.

24 In addition, since that time Tesoro has
25 presented additional documents for potential use on

2216

1 cross examination, and I will identify those for the
2 record at this time.

3 They are 226, which is excerpts of Mr. Schink's
4 direct testimony. Orange and Rockland Utilities, Inc.,
5 227. Excerpts in NYPSC v. Natural Fuel Gas Dist. Corp.,
6 228, which consists of two schedules.

7 229 which consists of excerpts from WUTC v.
8 Pacific Power and Light, U84-65, fourth supplemental
9 order. 230 which consists of excerpts from WUTC v.
10 Continental Telephone Company of the Northwest, Inc.,
11 U824.

12 231 which consists of excerpts from WUTC v.
13 Puget Sound Power & Light Company, U85-53. And Exhibit
14 232 for identification, which consists of excerpts from
15 WUTC v. US West Communications, UT 950200.

16 Those documents now are identified for the
17 record and potential use on cross examination.

18 Now, excuse me, Mr. Marshall.

19 (EXHIBIT IDENTIFIED.)

20 Q BY MR. MARSHALL: Dr. Schink, are you
21 sponsoring, today, your testimony Exhibit 221-T and
22 201-T, and the supporting exhibits that Administrative
23 Law Judge Wallis just referred to, which include 202-T
24 through 225-C?

25 A Yes, I am.

2217

1 Q Did you have any corrections or additions to
2 make to that testimony?

3 A Yes, they are contained in the errata I have
4 supplied.

5 MR. MARSHALL: Your Honor, should we have that
6 errata marked so that we can have it for the record?

7 JUDGE WALLIS: Yes, I am marking as Exhibit 233
8 for identification a multi-page document entitled
9 errata.

10 (EXHIBIT 233 MARKED.)

11 Q BY MR. MARSHALL: Dr. Schink, with those
12 additions and changes, do you adopt that testimony as
13 yours today?

14 A Yes, I do.

15 MR. MARSHALL: The witness is available for
16 cross examination.

17 MR. TROTTER: Can we go off the record for a
18 second?

19 JUDGE WALLIS: Yes.

20 (Discussion off the record.)

21 JUDGE WALLIS: Let's be back on the record.

22

23 CROSS EXAMINATION

24

25 BY MR. TROTTER:

2218

1 Q Good morning, Mr. Schink.

2 A Good morning.

3 Q Could you turn to Exhibit 221-T, your direct
4 testimony?

5 A Yes.

6 Q And am I correct that in that testimony you
7 used the term "Commission" to mean FERC?

8 A Yes. In that testimony, the 221-T, was the
9 testimony that I had submitted to the FERC and the
10 federal docket. And it was resubmitted here as
11 submitted there. So in that testimony the reference to
12 Commission is to the Federal Energy Regulatory
13 Commission.

14 Q Well, on page one of your FERC testimony, which
15 is several pages in on the exhibit, when you refer to
16 the DCF based methodology for estimating the cost of
17 common equity capital for oil pipelines adopted by the
18 Commission, you are not referring to this Commission,
19 are you?

20 A No, I am referring to the Federal Regulatory
21 Commission.

22 Q Now, in your rebuttal testimony, 201-T, you use
23 the term "Commission" to mean the WUTC; is that correct?

24 A That's correct. This testimony was prepared
25 for submission to this Commission. And when I use the

2219

1 word "Commission" in the rebuttal, it refers to this
2 Commission.

3 Q And in your rebuttal, when you refer to -- when
4 you mean to refer to FERC, you use FERC, or Federal
5 Energy Regulatory Commission?

6 A Yes, I do.

7 Q Staying with your direct exhibit, 221-T, would
8 you turn to page 3, line -- starting on line 38,
9 referring to your return on equity, or ROE estimates,
10 you say that, quote, "My estimates are consistent with
11 these earlier estimates. And as would be expected, the
12 ROE estimate as of September 2001 is significantly lower
13 than was the case at the end of 1999, or 2000." Do you
14 see that?

15 A Yes, I do.

16 Q Why is it expected that ROE estimates in
17 September of 2001 are expected to be lower,
18 significantly lower than at the end of 1999 or 2000?

19 A Well, we were in the middle of a recession, and
20 we also were suffering -- the stockmarket had plummeted.
21 So these two events would tend to downwardly -- or push
22 the estimate downward.

23 Q And that is because cost of money had declined
24 over that period?

25 A The Federal Reserve had cut the rates

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1 repeatedly in an attempt to stimulate the economy, and
2 that tended to suppress the cost of the interest rates
3 at that time.

4 Q Is that the same thing as saying the cost of
5 money had come down?

6 A I don't know exactly what you mean by cost of
7 money. To who? So --

8 Q All right. On line 47 of that page you say the
9 weighted average?

10 A Pardon me. I am missing a page?

11 Q We're on Exhibit 221-T, and I am ignoring the
12 first three pages which introduce your testimony.

13 A No, I was -- I mean, I was where you were
14 before you moved. I am sorry.

15 MS. SHOWALTER: Page 3, line 47.

16 THE WITNESS: Okay. Thank you.

17 Q BY MR. TROTTER: And you say that for Olympic's
18 parent companies, the weighted average capital structure
19 contains 82.92 percent equity, and 17.08 percent debt.
20 Do you see that?

21 A Yes, I do.

22 Q And that's the capital structure you proposed
23 for Olympic for rate making purposes in your direct
24 testimony; is that correct?

25 A That's correct.

2221

1 Q In rebuttal you are not proposing an equity
2 ratio of 86.85 percent; is that correct?

3 A That's correct. The numbers in the direct were
4 end of year 2000, which was the most recent I had then.
5 The numbers in the rebuttal are the numbers at the end
6 of 2001, which were not available.

7 Q So that caused you to change your
8 recommendation?

9 A It was an updating. Again, it's an update,
10 because at the time I did the rebuttal we didn't have
11 end of year -- or full year data for 2001, and we now
12 have it.

13 Q Let me rephrase. It caused you to update your
14 recommendation?

15 A That's correct.

16 Q Please turn to your Exhibit 222, which I will
17 note for the record contains numerous, what we're going
18 to call, schedules.

19 The first page is a map, Exhibit OPL 35, is
20 that right, Mr. Schink?

21 A Yes.

22 MR. TROTTER: And, Your Honor, is it correct
23 that we are to refer to these as schedules for purposes
24 of examination?

25 JUDGE WALLIS: Yes.

2222

1 Q BY MR. TROTTER: Please turn to schedule 45 in
2 that exhibit.

3 A Yes.

4 Q Page two is -- page four.

5 A Page four of four?

6 Q Yes.

7 A Okay.

8 Q And here you are -- here you show your
9 calculations of Olympic's parents' weighted capital
10 structure over a several-year period?

11 A That is correct.

12 Q At the end of 1999 the weighted average equity
13 ratio was 57.49 percent; is that correct?

14 A That's correct.

15 Q And that's shown on line 38?

16 A That's correct.

17 Q And that increased to 82.92 percent in the year
18 2000; is that right?

19 A Yes, that's due to -- primarily to BP's
20 acquisition of ARCO, and the two corporations have quite
21 different capital structures.

22 Q And is it also because of BP's acquisition six
23 of GATX's ownership?

24 A Yes, that's correct also.

25 Q Turn to page 2 -- turn to page 2 of the

2223

1 exhibit.

2 MS. SHOWALTER: 2 of the --

3 MR. TROTTER: Page 2 of 4 on schedule 45.

4 Q BY MR. TROTTER: And the 1999 column for GATX on
5 line 15 in that year, GATX had an equity ratio of 20.46
6 in that year; is that correct?

7 A That's correct.

8 Q I would like you to assume that in the year
9 2003 Olympic is taken over by a company like GATX, which
10 has a 20 percent equity ratio. Do you have that
11 assumption in mind?

12 A Yes, I do.

13 Q In your opinion, would it then be appropriate
14 to use a capital structure of 20 percent equity and 80
15 percent debt for Olympic for rate making purposes?

16 A No.

17 Q Why not?

18 A I think Olympic is riskier than the average
19 pipeline. I think BP is in the business, is also
20 riskier than average. I think the parents, in general,
21 their capital structure and their risks are appropriate
22 to Olympic, and certainly an above-average equity share
23 in capital is appropriate for them.

24 The GATX is not appropriate given Olympic's
25 risk. GATX's equity share, or the hypothetical

2224

1 company's, in 2003, equity share would not be
2 appropriate for Olympic.

3 Q I want to make sure you understand my
4 hypothetical. Olympic is completely taken over, 100
5 percent, by a company with a 20 percent equity ratio.
6 Do you have that assumption in mind?

7 A Yes.

8 Q Is your answer the same?

9 A Yes -- well, I see what you are saying here.

10 Q Under my assumption the weighted average equity
11 ratio for Olympic, if it's taken over by a company with
12 a 20 percent equity ratio, would be 20 percent; isn't
13 that correct?

14 A It depends if you are saying -- we get, rather
15 than "parents" we get "parent", and Olympic is still, in
16 a sense, a wholly owned company, as it is today, and is
17 part of -- and is owned by a different company, my
18 answer is no.

19 There are two tests, if you would allow me --
20 there are two tests here. One, the FERC, Federal Energy
21 Regulatory Commission -- and again, bear in mind this
22 testimony was written in submission to them, so --
23 believes that if it were a stand-alone company, it would
24 be their own -- a stand-alone pipeline company, you
25 should use their capital structure.

1 For example, if any one of the five companies
2 in the oil pipeline proxy group came forward, the
3 Federal Energy Regulatory Commission would use their
4 capital structure, because they are stand-alone
5 companies engaged in the oil pipeline services business.

6 If you get a case like Olympic where it's
7 wholly owned by companies not in the pipeline business,
8 there is a preference, if the structure is appropriate,
9 that given risk considerations for the pipelines, to
10 adopt the parents' structure simply because they are the
11 entity charged with raising capital for the pipeline.

12 However, if the parent is engaged in the
13 business which is less risky, which presumably would
14 permit it to be very highly leveraged, then its capital
15 structure would not be appropriate. And I would say
16 that a capital structure, given Olympic's risk and
17 equity share that low, would be totally inappropriate.

18 Q Was GATX less risky than Olympic?

19 A I don't know the circumstances of why the
20 equity share is as low as it is. It could -- I have not
21 studied the company. And I don't know where you can get
22 a very low equity share if your company's in financial
23 trouble. So it might not have been a plan. It may have
24 been a result. I just don't know.

25 Q Is it your testimony that GATX was in financial

2226

1 trouble?

2 A I really -- I really can't say with any
3 certainty. I know what I read in the papers.

4 Q So it's your testimony that the Commission here
5 should not just blindly adopt the parents' capital
6 structure. You must consider the reasonableness of the
7 parents' capital structure and adopt something
8 reasonable; is that correct?

9 A That's correct.

10 Q In your direct testimony you discuss the
11 subject of water-borne competition, and I believe that
12 begins on page 13 of the -- 13 of the Exhibit 221-T.

13 A 13, sir?

14 Q 221-T.

15 A Yes, I am there. Thank you.

16 Q Starting on page 13, and over on page 14, line
17 258, you indicate that the reported data show a 32.4
18 percent increase in water-borne shipments of light
19 refined petroleum products into Puget Sound and the
20 Seattle area. Do you see that?

21 A Give me a line number, please.

22 Q 258 to 260.

23 A Yes, I see that.

24 Q And you indicate that that was a sharp increase
25 in the use of barges and tankers, correct? Line 257.

2227

1 A Yes. But bear in mind these are deliveries
2 into; not shipments out of.

3 Q Fine. In your opinion was that sharp increase
4 in water-borne shipments of light refined petroleum
5 product into Puget Sound caused by water-borne
6 transportation being more efficient and less costly than
7 pipeline transportation?

8 A Where are we? Part of it was the result of the
9 shutdown of Olympic following the accident, and part of
10 it may be -- and that the pipe from the ruptured pipe
11 was not replaced, as I recall, or put back in service
12 until February 2001. So it certainly was related to
13 that, also. I can't separate the two, obviously.

14 Q In 1999, in fact, Olympia Pipeline was
15 substantially shut down, and shippers turned to water-borne
16 alternatives because they didn't have a pipeline
17 available; is that correct?

18 A The upsurge is largely due to the aftermath of
19 the accident, yes.

20 Q What part of the 32.4 percent increase was not
21 due to Olympic Pipeline --

22 A I do not know.

23 Q Did water-borne transportation that expanded
24 32.4 percent in 1999, expand at constant unit cost?

25 A It appears so, yes.

2228

1 Q And what is your basis for that?

2 A The marginal source of supply of refined
3 products in both Seattle and Portland is via water.
4 That means that the wholesale and retail prices of
5 gasoline and diesel fuel are set based on the cost of
6 the marginal supplier. In this case it would be the
7 cost of supplying gasoline and diesel fuel via barge.
8 If the unit cost per barge had gone up, you would expect
9 it to have seen increases in the wholesale prices of gasoline
10 -- sustained increases in the wholesale prices of
11 gasoline and diesel.

12 And as I demonstrated at great length in my
13 appendix B, and also discuss I think in the testimony
14 we're looking at, or below what we're looking at, in
15 fact, prices had returned to their normal relationship
16 with prices elsewhere on the West Coast and on the Gulf
17 Coast by September. And the only way this could have
18 happened is if, in fact, the unit cost of barging did
19 not increase

20 Q What price was water-borne transportation for
21 petroleum products before the Whatcom Creek explosion,
22 and what was the price after?

23 A We don't have the actual data, but we can infer
24 it didn't change because of what happened to wholesale
25 prices of gasoline and diesel.

2229

1 Q So you never -- you didn't actually examine the
2 pricing; is that correct?

3 A As we have I think in our data request, and in
4 other places indicated, we do not have access to these
5 data, and have asked both Tesoro and Tosco for these
6 data, and they refused to supply it.

7 Q Did you ask ARCO and Equilon for the data?

8 A No.

9 Q What prices would Olympic have to charge in
10 order to lose pipeline traffic to water-borne
11 transportation?

12 A Would you repeat that question, please?

13 Q What specific prices would Olympic have to
14 charge in order to lose pipeline traffic to water-borne
15 transportation?

16 A I can't tell you if I don't know the prices the
17 barges or the tankers are charging.

18 Q Other than times when Olympic was out of
19 service or capacity constrained, Olympic has never had a
20 major loss of through-put to any other mode of
21 transportation, correct?

22 A I know of no data that either supports or
23 doesn't support that statement, sir. There are no data
24 to prove or disprove it, that I have, certainly.

25 Q Turn to page 34 of Exhibit 221-T. Here you

2230

1 discuss one of your proposed modifications to FERC's
2 method of calculating ROE for an average typical oil
3 pipeline; is that correct?

4 A Beginning at page 34, yes.

5 Q Is it correct that FERC uses the median ROE of
6 a proxy group, and you record using means as a way to
7 measure central tendency of the data?

8 A That's correct.

9 Q Is it correct that FERC on Monday of this week
10 rejected use of the median in an order issued by FERC?

11 A Rejected use of median?

12 Q Rejected use of the mean, excuse me.

13 A I wasn't aware of the order, but they have
14 been, in fact -- their choice of the median was the
15 result of a lot of litigation. I think they are wrong,
16 obviously, and I don't know the arguments made by the
17 parties whose request was denied so I really can't
18 comment on that order.

19 Q Turn to page 35 --

20 MR. MARSHALL: Just for the record, could we
21 have a citation to that order so we have the opportunity
22 to examine that order?

23 MR. TROTTER: I will provide it at the break.

24 JUDGE WALLIS: Thank you, Mr. Trotter.

25 MR. MARSHALL: I would note an objection as to

2231

1 the characterization of the order until we have an
2 opportunity to see it, but I won't object to having any
3 FERC order referenced. They don't need to be marked as
4 exhibits.

5 JUDGE WALLIS: Mr. Trotter will provide that at
6 the break.

7 Q BY MR. TROTTER: Page 35 of your testimony in
8 footnote 22 you --

9 A Sir, what was the page? I am having trouble
10 hearing for some reason.

11 Q 35, footnote 22.

12 A Yes.

13 Q You indicate that the mode is another measure
14 of central tendency in addition to means and median; is
15 that correct?

16 A That's correct.

17 Q You do not use mode in your analysis, did you?

18 A No, I did not for the reasons I think I spell
19 out in that footnote.

20 Q Mode is the most commonly occurring value,
21 isn't it?

22 A Yes.

23 Q Turn to Exhibit 222, schedule 42.

24 A Page 1, or --

25 Q Yes. And here you show five companies in the

2232

1 FERC proxy group, correct?

2 A Yes.

3 Q And three of your -- three of the five
4 comparable companies have ROE values between 12 and a
5 half and 13 and a half, one is between 15 and a half and
6 16 and a half, and one is between 17 and a half and 18
7 and a half; is that correct?

8 A Three are between 12 and a half and 13 and a
9 half. Is that what you said?

10 Q Yes.

11 A And the other is between 13 --

12 Q 15 and a half and 16 and a half, and one
13 between 17 and a half and 18 and a half?

14 A Yes, that is correct.

15 Q Would 12 and a half to 13 and a half be the
16 most common occurring range of this data?

17 A The way you have defined it, yes. I could
18 define another set of ranges, which would be most
19 common -- I would say I have five in the range of 12.71
20 and 17.94. So I have five in my group. My mode has got
21 five in it. This is not a worthwhile exercise, sir.

22 Q Do you not consider 17.94 percent to be an
23 outlier, Mr. Schink?

24 A No, I do not. And I conducted specific
25 statistical tests and that is not on there.

2233

1 Q Well, on page 36 of your testimony line 1, you
2 do say there are no outliers. You also say there is not
3 a strong skew in the distribution of ROEs for the proxy
4 group companies. Do you see that?

5 A What was the page again? I am having trouble
6 keeping up to you, I am afraid.

7 Q Page 36.

8 MS. SHOWALTER: Mr. Trotter, can you first let
9 us get to the page, and then after a pause tell us the
10 line number? What line number was that?

11 MR. TROTTER: I will, thank you. Page 36, line
12 1.

13 THE WITNESS: There is no line 1.

14 Q BY MR. TROTTER: Excuse me, line 692. Are you
15 with me there, Mr. Schink?

16 A Yes, I see that.

17 Q Can you define what you mean by strong skew?

18 A I conducted the tests of both normality and log
19 normality and couldn't reject either, which suggests
20 that the skew isn't sufficient to reject the hypothesis
21 of a normal distribution, which has no skew in either
22 direction. But it also -- there was enough of a one so
23 I couldn't reject the possibility of a slight skew,
24 which is implied by the log normal. That's what I mean
25 by that.

2234

1 Q So you admit there is some skew in the data in
2 the distribution?

3 A Not a statistically significant one.

4 Q Turn to page 54 of your testimony.

5 A Yes.

6 Q Line 992, you conclude that Olympic faces
7 above-average business risk for an oil pipeline, and
8 therefore it is appropriate for Olympic to be financed
9 using a capital structure with an above-average share of
10 equity. Do you see that?

11 A Yes, I do.

12 Q And is that your justification for using an
13 above-average equity ratio of 82.92 percent equity in
14 your direct case and 86.85 percent in your rebuttal?

15 A Well, I think those three lines are not the
16 justification. My analysis, which would suggest that
17 Olympic isn't a -- well, above-average risk pipeline
18 company suggests it should have an equity share above
19 that of other pipelines and that the equity share of its
20 parent certainly satisfies that on the one hand.

21 On the other hand, it is also the capital
22 structure that is used to raise financing for Olympic.
23 So those two reasons, to justify the higher equity share.

24 Q But one of the reasons is based on your
25 conclusions of Olympic's above-average business risk?

2235

1 A That's correct.

2 Q You also add 75 basis points to your equity
3 return for this above-average business risk, is that
4 correct, in your direct?

5 A That's correct.

6 Q And in your rebuttal that's now .95 percent; is
7 that correct?

8 A Yes. I calculated it the same way. Again,
9 it's the updated analysis. It's 95 basis points in the
10 rebuttal, and the same analysis provided 75 in the
11 direct.

12 Q And the analysis was to measure the business risk
13 of Olympic pipeline?

14 A I am sorry?

15 Q The analysis leading to your .75 and .95 adders
16 was the measure of the business risk of Olympic
17 pipeline?

18 A The calculation -- I looked at the return. I
19 calculated the average return first, including the
20 lowest ROE pipeline from the proxy group. And then I
21 calculated the average excluding the lowest two. So on
22 one case it's the lowest of everyone, and then the
23 second case it's the lowest starting with the median
24 working up. And that range was, as I recall in the
25 direct, was about 50 to 100 basis points above the

2236

1 average. And in the case of the rebuttal, it was about
2 20 basis points higher.

3 Q Is it your testimony that these equity adders
4 are not related to the business risk of Olympic
5 pipeline?

6 A No, they are related by -- the notion was to
7 try to look at what the -- at least use what the higher
8 ROE cost pipelines use, that as a basis for trying to
9 establish a reasonable adder to provide, given the risk.

10 Q And page 55 of your testimony, line 1004, you
11 state that the beta is a measure of the business risk
12 faced by the firm. Do you see that?

13 A Yes I do.

14 Q Olympic does not have a beta value of its own,
15 does it?

16 A No, it does not.

17 Q Olympic's parents all have beta values, do they
18 not?

19 A Yes, they do.

20 Q And they all have beta less than one, don't
21 they?

22 A I would have to check the data.

23 Q Would you accept that subject to your check?

24 A Yes.

25 Q And the companies in the proxy group, all that

2237

1 you use -- all have betas less than one, do they not?

2 A As I recall, yes.

3 Q Betas below one indicate less than average
4 risk, correct?

5 A Less than market risk by that measure. That is
6 correct.

7 Q Let's now turn to your rebuttal testimony,
8 Exhibit 201-T.

9 A Could I expand on the last one or are we done?

10 Q I think we're done for the moment. Refer to your
11 bit 201-T, page 10, and here you are discussing the
12 result test from the Hope Natural Gas case, correct?

13 A That's correct.

14 Q Is that sometimes referred to as the doctrine
15 of end results?

16 A I haven't seen that terminology, but it would
17 make sense.

18 Q Is it your understanding that the end result
19 test was the Supreme Court's way of resolving disputes
20 about method of determining fair market rate base?

21 Q I don't think it's quite that simple. My
22 understanding was that the Supreme Court's ruling said
23 that the Commission did not have to use a specified or
24 specific rate, specific methodology to arrive at a
25 result as they had under Smith versus Ames.

2238

1 Q And Hope reversed Smith versus Ames, did it
2 not?

3 A It's my understanding, yes.

4 Q Would you agree that the same notion, that is
5 the methodology, is not the last word? You looked to
6 other factors to decide whether a rate is fair, just, or
7 reasonable. Does that same notion apply to rate of
8 return; that is, commissions are not bound to particular
9 methods as long as the end result is just and
10 reasonable?

11 A That's correct. But the court -- the court, as
12 long as the method is defensible, the court will not
13 intervene.

14 MS. SHOWALTER: Can you just clarify that,
15 because the question was, I thought, was the end result
16 reasonable, and the answer said so along as the method
17 is reasonable. And I am wondering -- it seems like the
18 answer might not have joined the question.

19 THE WITNESS: Can I try to make it join?

20 Q BY MR. TROTTER: Let me reask it. You would
21 agree, would you not, that the methodology used to
22 determine cost of equity is not cast in stone; the
23 Commission can use various methods of determining that
24 as long as the end result is a rate that is just and
25 reasonable?

2239

1 A Yes, I think the point I was trying -- the
2 distinction is that the Commission has to have a means
3 of documenting that the rate is just and reasonable. They
4 can't just pick one and announce it is true. The courts
5 have in fact reversed commissions where it sounded right
6 to them. So there has to be an underlying methodology
7 that is used to defend it.

8 Q Turn to page 26. And my questions deal with 201-T,
9 line 23. You state in your direct testimony and in
10 Olympic's responses to data requests it's been made
11 clear that either you or Olympic have reliable data on
12 the cost of the water-borne transportation alternatives
13 for Olympic. Do you see that?

14 A Yeah, there's a typo we didn't catch. There
15 are actually Olympic's data requests for Tesoro and
16 Tosco. It's bad English.

17 Q I am not sure --

18 A I misread it.

19 Q My question to you is other than the exhibits
20 you have prepared for purposes of this case are you
21 aware of any document in which Olympic has studied the
22 issue of competitive alternatives to pipeline services?

23 A I certainly don't have any such document or
24 haven't seen one.

25 Q Are you aware whether Olympic collects market

2240

1 research on what you consider to be its competitors?

2 A Not that I have seen. I think these are
3 questions better asked of someone from the company.

4 Q In any event they supplied you such market
5 research, did they not?

6 A I asked if they had any such material and they
7 said no. I certainly discussed with them, what I was
8 looking for. And they looked for anything that would be
9 helpful in the area of water-borne and weren't able to
10 find anything.

11 Q And in fact the only information on prices of
12 water-borne transportation that Olympic gave you was that
13 water-borne transportation were, quote, generally higher,
14 unquote; isn't that correct?

15 A That was their impression from the market.

16 Q And that's the only information on prices they
17 gave you; correct?

18 A That's correct.

19 Q Isn't it also correct that water-borne
20 transportation of petroleum products is subject to
21 different taxation in this state than pipeline
22 transportation?

23 A I can't answer that.

24 Q You didn't consider that?

25 A Well, since I don't have the rates the tax rates

2241

1 didn't seem to matter.

2 Q Turn to page 33, line 22. According to you, you
3 are saying, quote, Dr. Wilson on behalf of Staff also
4 argues that Olympic's owners should be, quote, punished,
5 unquote, if they do not inject more equity capital into
6 Olympic. Do you see that?

7 A Yes. Yes, I do.

8 Q Did you read the Commission's order in the
9 American Water Company case that Dr. Wilson cited in his
10 testimony regarding appropriate equity ratio?

11 A I looked through it. I can't say I read it
12 carefully.

13 Q Did you consider that Commission order on
14 capital structure in that case to be punishment of that
15 company?

16 A No, the situation was different. That was a
17 stand-alone company where, in fact, the capital
18 structure of that company affected its ability to raise
19 financing.

20 And in this case we have a company that's
21 wholly owned by two major oil companies and the only
22 capital structure that matters to the potential lenders
23 is that of the parents. The only characteristic of
24 Olympic that matters to lenders is its cash flow. So we
25 have a very different situation here in that Olympic is

2242

1 a wholly -- is wholly owned by two major, very healthy
2 corporations.

3 Q So Olympic's capital structure containing 150
4 million dollars of debt is not an impediment to Olympic
5 obtaining financing?

6 A No. Its lack of cash flow is because the
7 parents guarantee the debt. Anyway, the relevance of
8 capital structure is in terms of risk of repayment, and
9 for that kind of risk you look to the capital structure
10 and financial health, if you will, of the people
11 offering the guarantee. And in this case it would be
12 the parent corporations, not Olympic.

13 Q Do Olympic's parent corporations look on
14 Olympic as a stand-alone company?

15 A Only to the extent that they expect it to
16 generate a sufficient cash flow to make their investment
17 in it worthwhile. They look at it more as a joint
18 project or a joint venture in that they value it. They
19 look at the value of the cash flow they are receiving
20 from it in terms of how much money they are willing to
21 invest in it, and the cash flow is driven in this
22 instance by the rates.

23 Q Turn to page 35 of your testimony. On line 1 you
24 indicate that Olympic's revenues in the year 2000
25 covered only 54.1 percent of its operating and

2243

1 maintenance expenses. Do you see that?

2 A Yes. And this is based on the filings in the
3 FERC form 6s.

4 Q And you note that the other four pipeline
5 companies that you looked at had 165.4 percent to 241.8
6 percent in revenues. Were those percentages of their
7 O&M expenses correct?

8 A Yes, and these were companies that had almost
9 100 percent debt capital structure. And the difference
10 between Olympic and these companies is cash flow, not
11 capital. And the capital structures are very similar.
12 And it really, I think, is further evidence that the
13 capital structure of a wholly owned company like Olympic
14 is irrelevant.

15 Q And is it irrelevant to the 54.1 percent that
16 you used that Olympic was shut down part of the year 2000?

17 A That certainly is part of it. They certainly
18 were running at less than full through-put, which they
19 still are.

20 Q Turn to page 47 of your testimony. Beginning on
21 line 7 you discuss your review of recent Commission rate
22 case decisions on cost of equity. Do you see that?

23 A Yes, I do.

24 Q And you state that in the 1995 Avista case the
25 Commission accepted standard DCF studies, but did not

2244

1 accept the assumptions underlying the multi-stage DCF
2 studies; is that correct?

3 A That's correct, yes.

4 Q The DCF method that you have employed in this
5 case is a multi-stage DCF study, isn't it?

6 A Not really. You have a constant estimate of G
7 over time. The multi-stage studies typically will apply
8 one growth rate for say the first five years and another
9 growth rate further out. This just averages to two
10 estimates of growth to come up with a single constant
11 growth rate to apply over the entire horizon.

12 So it does base the estimates -- the single
13 growth rate, G, on two different growth rates, but an
14 attempt to get a better average of the overall long term
15 growth rate. But it is a single stage model.

16 Q You used an IBF growth estimate for the first
17 five years in your analysis, did you not?

18 A Yes.

19 Q And you used GDP for other long term estimates,
20 did you not?

21 A Yes.

22 Q Turn to page 79. Your testimony beginning on
23 line 16 to 19. You say there is no reason for looking
24 beyond the oil pipeline proxy group because it consists
25 of five almost, quote, pure play, unquote, pipeline

2245

1 companies. Do you see that?

2 A Yes.

3 Q Kinder Morgan is one firm in the five oil
4 pipeline proxy group, correct?

5 A Yes.

6 Q Kinder Morgan has the same amount of natural
7 gas pipelines as it does oil pipelines; isn't that
8 correct?

9 A They have substantial holdings. Whether they
10 are the same amount or not, I am not sure.

11 Q Two other firms in FERC's five oil pipeline
12 proxy group are Enbridge, E-n, bridge, and Teppco,
13 T-e-p-p-c-o, correct?

14 A Correct.

15 Q Enbridge is also in the natural gas liquids
16 business, correct?

17 A Yes.

18 Q Teppco has interests in the natural gas
19 business as well, correct?

20 A I think they are small, as I recall.

21 Q So your answer is, yes, with that
22 qualification?

23 A Yes, with that qualification.

24 Q Turn to page 89.

25 A (Complies.)

2246

1 Q In the question and answer starting on line 3
2 you address testimony of Dr. Wilson. And you also refer
3 to Dr. Means where they testified that Olympic's return
4 to full capacity operation -- excuse me, Olympic's full
5 capacity -- let me just stop.

6 MR. MARSHALL: Are you at line 12?

7 MR. TROTTER: I am nowhere.

8 hard for me to phrase the
9 question. Just a moment.

10 (Pause in proceedings.)

11 Q BY MR. TROTTER: Your testimony beginning on
12 the question and answer on line 3, you state that both
13 Dr. Means and Dr. Wilson incorrectly infer that
14 Olympic's full capacity operation prior to June 19, 1999
15 supports the view that water-borne transportation is not
16 competitive, correct?

17 A That's correct.

18 Q And Olympic's pipeline traffic has in fact
19 returned to its full available capacity; that is, 80
20 percent of full capacity since it reopened in the summer
21 of 2001, correct?

22 A That's correct.

23 Q That reduced water-borne transportation
24 substantially, did it not?

25 A Yes, I would presume so.

2247

1 Q Now, in your capital structure analysis you have
2 used Olympic's parents' debt and equity ratio as
3 Olympic's debt and equity ratio; correct?

4 A Correct.

5 Q And you have used Olympic's parents' embedded
6 cost of the debt as Olympic's cost of the debt, correct?

7 A Correct.

8 Q Did you -- but you did not use Olympic's cost
9 of equity as Olympic's cost of equity, did you?

10 A That is correct.

11 Q We discussed a moment ago some of your
12 testimony where you reviewed this Commission's recent
13 order on cost of the equity. Do you recall that?

14 A Yes.

15 Q Did you review any orders of this Commission on
16 the issue of retroactive rate making?

17 A Not specifically, but I assume if it's like
18 every other Commission, it doesn't permit it.

19 Q Retroactive rate making is when the regulator
20 takes a past expense or revenue item and brings it
21 forward to have it recovered in rates currently; is that
22 correct?

23 A That's correct.

24 Q The test year concept did not violate the
25 retroactive rate making principle since rates are not

2248

1 set to cover those explicit test year costs but rather
2 the test year is used to access recovery of future
3 costs, correct?

4 A Yes. The one thing I wanted to make very
5 clear, on the past cost the Commissions will, in fact,
6 include deferred costs, capitalized costs, if you will,
7 in the cost of services. If, for example, if a pipeline
8 or any regulatory entity had an unusual expense, rather
9 than have a rate shock they prefer to spread it out over
10 a period of time. They will do that, even if it isn't
11 typically capital. So that's not really retroactive
12 rate making. It's a way of spreading costs over a
13 number of years.

14 Q Are you familiar with this Commission's order
15 on when a company is entitled to defer costs and when it
16 isn't?

17 A I am not familiar with the details, no.

18 Q If a company incurs a debt expense in the year
19 2000 but defers it without permission of a regulatory
20 authority and seeks to recover it in rates in 2002, that
21 would be retroactive rate making, wouldn't it?

22 A Yes, I would think so.

23 Q Turn to page 104.

24 A (Complies.)

25 Q You give some testimony on electricity pricing

2249

1 in this area of your testimony. And at the bottom of
2 page 104 you provide an overview of changes in the
3 wholesale market for electricity over the past few years.
4 Do you see that?

5 A Yes.

6 Q And you conclude that Olympic faces a lot more
7 uncertainty regarding electricity than has been the case
8 historically, correct?

9 A Yes.

10 Q Isn't it true that several years ago Olympic
11 elected to take service from Puget Sound Energy under
12 indexed electric rate that varied greatly with market
13 prices at the mid Columbia?

14 A I have not had a chance to review all of their
15 specific contracts.

16 Q I will ask you to assume that.

17 A Okay.

18 Q Those market prices became volatile in 2000 and
19 2001, didn't they?

20 A Yes.

21 MR. MARSHALL: I would object to the
22 hypothetical because I believe it's based on an
23 incorrect premise about -- of what facilities of Olympic
24 bear. I would ask Mr. Trotter to be specific about what
25 particular facilities of Olympic were on that market

2250

1 rate, because the implication is that all of the
2 facilities are --

3 Q BY MR. TROTTER: The only ones that were
4 subject to schedule 48 --

5 MR. MARSHALL: And those were also limited, not
6 all of the area --

7 MR. TROTTER: That's correct, because not all
8 of the area is served by Puget Sound Power and Light.

9 MR. MARSHALL: Even though the area is served,
10 there's a limitation on the facilities within the area.
11 I think the hypothetical misstates a fact. It's based
12 on an incorrect premise, and I won't further speak to
13 that.

14 JUDGE WALLIS: I will overrule the objection
15 because that information, to the extent Mr. Trotter has
16 not clarified it, may be brought out.

17 MR. MARSHALL: Very well.

18 Q BY MR. TROTTER: Do you understand that Olympic
19 Pipeline was allowed to go onto a fixed rate tariff
20 instead of an indexed rate tariff in the middle of that
21 price volatility problem?

22 A I wasn't aware of that, no.

23 Q Okay.

24 A But one thing we have to bear in mind is if
25 electric prices become higher over time they eventually

2251

1 get passed through. So if market -- if the market gets
2 chaotic and prices and costs are higher, it's going to
3 be reflected in everyone's rates, including Olympic's
4 over time. It's not just Olympic, but I think the
5 situation is sufficient that all electricity consumers
6 are more at risk than they have been historically.

7 Q Did you discuss future electricity pricing with
8 any utility provider than Olympic?

9 A No, I did not.

10 Q Do you understand that over 40 percent of
11 Olympic's power costs do not vary with usage?

12 A You mean their demand and facility type
13 charges?

14 Q Yes.

15 A I don't know the number, but it wouldn't
16 surprise me.

17 Q Turn to page 107, line 20. You say if shippers
18 have entered into long term firm agreements for water-borne
19 transportation, these shippers would not return to
20 Olympic until the agreements expired?

21 A Where are you again? I am sorry.

22

23 Q Page 107, lines 20 through 22.

24 A I must have numbering problems.

25 JUDGE WALLIS: Let's be off the record, please.

2252

1 (Discussion off the record.)

2 JUDGE WALLIS: Let's be back on the record,
3 please.

4 Let's be back on the record for announcing
5 that we will take our lunch recess at this time. We
6 will be back on the record at 1:30 p.m.

7 (Lunch recess taken.)

8 JUDGE WALLIS: Let's be back on the record,
9 please.

10 As a preliminary matter before we resume the
11 examination of Dr. Schink, Olympic has moved for the
12 admission of its Exhibits 201-T through 223, and I will
13 note for the record that there is a pending objection.
14 And subject to ruling on that objection, the exhibits
15 are received.

16 (EXHIBITS ADMITTED)

17 JUDGE WALLIS: Is there anything else
18 preliminary before we proceed?

19 (No response.)

20 JUDGE WALLIS: Let the record show there's no
21 response. And Mr. Trotter, you may resume the
22 examination of Dr. Schink.

23 Q BY MR. TROTTER: Thank you. Dr. Schink, turn
24 to page 107 of your rebuttal testimony Exhibit 201-T, and
25 I am focusing your testimony on lines 14 through 22, the

2253

1 beginning of the section. You say that delay in
2 achieving 100 percent operating pressure could ensue in
3 lawsuits that are filed to block the pressure increase
4 to seek and obtain a court injunction.

5 Do you see that?

6 A Yes, I see that.

7 Q Are you aware of any pending suits or
8 threatened suits?

9 A No, I am not.

10 Q On line 20 you say if shippers have entered
11 into long-term firm agreements for water-borne
12 transportation services, these shippers would not return
13 to Olympic until these terms agreements expired. Do you
14 see that?

15 A Yes.

16 Q Do you mean by this testimony that if the
17 pipeline is restored to 100 percent pressure there will
18 be insufficient volumes available to use that additional
19 capacity or through-put?

20 A If it is -- the supposition in that sentence is
21 correct, it's possible.

22 Q Do you know, in fact, whether any shipper has
23 entered into a long term firm agreement for water-borne
24 transportation that would render it unable to use the
25 additional through-put capability of Olympic Pipeline

2254

1 once it is restored to 100 percent pressure?

2 A No, we have asked for whatever agreements Tosco
3 and Tesoro has, and they refused to supply them.

4 Q Did you ask ARCO or Equili?

5 A No.

6 Q Olympic is overnominated today at 80 percent
7 pressure, correct?

8 A It's my understanding, yes.

9 Q Do you know how much it is overnominated?

10 A No, I do not.

11 Q So you don't know if the amount of the
12 overnominations would be enough to be served under the
13 additional through-put capability at 100 percent
14 pressure?

15 A Nominations and actual shipments can differ, so
16 I don't know if you can infer that because there are
17 overnominations, there would be a lot more shipments.
18 But I don't know exactly what those overnominations are,
19 no.

20 Q You do know that Olympic was overnominated for
21 several years prior to the Whatcom Creek explosion,
22 correct?

23 A Right.

24 Q At the top of page 107 you say, "Currently
25 Olympic has ten months of actual through-put data for

2255

1 the test year." Do you see that?

2 A Yes.

3 Q By test year do you mean the 12 months ended
4 April 2002?

5 A Yes.

6 Q Is 12 months ended April 2002 the test year
7 Olympic is now sponsoring in this case?

8 A I would have to check. I think that's the
9 case, but --

10 Q That's your understanding?

11 A I can check and tell you for certain. Just
12 give me a second. I think it's actually July to June,
13 is it not?

14 Q I would be asking Olympic that later. I want
15 to know what your understanding is.

16 A Based on case 2, I think it's July to June, is
17 the test year.

18 Q June 2002?

19 A Yes. But, again, I am not entirely certain.
20 There's two and I get confused also.

21 Q So Olympic's current through-put proposal, as
22 you understand it, uses ten months actual July 2001
23 through April 2002, and estimates for two additional
24 months?

25 A That's my understanding, yes.

2256

1 Q And are the estimates for May and June of 2002
2 or May and June of 2001?

3 A May and June of 2002.

4 MR. TROTTER: Excuse me, Your Honor. I am
5 trying to find a reference.

6 (Pause in proceedings.)

7 Q BY MR. TROTTER: Mr. Schink, I don't have the
8 cite to this testimony, so I will quote it and ask you
9 if you recall. I am sorry.

10 You state in your testimony, quote, All that is
11 known and measurable with certainty is Olympic's
12 through-put capability at 80 percent operating pressure.
13 Further, this through-put capacity is best measured
14 by the actual through-put at 80 percent operating
15 pressure. Do you recall that testimony?

16 A Something to that effect. I can't remember
17 exactly where it is either.

18 Q There it is. Thank you. Page 108, line 12
19 through 15. Do you have that?

20 A Yes.

21 Q Line 14 you used the term through-put capacity.
22 What do you mean by that?

23 A Well, I think it should be just through-put.

24 Q As it's written, does that confuse the
25 concept --

2257

1 A As it's --

2 COURT REPORTER: Hang on.

3 Q BY MR. TROTTER: As it's currently written,
4 does that confuse the concepts of through-put and
5 capacity?

6 A As it's written, yes, it does commingle or
7 confuse them. The best measure of -- it does and it
8 doesn't. I think what they are actually able to
9 transport, what is based on ten months' actual data, it
10 appears they are actually able to move, is the best
11 estimate of what they, in fact, can move at 80 percent
12 capacity. If that helps clarify it.

13 Q Thank you. What downtime did Olympic actually
14 experience in the period July 2001 through April 2002?

15 A I can't tell you exactly. You would have to talk
16 to Mr. Talley about whether or not there's something
17 peculiar in this period.

18 Q Did you analyze that issue?

19 A No, I did not.

20 Q Do you agree that issue should be analyzed in
21 any through-put recommendation?

22 A Yes, I did ask if, in fact, the company
23 considered this representative of what they could
24 accomplish, and the answer was, yes. I didn't explore
25 it beyond that.

2258

1 Q Turn to page 13 of your rebuttal.

2 A Page 13?

3 Q Yes.

4 A (Complies.)

5 Q Beginning on line 17 you are referring to the
6 regulatory frame work since 1985. Do you see that?

7 A Yes.

8 Q You state on line 22, All prior tariff rate
9 increase submissions to the Commission have been
10 developed and justified within the FERC's frame work and
11 have been accepted by the Commission; is that correct?

12 A That's correct.

13 Q Did you personally examine all of the tariff
14 filings made by Olympic during that time frame 1985 to
15 present?

16 A No, I did not. I talked to the company about
17 what they had done, and they are -- their explanation
18 was that they had filed with this Commission what they
19 had filed with the Federal Energy Regulatory Commission.

20 Q Who told you that?

21 A Could have been Mr. Marshall, but I am not
22 entirely sure.

23 Q Did you examine the Sea-Tac tariff surcharge
24 filing?

25 A No, I did not.

2259

1 Q So if that was not filed consistent with the
2 FERC frame work, you wouldn't know that one way or the
3 other, would you?

4 A That's correct.

5 Q When you use the term accepted by the
6 Commission, do you mean the tariffs went into effect
7 without suspension?

8 A I don't know whether that is -- you know, it's
9 a legal concept. I'm not sure I know that the
10 Commission let them go in in essence with or without
11 suspension. I am not sure.

12 Q Are you relying on any order of this Commission
13 in which these tariffs were addressed?

14 A It's my understanding that the permission was
15 not accompanied by any discussion of the filing or the
16 methodology used to support. They were just approved.

17 Q Now, you have used the word approved, but let
18 me go back a second. So the answer to my question is,
19 no, you are not relying on any order of the Commission?

20 A That's correct.

21 Q Now, you said those tariffs were approved. By
22 using that term do you mean anything other than the
23 tariffs were allowed to go into effect without
24 suspension?

25 A They were allowed to go into effect without

2260

1 suspension. I'm not sure what you mean by that in this
2 context.

3 Q My question to you is by use of the term
4 approved, did you mean -- it's your term. Did you mean
5 by that term anything other than the Commission allowed
6 the tariffs to go into effect without suspension?

7 A I am having trouble -- "without suspension".
8 My understanding of the concept is delayed pending
9 hearing, or delayed for whatever. If that's what you
10 mean there, it was allowed to go in without hearing,
11 then I will agree with you.

12 MR. TROTTER: Those are all of my questions at
13 this time. Thank you, Dr. Schink.

14 THE WITNESS: Thank you.

15 JUDGE WALLIS: Mr. Brena.

16

17 CROSS EXAMINATION

18

19 BY MR. BRENA:

20 Q Dr. Schink, a few essentially preliminary
21 questions. Is it fair to say that the direct testimony
22 that you prepared for this Commission consisted of two
23 pages and an attachment of your FERC testimony?

24 A Yes.

25 Q Is there anywhere in your direct testimony or

2261

1 exhibits where you analyze this Commission's legal
2 precedent?

3 A In my direct, no.

4 Q Where you analyze this Commission's approach
5 for capital structure?

6 A In my direct, no.

7 Q Where you analyze this Commission's approach to
8 cost of debt?

9 A In my direct, no.

10 Q Where you analyze this Commission's approach to
11 the cost of equity?

12 A In my direct, no.

13 Q Where you analyze this Commission's approach to
14 overall rate of return?

15 A In my direct, no.

16 Q In short, the assumption in your direct
17 testimony is that this Commission should, based on an
18 attached copy of your FERC testimony, set the capital
19 structure, cost of debt, cost of equity, and overall
20 rate of return for a public service company within the
21 state of Washington based on an attached copy of your
22 FERC testimony. Is that fair?

23 A Certainly my assumption -- I was asked to
24 prepare testimony for the Federal Energy Regulatory
25 Commission, and the lawyers made the decision that the

2262

1 submission to the state would be the same. It certainly
2 wasn't my decision.

3 Q But it was your intention that this Commission
4 use that direct testimony for those purposes, correct?

5 A I don't think it's my intention, sir. I mean,
6 I think my answer to the first part was correct. I
7 think, as I've said, I think, supplementally in my
8 rebuttal, and I think there are reasons why it would be
9 appropriate for the Commission to do so.

10 And part because what the FERC does or has
11 required of the pipeline makes sense in the context of
12 this Commission's precedent, and also because it is
13 essentially the only guidelines this pipeline has had in
14 making a filing. But I didn't make the decision implied
15 by your question, sir.

16 MR. BRENA: If I could ask for an instruction
17 that he answer the questions I ask. He went on to give
18 reasons out of his rebuttal. He will have a full
19 opportunity to give the reasons out of his rebuttal.

20 JUDGE WALLIS: You mean on redirect?

21 MR. BRENA: Well, in a moment.

22 JUDGE WALLIS: And I will so instruct the
23 witness if -- we will instruct the witness that you
24 should listen very carefully to questions and respond to
25 the question.

2263

1 If it calls for a "yes" and "no", answer "yes"
2 or "no" and then please respond "yes" or "no" if, in
3 fact, either of those is the appropriate response. And
4 then if you must explain that answer, you may proceed to
5 do that subject to objection.

6 I will also ask that for the health and sanity
7 of our court reporter, as well as for having a good
8 record, if counsel starts to interrupt you, please let
9 them do that, and that will avoid her challenge of
10 trying to take two people at the same time.

11 Our experience is that the reporters have two
12 very able hands, but they cannot devote one to each
13 person who is talking, and get both people adequately on
14 the record simultaneously.

15 THE WITNESS: I apologize.

16 Q BY MR. BRENA: Mr. Schink, my questions are
17 directed at this point at your direct testimony only.

18 Did you intend that this Commission use your
19 direct testimony to analyze the capital structure, cost
20 of the debt, cost of the equity, and overall rates of
21 return in this proceeding?

22 A It was the intent of the submission. I did not
23 make the decision to do it that way.

24 Q Do you consider yourself an expert in the
25 law?

2264

1 A No, I do not.

2 Q Are you familiar with the legal obligations
3 under the Interstate Commerce Act and FERC's regulations
4 and federal legal authority, and whether or not they
5 will be the same or different from this Commission's?
6 Is that something you are comfortable opining on?

7 A Whether or not the statute they operate under
8 are the same, I have not studied them. I can't answer
9 that. And I am not a lawyer, and probably not qualified
10 to do so.

11 Q So it's fair to say with regard to your direct
12 testimony that there is no analysis whatsoever of this
13 state's law or this Commission's approach to capital
14 structure, cost of debt, cost of equity, or rate of
15 return in your direct testimony. Is that fair to say?

16 A Yes.

17 Q Do you consider your entire analysis of this
18 jurisdiction's approach to capital structure and rate of
19 return to be the proper subject of rebuttal?

20 A Could you repeat that, sir? I am sorry.

21 Q Do you consider your entire analysis of this
22 jurisdiction's approach to capital structure and rate of
23 return to be the proper topic for rebuttal testimony?

24 MR. TROTTER: Your Honor, I am going to object
25 to the question. It calls for a legal

2265

1 conclusion.

2 MR. MARSHALL: I join the objection.

3 MR. BRENA: If he's not capable to respond,
4 then he may -- I am trying to understand. He's put in
5 lots of testimony. If this is what he thinks is proper
6 rebuttal, or not, the way he understands the question.
7 So I would ask for his opinion as he understood the
8 question, not a legal conclusion.

9 THE WITNESS: I assumed --

10 JUDGE WALLIS: As qualified, the objections are
11 overruled.

12 THE WITNESS: I assume my rebuttal was
13 written -- there are two things I did in my rebuttal. I
14 updated my results, and I responded to positions taken
15 by other parties, which I consider to be proper
16 rebuttal.

17 Q BY MR. BRENA: Has any party to this proceeding had
18 any opportunity to answer your entire analysis of this
19 jurisdictional approach, this state's jurisdictional
20 approach to capital structure or rate of return?

21 A No. At least not that I am aware of.

22 MR. BRENA: I would renew my motion to strike
23 that portion of his rebuttal testimony.

24 JUDGE WALLIS: So noted. That motion will be
25 taken under advisement.

2266

1 Q BY MR. BRENA: Turning to your FERC testimony,
2 is it fair to say that your FERC testimony relies solely
3 on the DCF methodology?

4 A Yes, it does.

5 Q And footnote three of your direct case points
6 that out, doesn't it?

7 A Can you give me a page, sir?

8 Q Page 3, footnote 3.

9 A Yes, it does.

10 Q The reason that you gave for your sole reliance
11 on the DCF in footnote 3 was the Commission in SFPP is
12 clearly indicated that the plans rely solely on the
13 results produced by the DCF methodology proxy group.
14 Do you see that language, sir?

15 A Yes.

16 Q And that is the reason you chose to rely on the
17 DCF exclusively?

18 A In this matter, yes, rather than explore other
19 methods I attempted to say -- to suggest alternatives or
20 modifications to that method as opposed to argument that
21 they should consider other methods.

22 Q Did you, in fact, modify the FERC methodology
23 in your testimony?

24 A Well, I suggested modifications, yes.

25 Q And your modifications to the DCF method -- let

2267

1 me rephrase the question.

2 So it is not your testimony that the DCF method
3 that you proposed is consistent with the FERC's
4 currently approved DCF methodology; is that correct?

5 A I presented the results of the methodology as I
6 perceive it to be now approved by the Commission, and I
7 also presented my alternatives and clearly label them.

8 Q And which do you recommend?

9 A I recommend my alternatives.

10 Q So you do not recommend the results of your
11 analysis of what you consider to be a proper FERC DCF
12 methodology. Is that fairly stated?

13 A I recommend modifications to the methodology.
14 I certainly didn't abandon it. I suggested changing it.

15 Q Are you recommending the unmodified FERC DCF to
16 this Commission, or not?

17 A No, I am not.

18 Q How many modifications did you make?

19 A Essentially two. I modified the way that the
20 current period dividend yield be calculated, and I
21 suggested that the mean was a better measure of central
22 tendency than the median, and explained why.

23 Q What was the net impact on your recommendation
24 as a result of those modifications?

25 A I would have to calculate that to be certain.

2268

1 Q Did the rate go up or down?

2 A It went up.

3 Q A lot or a little?

4 A The lot or little is in the eye of the
5 beholder. I would calculate it for you, if you would
6 like.

7 Q If you would, please.

8 A This isn't -- this is in my direct.

9 Q I'm going to ask the same question with regard
10 to rebuttal as well, if that's helpful.

11 A All right. The nominal estimate of the cost of
12 equity capital for a typical oil partnership line based
13 on the Commission's method is 13.31 percent. And --

14 Q Compared with what under your recommendation?

15 A I am looking.

16 CHAIRWOMAN SHOWALTER: When you said
17 Commission, which Commission?

18 THE WITNESS: The Federal Energy Regulatory
19 Commission. I will try to say "FERC" from now on to try
20 to avoid this. I apologize. I have to -- and the
21 recommended -- my recommendation is 14.61 percent for a
22 typical pipeline, based on my modifications.

23 Q BY MR. BRENA: So the net impact is 1.3 percent of
24 your modifications to what you consider the proper FERC
25 DCF methodology. Do I understand you correctly?

2269

1 A I am not sure about the word proper
2 modifications to the methodology. As currently accepted
3 by the FERC.

4 Q And that was in your direct case?

5 A That was my direct case.

6 Q And would you please respond to the same
7 question with regard to your rebuttal case?

8 A As you are, I am sure, aware, I actually
9 evaluated the cost at two points, at the end of 2001 and
10 at the end of March 2002. And in part because it
11 straddled the period considered by some of the other
12 witnesses.

13 Let me work with the most recent one. It also
14 happened to be the lower of the two, so we won't have to
15 quibble about that.

16 Q Which one are you recommending, Mr. Schink?

17 A I am recommending an average of the two.

18 Q Would you use the average, then, for your
19 calculations, please.

20 A If you -- the method, as accepted, or the
21 accepted method of the FERC would be 14.56 percent. And
22 the preferred or best method, if you will, that I
23 recommended in my direct is about 14.79 percent.

24 CHAIRWOMAN SHOWALTER: You just said direct.

25 Is that what you meant? The question was --

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1 THE WITNESS: I am sorry. Let me do this
2 again. I apologize. I am not having my best day with
3 my calculator here.

4 Q BY MR. BRENA: Please double-check those numbers,
5 if you would.

6 A 14.56 would be what the average of the two
7 medians would be based on the unmodified Commission
8 method. And I guess the actual recommendation -- let me
9 do it that way. I think my recommendation is 14.74. Is
10 that about right? I can check that. I did do that in
11 front of the rebuttal --

12 Q If you would confirm that number, please, sir.

13 A (Complies.) 14.7.

14 Q That's changed three times now. If you are not
15 sure what it is --

16 A It is 14.7, sir. I am sorry. I am having
17 problems running my calculator.

18 JUDGE WALLIS: Mr. Schink, I know you were
19 distracted, but we will remind you that it is important
20 to let the lawyers talk, rather than stepping on their
21 toes.

22 THE WITNESS: I will.

23 MR. BRENA: That's one of the few times I have
24 ever heard that. I apologize.

25 Q BY MR. BRENA: Your risk additer in your direct

2271

1 case was .79, correct?

2 A .75.

3 Q And in your rebuttal case was what?

4 A .95.

5 Q If I could direct you to page seven and eight
6 of your direct testimony, the last line, the last
7 sentence fragment, it says, As a result of this water-borne
8 competition, Olympic faced above-average business
9 risk because many pipelines face limited, if any, direct
10 competition from barges and tankers.

11 Do you see that direct testimony?

12 A Yes, I do.

13 Q And is it fair to say that this is the
14 justification as analysis supporting your risk additer?

15 A It's part of it.

16 Q Would you direct me to any other part in your
17 direct case?

18 A The pipeline -- I don't know if -- well, I am
19 not sure to what extent I focused on the water-borne in
20 the case as a clear example. I think that was what I
21 emphasized there.

22 Q And my question is, if there's any other risk
23 factor that you use in your direct case to justify your
24 risk additer, would you please direct my attention to
25 it?

1 A I think that's the only point I made in direct.

2 Q Have you added other factors in your rebuttal?

3 A I considered, based on testimony, but I
4 think -- Mr. Brown and others -- that a general notion,
5 that they saw no difference in risk between Olympic in
6 general and other pipelines. In response to that, I
7 explored what I have called isometric risk.

8 Q So you added the concept of isometric risk in
9 your rebuttal as a further justification for your risk
10 additer?

11 A In response to testimony made by others that,
12 in general, the company was no riskier in any dimension
13 that they could see relative to other pipelines.

14 Q If there were other risks that you think
15 justified that risk additer to you, don't you think you
16 should have brought it forthright in the direct case?

17 A I believe the water-borne competition would
18 justify the risk additer. I was asking, and in essence
19 thought, it was fairly obvious, given all the problems
20 that Olympic had, that they faced, it had other risks
21 that were -- in fact, put it in financial jeopardy. But
22 it became one, so I addressed it in my rebuttal.

23 Q Let me be sure I understand your theory of
24 direct testimony. We're supposed to imply into that
25 there are obvious business risks that you do not

2273

1 reference in your direct testimony. Is that how you
2 intend --

3 A No.

4 MR. MARSHALL: I object; argumentative --

5 MR. BRENA: I withdraw the question --

6 COURT REPORTER: Hold it.

7 JUDGE WALLIS: Between lawyers, give the
8 priority to the person who starts first. So
9 Mr. Marshall.

10 MR. MARSHALL: I stopped dead. I am not to blame.

11 JUDGE WALLIS: Would you restate your objection
12 for the court reporter, please.

13 MR. MARSHALL: I objected as argumentative,
14 that this asked the witness to draw certain conclusions
15 about what was proper or improper in response to a whole
16 series of factors that we talked about yesterday.

17 JUDGE WALLIS: And Mr. Brena, your response is
18 still that you withdraw that question?

19 MR. BRENA: It is, Your Honor.

20 JUDGE WALLIS: Very well. Please proceed.

21 Q BY MR. BRENA: Turning to debt costs,
22 Mr. Schink, what was your debt cost in your direct case
23 and rebuttal case?

24 A In the direct case it was 6.74 percent, and in
25 my rebuttal case, for fear of misspeaking again, it is

2274

1 5.26 percent. I am sorry.

2 Q Are you proposing through your FERC testimony
3 that there's any modifications to the FERC with regard
4 to its methodology for determining a cost of debt, or
5 do you consider the cost of debt that you use to be
6 consistent with the FERC methodology -- I will rephrase.
7 Compound question. I object.

8 MR. MARSHALL: Actually it was premised on him
9 referring to his FERC testimony in rebuttal, and I don't
10 think -- we don't have that.

11 MR. BRENA: Okay. I will rephrase.

12 Q BY MR. BRENA: While your -- by your FERC
13 testimony, I mean your direct testimony.

14 A Okay.

15 Q In your FERC testimony, are you intending to
16 apply directly your understanding of the FERC
17 methodology to determine cost of debt?

18 MR. MARSHALL: I would object to the form of the
19 question. This witness has adopted the FERC testimony
20 in his direct testimony here, because that's the
21 methodology that we have asked be applied. And so I
22 think now we're getting into an argumentative form of
23 the testimony.

24 I think that clearly it can be established
25 through the questions as to what we're talking about.

2275

1 Otherwise, it may get confused, because Mr. Schink does
2 have a separate FERC rebuttal testimony. The direct
3 testimony was the same here and at the FERC.

4 JUDGE WALLIS: I think for the standpoint of
5 clarity in our own transcript, it would be better, Mr.
6 Brena, to refer to his direct testimony as his direct
7 testimony. And that way we eliminate the possibility of
8 questions or uncertainties as to what is being
9 referenced.

10 MR. BRENA: I agree. Happy to do that.

11 Q BY MR. BRENA: In your direct testimony, with
12 regard to your calculations of the cost of debt, are you
13 intending to apply your understanding of the way FERC
14 determines the cost of debt?

15 A Yes.

16 Q Have you modified that in any way?

17 A In the rebuttal?

18 Q In the direct.

19 A No.

20 Q Have you modified FERC's methodology through
21 your rebuttal in any way?

22 A No. It's an update. Again, it was -- the
23 direct had end of 2000, and the update had end of 2001
24 date in it.

25 Q But there was no change in methodology in

2276

1 either your direct or your rebuttal from your
2 understanding of how FERC determines the cost of debt?

3 A That's correct.

4 Q Capital structure, what was your capital
5 structure, percentage of equity direct and in rebuttal?

6 A Direct was 80 -- I will have to find it again.
7 For some reason I am having trouble with the numbers
8 this afternoon.

9 My recommended capital structure had 82.9
10 percent equity in my direct testimony, and in my
11 rebuttal testimony the equity share of capital was 86.85
12 percent.

13 Q I would like to draw your attention to page 24
14 of your direct case. The first Q and A on the top of
15 54, going through line 985 through lines 994. Do you
16 have that testimony in mind?

17 A Yes.

18 Q That is your explanation for why you applied
19 parent capital structure?

20 A That is my explanation. That is correct.

21 Q Is there anywhere else in your direct case that
22 you offer additional reasons than in that one answer?

23 A Well, I talked about the relationship between
24 risk and capital structure in the next Q and A. I would
25 suggest that is relevant to the issue, but it's

2277

1 certainly in this section where I deal with it.

2 Q Please understand, my question isn't defined,
3 every bit of testimony that is relevant.

4 The direct reasons you have stated in your
5 direct case for why this Commission should adopt the
6 parent capital structure is the only explanation of
7 those reasons in that answer running from 986 through
8 994 on that page?

9 A No, I think the subsequent question and answer
10 are also relevant to the decision, and I think should
11 be -- is also part of the explanation for what I have
12 done.

13 Q Anything further?

14 A I think those two questions and answers, I
15 think, are the explanations I have provided, I guess.

16 Q Thank you. Do you have a copy of your cross
17 exhibits with you?

18 A My cross exhibits? Do you have --

19 JUDGE WALLIS: For the benefit of the witness,
20 a number of documents have been marked in advance for
21 possible use on cross examination, and they have been
22 distributed to the parties.

23 Let me ask if Olympic has a copy of the
24 documents that were proposed for possible use with
25 Dr. Schink, and if those could be made available to him.

2278

1 Those are the documents we marked as Exhibits 226
2 through 232.

3 Q BY MR. BRENA: Mr. Schink, have you seen this
4 prior to now?

5 A (Reading document.) It's been several years.

6 Q It's 226.

7 A Pardon? Have I seen these exhibits?

8 Q Yes.

9 A No. I am seeing them for the first time.

10 Q Do you recognize 226 as your testimony?

11 JUDGE WALLIS: Let me ask if those documents
12 are marked with numbers, Dr. Schink.

13 THE WITNESS: Not on my copies.

14 JUDGE WALLIS: Mr. Brena, could you refer to
15 the common name for the documents when you refer to
16 them?

17 MR. BRENA: I could. Or we could go up and
18 have them marked.

19 JUDGE WALLIS: Very well. Let's take a moment
20 while that occurs.

21 (Brief recess.)

22 JUDGE WALLIS: Mr. Marshall, would you like to
23 do that, or would you like to have Mr. Brena assist with
24 that?

25 MR. MARSHALL: We can do that, and then have

2279

1 him check to make sure we have them marked correctly.

2 JUDGE WALLIS: Let's be off the record.

3 (Discussion off the record.)

4 JUDGE WALLIS: Let's be back on the record,
5 please.

6 Mr. Brena.

7 Q BY MR. BRENA: Mr. Schink, Exhibit 226 is an
8 excerpt of your direct testimony in the Orange and
9 Rockland Utilities Case. Is that marked correctly?

10 A Yes, it is.

11 Q Now, I would like to focus on your testimony.
12 First, in your testimony, can you tell me how many
13 approaches, how many different analytical methods you
14 used in setting forth the rate of return in this case?

15 A I think on page 3 it says I used five.

16 Q And I would like to draw your attention to page
17 4 under the heading, Relying solely on the DCF method or
18 any other single method is not reasonable.

19 A That's correct.

20 Q And I would like to ask you some questions
21 about that section. Do you have it in mind?

22 A Yes.

23 Q You point out that in the bottom of the answer,
24 further, the basic market assumptions under like the DCF
25 model have been questioned seriously in the financial

2280

1 literature. Do you see that?

2 A What page?

3 Q Page 4, lines 20 to 23.

4 A I see that.

5 Q And would you explain what basic assumptions
6 have been seriously questioned that you are referring
7 to?

8 A Basically like all the other models the
9 assumption -- I don't know. I mean this has been long
10 ago enough I don't have -- I don't know if I had any
11 specific ones in mind. But all the models in DCF, cap,
12 and so on are based on simplifying assumptions which
13 don't appear to be -- to hold in the real world.

14 So in the case of using all models, you have to
15 live with the fact that the models are, at best,
16 approximations to what is going on in the real world.

17 And rather than venture what I was thinking
18 when I wrote this several years ago, I would rather keep
19 it that general.

20 JUDGE WALLIS: Mr. Schink, would you bring
21 yourself closer to the microphone, or the microphone
22 closer to you.

23 THE WITNESS: (Complies.)

24 JUDGE WALLIS: Had you completed your answer?

25 Q BY MR. BRENA: I would like to draw your

2281

1 attention to that last sentence. More important, there are
2 methods which have been shown to estimate the cost of
3 equity which have been shown to be at least as accurate,
4 if not more accurate, than the DCF model. Which other
5 methods were you referring to?

6 A I have used -- I think what I refer to here are
7 the newer APT (ph.) and fama French (ph.) models, which
8 I think are major breakthroughs in this area. They
9 have not won wide acceptance by regulatory commissions
10 yet. And also, in other venues, I have used the cap M
11 model.

12 Q You acknowledge, and do you still agree with
13 the statement that these alternative methods are used
14 throughout the financial community to evaluate the
15 return required by investors? Do you still agree with
16 that?

17 A The DCF, APT, fama French, cap M, are used,
18 yes.

19 Q And you refer to this testimony as being 1993,
20 the date you prepared this testimony?

21 A Unless you can provide a date I couldn't tell you
22 for certain.

23

24 Q Subject to check, you accept that?

25 A It's certainly possible, yes.

2282

1 Q I would like to draw your attention to page
2 seven of your direct testimony in that case, lines 20
3 through 22, which reads, While the DCF method will
4 provide use physical information with respect to cost of
5 equity capital it must be used in conjunction with other
6 methods in order to do so. Do you see your testimony?

7 A Yes, I do.

8 Q Did you, in this case, use the DCF in
9 conjunction with other methods?

10 A Yes, I did.

11 COMMISSIONER HEMSTAD: I am uncertain. When
12 you say "this case," which case?

13 MR. BRENA: This proceeding, Olympic Pipeline.

14 THE WITNESS: Wait a minute.

15 Q BY MR. BRENA: Perhaps there was confusion with
16 regard to my question.

17 A There was. I thought you were referring to the
18 Orange and Rockland case. Thank you for asking the
19 question.

20 Q I was about to ask what other method you
21 used in this case before this Commission, and
22 this proceeding with Olympic Pipeline. Did you use the
23 DCF method in conjunction with any other method?

24 A No, I have not, and for the reasons I explained
25 in my direct. I did not use it before in the FERC

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1 proceedings, and for the reasons I explained in my
2 rebuttal. I believe this Commission relies almost
3 exclusively on the DCF method.

4 Q I would like to turn your attention to page 9,
5 beginning line 16, and continuing through page 10, line
6 2.

7 A (Complies.)

8 Q Would you review that testimony, please?

9 A Page 9?

10 Q Page 9, line 16, beginning as, Dr. Fama (ph.)
11 and other researchers cited above have indicated and
12 continuing through page 10, line 2.

13 A (Reading document.) Yes.

14 Q Do you have the testimony in mind?

15 A Yes.

16 Q This is you saying in another way what you said
17 earlier on the stand, that markets and models aren't
18 quite the same, so you should use several models in
19 trying to get to the market?

20 A It's similar, yes. It's not exactly the same.
21 The efficient market hypothesis certainly underlies all
22 the methods. And if it's flawed, all methods are
23 flawed.

24 Q I would like to direct you to page 10 of your
25 testimony.

2284

1 A Are we still on the Orange and Rockland?

2 Q Yes, we are. And your testimony in the Orange
3 and Rockland where you are asked, Are there other
4 reasons to employ multiple methodologies? And you say,
5 yes. Particularly the language, However, if several
6 analytical methods are used to calculate estimates, that
7 sentence beginning there.

8 CHAIRWOMAN SHOWALTER: What line?

9 MR. BRENA: Lines 8 through 13 on page 10 of
10 226.

11 THE WITNESS: I see that, yes.

12 Q BY MR. BRENA: Isn't it fair to characterize
13 that testimony as saying it is your opinion that
14 multiple models more closely approach the market than
15 does any single model?

16 A It is, subject to the proviso that results are
17 meaningful and correctly done. In fact, it is viewed by
18 many to be a superior approach.

19 Again, I say, as I have said in my testimony I
20 have done with the FERC, I pursued the DCF only because
21 I learned that that is the methodology the FERC is going
22 to rely on, and put my efforts into putting the best
23 estimate I could put together based on that one model.
24 And in rebuttal, upon reviewing this Commission's
25 decisions, recognize that they also had relied on almost

2285

1 exclusively on the DCF method. So I again tried to
2 produce evidence that they would in fact consider.

3 Q Did you average all the models in this case, in
4 the Rockland case?

5 A I don't remember what I actually ended up
6 doing, whether upon review some of them turned out to be
7 results, that for various reasons, I thought were not
8 plausible or whatever. I cannot remember at this point
9 what the final result was.

10 Q I am trying to understand what you would
11 generally do. Would you generally average them unless
12 you saw an outlier in the information that you needed
13 to look into further?

14 A Generally. If they produce methods that were
15 similar, then averaging produces a real result. If they
16 produce results that are quite different, then I would
17 want to look into what was causing them and determine
18 whether or not one or the other methods was obviously
19 flawed or inappropriate in the context I was applying
20 it.

21 So I would certainly not want to -- if you --
22 with the proviso that these methods produced reasonable
23 results, I would tend to average them. But I would not
24 blindly accept them, no.

25 Q I would like to draw your attention to Exhibit

2286

1 227, which is the Natural Fuel Gas case -- National Fuel
2 Gas Distribution case?

3 A Yes.

4 Q This is also direct testimony that you filed in
5 another case before the New York Public Service
6 Commission?

7 A Yes.

8 Q And can I draw your attention to page 8 of the
9 testimony in the National case, lines 4 through 16?

10 A Yes.

11 MR. BRENA: I would like to make the record
12 clear that the page numbers I am referring to are not
13 the page numbers of the exhibit, but the page numbers of
14 the case.

15 JUDGE WALLIS: Thank you, Mr. Brena.

16 Q BY MR. BRENA: Have you had an opportunity to
17 review the testimony, Mr. Schink?

18 A Yes, I have.

19 Q It's fair to say that you don't believe any
20 single method should be relied on. That's what you say,
21 isn't it?

22 A That's my belief is that you should consider
23 multiple methods, but not use them blindly. Yes.

24 Q Were you one of the drafters of the consensus
25 document?

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1 A Yes, I was.

2 Q And the consensus document was a document that
3 included representatives of the Commission Staff, the
4 Public Utility law project of New York, and nine
5 major utilities in the state; is that correct?

6 A That's correct.

7 Q And I draw your attention to page 11 of the
8 National case, and in the consensus documents, isn't it
9 true that cumulatively all those sources found the DCF,
10 as applied by the Commission over the last 13 years,
11 produced volatile returns that were, among other things,
12 highly interest rate sensitive?

13 Is that what your testimony is on page 11 of
14 the case, from lines -- excuse me, lines 5 through lines
15 9?

16 A Well, the Commission in New York relied on DCF.
17 And I think one of the things, as applied by the
18 Commission -- and I don't remember exactly what
19 variables of the DCF they were using. I don't think
20 that they were relying on a forward looking growth rate
21 or forward looking estimate of growth.

22 Quite frankly, this was too long ago. I
23 remember this discussion, and I remember part of the
24 problem was that while DCF was a method, there was some
25 question as to whether or not it could be, in fact, made

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1 better by modifying the DCF they used as opposed to --
2 the volatility itself was probably due to the method, the
3 specific method they were using, as I recall.

4 Q The conclusion of the consensus document wasn't
5 to change the DCF. The conclusion was that no single
6 methodology should be solely relied on, and several
7 different methodologies should be employed. And that is
8 your testimony on page 11, lines 10 through 14; is that
9 correct?

10 A The consensus document did include that
11 multiple methods should be employed.

12 Q On page 12 of the National case, on lines 4,
13 don't you concur in that conclusion?

14 A Yes, I do.

15 Q I would like to draw your attention to page 16
16 of the National case under the heading, Relying solely
17 on the DCF method or any single method met is not
18 reasonable. And if we were to go through the same
19 questions and answers on the National case that we went
20 through with the Rockland case, would they be the same?

21 A I don't think I can answer that question.

22 Q Okay. Then we will do it in parts -- well, in
23 fact, it's the identical language as the other case,
24 isn't it?

25 A Is it? I don't remember.

2289

1 Q I would like to draw your attention -- I am
2 done with that case now. Thank you. And I apologize.

3 Do you know what the total rate of return was
4 that Olympic filed as a regulatory reporting matter on
5 its FERC 6 in 2000, '99?

6 CHAIRWOMAN SHOWALTER: What did you say? 2000?

7 MR. BRENA: I said, do you know what the
8 average rate of return was that Olympic used in its
9 model to report on its FERC 6 form, for 2000 and
10 1999?

11 THE WITNESS: What it's using in the cost of
12 service calculations that's included on page 700. Is
13 that what you are talking about?

14 Q BY MR. BRENA: Yes.

15 A No, I don't recall.

16 MR. BRENA: I am about to go into a
17 confidential exhibit, 224-C. I would ask the
18 confidentiality in this exhibit and 225 be waived.

19 JUDGE WALLIS: Mr. Marshall.

20 MR. MARSHALL: What are those exhibits
21 generally?

22 JUDGE WALLIS: Let's be off the record, please.

23 (Brief recess taken.)

24 JUDGE WALLIS: Let's be back on the record.

25 Mr. Marshall, are you prepared to respond to

2290

1 the request for waiver?

2 MR. MARSHALL: Yes, I am.

3 JUDGE WALLIS: What is the response?

4 MR. MARSHALL: The response is if it does not
5 include this reference to the Zip file, then the rate of
6 return answer here is not confidential, that part of the
7 data request -- request response is not.

8 JUDGE WALLIS: Mr. Brena, does that satisfy
9 your concerns?

10 MR. BRENA: It does.

11 JUDGE WALLIS: Please proceed.

12 Q BY MR. BRENA: Mr. Schink, in response A, the last
13 sentence to response A, the language, The rate of return
14 used to develop the return of allowance in cost of
15 service was 9.0 in 1999, and 11.05 for 2000. Do you see
16 that?

17 A No, I don't seem to have it.

18 Q Do you have 224-C, sir?

19 A I don't think so.

20 CHAIRWOMAN SHOWALTER: Mr. Brena, while there
21 is a pause, if you could slow down just a little. Your
22 words are running together so it's hard to understand.
23 And it's so fast it's hard to take in.

24 The court reporter feels the same way.

25 MR. BRENA: Thank you, Chairwoman.

2291

1 JUDGE WALLIS: We want to finish within the
2 time table available, but we also want a record.

3 MR. BRENA: Boy, are you guys demanding.
4 Understand what is in, and do it. I'll stretch my
5 creative imagination.

6 THE WITNESS: I can now, I think, react to your
7 question if you will reask it, because I don't remember
8 it.

9 Q BY MR. BRENA: I will just reask it. Were
10 you aware that this is what they filed in their cost of
11 service model in the regulatory reporting to FERC for
12 the 1999 and 2000 rate of return?

13 A I -- no, I really wasn't. It's not -- and I
14 don't know how these were developed and what the basis
15 for them was. I certainly didn't help them make the
16 filings, and I don't know who did or how they were done.

17 Q So you haven't reviewed any of this, any of the
18 underlying models or cost of service information that
19 was provided to FERC?

20 A When this was filed the pipeline was managed by
21 Equilon. And the company, as I am aware, has no records
22 of it, and nobody directed me to try to figure out what
23 the source of these were.

24 My experience with form 6 is that people take a
25 rate that either they see in a recent case, or they have

2292

1 used before. I really -- I don't have any idea what the
2 basis for this is.

3 Q Thank you. I won't ask you with regard to the
4 risk additer that you have added. I am going to try not
5 to duplicate Mr. Trotter's cross with regard to the
6 water-borne risk, but your analysis seems predicated upon
7 the idea that because transportation shifted to barges
8 when there was a disruption to their system, that
9 therefore it represented some sort of competitive risk.

10 Now, my question to you is, isn't it an
11 occasion of competitive risk when the barges capture
12 market share while Olympic is still capable of
13 transporting it?

14 A I have trouble with the premise of that
15 question, that the fact that barges took over is the
16 basis for my presumption that they are competitive.

17 I think the fact that they were able to in fact
18 step in and make the movements that had been made by
19 Olympic. And there was no increase -- or beyond the
20 original shock there was no increase in the price of the
21 wholesale prices of gasoline or diesel fuel as a result
22 of the shift from one mode of transportation to the
23 other. So the fact that they stepped in isn't -- it
24 mischaracterizes what my arguments were, sir.

25 Q So let me try it another way. Do you know --

2293

1 and I believe you answered this -- you don't know how
2 much the barges charge, right?

3 A That's correct. We requested data, and didn't
4 receive it.

5 Q You were a witness in the Wolverine case before
6 the FERC?

7 A Yes, I submitted testimony.

8 Q Do you remember what their definition of a
9 competitive origin or destination market was in that
10 case?

11 MR. MARSHALL: When you say "they" --

12 MR. BRENA: FERC, in the Wolverine case.

13 THE WITNESS: Competitive origin or destination
14 market, they measured it in terms of market share and
15 HHI, essentially.

16 MR. BRENA: If I could go off the record for a
17 minute. I apologize.

18 JUDGE WALLIS: Very well.

19 MR. BRENA: Okay. I am back.

20 JUDGE WALLIS: For clarification, if all you
21 want is a moment of silence, you don't have to go off
22 the record. You can do that on the record.

23 MR. BRENA: I wasn't sure how long the moment
24 would be when I started looking for the case, Your
25 Honor.

1 Q BY MR. BRENA: And I only do this to refresh
2 your memory. But Mr. Schink, if they defined an origin
3 market as competitive if there was sufficient
4 alternatives available to shippers to prevent
5 Wolverine from sustaining a small but significant price
6 increase, would that jog your memory about how they
7 viewed what a competitive market was?

8 A Yes. Sufficiently competitive to allow the
9 pipeline to set its rates based solely on market factors
10 and not to have to justify them based on cost
11 whatsoever.

12 Q But this concept is if you have a pipeline that
13 can't raise its rates because of competitive forces,
14 then that's a competitive marketplace. That's this
15 concept, correct?

16 A But the way you are phrasing it, sir, like
17 it's an on-off switch. That test is one of degrees, and
18 passing that test was a basis for them assuming that
19 they no longer needed to test the rates against cost,
20 that the market forces themselves would do it.

21 The fact that there may not be sufficient
22 competition to allow pipelines to set rates irrespective
23 of costs doesn't mean that they don't face competition.

24 Q But how can you say Olympic faces competition
25 when it can file a 76 percent rate increase and still be

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1 overnominated?

2 MR. MARSHALL: Well, I have to object to the
3 question because the 76 percent rate increase is not
4 what we're requesting here. And I also object as being
5 argumentative and assuming facts not in the evidence.

6 MR. BRENA: I withdraw. I was thinking about
7 the first filing at 76 percent.

8 Q BY MR. BRENA: Olympic is currently requesting
9 a 62 percent higher rate on the FERC side, correct?

10 A Correct.

11 Q Has it lost any volume whatsoever as a result
12 of that increase in rate?

13 A I can't answer that.

14 Q You don't know whether or not the Olympic
15 system is overnominated with regard to the FERC tariff?

16 A I don't know that people -- I don't know
17 whether or not people who would otherwise have moved via
18 Olympic have chosen to move by any other means, barge or
19 tanker. I can't answer that.

20 Q My question wasn't focused on shippers and
21 their choices. Isn't it true that Olympic has raised
22 its rates 62 percent and still is overnominated for a
23 transportation movement?

24 MR. MARSHALL: I further object to the
25 question, because it's a blend. Also, we have the same

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1 pipeline carrying different rates, so I would object to
2 the form of the question. And it's an incomplete
3 hypothetical.

4 MR. BRENA: Your Honor, perhaps we should talk
5 about talking objections. I have no problem responding
6 to an objection, but I do not believe that the phrasing
7 of the objection should suggest an answer to the witness
8 that I am cross examining. And I believe that one just
9 did. I will stand by my question, though.

10 JUDGE WALLIS: Very well. I believe that the
11 question is appropriately qualified, and that it refers
12 only to traffic under the FERC tariff, and consequently
13 it does not imply a blending.

14 Mr. Brena, did I hear your question correctly?

15 MR. BRENA: You did, Your Honor.

16 JUDGE WALLIS: And it is our practice that we
17 ask counsel phrasing the objection to do it in a way
18 that does not suggest an answer.

19 However, in this case, I did not hear
20 Mr. Marshall's objecting as suggesting an answer.

21 So does the witness, after all of that, have
22 the question still in mind?

23 THE WITNESS: I can try.

24 JUDGE WALLIS: And would you please pull that
25 mic closer?

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1 THE WITNESS: I am sorry. I tend to do that
2 when I am thinking, so maybe I should stop thinking.

3 The fact -- I mean, you have to bear in mind a
4 couple of things. They are running at about -- they are
5 running at 80 percent, something less than 90 percent of
6 the through-put. The market should have grown, so
7 there's more demand for the services. The pipeline
8 proration policy, as I understand it, does not
9 discriminate in favor or against inter- and intra-state
10 movements, but in fact prorates the space equitably
11 across all movements.

12 So the pipeline overnomination could be a
13 reflection in and part of the lower rates and increase
14 within Washington state. A combination of that, and of
15 the fact that you have less through-put capability than
16 before. The fact that you have more demand for the
17 services than you had before, because the economy, as
18 far as the oil, continues to expand. So there isn't a
19 simple answer that you are asking for.

20 Q Do you have my question in mind, Mr. Schink?

21 A I thought I did.

22 Q Let me ask -- perhaps I didn't -- I intend for
23 it to be the same question, but perhaps it's different.

24 Isn't it true that Olympic has raised its FERC
25 rates 62 percent, and still continues to be

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1 overnominated with regard to its FERC transportation
2 movements?

3 A Overnominated, I couldn't tell you exactly
4 whether it's overnominated with those movements. I
5 could accept it subject to check, if you know.

6 Q Does that sound like a competitive market to
7 you, Mr. Schink?

8 A Certainly could be.

9 Q If you raise your rates 62 percent, and you
10 still work the same amount -- well, I withdraw the
11 question.

12 Why didn't you go out and find out what the
13 barge rate was?

14 A Tried.

15 Q Who's the majority owner of Olympic?

16 A BP.

17 Q Who is the biggest refiner in Washington?

18 A I think BP.

19 Q Who is the largest shipper of water-borne
20 traffic in Washington?

21 A I can't say for certain. Could be BP, because
22 they are the largest. But I don't know that for a fact.

23 Q Why didn't you ask BP what their barge rate
24 was?

25 A I asked the company about that, and they felt

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1 for various reasons it was not appropriate. And you
2 will have to ask them.

3 Q You asked Tesoro for it, didn't you?

4 A I did. But they are parties to the case.

5 Q You mentioned that Tesoro didn't respond.

6 Isn't it true that Tesoro produced its only water-borne
7 contract that is over a year long, which is all that was
8 requested of it?

9 A As I read the data requests, sir, we asked for
10 all contracts -- not long-term contracts. And the fact
11 that you may only have one long-term contract is not
12 terribly surprising, because many contracts are 90 day
13 cancelable. So what we have basically been given is
14 one out of many contracts. And I haven't seen the one,
15 for that matter, or I don't know when it was turned
16 over.

17 Q Are you aware that there was subsequent
18 negotiation that's narrowed the contracts -- meaning
19 contracts over a year?

20 MR. MARSHALL: I object. I think the
21 questioner is testifying. This witness wouldn't have
22 any way of knowing what Mr. Brena's negotiation has
23 been, and I don't know either. So I would object that
24 this is an attempt by the questioner to introduce
25 testimony. There's no fact to be proven here.

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1 MR. BRENA: He testified that Tesoro did not
2 respond to their data request, so I am probing his
3 knowledge with regard to that fact, but --

4 MR. MARSHALL: But he's assuming facts not in
5 evidence, and trying to put them in as evidence in his
6 own question.

7 JUDGE WALLIS: This is an interesting question,
8 and I would like to hear from other counsel inasmuch as
9 it relates to the practice relating to data requests.

10 Mr. Finklea, do you have any thoughts on this
11 topic?

12 MR. FINKLEA: I can only have thoughts. I am
13 most certain I can come up with something.

14 I do think that if the witness was aware of the
15 data requests and responses that this is an area that is
16 ripe, especially given the statement the witness made
17 earlier about Tesoro not producing information, which
18 seemed to imply that he did have knowledge.

19 JUDGE WALLIS: Mr. Trotter.

20 MR. TROTTER: I took the question as probing
21 this witness' personal knowledge of discussions that
22 took place regarding the scope of the data request. And
23 it sounds like he may not have personal knowledge, but I
24 thought it was appropriate in that way.

25 MR. MARSHALL: My objection is not whether this

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1 witness knew of discussions. But my objection was to
2 have the questioner state what the view was of the
3 discussions themselves, I think the foundation should be
4 question first, does this witness -- did he participate
5 in these discussions to, quote, narrow the discovery
6 request.

7 The implication in the question is that the
8 data request was narrowed along the lines of something
9 not in evidence. And I think they are entitled to ask
10 the witness does he know of those discussions, and if he
11 does, he does. If he doesn't, he doesn't.

12 JUDGE WALLIS: I believe that the inquiry is
13 permissible. I think that the witness first raised the
14 issue by saying that he had not received a response, and
15 I think that Mr. Brena's question merely inquires into
16 the scope of the witness's knowledge about the request
17 and what was requested.

18 THE WITNESS: Well, I am aware -- should I just
19 answer?

20 Q BY MR. BRENA: Yes.

21 A I am aware of the original questions that were
22 drafted and sent. My intent in helping to draft them
23 was that we get all contracts. The initial response
24 that I saw was from both Tesoro and Tosco to, I think, a
25 case of Tesoro's 509 and 510 and Tosco of 609 and 610,

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1 was that this data was irrelevant to this proceeding.
2 And it wasn't necessary for the purposes of the hearing.

3 I recently saw a second and amended or
4 supplemental response from Tesoro, not from Tosco. I
5 may not have seen a supplemental response from Tosco,
6 but from Tesoro.

7 Their supplemental 509 and 510 said, well, we
8 have been looking for long-term contracts, and at the
9 time of that haven't been able to locate any. As I
10 recall that was a paper document I saw. I was not
11 aware -- I certainly didn't participate in any narrowing
12 of the scope. I am not aware of it. And certainly if I
13 had been made aware, I would have objected strenuously.
14 But if the company agreed to it -- it was a mistake to
15 agree to it. But if they did, they did.

16 Q Mr. Schink, you mentioned earlier in one of
17 your responses that you were aware of one long-term
18 contract that Tesoro produced?

19 A I was not aware of any. You said they had
20 produced one. The last document I saw said we have been
21 looking, but can't find any.

22 Q I am trying to understand the lynch pin of your
23 whole water-borne analysis that barge rates are
24 competitive with Olympic. All you had to do was phone
25 up Olympic's owner and ask them what their barge rate

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1 was. Explain to me clearly why you didn't do that.

2 A I asked the company -- I am not -- well, I
3 don't have personal contacts at BP, so I can't just call
4 them up and say, tell me your barge rates.

5 I called Olympic and asked them, and I think
6 other people will have to explain. The decision was
7 made that it would not be appropriate for them to make
8 that request, because they weren't parties to this case.
9 And that this gets into -- I don't know the legal
10 reasoning. Somebody else will have to supply it.

11 But in fact it was appropriate to ask Tesoro
12 and Tosco, because they were active participants in this
13 case and had alleged essentially that water -- as part
14 of their case that water-borne transportation wasn't
15 competitive, and that given that they had the data to
16 either prove or disprove this, it would be appropriate
17 for them to supply it. And they haven't supplied it, as
18 far as I know.

19 And I am not aware that one contract -- and if
20 you are only going to supply long-term contracts, it
21 wouldn't probably be meaningful anyway, because I
22 suspect if you only have one long-term contract that
23 means that almost all of them are all not long-term
24 contracts.

25 JUDGE WALLIS: Dr. Schink, I am going to remind

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1 you to focus on the question that is asked, and limit
2 your response to the question that is asked.

3 THE WITNESS: I apologize.

4 Q BY MR. BRENA: Who told you that?

5 A Who told me what?

6 Q Can you -- you asked if you could get ahold of
7 BP's barge rates, and someone explained that wasn't
8 appropriate. Who?

9 A I called Cindy, who was the focal point of
10 data. She said she would pass it on, she said. Called
11 back, and said the decision was made for a number of
12 reasons not to pursue BP, but to pursue Tesoro and
13 Tosco. And I said, okay. I do not know how or why.

14 JUDGE WALLIS: By Cindy, do you mean
15 Hammer?

16 THE WITNESS: Cindy Hammer, I apologize.

17 JUDGE WALLIS: Mr. Brena, we have been at this
18 collectively for about an hour and a half, and this
19 might be an opportune time for a break. How does it fit
20 in with your questioning?

21 MR. BRENA: I was ready to move to an entirely
22 new topic.

23 JUDGE WALLIS: Let's take a 15-minute recess,
24 please.

25 (Brief recess.)

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1 JUDGE WALLIS: Let's be back on the record
2 following our afternoon recess.

3 The Commission is prepared to announce its
4 decision relating to the motions to strike. In doing
5 so, the Commission has considered the arguments that
6 were made yesterday orally, both to speaking to the
7 generally applicable factors, and also specific
8 illustrations of those arguments or factors or other
9 elements as to each of the witnesses to whom a motion to
10 strike was directed.

11 In addition, the Commission considered the
12 arguments that were stated in the motions, and the
13 responses to the motions. As to case 1, the motion to
14 strike the case 1 information is granted, and we
15 understand that there is no objection to that being
16 stricken.

17 As to others, with a couple of qualifications
18 or exceptions that I will mention later on in this
19 discussion, the motions are denied. At least they are
20 denied conditionally.

21 We have reviewed the motions item by item, and
22 the Commissioners found that one or more of the
23 following factors were pertinent as referred to earlier.

24 They are essentially that the subject matter
25 addressed in the motion to strike may arguably or

1 clearly be in response to the presentations of answering
2 parties. It is also true, in many instances, that the
3 subject of the motion to strike is an update or a
4 correction of the witness's earlier testimony despite
5 counsel in some instances referring to that as new
6 theories or new presentations.

7 In addition, as Mr. Marshall argued, the
8 Commissioners believe that it is in the public interest,
9 and in the interest of all the parties, that in
10 resolving matters of importance, the Commission consider
11 the best information that is available to it. That is
12 consistent with the law, the requirements of due
13 process, at the requirements of the proceeding.

14 Finally, the Commission acknowledges the high
15 level of skill and experience of counsel, and the
16 witnesses who are involved, and it believes that the
17 challenges that may be imposed by the recency of the
18 rebuttal submission may be met by the parties, and that
19 they will not be unduly burdened in exploring that
20 information on the record.

21 The Commission has fundamentally two conditions
22 that it would like to impose with regard to the ruling,
23 and that is the following: first of all, parties who at
24 the conclusion of this hearing believe that they need
25 the opportunity to seek discovery through deposition or

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1 further cross examination or discovery, that they have
2 the opportunity to present to the Commission a request
3 to engage in that process.

4 In doing so, they should state the specific
5 subject that they want to inquire into, and explain why
6 the current record on that subject is not adequate, and
7 why the relief that is requested is reasonably
8 necessary.

9 The second condition is that if the Commission
10 grants such a request, that is, if a party asks for that
11 opportunity and if it is granted, the Company will waive
12 the suspension date for an additional month until
13 October 1 of 2002 to allow conclusion of the necessary
14 process.

15 There are a couple of other matters that should
16 be addressed. First of all, as was noted this morning
17 in the discussion of the Commissioner's decision to deny
18 the motion for summary determination, the Commission
19 recognizes that the issue of FERC methodology and the
20 presentation of Mr. Smith on that topic related to the
21 issue is a significant issue, and the testimony is
22 related to that issue.

23 The Commission believes that it is appropriate
24 that parties be comfortable that they have a full
25 opportunity to prepare for cross examination before

1 Mr. Smith takes the stand. On that topic, and if
2 needed, they should have the opportunity for an evening
3 or a weekend deposition, and should have the opportunity
4 to defer Mr. Smith's examination until later in the
5 hearing.

6 The Commission is concerned that it do have
7 both adequate and accurate information relating to FERC
8 rate making methodology, so that it may make an informed
9 decision about the consequences of a decision to use or
10 not to use that methodology.

11 In deciding not to strike related testimony,
12 the Commission is not commenting on the merits of the
13 subject, but only implementing its decision to achieve a
14 full record, on which to base a sound decision.

15 Finally, the factors that were argued with
16 regard to Ms. Omohundro's testimony related to her
17 qualifications to address the topic of FERC regulatory
18 practices, the proponents of the motion to strike the
19 testimony support it with excerpts from her deposition,
20 a document that is not yet in evidence.

21 The Commission denies the motion to strike. If
22 the company chooses to offer her testimony on this
23 topic, the motion may be renewed after exploration of
24 her qualifications, or receipt of the deposition.

25 Requests for scheduling and/or deposition of

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1 Mr. Smith should be made by the end of the day tomorrow.

2 Mr. Marshall, are you able to agree to the
3 opportunity for further process, and an extension of the
4 suspension period at this time, or do you need
5 additional time to respond?

6 It is conceivable that the additional process
7 may include surrebuttal and conceivably even further
8 rebuttal from the company. But it is the Commission's
9 goal at this juncture to complete that process no later
10 than October 1.

11 MR. MARSHALL: I believe those would be
12 acceptable, but we would like to make sure by contacting
13 the client, and if we could do that by --

14 MR. BEAVER: -- tomorrow morning. And I don't
15 think --

16 JUDGE WALLIS: Speak into the microphone,
17 please.

18 MR. BEAVER: I don't think it's going to be a
19 problem at all, but I would like to confer with the
20 client.

21 JUDGE WALLIS: Very well.

22 MR. MARSHALL: With regard to Mr. Smith, he is
23 here. He is available. We can make him available on
24 Saturday. I think that would be -- I mean, for
25 everyone's scheduling purposes, or Friday night, or this

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1 evening or tomorrow evening, for that matter.

2 After Saturday, I think he would be hopeful of
3 returning until he had to come back, if the choice is to
4 have him come back, rather than go on Friday.

5 JUDGE WALLIS: It may work out here to conduct
6 that opportunity Friday after 3:00 p.m.

7 MR. MARSHALL: That would be fine, too.

8 JUDGE WALLIS: However, at this juncture, no
9 one has asked for the opportunity to depose him, and I
10 would ask that counsel consider that discussion in your
11 decision, and your determination as to whether a
12 deposition is needed.

13 Now we focus on that, unlike the other issues
14 in this proceeding which relate to rate making and
15 regulation, which are matters within the Commission's
16 expertise and the expertise of the participants. Not
17 all of the participants have that level of expertise
18 with the application of the FERC methodology. That is
19 one of the Commission's concerns.

20 Mr. Brena.

21 MR. BRENA: I have -- I just want to be sure
22 that I understand the ruling, so let me ask some
23 questions.

24 First, I want to make an observation or two.
25 We leave this hearing and we go to FERC, and we're there

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1 for a month. So I am not -- so it's not clear to me
2 when there would be an opportunity to participate in the
3 next round of discovery, or preparing testimony while
4 we're in hearing at FERC.

5 Secondly, I would like Smith put on the tailend
6 of their list of witnesses, and I would like an
7 opportunity -- they have put on a methodology witness.
8 They put him on in their rebuttal case, and I would like
9 the opportunity to have a witness answer his testimony.

10 We have had no opportunity to respond to any of
11 his testimony, and it's not adequate to just give us a
12 cross examination opportunity with him. I want an
13 opportunity to bring in my own FERC person.

14 So my suggestion is -- and I am trying to think
15 through this process. This hearing ends, we ask -- we
16 request additional discovery, but specifically we
17 request an opportunity to file methodology answering
18 testimony to Witness Smith, if he's allowed to put on
19 their case in rebuttal.

20 And if that's allowed, then are we in a second
21 hearing? I mean, I am trying to think through, because
22 we have partial steps, we have discovery, we have the
23 possibility for testimony, then they have a right to
24 cross examine. What is the total process that we're in
25 here now?

1 JUDGE WALLIS: It is the Commission's
2 expectation, given the skill level of the attorneys and
3 their expertise of the witnesses, that at the conclusion
4 of the hearing there will not be a request for further
5 discovery for depositions as to all of the company's
6 witnesses. But it would be very closely limited to
7 those matters as to which there is some demonstrable
8 indication that such steps are necessary. And parties
9 would have the opportunity to request that opportunity
10 and state those reasons.

11 The thinking at this point is that an
12 additional day of hearing may be adequate to accomplish
13 that, and the schedule would be determined given the
14 nature of requests and the other factors that go into
15 scheduling right now.

16 The briefs are due on July 26, and the order by
17 the end of August. It would be the Commission's
18 aspiration to accommodate any additional necessary
19 process within a schedule that is bumped out by a month.

20 MR. BRENA: Well, please understand my request.
21 I will make it clearly and right now. I want an
22 opportunity to file answering testimony with regard to
23 Witness Smith, if he is allowed -- if his testimony is
24 not struck. So I don't need to depose him. I want to
25 cross him towards the end, and I want an opportunity to

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1 cross him, and I want an opportunity to put in an
2 answering case.

3 We have a right to put in an answering case,
4 and that's not through cross examination. That's an
5 answering case. And if the Commission is going to allow
6 them to put in their direct case on rebuttal and not
7 give us an opportunity to answer it overall, that is the
8 way it is.

9 But if their only methodology witness is in
10 their rebuttal case, I want an opportunity to put on an
11 answering case to that.

12 JUDGE WALLIS: We understand that request, and
13 we will take it under advisement.

14 Are there other questions? Mr. Trotter?

15 MR. TROTTER: No, Your Honor. I would just say
16 that we understand the ruling, and we will consider with
17 the other parties what the best approach is with regard
18 to Mr. Smith. We may want a deposition. I don't know
19 at this point.

20 JUDGE WALLIS: Very well.

21 MR. FINKLEA: Your Honor, for Tosco, I am also
22 not sure if it's a deposition we need or an opportunity
23 to file essentially surrebuttal testimony. And I will
24 consult with our expert this evening.

25 It's also possible, since our expert will be

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1 testifying, that if we had some opportunity for oral
2 surrebuttal when our witness is here, that might suffice.

3 MR. BRENA: I have a witness available who is
4 the principle adviser to FERC at the time these orders
5 were adopted. He is not available before July 4, and if
6 the Commission wants the best available information,
7 there is no better person to put on the stand to respond
8 to this Commission's questions than him.

9 And he can be made available after July 4. So
10 just by way of information --

11 JUDGE WALLIS: Thank you, Mr. Brena.

12 CHAIRWOMAN SHOWALTER: Does that mean July 5?

13 MR. BRENA: I can answer that tomorrow, if I
14 can get a day.

15 CHAIRWOMAN SHOWALTER: It's a practical matter.
16 There are a couple of days in there before you are off
17 to D.C., and then after that it's around August 5 or so.

18 MR. BRENA: Yes. And from Tesoro's point of
19 view, we don't see serving a bunch of discovery and
20 getting that done in a month. We haven't gotten any
21 discovery done in a month in this case. It's been a
22 very frustrating point.

23 So to the degree that you are putting a
24 mechanism that would be discovery that would be a
25 solution to this problem, we don't view it as a

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1 solution. Having an opportunity to speak to the
2 substance, the rebuttal testimony, is what I am asking,
3 and have my witness speak, not through cross, not
4 through an attorney crossing an adverse witness, but an
5 opportunity for surrebuttal to speak.

6 COMMISSIONER HEMSTAD: Do you have any
7 preferences on written or oral testimony? When I say
8 preference -- do you mean, in terms of expediency, and I
9 realize oral testimony --

10 MR. BRENA: We could get it -- if it were
11 written, we could get it filed, I mean, probably before
12 the witness were available for cross. If I could have a
13 day, I need to check. I know he's not available before
14 July 4. In anticipation of this option, I asked when he
15 could be available, but it was my intention to ask you
16 for this. So if I could have until tomorrow to respond
17 to that as well.

18 COMMISSIONER HEMSTAD: I have a question of
19 Staff counsel. Would you anticipate the need to file
20 surrebuttal?

21 MR. TROTTER: I can't say at this moment. It's
22 something we're talking about, but I will be talking
23 to -- continue talking to Staff about it, and I may have
24 an answer for you tomorrow.

25 JUDGE WALLIS: Very well. I would suggest that

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1 we bump the issue over now until an informal conference
2 prior to beginning tomorrow's session. Start about 15
3 minutes before, or about 9:15, assuming a regular 9:30
4 start, and that would give us a chance to update where
5 people are. If additional time is needed, then we will
6 take that time.

7 So thank you all very much.

8 And Mr. Brena, I am sorry to take a few minutes
9 away from your cross examination today.

10 MR. BRENA: I hope it wasn't away from my cross
11 examination.

12 JUDGE WALLIS: To defer the start of your cross
13 for a few minutes.

14 MR. BRENA: I can't talk any faster. I am just
15 trying to get there.

16 JUDGE WALLIS: Dr. Schink, are you up for a few
17 more questions now?

18 THE WITNESS: I hope so.

19 JUDGE WALLIS: Please proceed, Mr. Brena.

20 Q BY MR. BRENA: Do you have available to you the
21 cross examination, 229, 230 and 232.

22 A Would you read the numbers? 229, 230, and
23 two --

24 Q 229 through 232.

25 A I don't have a 231.

2317

1 Q The Puget Sound case.

2 A I do. I am sorry. 229 through 232, yes.

3 Q Are you familiar with how this Commission has
4 approached the topic of capital structure in prior
5 cases?

6 A I think you have to ask a more specific
7 question. I have done some looking into it, but I can't
8 say I have a broad general knowledge.

9 Q Have you reviewed, specifically, authority with
10 regard to the way this Commission approaches the issue
11 of capital structure?

12 A I have looked at some decisions. I think I
13 would -- I may or may not be able to answer your
14 question. I think it would be better to ask it.

15 Q Have you looked at the Pacific Power case, 229?

16 A I think this is one of the ones I cited, isn't
17 it? Or I have to check. Do you know if it is one of
18 the ones I cited?

19 Q No, I don't. I wasn't intending to -- I will
20 withdraw the question, Mr. Schink, and we can approach
21 it a different way, perhaps.

22 What is the highest equity percentage, in your
23 knowledge, that this Commission has ever allowed?

24 MR. MARSHALL: Objection. I don't think the
25 witness has testified that he's made a survey to find

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1 that number out. If the request is for us to go and do
2 that, or if you would like to have that subject to
3 check, we can do that.

4 But this isn't part of his testimony to find
5 the highest number or lowest number or average numbers
6 of what has been permitted in the past. The past isn't
7 even defined, so I would object. And I have suggested a
8 way we might approach it.

9 MR. BRENA: I am just probing the witness's
10 knowledge of this Commission's decisions in the capital
11 structure area, and believe it's appropriate.

12 JUDGE WALLIS: I think it is, at a minimum, of
13 a preliminary nature. It does ask not for the
14 information, but as to the extent of the witness's
15 knowledge, and the question will be allowed.

16 THE WITNESS: I do not know what the highest
17 percentage equity that the Commission has ever allowed
18 is.

19 Q BY MR. BRENA: That wasn't my question. What is
20 the highest percentage of equity that you are aware of
21 that this Commission has ever allowed?

22 A I do not recall. I was not looking for a
23 number when I read these. I was looking for
24 methodology, and I don't remember a number.

25 Q Do you recall any specific capital structures

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1 in any particular cases by this Commission?

2 A No, because none of them were pipelines that --
3 at least, I didn't find any for pipelines. I looked for
4 those, but I couldn't find one that I thought was the
5 same industry. So where I could draw some substance,
6 some quantitative active conclusions that would be
7 meaningful.

8 Q Would you state for me your understanding of
9 the standard that this Commission applies -- without
10 reading from the cases in front of you, the standard
11 that this Commission applies in determining capital
12 structure?

13 A My understanding is that they believe the
14 capital structure should be appropriate for the risk
15 faced by the regulated entity, and that they believe
16 that it shouldn't be either excessive or too little.
17 And they formed the judgment as to what is correct based
18 on the circumstances of the case. That's my
19 understanding of what they do.

20 Q What is the -- if you know, the greatest
21 differential between the actual capital structure of the
22 public service company and the hypothetical capital
23 structure permitted?

24 MR. MARSHALL: I would object to the same basis
25 I did before. This witness has not done a survey. If

2320

1 they would like to ask something subject to check, that
2 would be one thing. But there's nothing in his
3 testimony that suggests it would be appropriate to do
4 that kind of study or that he did do that kind of study.

5 JUDGE WALLIS: The ruling would be same as
6 earlier. This does not appear to require a study, but
7 to inquire into the state of the witness's knowledge.

8 THE WITNESS: I do not know what the biggest
9 difference is, if I have gotten the question right.

10 Q BY MR. BRENA: The question is, what is the
11 greatest differential that you have come across, that
12 you are aware of, between the actual capital structure
13 of the public service company and the hypothetical
14 capital structure employed by the Commission in rate
15 setting?

16 A In reading this case, I wasn't looking for
17 that kind of quantitative differential. I do not recall
18 any as I sit here.

19 Q Do you recall any differential greater than ten
20 percent, or have no knowledge at all?

21 A I was not looking at those numbers. I was
22 trying to get procedure and methodology down. I wasn't
23 looking for numbers, so I would have no knowledge. I
24 cannot answer that as I sit here.

25 Q Could we go to cross examination Exhibit 229,

2321

1 please.

2 MR. MARSHALL: Wasn't that the number we were
3 just on?

4 MR. BRENA: Yes.

5 THE WITNESS: Okay.

6 Q BY MR. BRENA: Specifically page 12, capital
7 structure discussion at the bottom of page 12, and top
8 of page 13. If you take a moment to review that,
9 please, last paragraph on page 12 first, paragraph on
10 page 13.

11 CHAIRWOMAN SHOWALTER: Can I ask both counsel
12 and the witness to speak up. It's maybe afternoon
13 slowness, but you kind of need to pick your voice up a
14 bit, and not drop your words at the end of the sentence.
15 It becomes very hard to hear, or I am straining to hear
16 all the words.

17 THE WITNESS: I apologize. I am prone to do
18 that.

19 MR. BRENA: As do I.

20 THE WITNESS: (Reading document.) I think I
21 have read the section you wished me to read.

22 Q BY MR. BRENA: Do you understand or not that
23 this case stands for the proposition that this
24 Commission rejected the parent company's capital
25 structure because only 55 percent of its revenues were

2322

1 associated with electricity?

2 MR. MARSHALL: I would object in that the
3 opinion speaks for itself, and I don't know what this
4 witness's summary of the opinion would do. But I do
5 believe that he would have to read the entire decision
6 in order to be able to respond to that, and the entire
7 decision speaks for itself, and all of the different
8 subparts. He's only asked the witness to read two
9 paragraphs of the opinion, so I would object.

10 MR. BRENA: If he would like to provide the
11 entire opinion on his redirect and have the witness
12 review it, that would be fine. He has the entire rate
13 of return section.

14 The point that I am drawing to is this is a
15 witness who has -- who is testifying that it's
16 appropriate to use BP parent company's capital structure
17 with regard to Olympic Pipeline when Olympic Pipeline
18 makes up one-thousandth of one percent of BP's total
19 operations when the Commission rejected the use of the
20 parent, and the parent had 55 percent.

21 So I am asking this in a preliminary question,
22 and then to probe why this witness thinks that the
23 company has revenues that are miniscule.

24 JUDGE WALLIS: I am wondering, Mr. Brena,
25 whether it would be appropriate for you to make that

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1 legal argument in argument, or brief as opposed to
2 posing it as a question to the witness.

3 I am not sure you indicated that you tied that
4 in with a future question to the witness, but I am not
5 sure the extent to which the interrelationship between
6 the legal consequences of the decision or decisions
7 might be more appropriate when posed in your argument as
8 opposed to in your question to the witness.

9 MR. BRENA: Two points. One, is that much of
10 this witness's rebuttal testimony with regard to rate of
11 return cited a great deal from this Commission as
12 specific authority. What was completely absent was any
13 discussion of this Commission's authority with regard to
14 capital structure.

15 So it's kind of a six of one or half dozen of
16 another. With regard to whether you go into the issue
17 of the legal authority of this jurisdiction with this
18 witness, he has advanced it. He's commented on it, and
19 he's testified on it. So I am probing that.

20 Secondly, the things that this witness is
21 recommending in this case are inconsistent with these,
22 and first I have to set up what the standard is, and
23 then I have to probe how it is that he's offered
24 testimony that what he was doing is consistent with this
25 precedent. I am trying to explore with him on cross

1 examination how that could be. That isn't something I
2 can do without setting up the legal authority. It's not
3 something I can do in briefing because I have no ability
4 to challenge this witness.

5 JUDGE WALLIS: Mr. Marshall.

6 MR. MARSHALL: This witness has been very clear
7 that he's made a distinction between capital structures
8 for oil pipeline companies, where he's used the
9 methodology from the FERC on page 51 of his direct
10 testimony, with all the citations and opinions and
11 rationale for why oil pipeline companies use the capital
12 structure of the parent. He has not attempted to use
13 this Commission's approach on capital structure at all.

14 Mr. Brena has tried to connect up and say,
15 well, he has tried to use this Commission's approach
16 with rate of return on equity, but that's only to show
17 that the DCF model that this Commission uses is very
18 consistent with the FERC model, in any event.

19 So on capital structure, there's been no
20 advancing by this witness that he's trying to comply
21 with capital structure applicable to other industries
22 within the state or elsewhere. He has said that he has
23 quite clearly limited his analysis to the appropriate
24 capital structure for oil pipeline companies wholly
25 owned by large integrated oil company parents, which is

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1 what his footnote 26 on page 51 of his direct testimony
2 said that he intended to do.

3 So this line of questioning is not only going
4 to be, I think, a waste of time because it can be
5 addressed on legal briefs, but it is also irrelevant to
6 this witnesses.

7 If Mr. Brena wants to simply state that this
8 witness has not made the inquiry about what this witness
9 knows about capital structure decisions from this
10 Commission, that's fine. He's not attempted to adduce
11 evidence on that.

12 MR. BRENA: I believe in part that he just
13 offered a judicial admission that this witness's capital
14 structure testimony was not intended to be in compliance
15 with this Commission's precedent. If I understood the
16 judicial admission correctly, then I will argue one way.
17 If I do not understand it correctly, I will argue
18 another.

19 MR. TROTTER: Your Honor.

20 JUDGE WALLIS: Mr. Trotter.

21 MR. TROTTER: I would like to point out on page
22 93 of Mr. Schink's rebuttal testimony, 201-T, he does
23 refer and criticize Dr. Wilson's use of this
24 Commission's use of cap structure. So he's opened the
25 door on that issue.

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1 JUDGE WALLIS: The question is permissible, and
2 the witness may respond.

3 MR. BRENA: Could I have clarification if I
4 understood the judicial admission correctly?

5 JUDGE WALLIS: I did not understand
6 Mr. Marshall's statement to be consistent with your
7 restatement.

8 MR. BRENA: That's why I am asking for
9 clarification, if I may.

10 MR. MARSHALL: I think the Administrative Law
11 Judge understood me perfectly. I wasn't making an
12 admission on anything. I was making a statement about
13 what this witness has done. And this witness, on both
14 page 51 of his direct testimony, and page 91 states what
15 he bases his capital structure testimony on. He's
16 advancing and recommending to this Commission that it
17 adopt that approach to capital structure.

18 He's not saying that he's trying to break
19 Commission precedent, because I think he said there is
20 no Commission precedent with respect to oil pipeline
21 companies under these circumstances.

22 JUDGE WALLIS: Very well. Let's proceed.

23 Q BY MR. BRENA: Do you have my question in mind,
24 or is that too much to ask?

25 A There's way too much in between.

2327

1 Q All right. Do you or do you not understand that
2 this case stands for the proposition that this
3 Commission rejected the use of a parent company's actual
4 capital structure, because it would only provide --
5 because electric operations only provide 55 percent of
6 the company's revenues?

7 A When you say this case, you mean the case cited
8 in 229?

9 Q Correct.

10 A I can't -- without the testimony that the
11 people put forward, and the detail behind this, it's
12 hard to say what it is. First it said that none of the
13 parties advocated the use of the parent structure, so it
14 doesn't seem -- the issue in that case was not whether
15 it was or whether or not it was. Everybody conceded for
16 whatever reason it wasn't.

17 I think in this case the difference is at least
18 I am advocating the use of the parent's capital structure
19 to the reasons set forth in my direct and rebuttal
20 testimony.

21 The Commission offers the opinion that such a
22 structure would have little bearing on electric
23 utilities' electrical operations, and parenthetical
24 notes, they only provide 55 percent of the company's
25 revenues. I think the two statements are, in fact,

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1 disconnected. They just say the structure isn't
2 appropriate, and I don't think -- the sole reason isn't
3 just because 55 percent of the operations are electric.

4 So all this is saying in this case when nobody
5 advocates that anybody use Pacific Corp Power for
6 electric utility operations, that the Commission isn't
7 going to say they are wrong. I don't read what you are
8 reading into it.

9 Q On the next page, 13, do you see the language,
10 in determining an appropriate capital structure the
11 Commission and presumably the company attempt to
12 minimize the overall cost of capital by finding that
13 proportion of the lowest cost debt capital, which
14 maximizes economy without jeopardizing safety. Do you
15 see that language?

16 A Yes, I do.

17 Q Does, in your professional opinion, does a
18 capital structure which is over 80 percent equity
19 minimize the overall cost of capital?

20 A I can't -- it's asking -- I think in this case
21 the structure is appropriate for all the reasons I have
22 set forth in my testimony. I have also discussed in my
23 testimony that the process of determining optimal
24 capital structure is not just a matter of doing a
25 weighted average of debt and equity. It's a matter --

1 there's questions of analysis and a whole bunch of
2 issues that one must take into account in determining
3 the appropriate capital structure.

4 And this is one sentence summarizing what the
5 Commission's impression is, and it's not mechanistic.
6 It does look at the bigger picture, and I think this one
7 sentence essentially is fairly general. And, in fact,
8 could incorporate consideration of all the factors I
9 have advocated.

10 Q Do you have my question in mind, sir?

11 A I thought I answered it.

12 Q My question is, does an 80 percent hypothetical
13 capital structure work towards the goal of minimizing
14 the overall cost of capital?

15 A I have not and I am not capable of analyzing
16 whether, you know, any specific number is appropriate.
17 I have followed the FERC precedent in this. Don't
18 know that it's inconsistent, but I certainly haven't put
19 forth a study that this is this case, if that's what you
20 are asking.

21 Q Cross examination Exhibit 230, please.

22 A (Reading document.)

23 Q Have you reviewed this case before, the
24 Continental Tel case?

25 A It doesn't seem familiar.

2330

1 MR. MARSHALL: May I ask if this Exhibit 230 is
2 the complete case or excerpts?

3 MR. BRENA: These are all excerpts. And if
4 they would like to put in the full case on rebuttal
5 after reviewing it, I have no objection.

6 JUDGE WALLIS: The witness is likely to be on
7 the stand again tomorrow, and we can see that copies of
8 the full text of each of these are made available to
9 counsel and the witness.

10 MR. MARSHALL: Right. And again, I don't think
11 having cases as exhibits is necessary, because anybody
12 can cite to a case without having to prove or have them
13 as an exhibit. I was just wondering.

14 JUDGE WALLIS: Technically I think you are
15 correct. But our experience over time is it's really
16 handy to have the document in with the exhibits so that
17 we don't have to run around looking for a book. And
18 it's a help to the Commission.

19 MR. MARSHALL: Correct. And in that regard it
20 would be helpful to have the entire case.

21 JUDGE WALLIS: If you wish to offer the entire
22 case, you are certainly able to do that.

23 MR. MARSHALL: Thank you.

24 Q BY MR. BRENA: Have you reviewed that case
25 before?

2331

1 A I don't recall it as I sit here.

2 Q Do you understand as you are reading this case
3 that they rejected 47.8 percent of equity, of
4 actual capital structure because it was overly safe?

5 MR. MARSHALL: I object. He has established the
6 witness has not reviewed the case. Now he's asking the
7 witness to agree to certain conclusions. The case
8 speaks to for itself.

9 MR. BRENA: I asked if that was his reading. It
10 was a preliminary question to ask if he's --

11 THE WITNESS: If you want me to read this, I
12 can. I just opened it.

13 JUDGE WALLIS: Mr. Brena, the ball is back in
14 your court.

15 MR. BRENA: I think it is, too.

16 Q BY MR. BRENA: If I could direct you to page 7, the
17 second paragraph -- well, go ahead and page 8, the
18 second paragraph, perhaps that would save time.

19 Let me phrase it this way. Would it surprise
20 you to learn that this Commission rejected 47.8 percent
21 equity as too much equity?

22 MR. MARSHALL: Well, I want to object to the
23 question, because it assumes exclusions from this case.
24 The case speaks for itself. And this witness, whether
25 he's surprised by Mr. Brena's summary of this or not, is

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1 not relevant.

2 MR. BRENA: I am just probing this witness's
3 knowledge of this Commission's precedent, and the way
4 it's approached capital structure in the past. If he's
5 not responsive to the questions, I am not going to spend
6 long on the case if he doesn't know the answers.

7 JUDGE WALLIS: Would it suit your purposes in
8 getting your question to the witness if you were to ask,
9 subject to check regarding the results, and then
10 continue with your examination?

11 MR. BRENA: Yeah, I will rephrase that.

12 JUDGE WALLIS: Then the witness would have the
13 opportunity to check, and check against the entire text.
14 And if the check proves to be inaccurate, then the
15 witness may respond to that effect while the witness
16 remains on the stand.

17 MR. BRENA: Thank you, Your Honor. Let me
18 rephrase.

19 MR. MARSHALL: That would be fine as long as I
20 have a continuing objection that the documents do speak
21 for themselves and any attempt to interpret them by
22 question or answer runs the risk of not getting the
23 cases right.

24 JUDGE WALLIS: Your objection is noted, and Mr.
25 Brena you may proceed.

2333

1 Q BY MR. BRENA: Subject to check, Mr. Schink,
2 would it surprise you to learn that in the Continental
3 Tel case that the Commission rejected the 47.8 percent
4 equity as too much equity?

5 A That's what the case says. That's what they
6 said they did. They don't -- again, they don't give the
7 reasons for why, or I am unable to discern from what is
8 here the reasons for believing it was too much, but
9 that's what it says.

10 Q Draw your attention to page 8, the fourth line.
11 The Commission find CTNW's actual capital structure to
12 be overly safe and therefore expensive.

13 Does that appear to be the reason why the
14 Commission rejected it?

15 A But overly safe for what reasons? I don't
16 know. I don't know the facts of the case. I don't know
17 the risks the company faced. I don't know whether
18 it's -- I mean, I can't address whether or not I would
19 agree with whether -- well, it's what they said. That's
20 all I know.

21 Q Okay. 231, Puget Sound case, are you familiar
22 with this case?

23 A (Reading document.) I am not. I don't think
24 it's one of the ones I studied, but I am not sure.

25 Q If you would turn to page 21, the second full

2334

1 paragraph on 21. The concept of safety is specifically
2 defined, if you would take a minute to review that
3 paragraph.

4 CHAIRWOMAN SHOWALTER: You are on Exhibit 232,
5 right?

6 MR. BRENA: 231.

7 CHAIRWOMAN SHOWALTER: Mine is misnumbered. My
8 232 is Puget Sound and 231 is --

9 MR. BRENA: Perhaps mine are. My 232 is US
10 West, and 231 is Puget, but I am not sure - well, my
11 boss tells me it's right.

12 CHAIRWOMAN SHOWALTER: Okay. I have it wrong.

13 Q BY MR. BRENA: Mr. Schink, are you familiar
14 with that case, or 232, the US West case?

15 A As I sat here they don't seem familiar.

16 Q I direct your attention to the US West case on
17 page 87.

18 A We're on 232 now?

19 Q Yes, we're on 232 now.

20 A Page what?

21 Q Page 87 where the Commission states, we find
22 the existing capital structure is unreasonable and
23 unwise for the company, and it unreasonably varies from
24 the usual practice as to impose an unfair burden on
25 the consumer.

2335

1 And they held that with regard to a 56.6
2 percent equity. Do you see that language?

3 A I see where they are rejecting it. I haven't
4 seen what was being proposed.

5 MR. BRENA: I will withdraw the question, and
6 move on. The hour is late, and this line of cross is
7 not getting anywhere if you are unfamiliar with the
8 case. So I apologize for dwelling on it for so long.

9 Q BY MR. BRENA: Is it your understanding that
10 Olympic's parents guarantee all of its debt?

11 A There's one loan which I think is the
12 Prudential loan that is guaranteed by through-put and
13 deficiency. I think the other ones are either
14 guaranteed by the parents or made by the parents
15 directly.

16 Q The Prudential debt is not guaranteed by a
17 parent; is that correct?

18 A No, it's guaranteed by through-put deficiency.
19 In other words, they get first crack at the revenue
20 transported by transporting barrels.

21 Q Is it your judgment that the business risk of
22 BP is the same as the business risk to Olympic?

23 A It's my position that the business risk of
24 Olympic Pipeline is much higher than that for a typical
25 pipeline, and that an equity share in the -- a higher

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1 equity share of the sort that BP or Olympic's parents
2 have, I think would be reasonable, given that risk.

3 And I think the other reason I have advanced is
4 that they, in fact, are the entities that in fact raise
5 capital for Olympic, and are raising capital now to fund
6 the projects that Olympic is undertaking.

7 Q I believe that you testified with regard to
8 parent company guarantees, that they guaranteed the
9 other debt. Do you mean that they are the lender for
10 the debt?

11 A There is a debt from someone -- there is a loan
12 from a third party that is guaranteed by the parents,
13 and then there's loans, additional loans from the parent
14 to Olympic.

15 Q So with regard to third party debt, it's your
16 understanding one is guaranteed by a parent, and the
17 other is not, correct?

18 A Yes, I think the one that is guaranteed is
19 about 30 million, and I think the other one is larger
20 but --

21 Q With regard to the parent company loans to
22 Olympic, those are direct loans and in the status of the
23 lender and not a guarantor; is that correct?

24 A They have the status of a lender but in essence
25 it's a self guarantee. They have no one else to turn to

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1 but themselves if it doesn't get to be paid.

2 Q Do you consider a guarantor and a lender to be
3 in the same position?

4 A In this circumstance, yes.

5 Q Do you think in determining the capital
6 structure of the company the Commission should consider
7 the company debt as equity?

8 A I think it is inappropriate as I have said a
9 number of places for this Commission to consider
10 Olympic's own capital structure at all because it is
11 meaningless for a company such as Olympic that is wholly
12 owned by two large integrated oil companies.

13 Q Well, let me follow your answer instead of
14 restating my question.

15 Are you requesting that this Commission
16 consider the parent loans as though they are equity for
17 the purposes of determining the capital structure?

18 A No. The loans -- in essence the capital
19 structure of Olympic, actually of Olympic itself, is not
20 entered into my recommendation of capital structure.
21 And these loans in no way have entered into the
22 determination of the cost of service.

23 Q Now, you mentioned that the parents are the
24 source of the funds. Was that true prior to the parents
25 lending the money to Olympic?

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1 A In a sense of providing guarantees, or I am not
2 quite sure I understand your question.

3 Q Well, didn't Olympic used to go into the
4 marketplace and get its own loans until the parent
5 companies burned it with all the short-term debt?

6 MR. MARSHALL: Object to the form of the
7 question. It assumes fact not in evidence.

8 Number two, it's highly argumentative.

9 MR. BRENA: I stand by my question. There's
10 100 million dollars of short-term debt, and I am asking
11 whether or not this company participated in the debt
12 marketplace prior to that short-term debt.

13 JUDGE WALLIS: As thus phrased, I think the
14 question is permissible.

15 THE WITNESS: The company -- a company like
16 Olympic, unless it can offer through-put and deficiency
17 guarantees, which are basically guaranteeing it from the
18 revenues of the shippers, who are also integrated oil
19 companies. So one way or another, either the
20 through-put deficiency is guaranteed by the shippers on
21 Olympic, which include the owners or others, or
22 all large companies, or the lenders require a guarantee
23 from the parents given the nature of the company.

24 And this is true not just for Olympic, but for
25 similarly situated oil pipelines that are wholly owned

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1 by oil companies throughout the industry. This is not
2 unusual that companies of the size and of the structure
3 of Olympic, lenders demand guarantees from the parents.
4 That's just a fact.

5 Q Mr. Schink, my question was specifically, isn't
6 it true that Olympic went to the marketplace and got
7 third party debt just a few years ago without corporate
8 guarantees?

9 A With through-put and deficiency --

10 Q Without corporate guarantees?

11 A With the through-put and deficiency. Without
12 corporate guarantees, but the guarantee behind the
13 through-put deficiencies are the shippers who made the
14 commitments who are large integrated oil companies. So
15 effectively, by the backing of the through-put and
16 deficiency is the same as the backing provided directly.

17 Q You mentioned two third party debts. You
18 mentioned that there was a corporate guarantee of one.
19 Was that corporate guarantee in place at the time of the
20 initial loan?

21 MR. MARSHALL: If we could ask to have that
22 specific TNT agreement identified by the date.

23 First of all, the document would speak for itself, and
24 second, we would have an accurate response.

25 MR. BRENA: This witness has offered testimony

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1 that the capital structure should be disregarded because
2 in effect it's treated like part of an integrated whole.
3 In fact, it hasn't been, and what I am exploring is
4 whether he's familiar with the facts.

5 MR. MARSHALL: I am just asking for the specific
6 loan that he's talking about, that that be particularly
7 identified so that we know what we're responding to.

8 JUDGE WALLIS: I think the witness may be
9 allowed to respond to the question. If the witness does
10 not know the answer, or is not familiar with the
11 documents that are referenced, the witness can so
12 indicate.

13 Q BY MR. BRENA: Mr. Schink, we're talking about
14 the Chase debt, aren't we?

15 A The one that is guaranteed?

16 Q Yes. When the Chase debt was originally put in
17 place, was it guaranteed by a parent?

18 A That's my understanding that it was, but that's
19 my understanding.

20 Q If I were to represent to you, subject to
21 check, that, in fact, it was not, but that subsequent
22 to -- but that in order to have it renewed that was a
23 requirement to have it renewed by Chase, would you have
24 any reason to disagree with that?

25 A I have no reason to agree or disagree.

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1 Q With regard to the Prudential debt we have
2 already established that that is not subject to a parent
3 guarantee, correct?

4 A Subject to through-put and support by
5 through-put and deficiency, but it has no direct parent
6 guarantee.

7 Q And the through-put and deficiency is given to
8 it by whom? By what entity?

9 A President entities that signed the through-put
10 and deficiency with Olympic, who would be the shippers.

11 Q So it's your testimony that the through-put and
12 deficiency agreement that is underlying the Prudential
13 debt is signed by shippers and not by Olympic?

14 A Well, they are a party to it, sir. Olympic
15 certainly is.

16 Q If the parent company debt were converted to
17 equity, is there any reason in the world that you can
18 think of that this company can't go out and get loans?

19 A Yes. Its cash flow is terrible.

20 Q It would have sufficient equity on its books,
21 would it not, to offer security for the loan?

22 A Mr. Hanley has concluded, the Standard and
23 Poors rating guide in his testimony as an exhibit, and
24 as that explains a key element in determining whether a
25 company is creditworthy is its cash flow. And

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1 Olympic's cash flow is such that it's not creditworthy
2 independent of whatever its own capital structure is.
3 And I repeat that for a company like Olympic, parent
4 guarantees are the normal, not the exception.

5 Q It's your testimony that the cash flow is
6 insufficient to participate in the debt marketplace if
7 it's less than 80 percent equity for a public service
8 company in the state of Washington?

9 MR. MARSHALL: His testimony was regarding
10 Olympic. Now he's changed the subject matter to a
11 public service company.

12 JUDGE WALLIS: Mr. Marshall, the question was
13 as it was, and I think the witness is entitled to answer
14 as to whether that is or is not the witness's testimony.

15 MR. MARSHALL: Then I would object that it
16 misstates the witness's testimony. I mean --

17 MR. BRENA: Mr. Schink --

18 MR. MARSHALL: -- it's -- or it's been misstated.

19 JUDGE WALLIS: Mr. Marshall, have you completed
20 your statement?

21 Mr. Brena.

22 MR. BRENA: I will rephrase, Your Honor.

23 Q BY MR. BRENA: Mr. Schink, what I hear you
24 saying is that the cash flow is insufficient with the
25 capital structure that has been recommended by other

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1 parties in this proceeding. Is that your testimony or
2 not?

3 A That the revenues that are suggested ought --
4 or the applied tariffs and revenues that would be
5 forthcoming flowing from these recommendations would be
6 insufficient, yes.

7 Q Why is it that every public service company in
8 the state of Washington can go out and participate in
9 the debt market between 40 and 50 percent equity, but
10 Olympic could not?

11 A As far as I know, every other public utility in
12 the state of Washington is, in effect, a stand-alone
13 corporation, not wholly owned by others, and would be
14 looked at as a stand-alone entity. And its capital
15 structure is important in that instance.

16 Olympic is, for all practical purposes -- it's
17 not -- the legal structure, a joint venture of two major
18 companies. And as a joint venture, lenders look at it
19 and say, I have to go to the parent to get the
20 guarantees I need for these loans because it is, in
21 effect, a joint venture, where the equity -- or the
22 equity that's important to me as backing for the loan is
23 residence in the parents and not in the joint venture
24 company.

25 This is not the legal characteristic of the

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1 company, but it functions like a joint venture company.
2 And what you are asking is, well, suppose this were a
3 stand-alone company. All by itself would it be
4 appropriate for it to have a return of equity structure?
5 And Olympic as it is now defined has, yes, but it would
6 be relevant. Its capital structure as it's now set up
7 is irrelevant to lenders. The only aspect of Olympic is
8 its cash flow. It is inadequate. I can assure you the
9 capital structures of its parents are more than adequate.

10 Q My question to you was, why is it that on the
11 stand-alone basis that Olympic needs a greater cash flow
12 than every other public service company? Let me
13 rephrase the question.

14 If the cash flow is sufficient to participate
15 in the debt marketplace for a public service company
16 that has 45 percent equity, and I am asking you to
17 assume that that is average for public service
18 companies, why is it that Olympic uniquely needs the
19 cash flow from 80 percent hypothetical equity in order
20 to participate in that same debt marketplace?

21 A You are making the assumption that the risk of a
22 public utility, like an electric utility or gas
23 distribution or water utility, and that of a pipeline are
24 more or less the same, and they are not. The one thing
25 I think that's been clear throughout the FERC, the

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1 Federal Energy Regulatory Commission regulates electric
2 companies in terms of transmission. They are involved
3 in all of these other industries, and they have
4 recognized consistently over time that this is a risk of
5 the industry, and it's quite different from all the
6 other industries that it regulates, and has treated it
7 so, and treated it appropriately.

8 And the answer to the question that the reason
9 Olympic is a lot riskier type of question is pipelines
10 are a lot riskier. Oil pipelines are a lot riskier than
11 conventional utilities.

12 One, they have -- for service territory they
13 are not a natural monopoly, and they are not given
14 monopoly power, and regulatorily -- in other words,
15 there's no -- there's no regulatory control on pipeline
16 over entry and exit, so it's a totally different animal.

17 And to try to say, well, this is how we handle
18 electric utilities, and since they are regulated and
19 since the pipeline is regulated we will take all the
20 rules we use in electric or gas or water and move them
21 over here and the capital structures and the cost of the
22 equity and everything else is appropriate, and one is
23 appropriate in the other, just ignores the difference in
24 the industry.

25 And FERC has been at this for a long time.

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1 They inherited this from the ICC in the early '80s.
2 They spent a lot of time looking at this. They came
3 into this initially looking with no familiarity and over
4 time have developed that familiarity and developed a
5 regulatory mechanism that makes sense.

6 Again, the facts about this industry, there's
7 nothing magical about that specifically. There are
8 other ways of doing this that might be appropriate. But
9 you know, it's not appropriate to take something that
10 fits a very different kind of industry and just impose
11 it on this industry when the federal agency that is
12 responsible for regulating this industry, in fact,
13 recognizes it is different and quite different. And the
14 regulatory mechanisms it applies to its other regulated
15 industries don't fit here.

16 Q What is the average percentage of equity in the
17 proxy group that you used to determine your rate of
18 return with regard to the entities that were regulated
19 by FERC? What was the average equity?

20 A 50 percent. And they are stand-alone companies
21 they aren't wholly owned subsidiaries of oil
22 companies.

23 Q So is it the industry that is different or the
24 form of ownership that is different?

25 A The form of ownership is different. And as I

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1 also argued in my testimony, Olympic is much riskier
2 than the average pipeline, both in direct and rebuttal
3 testimony.

4 Q And we have explored that risk.

5 Are you aware of any oil pipeline company that
6 has an 80 percent capital structure that is used for
7 rate making purposes?

8 A I think the highest I am aware of is somewhere
9 in the 70 percent range, but I can't say with certainty
10 that there aren't some in the 80s.

11 Q What company that is?

12 A Which one?

13 Q What company are you aware -- are you referring
14 to?

15 A HOOP, Hoover Offshore Oil Pipeline facility.

16 Q The facility in Louisiana?

17 A No, it's an offshore pipeline system; brings
18 crude oil in from the Gulf Coast to onshore.

19 Q Terminal is in the Salt Beds (ph.), correct?
20 Am I thinking of the right pipeline?

21 A Well, it may deliver there, but the cost of
22 equity applies to the pipeline.

23 Q And you are saying that that is the cost that
24 is the equity percentage that is used for establishing a
25 rate on that system?

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1 A 74 percent.

2 Q And that's your testimony?

3 A Well, I have studied the settlement and that
4 was the agreed to amount in the settlement and approved
5 by FERC.

6 Q Well perhaps you are -- your answer didn't join
7 my question, so let me try it again.

8 What is the highest capital structure of any
9 oil pipeline that you are aware of where a commission,
10 any commission has adjudicated the issue of capital
11 structure and used it for setting rates?

12 A As opposed to settlement?

13 Q That's correct.

14 A I can't recall a specific number. I would have
15 to do some research.

16 Q Mr. Schink, you are suggesting an 89 percent
17 equity capital structure for the purposes of determining
18 a rate in the state proceeding that is 40 percentage
19 points higher than any I am familiar with. Are you
20 familiar with any that close that gap?

21 MR. MARSHALL: Object as argumentative, and
22 assuming facts not in evidence.

23 MR. BRENA: I will rephrase.

24 Q BY MR. BRENA: Mr. Schink, what is, as close as
25 you can get to your recommendation in terms of an

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1 adjudicated capital structure percentage equity used for
2 rate making purposes? What is as close to 89 as you can
3 get?

4 A Well, one of -- the company's asking for 86,
5 which may not be a big difference, but that's what they
6 are asking for.

7 Q I stand corrected.

8 A I can't tell you. I haven't done the research
9 on that specifically, and I can't tell you specifically
10 what the answer is.

11 Q You just made a series of arguments about the
12 industry being unique, how FERC recognizes that
13 uniqueness about integrated ownership. I'm asking you
14 for any adjudicated rate that even comes close to
15 what you are here telling this Commission what they
16 should use.

17 A Well, I don't -- well, A, I personally don't
18 view settlements as irrelevant. B, there haven't been
19 recently a lot of rate cases that have gone to
20 litigation. They have settled. And I can't tell you --
21 and I just don't know exactly what it is.

22 I am arguing that for a number of reasons, as I
23 have said in my testimony. Olympic is higher risk than
24 the average pipeline by a lot. And I believe for that
25 reason and for the reason that the parents are

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1 responsible for its debt and for its financing it is -- in
2 fact, it's appropriate to consider using its parents'
3 capital structure, as I have also said in my testimony.

4 I think at minimum we're talking about rates
5 that are at or above the upper end of the range for
6 other oil pipelines

7 Q Mr. Schink, are you aware of a single
8 adjudicated capital structure with equity in it greater
9 than 65 percent?

10 A Are we talking about the ARCO case?

11 Q I am just asking if you are aware of a single
12 adjudicated in which the capital structure has been
13 greater than 65 percent equity?

14 A I think that was the ARCO case. I am aware of
15 that. I don't know if there are any higher.

16 Q Isn't it fair to say that the typical capital
17 structure used by FERC is in the 40 to 50 percent range --

18 MR. MARSHALL: This is --

19 Q BY MR. BRENA: -- for regulating oil pipelines
20 in adjudicated --

21 A No, I would not agree with that. I think
22 there's been a large number in the upper 50s and lower
23 60s. And there's certainly the normal that it's -- 40
24 to 50 is not correct. There's no -- there's no such
25 normal.

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1 Q Are you familiar with the SFPP case?

2 A Yes.

3 Q Would you accept, subject to check, that the
4 FERC in that case states that that is the range that it
5 typically uses?

6 A 40 to 50, I am not familiar with that. I have
7 not -- I would have to check that.

8 Q Thank you. How much does -- well, first of all
9 we agree, don't we, that Olympic has zero equity in its
10 capital structure?

11 A In its own capital structure at this point, yes.

12 Q Correct?

13 A Yes.

14 Q And we agree that you are proposing a
15 hypothetical capital structure of 86 percent?

16 A That's correct.

17 Q How much is that going to cost the rate payers
18 to characterize that 86 percent as equity instead of
19 debt?

20 A 86 percent as opposed to zero?

21 Q Correct.

22 A Whatever the difference between what the
23 Commission determines to be the cost of equity and the
24 cost of debt.

25 Q Using your recommended cost of equity and your

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1 recommended cost of debt how much would that cost the
2 rate payers?

3 A It -- I would have to figure it out. But as I
4 have said before, I think we're dealing with -- we keep
5 coming or you keep coming back to the issue of Olympic's
6 capital structure and I have argued every way I can that
7 it doesn't matter. It is -- when you have a joint
8 venture like this, the official capital structure of the
9 company doesn't mean anything. And it's whether or not
10 this Commission thinks 86 percent is too high or not. It
11 should make the decision based on its assessment of the
12 risk of the company and not be dragged into this
13 senseless battle over what the debt structure of Olympic
14 itself is.

15 It doesn't matter. The Commission can decide
16 50 or 60 or 70 or 80 or whatever they want and it is the
17 right number based on whether they find my argument
18 regarding risk plausible or whether they find other
19 witnesses' contrary arguments plausible.

20 But Olympic's capital structure per se is not
21 relevant and really I think distracts the Commission
22 from the true issue, how risky is Olympic? Given that
23 risk, what is the appropriate equity structure? And if
24 they believe for whatever reason that they don't accept
25 my arguments, that they want to look on their own and

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1 make their own assessment, or to look to other FERC
2 cases and make their assessment on the capital structure
3 for this pipeline relative to what FERC has decided in
4 other cases, I think that's fine. But that should be
5 based on what is the risk of Olympic is and given that
6 risk what is the appropriate capital structure.

7 Q Mr. Schink, I understand the hour is late, so I
8 won't move to strike that. But do you understand that
9 my question to you is how much will it cost the rate
10 payers to pay in money if this Commission assumes your
11 recommended capital structure of 86 percent equity is
12 adopted as your cost of debt, and your recommended rate
13 of return versus the zero that is actual for Olympic,
14 what is the cost in that amount?

15 A In dollars?

16 Q Yes.

17 A I cannot tell you. And given my calculator
18 problems I would rather try to answer it in the morning
19 if you want me to.

20 MR. BRENA: With Your Honor's permission, that
21 would be fine with me. The hour is late to do that.

22 Q BY MR. BRENA: Would you, subject to check,
23 agree that it would be just about 22 or 23 million
24 dollars?

25 A The difference between -- let me make sure what I

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1 am agreeing to. The difference between zero percent
2 equity and 86 percent equity?

3 Q Excuse me, I misspoke. Go ahead.

4 A No, continue.

5 Q The difference between zero percent equity, the
6 actual capital structure of Olympic versus your
7 recommended capital structure of 86 percent given your
8 recommended rate of return and given your cost of debt,
9 how much is that going to cost the rate payer in
10 dollars? And I am assuming in the calculation that you
11 will include the differential between the cost of debt
12 and the cost of equity, and I am assuming you will also
13 take into consideration the income tax allowance.

14 A Yes.

15 Q And please assume the rate base that you are
16 recommending as well, or the company is recommending.

17 MR. BRENA: Could we go off the record for
18 a moment?

19 JUDGE WALLIS: Yes.

20 (Discussion off the record.)

21 JUDGE WALLIS: Mr. Brena.

22 MR. BRENA: I have no further questions. I have
23 one or two questions based open the calculations in the
24 morning.

25 JUDGE WALLIS: Very well. Mr. Finklea, what is

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1 the length of your examination in light of the questions
2 that have been asked?

3 MR. FINKLEA: It's approximately a half hour,
4 maybe more, maybe less. I am not sure.

5 JUDGE WALLIS: Very well. I am going to
6 suggest that we defer that to morning, or would the
7 Commission -- we will take that up in the morning.

8 We will be in recess until 9:30, and today's
9 session is closed. I will remind folks that we were
10 going to reconvene at 9:15 to talk about administrative
11 matters.

12 ENDING TIME: 5:00 p.m.

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