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BEFORE THE WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND	)
TRANSPORTATION COMMISSION,	)
	)
Complainant,	)
	)Docket No. TO 011472
vs.	)Volume XXIII
	)Pages 2356 to 2587
OLYMPIC PIPELINE COMPANY, INC.,	)
	)
Respondent.	)

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A prehearing conference in the above matter was held on June 20, 2002, at 9:30 a.m., at 1300 South Evergreen Park Drive Southwest, Room 206, Olympia, Washington, before Administrative Law Judge ROBERT WALLIS, CHAIRWOMAN MARILYN SHOWALTER, COMMISSIONER RICHARD HEMSTAD, and COMMISSIONER PATRICK OSHIE.

The parties were present as follows:  
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Deborah L. Cook  
Court Reporter

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BENCH REQUESTS

(NONE)

1 PROCEEDINGS

2 JUDGE WALLIS: Let's be on the record for the  
3 Thursday, June 20, 2002 session of Commission docket TO  
4 011472. We do have some administrative matters and  
5 we would like to begin with those.

6 As a result of yesterday's discussions, first I  
7 would like to call on the company and ask the company's  
8 position with regard to further extension of the  
9 suspension deadline in this docket. Mr. Marshall.

10 MR. MARSHALL: As we mentioned before, we are  
11 agreeable to that condition, and the extension, of  
12 course.

13 JUDGE WALLIS: Would it be possible for you to  
14 submit a written statement of that addressed to the  
15 secretary of the Commission?

16 MR. MARSHALL: Yes. Yes.

17 JUDGE WALLIS: Thank you very much. Are there  
18 other matters that the Company would like to address?

19 MR. MARSHALL: The only other matter was -- and  
20 I think we agreed to that, too. Apparently there's no  
21 desire to take Mr. Leon Smith's deposition so that  
22 we will release him to come back at a date at the end of  
23 the case, or the last -- one of the last three  
24 witnesses, I think, is the request. And that we will do  
25 and comply with.

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1 JUDGE WALLIS: Very well.

2 MR. MARSHALL: And the only other scheduling  
3 issue is Mr. Peck. And you had indicated before, I  
4 believe, that he would start out on Tuesday morning.  
5 And that would be best because he will have to be  
6 heading back late that afternoon. So if we do him in  
7 the morning, that would be terrific.

8 JUDGE WALLIS: My anticipation is that we would  
9 be able to take up with Mr. Peck as the first witness on  
10 Tuesday, and that that would then exclude the need for  
11 him to stay further.

12 MR. MARSHALL: Thank you.

13 JUDGE WALLIS: Mr. Brena.

14 MR. BRENA: If I could clarify, the request for  
15 Mr. Smith is that he be one of the last three for  
16 Olympic's witnesses. We are suggesting a change in  
17 the -- well, maintaining the order of Olympic's  
18 witnesses that they filed and was agreed to in the  
19 prehearing conference, not to change the order of the  
20 parties in the proceeding.

21 JUDGE WALLIS: Is that correct, Mr. Marshall?

22 MR. MARSHALL: That's what I intended to mean,  
23 one of the last three witnesses in our presentation.

24 JUDGE WALLIS: Mr. Finklea, do you have  
25 anything to add to your request as of yesterday that you

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1 be permitted to ask some questions on direct to one of  
2 your witnesses relating to the topic Mr. Smith will  
3 address?

4 MR. FINKLEA: Yes, Your Honor. I am checking  
5 still. Dr. Means may be able to be helpful on this  
6 issue. We are having him review Mr. Smith's testimony  
7 today. If we are going to do anything it would be  
8 through Dr. Means. We will not retain an additional  
9 witness. We have asked that Dr. Means be available for  
10 cross examination a week from tomorrow, and Olympic is  
11 going to accommodate that.

12 So if there is any oral rebuttal of Mr. Smith's  
13 direct testimony, it would come through Dr. Means. I am  
14 not certain at this time if he will or not.

15 JUDGE WALLIS: Very well. And I have indicated  
16 that the parties have agreed that Dr. Means may appear  
17 on Friday of next week. That schedule would be  
18 accommodated.

19 MR. FINKLEA: We appreciate that. We very  
20 much appreciate that.

21 MR. MARSHALL: Yes, Olympic agreed to  
22 accommodate them out of order for a date certain.

23 JUDGE WALLIS: Mr. Trotter, do you have any  
24 administrative matters you want to --

25 MR. TROTTER: Just one. We're continuing to

1 review the testimony of Mr. Smith, and we would like to  
2 reserve the right to ask for surrebuttal.

3 We're not in a position to add a witness at  
4 this date and under the circumstances, so we would like  
5 to do that, well, probably with Mr. Twitchell or  
6 Mr. Colbo and Mr. Elgin, but we don't -- we haven't made  
7 up our mind on that. If we do, we would attempt to do  
8 it in writing unless it's brief and can be accommodated  
9 by oral testimony.

10 But we're not asking for a ruling that it's  
11 going to be granted. We just want to reserve our right  
12 to ask for it after we have made our decision.

13 JUDGE WALLIS: Mr. Brena.

14 MR. BRENA: Three matters. I made a  
15 representation on the record yesterday that Tesoro had  
16 marine terminal contracts, because I had understood that  
17 contract to be slightly over a year, and that the  
18 discovery request was narrowed through negotiations to  
19 contracts lasting longer than a year.

20 My understanding is incorrect. That contract  
21 was slightly less than a year, and it was not produced.  
22 We intend to supplement our discovery and produce that  
23 document, even though that is beyond the scope of the  
24 discovery request as negotiated by Olympic. And we will  
25 put in them in in a subsequent witness, and I apologize



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1 for the confusion on the record.

2 MR. MARSHALL: May I respond? If he's moving  
3 on to the next point, may I respond to that point?

4 JUDGE WALLIS: Mr. Marshall.

5 MR. MARSHALL: The witness, of course, who  
6 would address that contract is on the stand now,  
7 Mr. Schink, and he is not likely to be on the stand  
8 tomorrow. So having that tomorrow puts us at a  
9 disadvantage.

10 Further, the negotiations on limitations of  
11 this request, data request, are not as represented.  
12 What we would like to have, and we understand those  
13 exist, are the actual invoices that Tesoro has on these  
14 shipping contracts. Just having a contract without  
15 having those invoices -- and we understand those  
16 invoices exist -- won't be sufficient.

17 If those are available, and we understand they  
18 are, we would like to have those available, too. And  
19 then if need be, supplement the record with a brief  
20 statement from Mr. Schink on the implications of those  
21 contracts.

22 JUDGE WALLIS: Mr. Brena -- Mr. Marshall.

23 MR. MARSHALL: Mr. Schink reminds me the idea  
24 was to have all the contracts, whether under a year or  
25 over a year. This particular one that Mr. Brena refers

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1       you to is for under a year.  Whether those are under a  
2       year or over a year, if they have them, and they  
3       apparently do, we would like them all produced.

4                JUDGE WALLIS:  Well, I am going to rule on this  
5       request based on the status of the hearing and the  
6       situation, and say that Mr. Brena's representation is  
7       that there was a modification.  He's volunteering to  
8       produce these particular -- this particular document.  
9       We will see if it's "these" in a moment.  And that we  
10      are not in a situation where it appears to be productive  
11      to rule on whether or not there was an agreement on the  
12      status or production of other documents.  So  
13      consequently we would limit the production of documents  
14      to the contract that Mr. Brena has mentioned.

15               MR. MARSHALL:  Again, we take issue with the  
16      representation of the modification.  There's nothing in  
17      writing indicating such modification.  We actually had  
18      an issue about a modification of another data request  
19      that became an issue.  That wasn't in writing, but this  
20      one is even in writing.

21               JUDGE WALLIS:  We understand, Mr. Marshall, and  
22      our preference at this time is just to take the  
23      situation as we find it, and deal with the document that  
24      Mr. Brena is addressing.

25               MR. BRENA:  Your Honor, first, I stand by my

1 representation, and am prepared to support and defend it  
2 if you feel that that is appropriate.

3 We are willing to produce the document, and we  
4 are willing to produce invoices showing actual rates.  
5 And what we propose to do is the most recent invoices,  
6 and -- but that, getting the invoices, will take more  
7 time. This was not what was negotiated, but if the  
8 Commission wants to know the barge rates, we will get  
9 them in the record.

10 And this isn't the only witness that can  
11 sponsor that testimony. They have other witnesses,  
12 Mr. Batch, Mr. Fox, who are in a position who have  
13 commented on the barges as well, and you can expect it  
14 to be a cross examination exhibit with regard to them.

15 So, I mean, we will get the barge rates in. I  
16 don't know, I mean once the information is provided to  
17 the witness, I don't know that there's a whole lot to  
18 cross on on that particular point. I mean, it's what  
19 Tesoro paid for that service, and we will show you.

20 JUDGE WALLIS: Very well. I would afford the  
21 opportunity to Mr. Marshall and Dr. Schink, because this  
22 matter arose during Dr. Schink's examination, if they  
23 feel a supplementation of the record through further  
24 written testimony is appropriate, we will certainly  
25 entertain their motion to offer that. And if necessary,

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1 look at -- if necessary look at means of securing oral  
2 testimony as well.

3 MR. BRENA: Your Honor, just so that I am  
4 clear, and I resist the suggestion, as I understood, it  
5 wasn't just a supplement on that, but to supplement on  
6 the meaning of that for his overall analysis.

7 We do not need another maritime competition  
8 analysis in after this is all done. So I want to be  
9 sure the scope of your ruling -- or what motion that the  
10 Commission is willing to entertain.

11 Because, I mean, the status of the case is that  
12 we weren't compelled to produce that discovery. We have  
13 no obligation to produce that discovery. I don't have  
14 to produce that discovery. I voluntarily have  
15 volunteered to supplement that, and put it into the case  
16 as there are other witnesses available to do that. So I  
17 would resist the idea of allowing -- of supplementing  
18 testimony under those circumstances.

19 JUDGE WALLIS: My suggestion is that the  
20 company be allowed to request the opportunity to present  
21 that testimony, and if they do, then we will entertain  
22 your objection.

23 MR. BRENA: Thank you.

24 JUDGE WALLIS: If you choose to make such an  
25 objection.

1           But let's get a little further on it and define  
2 exactly what is going on before we decide what we're  
3 going to do about it.

4           MR. BRENA:   Okay.  So we're working on it.  I  
5 have the contracts faxed to me last night.  The invoices  
6 are someplace else, and I didn't know until one second  
7 ago that the invoices were part of it.  So we will do  
8 our best.

9           JUDGE WALLIS:  If the contract is available,  
10 will it be possible to produce that today?

11          MR. BRENA:   I will try.  It's at the hotel, so  
12 yes, I think I will be able to do that.

13          Yes, I will produce it right now.  Let me go to  
14 the designation of this.  This is the backbone contract  
15 of our entire maritime transportation.  All of our other  
16 transportation is done on the spot market on when we  
17 have a barge we go to the spot market, and whatever they  
18 are charging for that month, then we use it.

19          It would be tremendously to our competitive  
20 disadvantage to have any information related to this,  
21 the backbone contract, known to the other freight  
22 haulers, who are in the spot market, or to our  
23 competitors.  So I am asking that it be designated  
24 highly confidential, as well as the invoices.

25          JUDGE WALLIS:  We will designate this document

1 as a highly confidential document. And at this point it  
2 is merely the subject of discovery. It has not been  
3 offered or referred to in testimony, and I would ask if  
4 there is reference to the testimony that the references  
5 be of a nature that the subject is not -- that the  
6 specifics of the reading is not disclosed on the record.

7 Does that satisfy your interests, Mr. Brena?

8 MR. BRENA: Yes, it does. And the invoices,  
9 the supplemental discovery, we will present under that  
10 same basis.

11 JUDGE WALLIS: Very well. And you will produce  
12 that as soon as you are able?

13 MR. BRENA: Yes.

14 JUDGE WALLIS: Yes. We are reminded that the  
15 highly confidential document designation is one that  
16 restricts, very severely, access to the document, and it  
17 is not available to clients but merely to attorneys and  
18 the experts.

19 MR. MARSHALL: Yes. And that's, of course,  
20 part of the -- we agreed to that, and that's part of the  
21 underlying difficulty with getting that information.

22 JUDGE WALLIS: Yes. Very well.

23 Mr. Brena, you said you had three matters?

24 MR. BRENA: I do. I make the following  
25 comments just to preserve my record.

1           And I am asking the Commission to reconsider  
2           its ruling dismissing Tesoro's first motion for summary  
3           disposition in this matter. Tesoro filed its motion  
4           within the procedural schedule that was established by  
5           this Commission for the filing of those motions. I  
6           pointed out that there was no testimonial support for --  
7           there was no testimonial support for two non-cost basis  
8           write-ups that were substantial in nature.

9           No party has advanced any direct case  
10          testimonial support for either of those. The Commission  
11          has not ruled that there was testimonial support for  
12          either of those. They were simply calculated and  
13          included in their case.

14          They did not include a methodology witness in  
15          general, but they also did not include any testimonial  
16          support for either of those rate base write-ups.

17          In addition, inconsistent with the law that the  
18          Commission shall deny affiliated payments that are not  
19          supported in the direct case and the rebuttal case, but  
20          the direct case, any of the 22 million dollars in  
21          affiliated payments that they have made over the last  
22          two years, there has not been any factual representation  
23          that they had in the direct case.

24          Devoid of that, as I understand the  
25          Commission's ruling, the Commission held it was in the

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1 public interest to go forward with the proceeding,  
2 including the consideration of those underlying issues.  
3 And while I understand the Commission's desire to let  
4 everything in and have it before it, particularly with  
5 the case of first impression with regard to methodology,  
6 I would ask you to reconsider. Because I don't believe  
7 it is in the public interest to hold that.

8           It's not in the public interest to consider a  
9 motion that is timely filed. If we filed the motion --  
10 if the Commission wanted the motions filed at some  
11 different point in the proceeding, then it's fully  
12 within the Commission's discretion to set the schedule  
13 however it would like.

14           It isn't, as a procedural matter, fair to the  
15 parties before it to -- when we file on time to say that  
16 the public interest avoids the proper consideration of  
17 our motion when it's filed on time. You can't change  
18 the rules on the procedure after the filing. We would  
19 have been happy to comply and file it months before if  
20 that would have been the Commission's preference.

21           So I just ask that you reconsider it. I think  
22 that if we comply with the Commission's procedural  
23 schedule, I feel that it's within the public interest  
24 for the Commission to respond to those motions and not  
25 hold that it's in the public interest not to because



1 they are untimely.

2 Thank you. That was for the purposes of the  
3 record. I understand and accept the Commission's  
4 rulings for the purpose of this proceeding, other than  
5 asking for reconsideration of that motion, particularly  
6 with regard to those three matters, the two rate base  
7 write-ups, and the affiliated costs with regard --

8 COURT REPORTER: Hold it. I can't hear.

9 (Discussion off the record.)

10 JUDGE WALLIS: Now that our momentary  
11 distraction is revolved, let us proceed.

12 Also, for the record, Mr. Brena, I will state  
13 that the Commission will take your request for  
14 reconsideration under advisement, and we will rule on  
15 it, whether at the present time or in a final order, or  
16 whatever, it will remain a matter within our discretion.

17 MR. BRENA: Thank you. And I was just going  
18 to summarize that by just saying that I believe the  
19 public interest is best joined by deciding issues for  
20 which there's not support for in the direct case.

21 The third matter goes to the Commission's  
22 rulings with regard to the motions to strike. And  
23 I will not ask for reconsideration of that.

24 My objections noted, in the Commission's ruling  
25 I sensed that the Commission was trying to find a way to

1 accommodate the parties so as to minimize the procedural  
2 due process and prejudice that may have resulted from  
3 the filing of a comprehensive rebuttal case that changes  
4 and substantially updated their case, and through some  
5 of the mechanisms that the Commission has offered, for  
6 example, the discovery at the end, and opportunity to  
7 file a motion and file surrebuttal.

8           So I would like to make a proposal to you about  
9 the types of procedural safeguards that I think would be  
10 appropriate under these circumstances for your  
11 consideration. First, there's two types of issues, two  
12 broad categories of issues; one methodology issues and  
13 one factual issues.

14           With regard to the methodology, I would join  
15 with your Staff in requesting an opportunity for  
16 surrebuttal. I am trying to, but have been unable at  
17 this late date to get a live witness to come in within  
18 the context of this hearing.

19           I would like the opportunity to continue to try  
20 to, and if I can, get a live witness. I am willing to  
21 have him testify live at the end of the hearing on the  
22 methodology issues, and that would be my preference.

23           And I would ask the Commission for the  
24 opportunity to do that, if I can find a witness on this  
25 short notice, that it's possible to do that with -- it's

1 very hard to do.

2           And the alternative to that, then, I would ask  
3 for an opportunity to give my existing witnesses who  
4 testified on methodology, I would like to ask them  
5 direct testimony so they can respond directly to  
6 Mr. Smith's testimony with regard to the fact issues.

7           The Commission -- please appreciate that the  
8 case that they are moving forward with, that we don't  
9 know how they got their numbers. And they didn't even  
10 provide their workpapers to us when they filed it.  
11 There's been no discovery at all.

12           My concern with the mechanism that the  
13 Commission had of having discovery after everything is  
14 over, is that it just -- it elongates it. So what I am  
15 trying to search for is a way so that we can have it in  
16 the hearing room when we need it right now, so we can  
17 get the case resolved. So my suggestions go toward that  
18 end.

19           First, I would request that their workpapers  
20 supporting their rebuttal case be provided. We have  
21 already served discovery on them. It's my understanding  
22 that those workpapers are available and can be provided  
23 to us tomorrow. We would ask that you compel the  
24 production of those workpapers.

25           And let me be specific about what I am looking

1 for, because of problems we have had with getting  
2 discovery. These are the workpapers that support how  
3 they calculated the numbers in their case. When you  
4 look at their rebuttal case they have a new number in  
5 there. We don't know how they got it. We don't know  
6 what is in it, and what isn't.

7 So specifically we're interested in the  
8 workpapers with regard to outside services, with regard  
9 to other expenses, and how they develop their numbers  
10 overall for expenses by category and by plant.

11 We're also interested in how they got their  
12 test year expense numbers, and made a series of new  
13 adjustments to their test period expense numbers.  
14 We would expect that their workpapers would have their  
15 changes in carrier plant and service in CWIP. And  
16 we would expect them to have an explanation for their  
17 one-time expense within outside services of 5.6 million  
18 dollars and how that is included within their costs.

19 This is information that we're asking be  
20 produced. It's information that should be in their  
21 workpapers. They should have provided it with their  
22 rebuttal case. It will give us at least some insight so  
23 I would be in a position to cross examine their  
24 witnesses with regard to how they get there.

25 Absent this, all I can do is look at an end

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1 number and talk about how their other case, that I  
2 understand they're judicially abandoning their second  
3 and final case they advanced in their direct. So I have  
4 all the insight in the world. I can't get there. I  
5 can't help the Commission understand the numbers or what  
6 the cost of service should be if I don't know how they  
7 got their numbers.

8 So I would ask for your assistance to assist my  
9 cross for the purposes of having a clean record. I  
10 would also ask --

11 CHAIRWOMAN SHOWALTER: Before you leave that  
12 request, I have one question. Will you know before your  
13 own witnesses come on the stand whether you will be able  
14 to have another witness come in at the end of the  
15 hearing on methodology?

16 MR. BRENA: Yes. Yes.

17 JUDGE WALLIS: Are you done with that topic,  
18 Mr. Brena?

19 MR. BRENA: I am not. Also, please understand  
20 that this whole new rerebuttal case, the problem I  
21 really have with it is we haven't had a chance for  
22 answering testimony.

23 First, we haven't had a chance for discovery or  
24 to penetrate it, and understand it. And secondly, this  
25 is a new case.

1           I understand the Commission's desire to let it  
2 all in, and let's sort it out. Give me an opportunity  
3 to help you sort it out. And what I am asking for is  
4 with each one of my witnesses to be afforded an  
5 opportunity to ask one hour of direct testimony from  
6 them. That would be direct testimony with regard to the  
7 rebuttal case that was filed.

8           So I would put my witness on the stand instead  
9 of just tendering them for cross examination. I would  
10 have an opportunity to ask him direct questions with  
11 regard to the rebuttal case that Olympic has filed.  
12 They would have a full opportunity to cross examine that  
13 witness with regard to any of his responses, and I would  
14 have at least some opportunity within the context of  
15 this proceeding of having my witnesses actually respond  
16 to what is a very new and different case.

17           So if you want it in, then let's get -- if  
18 that's the way, and my sense is, that's what the  
19 Commission is doing, saying let's show us all the  
20 information, then allow me to help you get the best and  
21 most reliable information. Allow me to have you hear  
22 what my witnesses have to say about their new case, and  
23 not just sit up here and listen to it through an  
24 attorney trying to make the points through cross  
25 examination, what would be rather laborious cross

1 examination of their witnesses.

2 And finally, I would ask for your patience on  
3 the cross examination. When I gave my time estimates I  
4 expected, and I explained to Judge Wallis at the time, I  
5 expected to kind of win some and lose some with regard  
6 to some of these motions, but for the issues to be  
7 narrowed and more focused.

8 And that's not the direction we're heading in.  
9 We're expanding the issues and substance of this  
10 proceeding through new and different matters. And if  
11 that's the Commission's preference, that's fine. But I  
12 would ask for your tolerance and understanding with  
13 regard to the cross examination that I have to do in  
14 order to develop our case; cross examination which would  
15 be made shorter by my opportunity to just offer direct  
16 testimony through my witnesses.

17 So just to summarize, with regard to the  
18 Commission's rulings yesterday, we have methodology  
19 issues. I am asking for an opportunity to provide a  
20 surrebuttal witness within the context of the case I  
21 would enter in the last week of the case, maybe the  
22 sixth or seventh, maybe fifth, sixth, or the end of the  
23 week. I am asking for an opportunity to ask my  
24 witnesses direct testimony.

25 Finally -- and that would be live. There would

1 be no writing. I would have them come in and say what  
2 his opinion was, and they could cross him and that would  
3 be the end of it.

4 With regard to the factual issues I am asking  
5 for their workpapers to be delivered tomorrow. I am  
6 asking for the opportunity for direct, and I would also  
7 ask for a limited opportunity to depose Cynthia Hammer.  
8 And by limited, I mean a three-hour opportunity to  
9 depose Cynthia Hammer, hopefully with minimum debate  
10 among the attorneys, just questions of Cynthia Hammer.  
11 She's the person sponsoring their numbers.

12 So if you consider it an update or you consider  
13 it a change in cases as we do, or you consider it a  
14 whole new case, the Commission's process can only be  
15 informed by the adverse parties' having an opportunity  
16 to understand how it is they put together their rebuttal  
17 case so we can better inform our cross.

18 It's going to focus things so much better than  
19 you guys sitting through me fumbling around and trying  
20 to figure out what they did in their case live on the  
21 stand. So workpapers, deposition, and an hour of direct  
22 for each of my witnesses with regard to each of the fact  
23 issues. And your patience, because I will do my very  
24 best to get you the best record that I can, and to stay  
25 focused on what I think the issues are that this



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1 Commission should proceed.

2 But I understand your rulings. My sense is  
3 that what is behind them is to have the best record you  
4 can to make the most thorough decision. I think the  
5 procedural due process mechanisms significantly reduce  
6 risks on appeal for the procedural due process issues  
7 that are within this hearing. And more importantly,  
8 most significantly, improve the quality of the record  
9 from which you will have to decide.

10 JUDGE WALLIS: Mr. Brena, your suggestions and  
11 requests raise, apart from the matters that I am sure  
12 Mr. Marshall will want to address, some logistical  
13 issues. We are already, based upon the estimates,  
14 trying to put a gallon of hearing into three one-quart  
15 containers. And it sounds like your request is to  
16 expand the time that would be necessary in hearing.

17 And I am wondering if you have any suggestions  
18 as to how to approach that, just strictly from a  
19 logistical standpoint to accomplish your goals, and the  
20 Commission's, and the other parties' goals of having a  
21 complete record.

22 MR. BRENA: Well, I couldn't go by that  
23 question without pointing out that when you have 14  
24 witnesses in a rebuttal case a week before hearing, and  
25 no opportunity to penetrate a case, you can expect the

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1 time scheduled for hearing would expand. The Commission  
2 set this procedural schedule anticipating that the  
3 rebuttal case would not be as substantial as it is, and  
4 it said so at the time it stated the procedural  
5 schedule.

6 So the first thing I would like to say is I am  
7 doing the best I can. It should have been a one-gallon  
8 case and now it has turned into a two-gallon case, and I  
9 am asking for a pint so I can make it a balanced case.

10 JUDGE WALLIS: And my question is where are we  
11 going to get that pint contained?

12 MR. BRENA: So the first thing I would like to  
13 say is the pint is what makes the gallon justified. So  
14 if you are going to let the gallon in, you ought to let  
15 the pint in, even if it means inconvenience or late  
16 hours.

17 But secondly, I am willing to work as late as  
18 anybody wants to work. It would certainly be my  
19 intention to, with these steps, I hope to reduce the  
20 amount of my cross. If I have an opportunity to ask my  
21 witnesses direct, then I don't have to sit here live on  
22 cross examination and explore the rebuttal case with --  
23 I will have an opportunity to ask my witnesses about it.  
24 So I would anticipate that that would help.

25 But between longer hours and more days and

1       trying to restrict cross examination in some balanced  
2       fashion, I don't know what to do. I mean, you have  
3       allocated the days. You have allocated -- look at the  
4       number of witnesses we have. I don't know how it fits.  
5       I'm just doing the best I can.

6                JUDGE WALLIS: Let me take up with that and say  
7       in light of this circumstance, does that change your  
8       views with regard to Mr. Marshall's motion to continue?

9                MR. BRENA: It does not.

10               JUDGE WALLIS: How can you bring those into  
11       square?

12               MR. BRENA: We're all here. Now is the time  
13       to hear this. Next, it's not going to get any easier  
14       any later. I don't want to disjoint. I have had to  
15       reestablish my office down here in order to participate  
16       in this proceeding. I brought in all my witnesses. The  
17       schedule is set.

18               I think it's possible to get this done, but not  
19       without a lot of work on everybody's part. But I don't  
20       see how to avoid it. If that rebuttal case comes in at  
21       the last minute, I don't see how to avoid it.

22               And, too, continuance doesn't solve these  
23       problems. I mean we still need to have discovery. We  
24       still need to answer a new case. We still need it. So  
25       all that continuance is going to do, in my estimation,

1 is increase the cost of this proceeding by another half  
2 million or million dollars for all the parties, and  
3 we're going to be right back in the hearing room with  
4 these issues.

5           So my sense is let's dedicate ourselves to  
6 getting it done. If we have to work late hours, let's  
7 do it. And it's my intention to focus my cross. I  
8 realize, perhaps implicit in Your Honor's question to  
9 me, that I have the most cross examination than any of  
10 the other parties.

11           So if these sort of procedural things are  
12 possible, it's to my advantage to get my cross done so  
13 my witnesses can be heard.

14           One of the senses I had from the interim  
15 hearing was that we got pushed against the time clock,  
16 and Tesoro's witnesses weren't fully heard. So I would,  
17 just as soon -- perhaps one thing we could do is set  
18 dates so that dates are reserved for parties to present  
19 their case, and try to work that way.

20           Because what I don't want to have happen is  
21 push this to the end and not having anybody have time or  
22 patience to hear what Tesoro's witnesses have to say.

23           But I am willing to entertain any efficiency  
24 matters that has a balance in it that allows us the  
25 opportunity to respond to this rebuttal case.

1                   JUDGE WALLIS: Very well. Before we turn to  
2 Mr. Marshall for his comments, I would like to ask Mr.  
3 Finklea and Mr. Trotter for their views on process at  
4 this juncture.

5                   MR. FINKLEA: Well, Your Honor, I concur with  
6 Mr. Brena that the process we now face is very different  
7 than what we thought we would face when we set the  
8 hearing.

9                   I do think that from the Company's perspective,  
10 if our witness, Dr. Means, had a similar one-hour  
11 opportunity when he testifies to essentially do oral  
12 direct testimony, that would certainly cut down a lot on  
13 what we would have to do on cross examination.

14                   There are three parties between Staff, Tesoro,  
15 and ourselves that are all coming at this case. We are  
16 trying our best to make sure that our cross is very  
17 limited. We don't replot ground.

18                   I do think, looking at the schedule, it's going  
19 to be an extreme challenge to be done by the 2nd of  
20 July. I don't know what people's schedules are past the  
21 2nd of July. I do know the FERC proceeding starts next  
22 week, so if it weren't on the -- if it weren't for the  
23 FERC proceeding, I would suggest we come back on the 8th  
24 of July and go into that week. But that's not a  
25 practical solution at this juncture.

1           I concur with Mr. Brena that we need  
2       workpapers. We have people at the Brattle,  
3       B-r-a-t-t-l-e, Group, a consulting firm in Massachusetts  
4       that works with Dr. Means, that are endeavoring to get  
5       through the rebuttal testimony as well. They haven't  
6       come out here. They are working from a distance, but  
7       it's become very challenging to conduct effective cross  
8       examination on the rebuttal case because of how it has  
9       come in.

10           Longer hours is probably where we're headed, in  
11       my sense. And I know this Commission has had to do that  
12       before. I know the people that were involved when you  
13       had to do that, and it's very, very challenging for  
14       everyone. But I think we should try to avoid being here  
15       until midnight because everyone's productivity goes  
16       straight down after 5:00. But we are probably going to  
17       need more time than we thought we were going to need.

18           JUDGE WALLIS: Thank you. Mr. Trotter.

19           MR. TROTTER: Just first off, we also ask for  
20       workpapers. We understand we're going to get them  
21       today. That will help. This is a very large rebuttal  
22       case. If you look at the time estimates and the time  
23       that is left to accomplish this hearing, as a practical  
24       matter, I think it's going to be very difficult to make  
25       it with the advent of the FERC proceedings starting as

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1 soon as this is over.

2 I alluded in my response to the motion for  
3 continuance, and Staff has some conflicts in the month  
4 of August that's going to be difficult to find another  
5 date.

6 Your question to Mr. Brena of how can you  
7 reconcile the request for more process in the limited  
8 time we have to do it and not to support a continuance,  
9 I think frankly it does. But that poses even additional  
10 practical considerations of availability and when we can  
11 get it done.

12 So I guess on balance, my recommendation would  
13 be let's try hard to do what we can, take stock in next  
14 week's setting, see where we are. We're not asking for,  
15 at this moment, for the right for oral surrebuttal. We  
16 may find ourselves in that position, and that may add  
17 efficiencies, it may not.

18 But the only thing I can suggest on the big  
19 picture here is to proceed ahead, and make the rulings  
20 that you feel you need to make on these requests for  
21 additional process, and then see where we are. But I  
22 agree, it looks like we're trying to fit a two-gallon  
23 hearing in a one-gallon jar, or whatever you said.

24 MR. BRENA: Your Honor, before Mr. Marshall  
25 has -- if I could just -- if the workpapers are

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1 available, if that is the correct understanding,  
2 we would like them today. The sooner we get them the  
3 better.

4 I am very sensitive to the fact that my cross  
5 examination is greater than other parties'. One reason  
6 I asked for patience is this is such a big rebuttal  
7 case. We didn't have a chance to answer it.

8 I can tell you for every hour you allow me to  
9 direct, I will take an hour and a half off of my cross  
10 examination estimates. I can just tell you -- I mean, I  
11 have been talking hypothetical about that it would  
12 shorten the case. There's just information I want you  
13 to hear and it's a lot more efficient if you let me put  
14 it on through my witnesses than it is if I have to get  
15 it through their witnesses. It's just a lot more  
16 efficient.

17 JUDGE WALLIS: Very well. Mr. Marshall, I  
18 would like to segregate these three matters, and first  
19 take up the question of the workpapers.

20 My understanding is that the company is working  
21 to produce those, and it will produce them when the  
22 papers are available; is that correct?

23 MR. MARSHALL: Correct. We have been working  
24 very hard to assemble all of those, and we have  
25 committed to produce them tomorrow. We will make every



1 effort to produce them today.

2 Those workpapers, by the way, relate to the  
3 cost of service study, and what we have done is we have  
4 updated some numbers. We have actually accepted some of  
5 what the Staff and others have suggested that we do on  
6 making modifications.

7 Mr. Brena talked about outside services, other  
8 expenses -- you know, I forgot all the different  
9 categories. But those are basically in the cost of  
10 service issues with Brett Collins and Cindy Hammer, and  
11 a little bit with Mr. Fox. So those papers will be  
12 either today or certainly tomorrow.

13 But those adjustments are adjustments. They  
14 are not a whole new case. They are adjustments to  
15 different --

16 JUDGE WALLIS: Right at this point we're just  
17 inquiring into the availability of those documents.

18 MR. MARSHALL: Well, the context is that  
19 we will do that, and we have been working very hard. We  
20 had 58 data requests immediately following the filing of  
21 our rebuttal case, so we have been working to do all we  
22 can to make sure we produce the materials that we can.

23 JUDGE WALLIS: Very well. And I would ask you  
24 if you have some papers available today, that you make  
25 those available to the parties without waiting until you

1 have all of them. Is that possible?

2 MR. MARSHALL: Absolutely. We will do that,  
3 and I will ask that that be done as soon as we can get  
4 those together.

5 JUDGE WALLIS: Thank you very much. Now, the  
6 question of additional direct and the opportunity to  
7 depose Ms. Hammer.

8 MR. MARSHALL: On Monday we suggested an  
9 alternative schedule of witnesses that would have  
10 Mr. Talley and some others here this week following the  
11 cost of service witnesses -- or excuse me, the cost of  
12 capital witnesses. The cost of capital witnesses  
13 everybody wanted first, and we have arranged to do that.  
14 And it looks like we will finish that.

15 The question is when do we start doing cost of  
16 service witnesses, Brett Collins and Cindy Hammer? It  
17 would probably be best to give the parties the  
18 opportunity to review whatever they need to review to  
19 have those witnesses go on Tuesday or Wednesday of next  
20 week, and then put -- Mr. Batch is going be the next  
21 witness. We could put Mr. Talley on next.

22 And then there's really nothing by way of  
23 additional workpapers and heavy lifting for that. That  
24 would then give them three days to review Brett Collins  
25 and Cindy Hammer's cost of service adjustments, which I

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1       hasten to add are not major adjustments. They are  
2       adjustments that you would expect to be made to a cost  
3       of service case and incorporating the new data and  
4       incorporating the responses and sometimes accepting the  
5       responses of Staff and Interveners.

6                 That's one solution that I think would afford  
7       the people the additional time. And we did make that  
8       proposal here on Monday, because we understand that,  
9       given the short time between our filing of rebuttal and  
10      the time of the hearing, that that posed problems for us  
11      to get the data requests done, and also problems for our  
12      witnesses in order to get ready and geared up at the  
13      same time they are trying to do the data requests. That  
14      would be one solution that we could recommend.

15                The other solution, of course, would be to  
16      finish up with the cost of capital witnesses, do the  
17      remainder of this week with Mr. Batch and Mr. Talley and  
18      however many non-cost of service witnesses we can, and  
19      then accept the motion for a continuance and allow the  
20      parties to reconvene after they have had a chance to  
21      review more material.

22                I don't believe they do, frankly. The rebuttal  
23      case really is a direct case in response to the  
24      different ideas on how to change cost of service. We  
25      have updated some numbers. Right from the beginning the

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1 question of what the methodology ought to be has been  
2 the case. It's a choice that the Commission will have  
3 to make between two methodologies that have been  
4 supported. That's not new.

5           So, again, in order to give everybody the time  
6 that they indicate that they need, without having to go  
7 late -- we have been going late on our own without being  
8 here, for seems like weeks. And I know we can continue  
9 to do it at least for a short time, but I think at some  
10 point people become less effective. And I think we will  
11 even wind up taking more time unless we have a chance to  
12 get back to normal work days.

13           So the overall recommendations we made on  
14 Monday, and also the motions that we made earlier, I  
15 think would meet everybody's needs here in this case  
16 without having to try to truncate the case. We have  
17 essentially as complicated a utility case as any  
18 electric or gas utility that would have eleven months,  
19 and we would still, with the motion for continuance to  
20 August or even September, finish within the eleven  
21 months that we made on the filing of December 13.

22           So what we have tried to do was something that  
23 was ambitious. We tried to do something that was  
24 basically the same type of case that you would have in  
25 an electric utility or gas utility case, only it's more

1 complicated because we have a choice for the first time  
2 in an oil pipeline situation of methodologies.

3 So we're taking less time to do a lot more, and  
4 I would hope that everybody recognizes that we're trying  
5 to do a lot within a short period of time.

6 JUDGE WALLIS: Will you be able to make  
7 Ms. Hammer available for a brief deposition?

8 MR. MARSHALL: We would. I think, again,  
9 probably the better way of doing it would be to have --  
10 Ms. Hammer is scheduled to come on right after this  
11 week. So if we moved her to come on on Tuesday after  
12 Mr. Peck, then we could have the opportunity to do a  
13 deposition on Monday, rather than try to do it at night  
14 when everybody else is preparing.

15 So I would agree to a deposition, but ask that  
16 it be done on Monday, and have Ms. Hammer testify. That  
17 would give everyone even more of an opportunity to  
18 review the material that they need to review.

19 JUDGE WALLIS: We did maintain the original  
20 list of witnesses based on counsel's notations that  
21 they were planning for cross examination in the order  
22 earlier presented.

23 Mr. Brena, does that change your view of the  
24 order of witnesses?

25 MR. BRENA: Your Honor, we asked for a

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1 three-hour deposition of Ms. Hammer, and one hour of  
2 direct. I didn't hear any reason why those can't be  
3 permitted from opposing counsel.

4 Flipping the order of the witnesses and  
5 delaying this whole proceeding just to be reconvened --  
6 first, flipping the order of the witnesses, that's not  
7 appropriate now. It's not appropriate in a delayed  
8 proceeding. It doesn't help.

9 He continues to suggest that a witness that is  
10 locally available, Mr. Talley, who provided very  
11 technical engineering information, comprehensive  
12 rebuttal, being moved forward. It's going to take me  
13 time to properly prepare for cross. I have relied on  
14 the schedule as it stands that Mr. Talley would be  
15 towards the end -- well, in the middle of their  
16 witnesses.

17 So I have relied on this schedule as have all  
18 the parties. So I do not agree that in the middle of  
19 the hearing to start flipping the order of the witnesses  
20 without clear reason, particularly highly technical  
21 witnesses with substantial rebuttal, in moving them  
22 forward, that that would be helpful.

23 JUDGE WALLIS: Very well. That responds to my  
24 question.

25 MR. BRENA: Okay. Well -- okay. So with

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1 regard to the delay, I don't think there's efficiencies  
2 in this delay, and I have said that. I think the  
3 concept is a false concept.

4 JUDGE WALLIS: We have your argument.

5 MR. BRENA: I was just going to say, delay or  
6 not, we need to answer the case.

7 I do have one more, if I may, and I realize I  
8 am stretching the limits of reasonable patience.

9 Why don't you just set time for cross? Why  
10 don't you just say people have so much time to cross  
11 examine and propose a schedule, and then -- as you did  
12 with regard to oral argument on the motions.

13 You just sat down with the parties and worked  
14 through it. And with regard to -- there are certain  
15 alignments that we don't agree completely with.

16 But I think there would be a lot of  
17 efficiencies in sitting down, and rather than continuing  
18 on with the schedule that people aren't sure how it  
19 works, why don't we make an effort to set one?

20 JUDGE WALLIS: Thank you, Mr. Brena.

21 (Discussion off the record.)

22 JUDGE WALLIS: We will take a break in a  
23 moment, but before we do that, we understand Mr. Finklea  
24 has a comment he would like to make.

25 MR. FINKLEA: Your Honor, I am trying to think

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1 on my feet, and I am going to make a suggestion without  
2 having checked with everyone. But sometimes, you never  
3 know, maybe I had a brainstorm.

4 We have until the 2nd of July already  
5 scheduled. As Mr. Trotter observed, by the middle of  
6 next week we will have a better idea if we are working  
7 in a skeet field, or suddenly we start hitting some  
8 pavement.

9 If we get to the 2nd of July and all we have  
10 accomplished is the cross examination of the company,  
11 then we could continue the hearing. Resume after the  
12 FERC proceeding, and take cross examination of Staff and  
13 Intervener witnesses sometime later, obviously depending  
14 on the Commissioners' schedules. And I anticipate a  
15 two- or three-week hearing at FERC, so late July or  
16 early August before we continue.

17 But we will have accomplished the cross  
18 examination of the company's case, and if we can't  
19 accomplish the cross examination of everyone in the  
20 course of the time we have allotted, then we would come  
21 back sometime later and have the cross examination of  
22 Staff and Interveners.

23 JUDGE WALLIS: Thank you, Mr. Finklea.

24 MR. BRENA: If I could ask one factor be  
25 weighed. Please consider we're -- at least I am -- in



1 two parallel hearings. I go from here to FERC, and  
2 after FERC then we have briefing in both. So it's not  
3 apparent to me when we're going to rejoin the issues  
4 even within the procedural context of this single case  
5 within two jurisdictions. So please, let's get it done.

6 JUDGE WALLIS: Thank you. We will take a  
7 15-minute break and be off the record.

8 (Brief recess.)

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

10 During the break the Commission considered the  
11 wishes raised by Mr. Brena relating to the further  
12 process of the hearing. We have already touched on the  
13 workpapers issue, and the company has pledged to provide  
14 those today, to the extent they are available, and the  
15 remainder tomorrow.

16 We do believe it is appropriate that Mr. Brena  
17 be allowed to present additional direct through his  
18 witnesses, or through -- in the nature of surrebuttal  
19 through an additional witness within his choice.

20 We agree with Mr. Brena that it is appropriate  
21 for us to review the remaining scope of the hearing and  
22 the time available for its completion, and to establish  
23 time limits. And I will engage with the parties in that  
24 discussion during a time either today or first thing in  
25 the morning that is least disruptive to the proceeding

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1 to hear the examination of the witnesses.

2 We believe that it is appropriate that  
3 Ms. Hammer be deposed at a time that is convenient to  
4 Mr. Brena. I am advised that Friday's hearing will end  
5 approximately 3:00 p.m., and that time will then be  
6 available to the parties.

7 We looked at the schedule for the weekend and  
8 believe that it may be most effective not to schedule  
9 any proceedings on Saturday, Sunday, or Monday, but to  
10 allow parties the opportunity to use that time for  
11 preparation. And then when we go into hearing on  
12 Tuesday, we will plan for at least three days of that  
13 week to have evening sessions.

14 And we anticipate that that will enable the  
15 completion of the hearing in the time that is available.  
16 We will recess then and see whether additional time may  
17 be necessary, and if so, where it could be snatched.

18 Does that respond to the parties' pending  
19 questions?

20 MR. BRENA: Your Honor, if we can tie down  
21 Ms. Hammer's depo. I just asked -- after we get their  
22 workpapers, then we need a day. So if we can set that  
23 time for Monday morning at 9:00?

24 JUDGE WALLIS: That's consistent with what  
25 Mr. Marshall had earlier suggested.

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1                   MR. FINKLEA:    And Your Honor, I take it from  
2                   your ruling that that opportunity to have oral rebuttal  
3                   would also be available to Tosco's witnesses?

4                   JUDGE WALLIS:    Yes.

5                   COMMISSIONER HEMSTAD:   And I assume the option  
6                   available to Mr. Brena would also be available to  
7                   Mr. Finklea and Mr. Trotter with regard to their  
8                   witnesses' oral rebuttal or oral direct.

9                   MR. TROTTER:     Thank you, Your Honor.

10                  MR. FINKLEA:     Thank you.   I do think that will  
11                  dramatically cut down the cross.

12                  JUDGE WALLIS:   I will ask the parties whether  
13                  it will be most effective to consider the issue of  
14                  timing later today, or perhaps first thing in the  
15                  morning?   Could we convene at 8:30 for that purpose?  
16                  That would give us an hour to go through it.

17                  MR. BRENA:     Yes.

18                  JUDGE WALLIS:   Very well.   Counsel will convene  
19                  at 8:30, and the evidentiary hearing will convene at  
20                  9:30.

21                  With that, are we ready to resume the  
22                  examination of Dr. Schink?   I believe Mr. Finklea is up  
23                  on that.

24                  MR. FINKLEA:    Yes, Your Honor.   There was a  
25                  pending question from Mr. Brena that was a calculation,

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1 and we can either have that happen first or --

2 JUDGE WALLIS: Very well. Mr. Brena.

3 MR. BRENA: Just to clarify, where I think we  
4 are at, I had asked Mr. Schink how much the rate payers  
5 would have to pay if his recommendation for capital  
6 structure if his recommended return and their  
7 recommended rate base were adopted in a comparative with  
8 their actual zero capital structure.

9 JUDGE WALLIS: Mr. Schink, do you have that  
10 question now in mind?

11 THE WITNESS: Yes. I actually prepared my  
12 homework in writing, if I can share it with you.

13 MR. BRENA: Certainly. May I have two copies  
14 of it, please.

15 CHAIRWOMAN SHOWALTER: I am going to observe  
16 that if Olympic had this information this morning, it  
17 clearly should have handed it out to counsel at the  
18 beginning of the day. Maybe it didn't?

19 MR. MARSHALL: It didn't. That's why  
20 Mr. Schink was out there trying to make copies and make  
21 change the first thing this morning. It was just a  
22 bunch of handwritten notes. And when we thought about  
23 the amount of additional process that we had, we thought  
24 it would be actually easier to have it written up.

25 JUDGE WALLIS: Thank you. As a matter of

2400

1 practice, if these documents could be distributed as  
2 soon as they are available, that is, at the first break,  
3 then we would appreciate that. We would all have it and  
4 not take the time for distribution.

5 MR. MARSHALL: We actually thought this would  
6 be more efficient than just have him talk about it.

7 JUDGE WALLIS: Very well. Thank you very much.

8 MR. BRENA: Your Honor, I have been given an  
9 exhibit that does things I didn't ask to be done, so I  
10 would ask that --

11 JUDGE WALLIS: Well, at this point we have a  
12 document that Dr. Schink has provided. And you, as we  
13 have noted, have not had the opportunity to review.  
14 This document has not been proposed as an exhibit. And  
15 unless the parties wish it be so proposed, it need not  
16 be.

17 So I think there is a question pending of the  
18 witness. Is the witness prepared to answer that  
19 question?

20 THE WITNESS: Yes, I am.

21 JUDGE WALLIS: And your answer is?

22 THE WITNESS: My answer is that the difference,  
23 the cost of service calculated and the Exhibit No.  
24 BAC-8C, schedule 11, line 7, for the cost of service was  
25 56.5 million. If you use that same model and replace

2401

1 the capital structure that Olympic is proposing with 100  
2 percent debt capital structure, assuming a 5.2 percent  
3 cost of debt, the cost of service becomes 42.6 million.  
4 And the difference between what Olympic is requesting  
5 and what that calculation provides is 13.9 million.

6

7 CROSS EXAMINATION (Continuing)

8

9 BY MR. BRENA:

10 Q In the exhibit that you handed out, that's --  
11 the answer is indicated on the first sheet, correct?

12 A That's correct.

13 JUDGE WALLIS: Dr. Schink, excuse me. But if  
14 you could move your hand, that would let your voice  
15 project to the microphone. Thank you.

16 THE WITNESS: Excuse me. I will keep my hand  
17 down.

18 Q BY MR. BRENA: Dr. Schink, what is the total  
19 increase -- the 62 percent increase, what is the total  
20 cost of service increase that Olympic is requesting? Do  
21 you know?

22 A What they filed for is 62 percent, as I recall.  
23 The cost of service is now calculated to 56.5, which  
24 supports an average cost per barrel increase of 52.9  
25 percent.

2402

1           Q   Excuse me.  I am trying to put this in context,  
2           and I am looking at real dollars.  Do you know what the  
3           total cost of the service was before the increase versus  
4           what is recommended?

5                   MR. MARSHALL:  Is that for interstate,  
6           intrastate, or --

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

8   (Discussion off the record.)

9                   JUDGE WALLIS:  Mr. Brena.

10           Q   BY MR. BRENA:  Dr. Schink, what is the total  
11           additional revenues, on a company-wide basis, that  
12           Olympic's rate increase represents?

13                   MR. MARSHALL:  Just for clarity, that's for  
14           both intrastate and interstate rates?

15                   MR. BRENA:  Yes, that's correct.

16                   THE WITNESS:  Okay.  Is this thing picking up?

17                   JUDGE WALLIS:  It is not.  Let's revert to the  
18           old technology.  This week, push the button.

19                   THE WITNESS:  Again, this is a number that's  
20           presented in BAC-8 -- Exhibit No. BAC-8C at prior  
21           tariffs and the through-put that -- that has been  
22           calculated at 103.2 million barrels per year, the  
23           revenues would be 35.5 million.  Is that what you were  
24           asking, sir?

25                   MR. BRENA:  I don't think so.  Give me just a

2403

1 minute.

2 THE WITNESS: Mr. Brena, I could clarify a bit  
3 if you like. The number that I gave you is on Exhibit  
4 BAC-8C, schedule 1, line 8.

5 Q BY MR. BRENA: That is the total new revenues,  
6 correct?

7 A That is the total operating revenues, what they  
8 will be at the prior pre-increase tariff rates as noted  
9 in that exhibit.

10 Q What would they be after the increase?

11 A Well, the current cost of service would be 56.5  
12 million, based again on the cost of service presented in  
13 Exhibits No. BAC-8C.

14 COMMISSIONER HEMSTAD: If I can ask, what is  
15 the number for that exhibit?

16 MR. BRENA: BAC-8C, schedule 1.

17 COMMISSIONER HEMSTAD: No, I need to find it.  
18 What is the exhibit number?

19 MR. BRENA: 703C.

20 THE WITNESS: So BAC-8C is 703C.

21 Q BY MR. BRENA: So just to summarize where we're  
22 at, it was 35.5 before the increase. And after the  
23 increase it's 56.5. The difference is the amount of the  
24 increase in total revenues that Olympic is seeking, and  
25 that was my question -- or the head room, as it's called



2404

1 on the schedule.

2 A 21 million dollars, as I calculate it.

3 Q So of the 21 million dollars that Olympic is  
4 requesting in its increase, the revenue impacts from  
5 their actual capital structure to the hypothetical  
6 capital structure is 13.9 million dollars, correct?

7 A The request would be reduced -- if you went to  
8 100 percent capital structure, the cost of -- 100  
9 percent debt capital structure with a debt rate of 5.26  
10 percent, the implied cost of service would be 42.6  
11 million, which is 13.9 million less are in what is now  
12 calculated in 703C.

13 Q So at two-thirds of the total request for a  
14 rate increase, the real dollars is attributable to  
15 equity that doesn't exist within the company?

16 A I beg to differ, sir.

17 Q Okay. Let me phrase it this way. If the  
18 Commission uses Olympic's actual capital structure, how  
19 much in real dollars would their increase be?

20 A You are saying if they chose to use Olympic's  
21 current -- Olympic Pipeline's current capital structure,  
22 there currently is 100 percent debt, which I guess by  
23 subtraction, zero percent equity.

24 Q Correct. And what would their requesting 21  
25 million dollars in additional revenues through their

2405

1 rate increase -- how much of a rate increase could be  
2 justified if the Commission adopted Olympic's actual  
3 capital structure under Olympic's cost of service in 8C?

4 A I guess -- well, this assumes that you are  
5 going to use the parents' embedded cost of debt, and not  
6 their capital structure, so it would depend. If they  
7 accepted the parents' embedded cost of debt of 5.26  
8 percent, and assigned the capital structure based on  
9 Olympic's 100 percent debt, it would yield 42.6 million,  
10 which is cost of service, which is 13.9 million less  
11 than they are requesting.

12 Q So of the 21 million they are requesting, the  
13 amount that could be justified if Olympic's actual  
14 capital structure is used under the assumption that you  
15 set forth would go from 21 million down to 7.1 million;  
16 is that correct?

17 A The calculation is correct, sir. I have a lot  
18 of trouble with some of the underlying assumptions.

19 MR. BRENA: I have no further questions of  
20 this witness. I am not sure when is the appropriate  
21 time to move the exhibits I have used into the record.

22 JUDGE WALLIS: Now.

23 MR. BRENA: I would ask that all of the -- all  
24 of the cross examination documents that we have  
25 previously marked, with the exception of 225C, which we

2406

1 did not use -- that the remainder of them be moved into  
2 evidence. And I would also ask that the first page of  
3 Mr. Schink's, as he called it, "Mr. Brena's homework  
4 assignment," that the first page be marked at the next  
5 available cross examination that shows the calculations  
6 and the conclusion.

7 JUDGE WALLIS: Very well. I am marking as  
8 Exhibit 234 for identification a single-page document  
9 entitled Dr. George Schink's response to Mr. Brena's  
10 homework assignment.

11 (EXHIBIT MARKED)

12 JUDGE WALLIS: Is there any objection to the  
13 documents that have been identified and discussed on the  
14 record through cross consisting of 224C through 232,  
15 plus 234, minus 225C?

16 (No response.)

17 JUDGE WALLIS: I will note that on the list  
18 that's prepared these are either correctly shown as  
19 identified, or erroneously shown as admitted, and we  
20 will correct that on tomorrow's iteration of the sheet.

21 MR. MARSHALL: We said earlier that excerpts  
22 of cases, we believe, ought to be supplemented by more  
23 complete excerpts.

24 JUDGE WALLIS: And we granted you to offer  
25 those.

1           MR. MARSHALL:   And also, with regard to the  
2   identification of Dr. Schink's homework assignment, it  
3   really is three pages that he has submitted, and not  
4   just one.   So we would ask at this time, for the sake of  
5   completion, so we don't have to mark yet another exhibit  
6   with another number which could confuse things, to have  
7   the entire three-page homework assignment be included.

8           And with that, we wouldn't have any objection  
9   as long as the entire document is marked as an exhibit.

10          JUDGE WALLIS:   Very well.   We will receive the  
11   exhibits up to and including page one of Dr. Schink's  
12   response.   And Mr. Brena, I believe, has some concerns  
13   related to pages two and three.

14          Mr. Brena.

15          MR. BRENA:   I do.   They simply aren't  
16   responsive to what I asked him to do.   On page three he  
17   goes on to compare to 1998 actual results.   He  
18   introduces a whole new analysis.

19          All I was asking him to do is what is the total  
20   cost of service impact from the capital structure that  
21   he's proposing and the recommendations that he's  
22   proposing, versus their actual.   And that's shown in its  
23   entirety on sheet one.   And sheet two and three go on to  
24   present what may or may not be proper recross -- or  
25   excuse me, proper redirect.

2408

1                   JUDGE WALLIS: Very well. For purposes of  
2 where we are in the proceeding we will receive page one,  
3 and we will not receive pages two and three, because  
4 they have not been inquired into, and they are not a  
5 part of the examination or related to the examination of  
6 the witness.

7   (EXHIBIT ADMITTED)

8                   JUDGE WALLIS: Now, Mr. Finklea, it's your  
9 turn.

10                  MR. FINKLEA: Thank you, Your Honor.

11

12   CROSS EXAMINATION

13

14 BY MR. FINKLEA:

15                  Q Good morning, Mr. Schink.

16                  A Good morning.

17                  Q In preparing your direct testimony, what  
18 efforts did you undertake to obtain tanker and barge  
19 transportation rates for the Oregon destination markets  
20 served by Olympic by consulting with published indices?

21                  A We did look for any published information on  
22 barge or tanker rates. We have been -- not in this  
23 matter or not in this area. I have been involved in  
24 pipeline cases before where water-borne rates were an  
25 issue, and in these matters we occasionally were able to

2409

1 find consultants who knew something about the area.

2 We attempted in this case, and could not  
3 locate, anybody who was responsive or who could provide  
4 us with the information because these arrangements, we  
5 were told, are all done contractually, and there is no  
6 publicly available data on it.

7 CHAIRWOMAN SHOWALTER: Dr. Schink, would you  
8 remove your hand from your face?

9 THE WITNESS: I am leaning forward and trying  
10 to support myself. I apologize.

11 In any case, we weren't able to get any -- get  
12 the information we wanted from that route.

13 Here we contacted the company. Our point  
14 person, as it were, was Cindy Hammer. We didn't expect  
15 her to have the answers necessarily, but she did check  
16 and informed us that the decision had been made -- not  
17 by her. I don't know by who -- to, in fact, attempt to  
18 get this information from Tesoro and Tosco. So that  
19 summarizes what we did in this area.

20 Q BY MR. FINKLEA: Did you make any attempt to  
21 contact the shipping companies themselves?

22 A We didn't directly. We found in the past that  
23 you need somebody who has contacts in the industry. We  
24 have tried to do that, and we have tried to do that in  
25 other matters, and found that unless you had somebody

2410

1 who worked in the industry and was known to the people  
2 who operate these systems or these barge and tanker  
3 companies, you couldn't get any vague cooperation.

4 Q Is there any association of these barge and  
5 tanker companies that exists? And if so, did you  
6 contact that?

7 A There is one, and we have researched it before.  
8 They do not provide this kind of information. At least  
9 I think there's some national index of cost, but there  
10 really isn't an area-specific information that we would  
11 need.

12 Q Shifting gears, is the ability to sustain a  
13 significant price increase evidence that a firm has  
14 market power?

15 A It's -- the ability of a firm to sustain a  
16 price increase above competitive levels is an indication  
17 of the ability to exercise market power. The ability to  
18 raise prices, per se, provides no such evidence.

19 You have to establish that the price level set,  
20 the increased price, is, in fact, above competitive  
21 levels. Which is one of the reasons we thought it was  
22 important to, in fact, find the costs or the rates  
23 charged by barges, because they are also major  
24 transporters of refined products or refined products  
25 produced by the four refineries that Olympic serves.

2411

1           Q    So the shear level of a five or ten percent  
2    increase, that isn't indicative to you of a firm having  
3    market power, going up the scale of 25 or 50?

4           A    It's not the size.  It's whether it's a rise to  
5    above competitive levels that is at issue.  And I  
6    think -- well, it is not an indicator of market power,  
7    no.

8           Q    And you don't know, testifying here today,  
9    whether even at the proposed rate increase level that  
10   Olympic is requesting, if its prices would be above or  
11   below the competitive alternatives?

12          A    I don't know with certainty, but I have  
13    reviewed a letter that Tosco had sent to this Commission  
14    when it was opposing the institution of the interim rate  
15    request.  And it states that one of the reasons that  
16    Tosco opposes this rate increase is it might force it to  
17    make shipments using other modes of transport.

18                    And that suggests to me that -- this is a  
19    letter dated November 14 to Chairwoman Showalter, maybe  
20    from you, sir.

21          Q    I recall the letter.  But the operative word  
22    was, "might."  We don't know.  You don't know today if  
23    the rate increase will take Olympic's rate above or  
24    below the cost of water-borne or barge transportation?

25          A    I am sure Tosco knows.  They know what their



2412

1 shipping costs are, and we have requested that they  
2 provide them, the shipping cost via barge or tanker.

3 Q In the destination market served by Olympic,  
4 what is the general cost of pipeline transportation as a  
5 percentage of the wholesale price of gasoline?

6 A The reference of where you were getting the  
7 numbers escapes me. Would you repeat the question?

8 Q Yeah. In the destination markets that are  
9 served by Olympic, what is the general cost of pipeline  
10 transportation expressed as a percentage of the  
11 wholesale price of gasoline, in rough? If you don't  
12 know precisely, in rough terms, is it five percent, two  
13 percent, three percent, ten percent?

14 A Give me just a second. I can even run my  
15 calculator today. Olympic's proposed cost of service of  
16 56.5 million divided by 103.2 million barrels of  
17 through-put produces an average tariff per barrel of  
18 54.7 cents per barrel. There are 42 gallons in a  
19 barrel. So that's 1.3 cents per gallon, is what the  
20 cost of the transportation is. And the last time I  
21 looked, gasoline prices are about -- is this wholesale  
22 or retail?

23 Q Wholesale is the question.

24 A Wholesale is around a dollar per gallon, which  
25 is 100 percent. So it's 1.3 percent, roughly.

2413

1           By the way, the wholesale price does not  
2 include taxes. The wholesale margin is not as big as it  
3 would seem between a dollar and a half retail and a  
4 dollar wholesale. Most of the difference is taxes.

5           Q    If we could turn to what is marked as --  
6 originally marked as OPL 39.

7           A    Is that now referred to as schedule 39, sir?

8           Q    Yes, I believe so.

9           JUDGE WALLIS: It's part of Exhibit 222.

10          MR. FINKLEA: Yes, it is, Your Honor. Yeah,  
11 it's part of 222. It's now the schedule 39.

12          THE WITNESS: I am there, sir.

13          Q    BY MR. FINKLEA: By how many cents did  
14 wholesale gasoline prices fluctuate in the Portland  
15 market in 1999?

16          A    Well, the scale on this chart is going to have  
17 from something above 35 cents a gallon to something in  
18 excess of 110 cents a gallon. Is that -- well, actually  
19 that goes into 2000, but the big swing at the end is  
20 that range.

21          Q    So how do these fluctuations compare to  
22 Olympic's tariff rate for pipeline service to Portland?

23          A    They are very large compared to the pipeline  
24 rate, obviously.

25          Q    Can we turn to page 13 of your direct

2414

1 testimony?

2 JUDGE WALLIS: Mr. Finklea, you mean Exhibit  
3 221?

4 MR. FINKLEA: Yes, Your Honor.

5 Q BY MR. FINKLEA: At lines 241 through 243 you  
6 make an observation, in the Portland area barge and  
7 tanker deliveries amount to 25 percent of the total  
8 supply in 1998, and you referenced what is now schedule  
9 OPL 37?

10 A That's correct.

11 Q Of that 25 percent of total product supply to  
12 Portland which was water-borne, what portion was from  
13 Washington refineries as opposed to refineries outside  
14 of Washington, including California?

15 A The data, these data, water-borne delivery data  
16 come from the Army Corps, and all we know is it came off  
17 the ocean into Portland. And where it entered the ocean  
18 could be California, could be Washington, could be the  
19 Seattle area, could be Canada, could be anywhere in the  
20 world. Most of it, based on my knowledge of the market,  
21 most of it comes from the refineries in the Seattle  
22 area, but certainly not all of it.

23 Q And is refined product pipeline service  
24 available between California refineries and Portland?

25 A Is a pipeline?

2415

1 Q Is there a pipeline from California to  
2 Portland?

3 A No, there's not.

4 Q Turn to page 14.

5 A (Complies.)

6 Q At lines 260 to 263 you, again, make an  
7 observation about net water-borne receipts into Portland  
8 area increased by 78 percent from the 52.4 million  
9 barrels a day in 1998 to 93.5 million barrels a day in  
10 '99, according to the Army Corps.

11 Of that 78 percent increase, what portion was  
12 from Washington refineries as opposed to refineries  
13 outside of Washington?

14 A The previous answer that I just gave suggests  
15 that from the Army Corps does not differentiate by  
16 source. We just know it came off the ocean.

17 But, again, based on my knowledge of the  
18 markets, most of it, if not all of it, would have come  
19 from the Seattle area refineries.

20 MR. TROTTER: Your Honor, excuse me. For  
21 clarification could we understand is MBD million or  
22 thousand?

23 THE WITNESS: It is thousands of barrels per  
24 day. I apologize.

25 MR. TROTTER: Thank you, Your Honor.

2416

1 Q BY MR. FINKLEA: In 1999 did imports into the  
2 PADD-5 West Coast market exceed five percent of total  
3 supply, if you know?

4 A What was the year, sir?

5 Q 1999.

6 A I can't answer that as I sit here. It wouldn't  
7 surprise me if that was the number, but I can't confirm  
8 or deny that specific number. I could accept it subject  
9 to check, if you have data.

10 Q I am probing your own knowledge. I am not  
11 representing five percent to be the right number or not.

12 A I could determine from data that I don't have  
13 with me what that number is, but I don't recall as I sit  
14 here what it is. I just don't know.

15 Q Could we turn next to appendix B to your  
16 schedule 34?

17 A Is appendix B itself schedule 34?

18 Q Appendix B, as I take it, is part of schedule  
19 34.

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

21 (Discussion off the record.)

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

23 For the record, we're talking about appendix B, which is  
24 a part of Exhibit 223.

25 Q BY MR. FINKLEA: If you could turn to page four

2417

1 of appendix B, Dr. Schink, in the middle of that page  
2 there's a reference to the Olympic accident event, and a  
3 reference to the rest of the pipeline has operated at 80  
4 percent of capacity.

5 And my question is, has Olympic operated at 80  
6 percent of capacity or 80 percent of normal pressure?

7 A 80 percent of normal pressure. This is  
8 obviously a misstatement. And if the question is still  
9 on your copy of the appendix, as it is in mine,  
10 obviously I didn't get the question answered before I  
11 submitted the testimony.

12 It is 80 percent of normal pressure. And also  
13 the requirement that it operate at 80 percent of normal  
14 pressure occurred in September of '99 as a result of the  
15 seam failure during a test and is not directly related  
16 to the accident.

17 Q And what does 80 percent of normal pressure  
18 represent as a percentage of Olympic's capacity?

19 A My calculations suggest that at 80 percent  
20 pressure, you are getting approximately 89 percent of  
21 the through-put you would get at 100 percent. And  
22 that's not taking into account whatever effect that may  
23 or may not have on that through-put. And that's  
24 accomplished by dividing 103.2 million barrels of  
25 through-put estimated for the period we're studying,

2418

1 relative to the 116.30 million barrels that were  
2 transported in 1998, which was the last year they  
3 operated at 100 percent operating pressure.

4 So at 80 percent operating pressure means you  
5 can move roughly 89 percent of your 100 percent  
6 operating through-put. This is -- it's complicated. I  
7 apologize.

8 Q Well, I think I followed. It's just there's  
9 not one correlation to say there's 80 percent of normal  
10 pressure. Doesn't mean you are at 80 percent of  
11 capacity, you are actually at 89 percent of capacity?

12 A The through-put you can move through the  
13 pipeline at 80 percent operating pressure is roughly 89  
14 percent of what you could move at 100 percent operating  
15 pressure.

16 Q Thank you. Would you turn to page eight of the  
17 same appendix.

18 A (Complies.)

19 Q We do have, again, a reference toward the  
20 bottom of the page. There's a sentence that starts  
21 with, "To address the question, it must be determined  
22 whether California and the refineries could be expected  
23 to supply enough increased light refined petroleum  
24 products to the Seattle and Portland areas to render a  
25 small but significant sustained price increase in the

2419

1 Seattle and Portland unprofitable (sic)."

2 I just read what was there. My question is,  
3 what percentage of product deliveries into the Portland  
4 market came from California refineries, if you are  
5 aware?

6 A I do not have an exact percentage. My  
7 understanding is it's relatively small, that most of it  
8 comes from the Seattle refineries.

9 Q And you also have references in that same part  
10 of your appendix to the Phoenix and Las Vegas markets.  
11 Do you know what percentage of product deliveries into  
12 the Las Vegas market comes from the California market  
13 refinery?

14 A All of it.

15 Q What percentage of deliveries into Phoenix come  
16 from California refineries?

17 A 60 or 70 percent. The rest comes from West  
18 Texas.

19 Q At page ten of the same appendix, again, about  
20 two-thirds of the way down, there's a sentence that  
21 starts with, "The marginal source of supply in the areas  
22 served by Olympic was thus barges and tankers."

23 A Yes, I see that.

24 Q And then you said, "Therefore, the price of  
25 refined products in these areas was set and based on



2420

1 water-borne transportation costs, and was not based on  
2 Olympic's tariff rates."

3 A That's correct.

4 Q Is it your testimony that the transportation  
5 rates establish the price of refined products?

6 A No. The deliver -- the cost of delivering --  
7 the delivered cost of the refined product is what sets  
8 it. And the largest share of the cost is clearly the  
9 cost of the refined product at the refinery itself.

10 And as you have pointed out, transportation is  
11 a relatively small part of the total. But ultimately  
12 the delivered cost of the barrel to any location is what  
13 it cost at the refinery plus what it costs to deliver it  
14 to where it is consumed.

15 And if it cost 1.3 cents per barrel to deliver  
16 it by Olympic, and something more than that by barge,  
17 the delivered cost of the product is determined by the  
18 product -- the price of the product at the refinery,  
19 which is the same whether it's delivered by pipeline or  
20 barge, plus the cost of transportation.

21 And I think as I have conceded in here, it  
22 appears that the cost of water-borne transportation is  
23 higher. And if that's the case, then it's the  
24 transportation component that is relevant. Or the  
25 transportation cost that is relevant to determining cost

2421

1 of product is the barge cost. Does that help?

2 Q Yes. So I am safe in concluding that if  
3 product price is increased by 50 percent in a market,  
4 that would not imply the transportation prices had  
5 increased?

6 A I think you are going to have to give me more  
7 facts before I can answer that. I am not alleging,  
8 certainly, that the shift from pipeline to barge  
9 transportation caused the delivery cost -- or refined  
10 products to increase by 50 percent. That's not possible  
11 given the relative cost of transportation and relative  
12 cost of the product. If that's what you are trying to  
13 get me to agree to, I do agree to that.

14 Q No, I am just trying to get a simpler agreement  
15 that if all we knew, hypothetically, is that product  
16 prices had increased in a particular market by 50  
17 percent, that wouldn't necessarily imply there had been  
18 any change in transportation rates; is that correct?

19 A In the abstract or hypothetically, if you told  
20 me that any market's prices went up by 50 percent, and  
21 you didn't tell me anything else, I would have no idea  
22 what caused them. No.

23 Q We turn next to page eleven at the top of the  
24 page. You have a sentence that begins with, "As  
25 demonstrated below, this shift to using more barge and

2422

1 tanker services apparently did not cause barge and  
2 tanker rates to rise significantly, because light  
3 refined product prices did not rise significantly."

4 In this context, what did you consider to be a  
5 significant increase in refined product prices?

6 A I conducted a number of statistical tests in  
7 this appendix, and I am not right at the spot we're  
8 talking about.

9 But based on those statistical tests, I  
10 concluded that there was no statistical significant  
11 difference between the prices in Portland and Seattle  
12 within three months after the accident, which is  
13 September '99, that the differential, if you will,  
14 between the prices in Portland and Seattle and those in  
15 California, or those in Gulf Coast have not changed.

16 And if, in fact, the shift to barges had, in  
17 fact, been accompanied by an increase in barge rates  
18 because of an increase in demand for those services,  
19 that differential should have widened, and there was no  
20 evidence that the differential widened.

21 So what it says is the unit -- per unit  
22 transportation costs by barge or water-borne  
23 transportation, I apologize, did increase as a result of  
24 the increase in demand.

25 And footnote 15, I think, is attached to the

2423

1 end of the sentence that you have just read me, gave an  
2 example in the case of BP Amoco, of how they, in fact,  
3 reduced their barge costs by entering into certain kinds  
4 of contracts at the time.

5 Q Am I correct that under federal regulation, if  
6 Olympic faces effective competition from water-borne  
7 transportation, that it could file an application to be  
8 granted the authority to charge market based rates?

9 A It could. It hasn't. And like a lot of other  
10 pipelines, it has chosen not to take that route, because  
11 it's usually objected to by the shippers. And they  
12 have -- it's my experience if a pipeline can justify a  
13 rate increase based on cost, they do view that as a more  
14 predictable and certain way to get cost increases.

15 Q If we could turn next to your rebuttal  
16 testimony, and marked for identification as Exhibit  
17 201-T, and I am at page 7.

18 A I am there, sir.

19 Q Is your recommended equity ratio of 86 percent  
20 influenced by the size of the risk premium adder that  
21 you are now recommending in your rebuttal testimony?

22 A The same factors that I think justify the risk  
23 adder to the cost of equity capital for Olympic would  
24 justify a thicker equity ratio for Olympic.

25 So it's not the adder itself that is the source

1 of this request, but various competitive factors that --  
2 I mean, I've talked about the water-borne, and other  
3 witnesses have -- for Olympic have emphasized the other  
4 factors. The fact that it's a high seismic risk area,  
5 that they have been subjected to, first, the accident,  
6 and then the seam failures in the pipeline, that they  
7 are in areas where, in fact, there's a lot of  
8 construction going. And it's an area where construction  
9 is likely, or more likely, to cause or potentially cause  
10 ruptures in pipelines.

11 And all of these factors, I think, serve to  
12 make the risk of this pipeline that much higher than  
13 average. And those are the factors that justify, or at  
14 least a movement in the direction of 86.85 as opposed to  
15 the roughly 50 percent recommendations that others have  
16 put forward here.

17 Q And conversely, is the size of the risk premium  
18 you are recommending influenced by the equity ratio, or  
19 in your mind are they independent?

20 A I would view them as joint recommendations. I  
21 mean, the Commission can clearly exercise its judgment  
22 as to either one or the other, or neither is  
23 appropriate. They are joint recommendations on my part  
24 based on what I believe to be the high risk faced by  
25 Olympic.

2425

1 Q Could you turn to page 32 of your rebuttal  
2 testimony and focus on lines 2 through 4.

3 A (Complies.)

4 Q You are suggesting in those lines that Olympic  
5 faces a real probability of bankruptcy; is that correct?

6 A I think I have a page -- I have a slight -- can  
7 you read me how the sentence begins?

8 Q It starts with -- I am on page 32, what's been  
9 marked for identification as 201-T. And the sentence  
10 begins, "In Olympic's case, the risk of failure is not  
11 low. In fact, it is substantial. If not for Olympic's  
12 financially sound parents, Olympic almost certainly  
13 would be in bankruptcy today."

14 A You are on page 32?

15 Q Yes, sir.

16 A I found it. I apologize.

17 I would certainly -- they were -- they would be  
18 bankrupt. But for the very large loans it made to the  
19 company it would have been bankrupt a long time ago.  
20 The reason for its solvency are the loans and credit  
21 worthiness of its parents. That's the only reason they  
22 weren't Chapter 11 some time ago.

23 Q A few moments ago when you were responding to  
24 Mr. Brena, didn't we establish that 13 million dollars  
25 of the Company's requested rate increase is tied to the

1 difference between the actual capital structure and what  
2 you are recommending? Isn't that correct?

3 A I have misplaced my homework. The dog ate it.  
4 (Pause.) I have it back. Could you repeat the  
5 question, please?

6 Q Oh, by the way, there's a new excuse. The dog  
7 doesn't eat it; you left it at the other parent's house.

8 A Well, now I need neither excuse. So I have it,  
9 and I am ready to go.

10 Q The question is, didn't we establish with  
11 Mr. Brena that 13.9 million of the requested increase is  
12 tied to the capital structure of the company?

13 A Well, this is the difference between 86.85  
14 percent equity and zero percent equity. I don't think  
15 anybody is seriously recommending anything less than 46,  
16 47 percent. So this greatly exaggerates the difference  
17 of the cost of equity, or the cost of service implied by  
18 all -- or what I would consider to be the serious  
19 recommendations for a hypothetical capital structure for  
20 Olympic. So I would not characterize it that way.

21 This, to me, is sort of a calculation that I  
22 performed at Mr. Brena's request, but at least I hope  
23 the Commission isn't realistically considering 100  
24 percent debt structure, because it's just not  
25 appropriate.

1           The Commission, in the past, when it has  
2       decided that a capital structure -- that the capital  
3       structure of the company itself, in this case they might  
4       decide the capital structure of the parent, wasn't  
5       appropriate, have not said, okay, we will use zero  
6       percent equity. They said we want to look to other  
7       companies that we believe, in fact, are in the same  
8       business you are in, and pick an equity structure that  
9       we think is appropriate for that.

10           And as I said in my testimony, I think the  
11       minimum -- the minimum that you could reach, or minimum  
12       conclusion you could reach regarding the share of equity  
13       based on that is 60 percent.

14           Q    To go back to your observation here on page 32  
15       about the risk of the company going bankrupt, am I  
16       correct in assuming that if the company got 13.9 million  
17       less than it's asking for -- and if we just stay with  
18       Mr. Brena's homework assignment -- if the result of the  
19       case was that the company only recovered 42 million  
20       dollars annually, it would still be meeting all of its  
21       debts, right?

22           A    Well, the answer to your question is on the  
23       second page of my homework, if you want to look at it.

24           Q    Well, I want to keep this at a basic level.  
25       You have made an assertion that unless the rate increase



1 here that the client is requesting is granted, that the  
2 company faces a risk of bankruptcy. In layman's terms,  
3 bankruptcy means you can't meet your debts, correct?

4 A As shown on the second page of my homework, the  
5 cash flow after tax -- under such a cost of service  
6 recommendation, the cash flow that would be available  
7 after tax to Olympic with that recommendation would be  
8 4.9 million dollars, which is -- certainly that includes  
9 covering the external debt costs. It doesn't give any  
10 return, or anything near an adequate return, I would  
11 assert, to the money that the parents have already put  
12 in, and would like to put in, to in fact, restore the  
13 pipeline to 100 percent operating pressure, and to  
14 ensure its long-run reliability.

15 Q But in lay terms, if I run a firm and my firm  
16 isn't making what I would like to make, but I am still  
17 covering my debts, I don't generally file for  
18 bankruptcy; isn't that correct?

19 A You are quite often forced to, because with  
20 this thin of margin, the lenders normally would -- I  
21 haven't studied the loan form, but they have minimum  
22 cash flow requirements. And this would not pass many  
23 that I have seen.

24 I am not saying the existing loan agreements  
25 that they have have such covenants because they are

1 ultimately guaranteed by the parents. So lenders would  
2 take comfort from the fact that the parents were there.  
3 If the parents weren't there, they would be very, very  
4 concerned with this kind of cash flow.

5 And so I think there would be a risk of -- the  
6 lenders can decide there's too much risk and demand --  
7 and because the covenants aren't met, demand immediate  
8 repayment, and force bankruptcy.

9 So I don't know if the covenants of these loans  
10 permit that. They probably don't, because of the  
11 guarantees of the parent, but in a stand-alone company,  
12 there wouldn't be these guarantees. So absent the  
13 guarantees provided by the parents, I can't believe they  
14 wouldn't be in bankruptcy.

15 Q Your last observation is based on what has  
16 happened between 1999 when the accident occurred and  
17 today; isn't that correct?

18 A They were a reasonably healthy -- not highly  
19 profitable, but reasonably healthy company in 1998, yes.

20 Q And the fact that Olympic chose not to seek a  
21 rate increase until it filed -- well, it filed and  
22 withdrew, and then filed a second time on October 31st  
23 of 2001, that was all within Olympic's control, correct?

24 A Yes. But the 4.9 million doesn't sort of bring  
25 forward any of these historical losses. This is a

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1 going-forward situation. This is based on, in essence,  
2 their operating costs today, their ongoing requirements  
3 to pay interest.

4 I mean, of the 42.6 million that the zero  
5 percent equity, 100 percent debt capital structure would  
6 generate, 33.4 million of it are, in fact, operating  
7 costs including depreciation. 1.6 million are payments  
8 to Prudential and Chase under their agreements, and that  
9 leaves 7.6 million. After those obligations, the IRS  
10 would take its 35 percent in taxes.

11 So the cash flow available after taxes would be  
12 4.9 million dollars, and that has nothing to do with any  
13 past losses or anything else. That is where we are  
14 today on a going-forward basis irrespective of whether  
15 the company did or didn't file promptly after the  
16 accident.

17 MR. BRENA: Your Honor, I would move to strike  
18 that last response. As I understood Mr. Finklea's  
19 question, he was asking a general question. It wasn't  
20 related to the second page of the exhibit. What has  
21 happened is this witness is starting to refer to his  
22 exhibit in a non-responsive way to the question.

23 MR. FINKLEA: I join in the objection, Your  
24 Honor. He just got to the microphone first.

25 JUDGE WALLIS: Mr. Marshall.

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1                   MR. MARSHALL:    I think the Commission can  
2 evaluate if it was responsive or not.

3                   MR. BRENA:     I agree with that, and I have  
4 asked them to.

5                   JUDGE WALLIS:   I believe the response was more  
6 than called for in the question, and will grant the  
7 motion to strike.

8                   Mr. Finklea, how are you doing, looking at the  
9 clock?

10                  MR. FINKLEA:   Well, this is a pure  
11 coincidence, but I have no further questions, and I  
12 didn't realize it was 12:04.

13                  JUDGE WALLIS:   Very well.  Let's adjourn now.  
14 We will return to the record at 1:30 this afternoon for  
15 recross by Mr. Marshall.

16                                   (Lunch recess taken.)

17                  JUDGE WALLIS:   Let's be on the record, please,  
18 following our noon recess this afternoon.

19                  We're opening the questioning of Dr. Schink  
20 with questions from the Commissioners, if any.

21                  CHAIRWOMAN SHOWALTER:   Are we done?

22                  MR. FINKLEA:    Yes, ma'am.  Coincidentally, my  
23 last question was at three minutes after 12:00.

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## EXAMINATION

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BY CHAIRWOMAN SHOWALTER:

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Q Well, I have a couple of areas of questions, and I think I will begin going backwards remembering some of the issues you discussed with Mr. Finklea. Could you turn to your rebuttal Exhibit 201, page 32.

A (Complies.) I am there.

Q Mr. Finklea asked you questions about lines three and four, which say, "If not for Olympic's financially sound parents, Olympic almost certainly would be in bankruptcy today."

And the question I have, isn't it also the case that if Olympic's parents, whoever they may be or might have been, had put equity into the company, it also likely would not be bankrupt?

A I think -- let me -- I think what I was arguing here is if it were a stand-alone, it would be bankrupt. As it stands now, it's not bankrupt because its parents aren't bankrupt. Its capital structure -- the parents did, in fact, put money at risk by loaning it to it, and which gives it over 100 percent capital structure. This money is as much at risk as if it were equity capital. Its balance sheet, its equity and capital share, is not really relevant to lenders.

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1           Q    I am not asking about lenders.  I think I am  
2 asking about the question of being in a near bankrupt  
3 state.  Are you saying there's not a difference in  
4 evaluating whether Olympic is near bankruptcy whether  
5 the parents have loaned it money, versus the parents  
6 have put equity into the company?  Do you see no  
7 difference using the bankruptcy issue in that case?

8           A    Olympic was not bankrupt because it was loaned  
9 money by its parents.  And the fact that it was a loan  
10 as opposed to equity makes no difference.  They kept  
11 Olympic afloat in essence by advancing money to it one  
12 way or the other.

13          Q    I am talking about the other right now.  If the  
14 parents had put in equity into the company, isn't it  
15 maybe also the case that the company would not be near  
16 bankruptcy?

17          A    It would be in the same position either way.  
18 It's not a stand-alone company, therefore it's not --  
19 you know, it's not bankrupt, because the parents won't  
20 let it go bankrupt, so far anyway.

21                    So it's -- this statement dealt with what would  
22 be the situation if Olympic were not the child, as it  
23 were, of these two companies.

24                    And I think the point is that Olympic has been  
25 kept alive by an infusion of capital, albeit in the form

1 of a loan. But it doesn't matter. In essence, the  
2 money from the parents are what kept it alive. And call  
3 it a loan, call it equity, it doesn't matter.

4 Q Well, most of my questions are going to be  
5 exploring the difference between a loan and equity and  
6 where it matters and where it doesn't. If the company  
7 had equity from its parents, would it need to borrow as  
8 much money as it has borrowed?

9 A The money, the capital would have had to be  
10 supplied externally, either given its revenues, given  
11 its costs, the money would have had to be injected  
12 externally from the parents, or from the -- or from  
13 outside.

14 If it were injected from the outside, it would  
15 have had to be guaranteed by the parents. So in some  
16 sense it doesn't matter whether the parents made the  
17 loan or backed the loan. Or really in terms of  
18 Olympic's situation, whether they just put cash in. The  
19 cushion is in there because of the parents.

20 Q That's a good enough answer.

21 Mr. Finklea then asked you some questions and  
22 you pointed to page two of your homework, as you called  
23 it, and you pointed at that time to the cash flow after  
24 tax of 4.9 million. And as I recall, you said that  
25 doesn't give return -- or it doesn't give an adequate

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1 return to the money the owners have put in. Is that a  
2 correct statement that you made?

3 A That's correct.

4 Q I have a couple of questions and one is,  
5 wouldn't the owners under this scenario be getting  
6 repaid on their loans? In other words, does the 4.9  
7 million -- is the 4.9 million before or after lenders,  
8 including the owners, have been paid?

9 A It's after the external lenders, i.e.,  
10 Prudential and Chase are paid, but before the companies  
11 get anything.

12 Q Okay. That answers that. So what you were  
13 saying is -- when you were saying the parents haven't  
14 put any money into the company, they have loaned the  
15 company money, so what you were saying, I think, is  
16 there wouldn't be enough to pay back the owners of what  
17 they had lent the company?

18 A No. The return on the money put in, be it debt  
19 equity, whatever you call it, is inadequate. The net  
20 cash flow from this project is just not adequate, I  
21 think, to justify the investments they have made, and  
22 are going to be expected to make. And it's -- I mean, I  
23 guess I have tried to explain why capital structure of a  
24 child corporation like Olympic doesn't matter. I guess  
25 I haven't succeeded.



1           Q   Well, would you say the investment that the  
2   parents have made, are you referring to the loans that  
3   the parents have made to the company?

4           A   The infusion of capital into Olympic to fund  
5   its operations, to fund its investments, to fund its  
6   operations, you know, the money, they are at risk to it  
7   as much one way or the other.

8           Q   Well, in this case is the infusion a loan as  
9   opposed to equity?

10          A   The infusion is labeled a loan.  But for all  
11   practical purposes of risks the company faces as a  
12   result of putting that money in are essentially the same  
13   as if it was called equity or a loan.  The money came  
14   from them.  The money is at risk, and it is not unusual,  
15   as I think I have tried to emphasize in my rebuttal  
16   testimony, for child corporations -- Olympic may take  
17   exception to that -- but child corporations like Olympic  
18   to have funds put into them as debt or equity.

19                 You will also see 100 percent equity child  
20   corporations, a function of how the parents choose to  
21   infuse capital.  But if they put it in as debt or  
22   equity, it really doesn't matter.

23          Q   Well, that really is the statement of yours  
24   that I want to pursue, that it doesn't matter.  And I  
25   want to look it at it from different angles.  Supposing

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1     you have a company, and this is a hypothetical, who's  
2     parents suck all the money out of that company. And so  
3     there is no equity in the company, and any money or  
4     profit that the company might have, the company no  
5     longer has its parents, and so therefore there is no  
6     equity in the company.

7             Well, supposing that the company mismanages  
8     itself, and there simply is no money within the company  
9     as equity to cushion that mismanagement. Isn't the  
10    implication in such a hypothetical that the rate payers  
11    then need to pick that up, or the owners have to do  
12    something about it by itself, but that the company  
13    itself has no ability to cushion that mismanagement or  
14    mistake, or accident. It doesn't -- this gets back  
15    to my question of, does it matter? Just not for the  
16    cost of capital, but just for the healthy condition of  
17    a company that it has equity versus no equity.

18            A    No, it really doesn't. Maybe I could  
19    illustrate that, if I might, by asking you to take a  
20    look at my exhibit that's labeled GLS 9. I don't know.  
21    I do not know the number. I apologize.

22                    JUDGE WALLIS: Exhibit 206.

23                    THE WITNESS: What I have shown -- is everybody  
24    there? What I have shown on Exhibit 206 is there are  
25    other pipeline companies that are -- even of these

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1 companies that are children of integrated oil companies.  
2 And I think -- I don't know if BP is the parent of  
3 any one of these or not as I sit here, but they may be.

4 As you notice, these pipelines had a debt share  
5 running from 92 to 99 and a half percent in the last  
6 couple of years. And the question is, does that signify  
7 that they are in trouble.

8 And if you go over to the next column and look  
9 at the ratios of revenues to operating expense, their  
10 revenues and rates and through-puts are perfectly  
11 adequate, and they are very healthy companies. Explorer  
12 and Colonial are two very, very healthy companies.

13 Q BY CHAIRWOMAN SHOWALTER: Of those five there,  
14 other than Olympic Pipeline, is it the case in any of  
15 the other four that the owners are less than, say, 80  
16 percent of the customer shippers? What I am trying to  
17 get at is to carve away the instances where the company  
18 is wholly and fully owned by its customers collectively,  
19 versus the Olympic situation where it is owned by two of  
20 the shippers, but not by the others.

21 A As I recall, the ownership is not spread across  
22 all the shippers in any of these cases. The owners  
23 happen to be very large oil companies. Being very large  
24 oil companies they ship substantial amounts of product  
25 on these pipelines. But I would say that at most, they

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1 don't ship -- some of them may ship as collectively as  
2 owners, but Explorer has seven owners, and Colonial has  
3 nine.

4 Q If you would just pick for me the company there  
5 whose owners comprise the lowest percentage of its  
6 shippers.

7 A Plantation.

8 Q Let's supposing the management at Plantation --  
9 turns out to be terrible, mismanages the company, the  
10 money is gone. Now something happens to Plantation,  
11 maybe it is an explosion, some kind of disaster that  
12 Plantation has to deal with.

13 At that point in time does it make a  
14 difference, do you think, that there is no equity in the  
15 company, or very little compared to a company that had  
16 equity?

17 A No, because the boards of these companies are  
18 the integrated oil companies, owners and shippers. And  
19 they meet whenever a crisis arises, or need for  
20 expansion, or rebuilding arises. They meet and either  
21 loan money or inject money.

22 Q So is the implication that really whatever the  
23 poorest status of the company has been, that the owners  
24 really are there to pick up the pieces when something  
25 goes wrong and we need not worry?

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1           A    That is exactly right.

2           Q    Then why are we worried in this case?

3           A    Our position has been all along that Olympic's  
4    capital structure isn't relevant.  You have to go for a  
5    hypothetical capital structure, because it's a company  
6    that doesn't issue its own debt.  It has to be  
7    guaranteed, and it has no publicly held stock so you  
8    can't really assign a capital structure based on that.

9                    And I think what this Commission has done in  
10   cases where a company wasn't a stand-alone company, but  
11   they believed because it was engaged in a bunch of  
12   different activities unrelated to the regulatory  
13   activities, they imposed a hypothetical capital  
14   structure that they believe to be appropriate.

15                   So the only issue here is what -- to me, in my  
16   case, what is the appropriate hypothetical capital  
17   structure?  Is it 45 to 50 percent, as I think Tosco and  
18   Tesoro have suggested?  Is it much higher as I have  
19   suggested, or is it somewhere in between?  Its own  
20   capital structure doesn't matter.

21                   I think the analogy to think about is the  
22   parent child kind of relationship.  Suppose you had a  
23   teenage son who wanted to buy a car.  And he has a job,  
24   and is making money.  He could actually make the  
25   payments.  It's an older car.  So he goes to the bank,

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1 and the bank said, yeah, you have income. You have no  
2 credit record. You have nothing to look to say you have  
3 a good credit rating. You will have to get your parents  
4 to co-sign, and the parents will quite often co-sign.

5 But the expectation of both the bank loan to  
6 the teenager and the parents is that the teenager will  
7 keep his job and make the payments.

8 Q Supposing the teenage son is 21, let's say, and  
9 gets the car and gets the parents to co-sign the loan,  
10 and then crashes the car, totals it, and kills two  
11 people, three people. Now does it make a difference  
12 who's backing the son's activities, and to what extent  
13 and for what purposes?

14 A It's important, I guess -- the only thing that  
15 was co-signed -- well, let's suppose --

16 Q Just the car loan?

17 A The parents would be liable for that  
18 independently as the -- as the owners of Olympic are  
19 liable for all the loans that have been taken. These  
20 have been guaranteed by the parents and made by others,  
21 in the case of Chase and Prudential, or made directly.

22 Clearly they are guaranteeing the loan if they  
23 are making it, because if it doesn't get paid, their  
24 company doesn't have adequate money. They don't get it.  
25 In the current case, they are getting no interest

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1 payments on these loans.

2           So in terms of its earnings treatment, it's  
3 being treated no different than equity. It's money they  
4 have put in, which they are earning no returns on  
5 because the company doesn't have the profits to repay it  
6 the money, and it's at risk.

7           Q I am trying to explore that not only the money  
8 issues and the risk to money, in one form or another,  
9 but also the other risk to rate payers of the public of  
10 a company that doesn't have equity in it. In other  
11 words, aren't there other factors to consider when  
12 looking at a company and trying to, say, cajole it  
13 towards a reasonable equity ratio than simply the factor  
14 of money, and what is at risk for a particular loan or a  
15 particular parent?

16           A The guarantor here, or guarantors here -- or  
17 will be shortly because Shell is taking over Equilon, so  
18 it will be Shell and BP within a short period of time.  
19 You will have two owners. You will have the Shell  
20 Corporation and you will have British Petroleum. These  
21 are the two parties who are, in fact, standing,  
22 affirming that they, in fact, will want to and will make  
23 this pipeline work, have put money into it -- I think  
24 are saying to this Commission that we want a reasonable  
25 return on our investment, but we're here. We have been

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1 here. We're going to be here.

2 And what you are getting is the backing of two  
3 of the largest corporations in the world, who have  
4 incredibly solid balance sheets. And I think you have a  
5 better guarantee here, given that backing, than you have  
6 from any other utility you regulate in this state. I  
7 don't think any other utility in this state approaches  
8 the size or the financial strength of BP and Shell.

9 Q But I want to follow up a little bit, on a sort  
10 of incidental quality of the equity ratio of the  
11 parents. I think Mr. Brena asked you questions, or  
12 Mr. Trotter, maybe, as to what would happen if, let's,  
13 say, Shell -- I don't know what their equity ratio is  
14 but supposing it's 20 percent, 30 percent -- why should  
15 the assumed capital structure rise up and down with  
16 whoever the parent happens to be, or whatever their  
17 equity ratio happens to be when the activity that is  
18 going on, of course, is the same, and in general the  
19 costs are going to be the same. I recognize some costs  
20 might be different depending on who the parents are.  
21 But if there was a radically different equity ratio for  
22 one parent versus another, from one year to the other,  
23 why should there be a radical or significant change in  
24 the rate that the rate payers pay?

25 A I think that there shouldn't be. And I think



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1 the Commission, the company is asking for you to assign  
2 a hypothetical capital structure which would be fixed  
3 once you have assigned it.

4 Q But then that's all the more pressing.  
5 Supposing we set it at 86 percent, or whatever you have  
6 recommended. And as we have seen, this company changes  
7 hands or might. So then along comes a new set of  
8 parents, and maybe their equity ratio is 50 percent.

9 A I based my recommendation on what I see is FERC  
10 precedent. FERC's first choice is to look to the  
11 capital structure of the parent. There's a number of  
12 cases that have been through this. The argument that  
13 says they are ultimately the companies that are --  
14 ultimately the companies that are providing the capital  
15 to the company, and their capital structures are really  
16 reflective of the cost of capital to that company.

17 Q So that's FERC's rationale for what it does?

18 A That is.

19 Q I am interested in what the FERC methodology  
20 is, and I am interested in why FERC has its methodology.  
21 But my greatest interest is why it is right, why it is  
22 correct. Meaning, why should we adopt it, so on. That  
23 is a much stronger interest of mine. It's not much of  
24 an answer to say that's how FERC does it. That's just  
25 the question of whether they should do it, but more

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1       importantly, whether we should do it.

2           A    I have a premise and maybe I can state it, and  
3       if you don't agree with me, maybe I can explain it.  The  
4       premise is if you are a publicly traded company, and  
5       that stand-alone publicly traded company, in fact, the  
6       market tends to dictate or tends to determine your  
7       capital structure, the lenders and other people in the  
8       financial community tend to push you in a certain  
9       direction, as the market pushes you.  Is that a premise  
10      that sounds reasonable?

11          Q    That's okay.

12          A    Now, the only -- in the oil pipeline industry  
13      there are five, what I call, stand-alone -- not exactly  
14      pure play.  I think close to pure play.  I think  
15      somebody else's view is less than pure play.  But they  
16      are viewed by the financial groups and other people who  
17      look at these things as oil pipeline companies.  They do  
18      other things, but they are primarily oil pipeline  
19      companies.  And their capital structures are market  
20      determined, and they range from 40 to 60 percent.

21                  Now, if you argue that -- if you believe that  
22      Olympic is no riskier than any of those pipeline  
23      companies, in fact, if you at the end of the day, which  
24      I think is not the correct conclusion, were to determine  
25      that, in fact, it was a typical -- what we're dealing

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1 with here is a typical oil pipeline company, like those  
2 in the proxy group, something in that range, if you  
3 would -- I am going to have to ask for a number again.  
4 Turn to Exhibit GRS 23. I don't have the right numbers  
5 as usual.

6 JUDGE WALLIS: Exhibit 220.

7 THE WITNESS: What I have done -- is everybody  
8 at 220?

9 What I have done is to look at the equity share  
10 of capital for the five oil pipeline proxy group  
11 companies over the period 1996 to 2001. The average  
12 over that six-year period over the five companies is  
13 49.28 percent. So it's in the vicinity of a 50 percent  
14 equity ratio. The average -- the average overall six  
15 years of the high end of that range is 61.35 percent.

16 So the riskiest pipelines in that group, the  
17 ones that are required to have the highest equity share  
18 in their capital structure, average about 61 percent,  
19 61.35 percent.

20 So if you believe that Olympic's risk -- I  
21 believe Olympic's risk is at minimum as high as any of  
22 these pipeline companies. That's my minimum position.  
23 And that would argue for, on the basis table,  
24 essentially a 60 percent equity share, or 61.35, if you  
25 want to play the averages game.

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1 Q BY CHAIRWOMAN SHOWALTER: But all of that is  
2 given the underlying assumed validity of assigning these  
3 pipelines this kind of equity ratio in the first place?

4 A You have to assume that since these are in the  
5 market, that FERC relies on the -- FERC relies on these  
6 companies as the basis for setting equity rates -- for  
7 setting the return on equity. It looks to these  
8 companies as to define the normal range of equity shares  
9 for these companies, and its market data. I can't offer  
10 you -- that's my -- that's market data.

11 Q I see. I don't think I understood that these  
12 are actual -- these are actual equity shares?

13 A Shares. These aren't -- these are market  
14 determined shares, and they are -- the average, if you  
15 look at it, is in the high 40s consistently. It's one,  
16 two, three, four, five lines. On the bottom go across  
17 that, and it's 47, 50, 49, 51. It's right around 50  
18 percent on a consistent basis.

19 Q Assume for purposes of argument that the  
20 average is exactly 50 percent. I am just trying to pick  
21 a round number. Your point is that Olympic is a riskier  
22 company?

23 A Than average.

24 Q Than average. I want to explore a little bit  
25 the implications of the discussion around risks, and I

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1 am going to ask three preliminary questions just to make  
2 sure that I understand in general what you were saying.

3 Were you saying or do you agree that all other  
4 things being equal, more competition for a company  
5 means -- implies that that company is a riskier company?

6 A Yes. I think that is broadly accepted, a  
7 notion that the more competition a company faces the  
8 more business risk the company faces. And then  
9 as a result, the higher its cost of equity.

10 Q Actually that's where I am going, so I just  
11 wanted the first part. So the second proposition was  
12 the greater the risk, the higher the cost of capital; is  
13 that correct?

14 A That's correct. Because think of it this way.  
15 If you are an investor, and you are told that you have  
16 a company with a very low business risk that will pay 10  
17 percent return, and you have a company that says we're a  
18 very high risk but we don't want to give you any more  
19 than 10. So the investors say, well, if a low risk is  
20 paying 10 percent, you as a high risk company have to  
21 pay more. It's common sense

22 Q The third question is, is it the case that the  
23 higher the cost of capital, the higher the resulting  
24 rates in a regulated company? Is that the right  
25 direction?

1           A    The higher the cost of capital from a  
2 regulatory perspective -- one of the reasons, if you  
3 take a look at the cost of equity capital calculated by  
4 the FERC staff, as well as other people -- the FERC has  
5 spent a lot of time on this on defining this proxy group  
6 and examining it, weighing it, and so forth. And it is  
7 a fact that the cost of equity capital for oil  
8 pipelines, which are perceived to be higher risk than  
9 gas pipelines, has been consistently higher.

10                The cost of capital to an oil pipeline is  
11 higher than a gas pipeline, and also higher than an  
12 electric utility or gas distribution company. Because  
13 it faces more competition, and is perceived as riskier  
14 in the marketplace.

15           Q    So what I got from that is these three  
16 propositions are true. The more competition the greater  
17 the risk; the greater the risk, the higher the cost of  
18 the capital; the higher the cost of capital, the higher  
19 the rates. And I really would just like a yes or no.

20           A    That's yes.

21           Q    Using the transitive property, doesn't that  
22 mean, by your logic, that the more competition there is,  
23 the higher the rates that you need to support the  
24 company?

25           A    Yes. To satisfy or to basically provide the

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1 equity investors with the appropriate reward for their  
2 investment.

3 Q So what I am interested in exploring, then, is  
4 the implication of that proposition. Because it means  
5 that the more competition you have, the higher your  
6 rates have to go; therefore, you will become less  
7 competitive. And it seems like either an upward spiral  
8 on rates putting the company beyond competition, or  
9 there is effective competition, and you don't need  
10 rates. Or the regulated -- or such a high rate is  
11 from -- is for a company that really doesn't need to  
12 exist --

13 A Well --

14 Q -- in the marketplace.

15 A If there's sufficient competition, if there  
16 really is sufficient competition that this competition,  
17 in fact, ensures that rates can't rise above competitive  
18 levels, then there's no need for regulation. But that's  
19 not what we're visiting here.

20 Q But I guess it's really right at that point  
21 that I am trying to explore, because if there were  
22 really effective competition, you wouldn't need to have  
23 a regulated company. The company could just exist and  
24 compete, and if its prices were higher and above the  
25 competitive levels, it just wouldn't get any business.

1           But isn't all of the evidence we have of this  
2 company is that under ordinary circumstances, it's quite  
3 competitive; in fact, don't we regulate it because if we  
4 didn't, it might have too much ability to control the  
5 market? And if not, why are we regulating it?

6           A    I am not here -- well, if in fact the market  
7 were sufficient to discipline rates, there's no need to  
8 regulate. And we haven't sort of -- we haven't -- I am  
9 not arguing that's a matter for this case, and we  
10 certainly haven't offered evidence of the sort. I think  
11 you would need to reach that determination.

12           But the fact is -- there's -- the fact that  
13 there is competition, whether it is enough so that you  
14 don't have to worry about the exercise of market power  
15 or not. There simply is more competition here than  
16 there is in the other -- in any other industries to  
17 regulate. Now the quid pro quo -- now that means higher  
18 risk, higher competition, higher cost of the equity.

19           But the market -- the competition raises the  
20 cost of equity, because of the risk. But it also  
21 disciplines the market in the form of promoting greater  
22 efficiency. And the trade-off you have between  
23 regulating rates, and allowing the market to function --  
24 you have more competition in this market.

25           So even if it is not sufficient to fully



1 discipline the rates, it does, in fact, work its magic  
2 in terms of promoting greater and greater efficiencies.  
3 And the irony is that a lot of very high risk, high cost  
4 of capital companies have, in fact, much lower overall  
5 costs. Because the same competition that made the  
6 investment risky, has made them very efficient.

7           And that's -- it's the old invisible hand of  
8 Adam Smith at work, if you will. And I think this is --  
9 the collapse of the Soviet Union is an example that the  
10 invisible hand is better than the visible one at times.  
11 And I think the Soviets demonstrated that -- I am going  
12 too far afield.

13           Q I have one last follow-up, and if you could  
14 turn to Exhibit 221, your direct testimony, page 54.  
15 And on lines 988 to 991 you made the statement which you  
16 just made earlier, which was your premise that you put  
17 to me, where you say, "It is reasonable to presume that  
18 Olympic's parents' actual capital structures are the  
19 ones which result in the lowest overall cost of  
20 capital."

21           And I understand that proposition with respect  
22 to your exhibit that shows the stand-alone companies. I  
23 don't really understand that proposition when you have a  
24 parent company that may be engaged in many activities of  
25 various risks, and one very small part of what it does

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1 happens to be a pipeline, or this particular pipeline.  
2 This doesn't follow logically to me, this theory.

3 A Well, I guess I apologize for not making it  
4 clear when I wrote it. What I meant is these are the  
5 best structures for BP and Shell. In other words, the  
6 market has pushed them, Shell and BP, to their optimum  
7 capital structures, market determined. It doesn't  
8 suggest -- that argument only suggests that. It doesn't  
9 take the next step of arguing that what is optimum  
10 necessarily for BP and Shell is also optimum for  
11 Olympic.

12 Q Okay. Well, then I am tracking. But in that  
13 case, if that's the case, why should we look to the  
14 equity structure of the parents in determining the  
15 appropriate structure for the Olympic?

16 A Ultimately they are the entities that are --  
17 that arrange the finance -- ultimately they are the  
18 entities that, in fact, raise capital for the company.  
19 And they raise it based on that capital structure. The  
20 first comment here is saying, and we can presume,  
21 because these are publicly traded companies, BP and  
22 Shell, that the market has forced them to, in fact,  
23 select the appropriate or optimum or best capital  
24 structure for themselves.

25 The Commission -- and I am arguing it's

1 appropriate for Olympic, because of that, because they  
2 are the source of capital, and because Olympic is  
3 certainly above average risk.

4 In my rebuttal testimony I offered, I think,  
5 what I would consider to be two reasonable alternatives  
6 for the Commission's consideration. One, I think at  
7 minimum, I think at minimum the company has put up  
8 evidence that says that Olympic is at least a risky oil  
9 pipeline. And that would suggest a capital structure in  
10 the neighborhood of 60 percent. And that's sort of the  
11 upper end of the range for the proxy group oil pipeline  
12 companies.

13 I also offered another example of what is a  
14 high risk pipeline. It's called HOOPS, it's Hoover  
15 Offshore something or other, and I can't get the rest of  
16 it straight. H-O-O-P-S is the acronym. And it filed a  
17 rate, and the rate was protested at FERC, and there was  
18 a settlement between the parties, which was approved by  
19 the FERC.

20 And this settlement called for a 74 percent  
21 equity share. And interestingly enough, it was the  
22 average of 60 percent, which is the upper end of the  
23 range of what you observe for the oil pipeline proxy  
24 group, and the equity share of the parent, in that case  
25 Exxon Mobile that has roughly 80 percent. So the

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1 average of 80 percent and 60 percent is 74, and that was  
2 a compromise they arrived at in negotiation among  
3 shippers and pipeline.

4 And FERC approved, presumably, because they  
5 believed that, in fact, this pipeline was riskier than  
6 average, and that was a reasonable compromise between  
7 the capital structure of the parent and the capital  
8 structure of the riskier or more conventional pipeline  
9 in the oil pipeline proxy group.

10 I've offered the same compromise here of 73  
11 percent as a compromise which is, in fact, the mid point  
12 between 60 percent, which is the upper end of the range  
13 for the oil pipeline proxy group equity shares, and 86  
14 percent, which is essentially the weighted average  
15 capital shares of the parents.

16 I think that we have -- I think the company,  
17 not just me, but I think all the other companies have  
18 established that this is a high risk oil pipeline, and I  
19 think that says that the reasonable range is 60 to 86  
20 percent.

21 Q But aren't you comparing two ranges or two  
22 figures, 60 percent and 86 percent, the higher of which  
23 already presumes the FERC methodology? And what I am  
24 here to learn about is whether that methodology makes  
25 sense, and is in the public interest. I am not here to

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1 take it as a given. That's what we're having a  
2 proceeding about. So it doesn't persuade me very much  
3 to hear of a compromise between one thing and another.  
4 The other being something that we're now deliberating.  
5 We have got to focus on the theory of that other, and  
6 why it is in the public interest.

7 CHAIRWOMAN SHOWALTER: And that was a comment  
8 not a question. I am finished with my questions.

9 THE WITNESS: Okay. Thank you.

10

11 EXAMINATION

12

13 BY COMMISSIONER HEMSTAD:

14 Q This really is first pursuing the Chair's  
15 questions. When you at least started with the  
16 proposition that the equity share should be analyzed,  
17 looking at the equity share of the parent, I assume  
18 that's not just coincidence. You are looking at the  
19 profile of British Petroleum as such, aren't you?

20 A The 86 percent is, in fact, representative of  
21 the risk faced by the parents, and therefore, the  
22 appropriate market determined rate. I would agree with  
23 that, sir.

24 Q All right. Let's assume that instead of the  
25 parent being BP with all of its many bucks, Microsoft

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1 decides to buy this pipeline. It has 100 percent  
2 equity. And has no debt, and has, what is it, 45  
3 billion dollars of cash. Would you then be arguing that  
4 we should look at 100 percent equity for the pipeline?

5 A No, I think not. I think it's appropriate to  
6 look to parents -- to the capital structure of parents  
7 that are integrated oil companies, because in a sense  
8 the risks that the parent oil companies face are in some  
9 sense reflected or are trickled down, if you will, to  
10 the risks that a pipeline faces in this case.

11 Say if BP, Equilon, or Shell Refineries were  
12 to, in fact, have an outage or problem or whatever, and  
13 produce less refined product, the -- whatever risk  
14 caused that would amount to a through-put reduction on  
15 the pipeline.

16 So in some sense the volatility of the  
17 through-put of a pipeline, its risk sets are not only  
18 its own risks, but are tied back to the risks of the  
19 parents, because the parents are, you know -- the  
20 parents' business is what produces what gets  
21 transported.

22 Here, the extent that there's risk to that  
23 output, there's risk to the through-put of the pipeline,  
24 so there is linkage.

25 Q Okay. That's helpful. So you are looking to

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1 the integrated nature of the pipeline to the refinery  
2 company?

3 A Yes. They aren't in the same business, but  
4 they are essentially in related businesses, or are  
5 integrated, if you will.

6 Q In Mr. Trotter's cross examination questions, I  
7 think, you brought out that both the parent and the  
8 proxy stand-alone companies have betas that are less  
9 than one?

10 A That's correct.

11 Q And you agreed with that?

12 A That's correct.

13 Q That would suggest a risk level below average,  
14 of the parent and those proxies, does it not?

15 A That statistic suggests that there are -- there  
16 is a problem with estimated betas of late, and I could  
17 expound if you are interested. But the bottom line is  
18 currently estimated betas underestimate a true beta  
19 substantially.

20 Q Well, I find that interesting, because I think  
21 you argue, and I think I generally agree with you, that  
22 the market determines these things. And the market is  
23 determining the betas, is it not?

24 A The market is determining the price and return  
25 on stock. That the betas are the result of a

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1 statistical calculation, and may or may not be accurate  
2 measures of the true risk faced by the companies. And I  
3 think there's a reason why, today at least, that  
4 companies, both like the integrated oil companies and  
5 the pipeline, betas are underestimated by the standard  
6 statistical techniques used to estimate them.

7 Q Beta measures volatility, which is, in a sense,  
8 the measurement of risk, is it not?

9 A It is. It measures the volatility of the  
10 earnings of the company relative to the average -- to  
11 the volatility of the market, or the average volatility  
12 of everybody in the market.

13 What has happened in the last five years, which  
14 is usually the period of time over which these betas are  
15 estimated, is you have the .com explosion upward, and  
16 the .com implosion downward.

17 So if you weren't a high-tech .com company,  
18 your returns did neither soar up nor plummet into the  
19 basement. And the fact that your returns, in fact, were  
20 not anywhere near as volatile as the .com driven market  
21 means that your estimated beta is depressed.

22 I would argue the last five years is an  
23 aberration in terms of the normal relationship of  
24 things, and I think if you look back to pre .com bubble  
25 periods, the betas for the oil companies are well above



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1 one or one or above, certainly. And these stand-alone  
2 proxy group companies have not been around long enough  
3 prior to the start of this thing to establish a, quote,  
4 normal market relationship between their earnings and  
5 the market.

6 Q Well, okay. But in any event, however one  
7 wants to analyze beta, the parent has a beta here, and  
8 you are using the equity share of the parent to  
9 determine -- or at least as your starting point for  
10 which would be the equity share for the subsidiary. And  
11 why do you choose that, but then argue that it's above  
12 risk when the parents are below risk -- below average  
13 risk?

14 A Well, I guess what I'm arguing is the beta is  
15 probably not, at this point in time, a good measure of  
16 risk. But if you believe the values of beta, both that  
17 are currently estimated, you are correct that both the  
18 oil industry and the oil pipeline industry are below  
19 average. However, both are below average and fairly  
20 close together.

21 Q Well, I guess whether you think it's accurate  
22 or not, there is a position in the marketplace that  
23 evaluates risk for integrated oil companies and  
24 pipelines?

25 A Yes. The people who publish these betas are

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1 the -- the published betas by the standard services are  
2 less than one. And if one were to rely on them for an  
3 assessment of beta, one -- for assessment of risk, one  
4 would conclude that the risks are below average, and  
5 that's what the statistics say. I think I have given  
6 reasons why I think the statistics are misleading.

7 Q I am trying to understand your position with  
8 regard to the significance of water-borne barge  
9 competition, or the risk. And I think your testimony in  
10 your FERC filing reflects a substantial increase in  
11 barge traffic explosion.

12 And I am still trying to grasp why that is in  
13 any way significant, as long as the pipeline with its  
14 pricing structure is able to operate essentially at full  
15 capacity, whatever that capacity may be at any time.

16 A Let me try to back up a bit on this. I think  
17 that what I have argued in there is that barges are in  
18 some sense poised to move in and make these moves, and  
19 are capable of making them. I think what the aftermath  
20 of the accident, and then the seam weld failures which  
21 kept operating operation pressure at no more than 80  
22 percent have demonstrated, is one the rapidity with  
23 which barges and tankers can respond to an increase in  
24 demand. Given the opportunity, they can, in fact,  
25 increase their -- the amount that they transport

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1 dramatically.

2 Q A demand for their services?

3 A Yeah. If the demand for their services  
4 increase, they can increase supply very rapidly. So  
5 they are there and available for competitors.

6 Q And in a certain sense, you can describe that  
7 as excess transportation supply, stand-by supply, ready  
8 to serve, if, for any reason, the pipeline can't?

9 A Or if the pipeline, as was suggested from the  
10 letter from Tosco, raises its rates to a level that is  
11 no longer competitive, they are ready to respond quickly  
12 and rapidly.

13 Q I was going to ask you that question. You  
14 started to say the Tosco letter shows, and then you got  
15 distracted in a different direction. Apparently that's  
16 what you argue that it shows?

17 A What I am arguing is that, you know, I think  
18 Tosco and Tesoro in this proceeding have argued they are  
19 not competitors. That's silly. They are just not  
20 competitors yet. In the letter that Tosco wrote to the  
21 Commission, We're concerned if we have to pay this high  
22 interim rate, that we will end up averting -- this will  
23 cause us to divert to another means of transport. And  
24 the other only other means of transport that is viable  
25 is water-borne. We have two choices. So other is

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1 water, I think.

2           So it's there. And I think it's more real than  
3 either Tosco or Tesoro have admitted in this proceeding,  
4 even though they did in their argument against granting  
5 the interim rate increase. Otherwise, the second thing  
6 I think that is shown is that -- my analysis showed that  
7 they can increase supply without increasing the average  
8 cost per barrel transport. In other words, not only is  
9 there a lot, there's a lot there at the current price.

10           What it does show that at the rates that  
11 prevailed then, a pre-increase, at least that Olympic  
12 was competitive, because the rates were probably lower.  
13 I think I have admitted that in my testimony. They are  
14 lower.

15           But a major -- if you look to merger  
16 guidelines, which the Federal Trade Commission and  
17 Federal Justice Department guidelines on how you gauge  
18 competition, they view as a critical factor in  
19 determining whether a market is competitive is whether  
20 or not there are people poised to enter if the company  
21 engages in anti-competitive practices; i.e., raises  
22 prices to above competitive levels. And they are there.  
23 They are there in large quantity, and they are there at  
24 the going barge rate.

25           So it's not -- I think they are real

1 competitive. They are a real competitive threat.

2 Q And let me ask you, then, in your professional  
3 judgment, is it your opinion that oil pipelines  
4 generally, or Olympic Pipeline specifically, should be  
5 price deregulated by this Commission?

6 A Let me answer it by something the FERC has  
7 said. I haven't done the kind of -- I haven't done the  
8 kind of analysis I want to do to make that  
9 recommendation. And I think there's a good chance if I  
10 did that, I might reach that conclusion.

11 Q But aren't you forced to that conclusion with  
12 your argument about water-borne threat of competition?

13 A It's a matter of degree. I mean, the question  
14 is competition isn't an on-off switch. Every company,  
15 even utilities face competition at some level. Olympic  
16 faces a high degree of competition. I think that  
17 water-borne transportation alone should be sufficient  
18 for at least the Federal Energy Regulatory Commission to  
19 grant it market-based rates, if it were to apply. They  
20 haven't, and I have no notion that they are intending  
21 to.

22 And the reason was -- and I can't remember the  
23 cite now, but I can get it for you, if you wish -- that  
24 the Commission at one point decided that if 10 percent  
25 of the market is served by water, that by itself was, in

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1 essence, grounds for presuming that the market was  
2 sufficiently competitive to allow market-based rates;  
3 i.e., they need not worry about market-based rates at  
4 all.

5 Q Let's assume 10 percent of the market is served  
6 by water-borne transportation. The pipeline is  
7 operating at capacity, and the 10 percent represents  
8 that refinery production that can't get access to the  
9 pipeline. Assume further that the cost of the  
10 water-borne transportation is twice the price as the  
11 pipeline is.

12 It's still your view that that would be a  
13 competitive environment?

14 A That's one of my frustrations in this matter of  
15 not being able to get from Tesoro and Tosco the barge  
16 rate, the oil tanker rates. I could have answered that,  
17 and I have to answer that question before I give you a  
18 definitive answer.

19 Q I do find it remarkable that the parents of  
20 your client declined to provide that information.

21 A I am not sure whether -- I think -- I can't  
22 tell you the exact reasoning why the decision was made  
23 to go to the participants in this case, rather than  
24 nonparticipants.

25 It's my experience, usually, that the

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1 Commission's -- that nonparticipants -- and really the  
2 parents are not participants per se in this case --  
3 generally are not requested by the Commission.

4 Q I understand. But, of course, they have a  
5 direct interest in this proceeding, even though they are  
6 not a party here. And in a certain sense there's an  
7 inference that can be drawn from that that they didn't  
8 want to disclose it because it wouldn't be attractive  
9 information.

10 A Well, I think the same inference could be drawn  
11 from Tosco and Tesoro's failure to disclose. I don't  
12 know the reasoning, and I wasn't involved in the  
13 discussion or the decision to, in fact, seek it from  
14 Tesoro and Tosco or participants to this proceeding, and  
15 not from the parents who are not. I don't know why.

16 COMMISSIONER HEMSTAD: Thank you. That's all  
17 I have.

18 CHAIRWOMAN SHOWALTER: I have one follow-up on  
19 Commissioner Hemstad's question.

20

21 EXAMINATION

22

23 BY CHAIRWOMAN SHOWALTER:

24 Q It just adds one more element, supposing 10  
25 percent of the market is water-borne transportation,

2467

1 Olympic is at capacity, and Olympic is oversubscribed,  
2 do you think those three facts imply that there's  
3 effective competition from water-borne transport?

4 A It doesn't say they are not.

5 Q Well, does it say they are, that there is  
6 effective competition?

7 A It says neither. The fact that they are able  
8 to be full doesn't mean that there isn't competition.  
9 All you have to do to stay full is charge less than your  
10 competitors.

11 CHAIRWOMAN SHOWALTER: Thank you.

12 JUDGE WALLIS: Dr. Schink, I have a couple of  
13 very short lines of questions to follow up on Chairwoman  
14 Showalter's questions.

15

16 EXAMINATION

17

18 BY JUDGE WALLIS:

19 Q Did I hear you correctly in saying that BP and  
20 Shell are committed to supporting Olympic irrespective  
21 of the funds that are needed and the form of those  
22 funds?

23 A I think the company -- I mean, it's my belief  
24 that they are. I think the people who can make that  
25 commitment better than I -- I believe they are. I think



2468

1 the people who can make that commitment better than I  
2 are Mr. Batch and Mr. Fox, and others from the company.  
3 That's my belief, but I can't make a pledge.

4 Q Would your analysis of the relationship between  
5 debt and equity be affected if the companies were not --  
6 the parents were not so committed?

7 A Well, would you repeat that question? I am not  
8 sure I got it right.

9 Q That statement arose in your response to  
10 questions about the practical differences between debt  
11 and equity in Olympic's capital structure, and I am  
12 wondering if it were not correct that the support, the  
13 funding were essentially unconditional, would that  
14 affect your analysis?

15 A I think -- I think the parent -- well, there's  
16 two pieces here. I am having trouble trying to deal  
17 with it.

18 Their commitment -- I mean, their commitment, I  
19 think, is important from a regulatory and concerned  
20 point of view. I think their commitment is an  
21 indication that there need not be concern. I think  
22 their commitment is also indication that it may be  
23 appropriate to consider their equity structure as  
24 appropriate in this proceeding.

25 But I think the -- independent of whether you

2469

1 believe they are strongly or weakly committed -- I  
2 believe they are strongly committed -- but the method  
3 they choose to finance whether it be infusion of debt,  
4 infusion of equity doesn't reflect my judgment that, a,  
5 the capital structure of Olympic is not really --  
6 doesn't mean -- it just doesn't mean anything.

7           You do have to look to the capital -- to at  
8 least a financial integrity of the parents here, and the  
9 capital structure of the pipeline itself says nothing  
10 at all about the financial integrity of the company.

11           Q   In terms of practical difference between debt  
12 and equity, if a company with substantial equity makes a  
13 poor investment, which turns out to be worthless or  
14 virtually worthless, would it then not write that off,  
15 and would it have been able to do so by its equity  
16 position?

17           A   It could fund it that way. I am aware of  
18 pipelines other than Olympic that, in fact, have written  
19 off, if you will, things. And they wrote it off by --  
20 the writing off of something, in fact, that was no  
21 longer used or useful, had nothing to do with the equity  
22 structure.

23           The parents had wherewithal to do it, and could  
24 infuse it whenever capital was necessary to cover it.  
25 And the fact that there's equity actually inside Olympic

2470

1 or not doesn't matter. It's the company -- you look to  
2 the financial health of BP and Shell, you know, if --  
3 you know, there was major disaster and I think they  
4 stepped up to it. There was a major setback in terms of  
5 the seam failures, and they stepped up to it.

6 And these are very, very large increases in  
7 cost, as I think you will see as the other witnesses  
8 come up. I think they may have demonstrated their  
9 commitment as strong as you would get from any  
10 stand-alone company with an equity cushion. And they  
11 have a stronger equity cushion than any stand-alone  
12 company I would ever think of. BP and Shell certainly  
13 do.

14 Q In terms of the situation of Olympic's actual  
15 equity structure, would the fact that parents have  
16 chosen to fund investments through loans rather than  
17 equity, and declined to write them off, leaving the  
18 company with an equity -- with a capital structure  
19 larger than its assets, and the fact that loans are not  
20 written off, don't disappear, and continue to accrue  
21 interest have any affect on your analysis, or would you  
22 say merely that, as you have said, the status of the  
23 parent corporations render this factor irrelevant to the  
24 Commission's analysis?

25 A The stature of the parent company does that.

2471

1 And also the fact that the Olympic structure per se is  
2 in -- Olympic's capital structure is in no way factored  
3 into the Company's cost of service calculations. In  
4 other words, they could have 200 percent. They are not  
5 asking for it. They are not asking for the debt to be  
6 recovered.

7 They are asking for a cost of service based on  
8 the property and service, based on a capital structure  
9 that you will determine, based on a debt cost and an  
10 equity cost you will determine. And nowhere in there,  
11 nowhere in our request whatsoever do these loans enter.

12 And what BP and Shell ultimately determine to  
13 do with these loans, write them off, not write them off,  
14 has no effect whatsoever on this cost of service  
15 request. And I assure has no effect whatsoever  
16 ultimately on Olympic's financial health, because that's  
17 always been dependent on the financial health of its  
18 parents.

19 JUDGE WALLIS: Thanks very much, Dr. Schink.

20 COMMISSIONER HEMSTAD: I have one follow-on  
21 question.

22 EXAMINATION

23

24 BY COMMISSIONER HEMSTAD:

25 Q I assume you will agree that if Olympic were a

2472

1 stand-alone company, that it never would have gotten to  
2 the point of having 100 percent debt structure, would  
3 it?

4 A Not without going into Chapter 11, no.

5 Q The point is, it would not have been able to  
6 function as a stand-alone company with that kind of  
7 structure, or anything approaching that?

8 A If this were a stand-alone company, it would  
9 have gone bankrupt and been bought by somebody else.  
10 There's no other way it could survive. It's not a  
11 viable company by itself. It's a viable company,  
12 because of the support of its parents.

13 JUDGE WALLIS: Thank you very much. Let's be  
14 off the record for a moment for a scheduling discussion.

15 (Discussion off the record.)

16 JUDGE WALLIS: Back on the record, please.

17

18 RE CROSS EXAMINATION

19

20 BY MR. TROTTER:

21 Q Turn to page 234 of the homework assignment --  
22 page 2?

23 MR. MARSHALL: There is no page 2 to that  
24 exhibit. We tried to make that part of the exhibit.

25 MR. TROTTER: I believe the Chairwoman asked a

2473

1 question on page 2.

2 CHAIRWOMAN SHOWALTER: I did, but it's not an  
3 exhibit.

4 MR. MARSHALL: I tried to, but --

5 MR. TROTTER: Well, let me ask the question  
6 without referring to page 2.

7 MR. BRENA: If you would.

8 Q BY MR. TROTTER: In your analysis in Exhibit  
9 234, one of the figures you used was 42.6 million  
10 related to the cost of service and 100 percent debt and  
11 capital structure, and 5.26 cost of debt; is that  
12 correct?

13 A That's correct.

14 Q And does that 42.6 million include return on  
15 the rate base that Olympic is requesting in this case,  
16 some 92 million dollars?

17 A The calculation is based on the rate base as  
18 defined by Olympic, if that's your question.

19 Q Yes. So when you were asked by the Chair --  
20 and I don't have the question clearly in mind -- about  
21 what interest payments are reflected in your analysis,  
22 it would be true that debt associated with 92.6 million,  
23 or 92 plus million in plant is reflected, as well as the  
24 Prudential and Chase note payments?

25 A Well, the cost of service is calculated based

2474

1 on an assumed 100 percent debt capital structure, and an  
2 assumed 5.6 percent cost of debt, which gives you cost  
3 of service. And I deducted -- on this page we don't see  
4 the operating cost per Olympic's estimates, and a  
5 calculation based on like Olympic's 2001 form 6 --  
6 Olympic's 2001 form 6 filing of 1.6 million.

7 So you take the 42.6, subtract 33.4, subtract  
8 1.6, and you are left with, after doing operating  
9 expenses, and after paying Prudential and Chase, with  
10 7.6 million dollars.

11 Q But the 42.6 includes a return on 92.6 million  
12 dollars of debt, correct?

13 A Well, 96.2 million dollars of rate base, and  
14 it's assumed to be 100 percent debt financed. That's  
15 how you calculate the cost of the service, yes.

16 Q You were also asked a question -- or answered a  
17 question and said that Olympic's risk profile is similar  
18 to BP's, because if BP's refinery lost output, that  
19 might have an impact on the pipeline. Do you recall  
20 that?

21 A Yes.

22 Q If BP Refinery reduced output, that would  
23 permit Tesoro and Tosco to increase their use of the  
24 pipeline, wouldn't it?

25 A Yes. If only one of the refineries went

2475

1 down -- and I think if you lost BP entirely you might  
2 not be able to fill the pipeline up anymore. But you  
3 are right in principle.

4 MR. TROTTER: Nothing further. Thank you.

5 JUDGE WALLIS: Mr. Finklea.

6 MR. FINKLEA: I have one set of questions.

7

8

RE CROSS EXAMINATION

9

10 BY MR. FINKLEA:

11 Q Dr. Schink, is there any evidence that you have  
12 seen that since Olympic's 62 percent increase of its  
13 interstate rates, and 24 percent increase in its  
14 intrastate rates, that there has been any price  
15 elasticity response resulting in a decrease in the  
16 through-put on Olympic's system?

17 A Can I do this in parts? The through-put hasn't  
18 declined. The through-put, it is full. And as full as  
19 it can get at the 80 percent operating pressure.

20 This, however, doesn't suggest that certain  
21 shippers haven't elected to use barges or tankers  
22 instead of Olympic, but they haven't lost enough  
23 business yet to, in fact, mean that they can't fill it  
24 up at 80 percent operating pressure.

25 That doesn't mean there hasn't been any shift



2476

1 from Olympic to barges or tankers. It means the shift  
2 hasn't been big enough to not to -- I mean, it's less  
3 than full at 80 percent operating pressure. It might be  
4 less than full at 100 percent. We don't know.

5 Q But at today's operating pressure, since the  
6 price increases, there has been, from your analysis, no  
7 measurable decrease in the demand placed on Olympic's  
8 pipeline that Olympic is capable of meeting today; is  
9 that correct?

10 A I don't know what has happened to demand. I  
11 can measure through-put. Through-put is the demand for  
12 its services are still sufficient after the increase to  
13 keep it full at 80 percent operating pressure.

14 MR. FINKLEA: No further questions.

15 MR. BRENA: I may have misrepresented myself.  
16 I do have one question.

17

18 RE CROSS EXAMINATION

19

20 BY MR. BRENA:

21 Q Are we here to set cost base rates, Mr. Schink?

22 A That's my understanding, sir.

23 JUDGE WALLIS: Mr. Marshall.

24 MR. MARSHALL: Thank you.

25

## REDIRECT EXAMINATION

1

2

3

BY MR. MARSHALL:

4

5

6

7

Q BY MR. MARSHALL: In the homework assignment that Mr. Brena gave you when he gave you 5.62 percent cost of debt, is that the parents' cost of the debt that he gave you?

8

9

A That is the embedded cost of debt for Olympic's parents.

10

11

12

13

Q So when you used the approach of the FERC that relies on the capital structure of the parents of the wholly owned oil pipeline, this was your choice to use the cost of the parents' debt in the capital structure?

14

15

A But with our capital structure, not with 100 percent debt.

16

17

18

Q But the two go hand-in-hand; is that correct?

A If BP had 100 percent debt, its debt cost would be much higher than 5.62 percent.

19

20

21

Q And what do other witnesses in this case assume for cost of debt, if you don't rely on the parents' cost of debt?

22

23

24

A I think Mr. Wilson assumed 7 percent, and Mr. Hanley assumed something a little bit -- or something in the neighborhood of 7 percent is fair.

25

Q Do you know why Mr. Brena gave you the 5.62

2478

1 cost of debt?

2 A I think he instructed me to use the cost of  
3 debt that we had in their filing. Is that accurate?

4 MR. BRENA: I object to asking the question why  
5 Mr. Brena did anything. I think Mr. Brena has a  
6 difficult time with that question on occasion. I don't  
7 think it's real helpful to have him speculate.

8 JUDGE WALLIS: Isn't the question why the  
9 witness used that?

10 MR. MARSHALL: The witness was instructed to  
11 use that, and I am trying to explore what the  
12 implications of that are.

13 Q BY MR. MARSHALL: And under the FERC approach  
14 that you have used, it would be appropriate if you used  
15 the capital structure of the parent company to use the  
16 debt rate for that debt part of the capital structure,  
17 correct?

18 A That's correct. Because the cost of debt to a  
19 corporation is affected by its capital structure.

20 Q And if you didn't use the FERC approach, your  
21 cost of debt that you would recommend, would that be  
22 different?

23 MR. BRENA: Your Honor, if I could object to  
24 the form of the question, and ask that it be rephrased  
25 as his approach. The question of whether or not it's

2479

1 consistent with a FERC approach is an issue to be  
2 discussed, and shouldn't be assumed in the question.

3 JUDGE WALLIS: Can the question be rephrased?

4 Q BY MR. MARSHALL: Let me go back and make sure  
5 we do that. Take a look at your direct testimony,  
6 221-T, page 51.

7 A Yes. Yes.

8 Q Do you see footnote 26?

9 A Yes, I do.

10 Q Now, what was your testimony in your direct  
11 case that the capital structure of the ultimate parents  
12 should be based on?

13 A It's based on Commission precedent -- or FERC,  
14 I am sorry -- FERC precedent, to keep the record  
15 straight. And the precedent that I was relying on  
16 are -- or the cases or decisions are listed in the  
17 footnote 26.

18 Q To the best of your ability, were you trying to  
19 apply the FERC approach to capital structure in your  
20 direct testimony filed on December 13, 2001?

21 A Yes, I was.

22 Q And is this something that you adopt as your  
23 testimony?

24 A Yes.

25 Q That recommendation?

2480

1           A    Yes, I would recommend that.  I think I have  
2   recommended -- it's my view at least that this  
3   Commission should consider the FERC approach in part,  
4   because the pipeline has been regulated under it since  
5   1985, part because the Commission has at least reviewed  
6   filings under it in the past.

7           And I think in reality, as I have tried to  
8   demonstrate in my rebuttal, that in fact, it isn't  
9   costing shippers more than they would pay under an  
10  alternative rate making approach if, in fact, the  
11  Commission worries about what it worries about of  
12  switching methodologies and compensating them for the  
13  switch.

14           And there's no benefit to rate percent of  
15  moving away from this methodology in terms of low rates  
16  if it's done as it should be.

17           Q    And your attempt to apply the FERC method to  
18  capital structure, what was your assumption with regard  
19  to the cost of debt in the capital structure that you  
20  came up with?  What do you believe you must follow using  
21  that FERC approach?

22           A    Well, the FERC has made it clear, I think --  
23  well, certainly in cases when it adopts the capital  
24  structure of the parent that it will also adopt the  
25  embedded cost of debt.

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1           And I think provided it keeps a capital  
2 structure that's reasonably similar to that of the  
3 parent, it may, in fact, not adjust the debt cost, in  
4 fact.

5           But in general the FERC looks in cases like  
6 Olympic to the embedded debt cost of the parents,  
7 because ultimately the parents are doing the borrowing,  
8 either directly or by guaranteeing the loans of a wholly  
9 owned company.

10          Q    But the assumptions that you were given last  
11 night in this homework assignment to assume 100 percent  
12 debt capital structure, at the same time assume a 5.62  
13 cost of debt, are the two consistent?

14          A    No, they are not.  If you had a much -- if  
15 you -- well, you couldn't get a loan if you had 100  
16 percent debt structure.  But the rate for a very highly  
17 leveraged company, a debt rate would be much higher than  
18 the debt rate for companies like BP or Shell.

19          Q    Now, when we refer to debt and equity in this  
20 situation, there is a different character of the debt  
21 that a parent loans or guarantees to the wholly owned  
22 subsidiary than there is to debt owed, say, by, Avista  
23 to a bank, a third-party bank?

24          A    Yes.  I think this goes back to my analogy of  
25 the parent guaranteeing the child's loan for a car.  In

1 essence, in every instance, as it turns out, the loans  
2 that have been made -- have been made to Olympic have  
3 either been guaranteed by its parents with a guarantee,  
4 in fact, the share of the guarantee is in fact an exact  
5 proportion for their ownership share, or in fact the  
6 loans have been made to the company directly by the  
7 parents.

8           So the debt here is debt effectively issued by  
9 the parents, and that's not the case for every other  
10 regulatory entity that you deal with. I looked through  
11 looking for something that looked like Olympic that was  
12 wholly owned by other companies that this Commission  
13 regulates, and I could not find any.

14           Q If a parent loans a child money or gives a  
15 child money and has an accident, is that capital at risk  
16 no matter what character you call it?

17           A Yes, just as loans by Olympic's parents are at  
18 risk if the revenue is not there to repay it.

19           Q When you have described the cash flow basis as  
20 the basis that lenders would look to in this situation  
21 as the key on whether to make future loans, or make  
22 future capital or other capital at risk infusions, what  
23 do you mean by cash flow in that sense?

24           A The analogy, again, to the child buying a car  
25 with a loan guarantee by the parents. The expectation

2483

1 of the bank making the loan and the expectation of the  
2 parents is that the child will be able to have  
3 sufficient revenues to both pay the interest on the loan  
4 and to, in fact, repay the principle on that loan.

5 The analogy here is that the lenders would loan  
6 directly to Olympic, would want it to have sufficient  
7 cash flow so that the expectation, a reasonable  
8 expectation would be that the Olympic could, in fact,  
9 pay the interest and repay the loan.

10 That expectation isn't present today. And it  
11 is, again, because of cash flow, because the through-put  
12 drop, because of cost increases. Olympic's cash flow is  
13 not sufficient to give potential lenders to Olympic the  
14 confidence they would need to make a loan, even with the  
15 parents' guarantee, which is my understanding to why the  
16 parents made the direct loans.

17 Q Taking a hypothetical one moment and assume a  
18 parent has given half loan and half gift to a child.  
19 The child has an accident, and the car is gone. The  
20 loan can't be repaid. The gift can't be restored, but  
21 yet there's a need to replace the car.

22 How does the child get any additional capital  
23 to do that?

24 A Goes back to the parents, just as Olympic has  
25 gone back to its parents.



1           Q    And what do they look to this time to determine  
2           whether to make a new loan, or a new capital at risk, or  
3           a new gift?

4           A    Well, as I understand, particularly the  
5           testimony of Mr. Fox, they are looking to a sufficient  
6           cash flow in the future so they can have -- a cash flow  
7           to Olympic so they can have a reasonable expectation of  
8           a reasonable return on the additional investment they  
9           are planning to make.

10                   And I think that's the expectation.  This is --  
11           corporations make decisions on whether to invest on  
12           something and whether or not that project will generate  
13           a sufficient return over its lifetime to make the  
14           investment reasonable.  And reasonable means you have a  
15           reasonable return on it.

16                   And they want to be able to look to Olympic on  
17           a going forward basis, not looking back, not doing  
18           retroactive rate making, but a going forward basis as  
19           being likely to generate the cash flow necessary to, in  
20           fact, give them a reasonable return on the investments,  
21           the very large investments they still have to make.

22           Q    You mentioned that you weren't asking for the  
23           debt to be recovered.  Assume that Olympic has 151  
24           million dollars of debt, but 92 million dollars in plant  
25           in service.  Is anything over the 92 million dollars of

2485

1 plant in service being requested here?

2 A Well, the 92 million has nothing to do with the  
3 debt of Olympic. It's, in fact, the value -- it's the  
4 value of its property and service. It's a rate base.  
5 It has nothing to do with any of the debt.

6 Q So when you say that Olympic is not asking for  
7 any of the debt to be recovered, what do you mean by  
8 that?

9 A Its request for cost of service is based on its  
10 rate base, on its operating costs, on a reasonable  
11 return and recovery on that rate base, which is based on  
12 capital structure, return on equity, and cost of debt.

13 Q Is there any case in Washington state that you  
14 know of where the character of the debt owed to wholly  
15 owned subsidiaries like that of Olympic compared to its  
16 parents?

17 MR. BRENA: Objection; I don't believe there  
18 was any cross examination on this point.

19 MR. MARSHALL: This goes to the whole question  
20 of how you characterize the debt, and what is a debt  
21 equity ratio. I think the characterization of debt  
22 here, because it's different in a situation where you  
23 have a loan or guarantee rather than a third-party debt,  
24 is a key factor.

25 MR. BRENA: And he can explore that to the

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1 witness' knowledge fully. But he's asking him to pull  
2 up cases that nobody asked about, and it's beyond the  
3 scope of the cross.

4 JUDGE WALLIS: I am going to sustain the  
5 objection.

6 Q BY MR. MARSHALL: At the FERC level with  
7 regard to oil pipeline companies, are there situations  
8 where the debt has the same kind of character as  
9 Olympic's debt owed to or guaranteed by its parents?

10 A Yes, this is very common for wholly --  
11 pipelines that are wholly owned by integrated oil  
12 companies. And in fact, most are owned by integrated  
13 oil companies.

14 Q And over time has this been looked at in  
15 significant degree on how to set a proper capital  
16 structure for oil pipeline companies that have that  
17 character of debt and equity supplied by parents?

18 A Yes. The FERC solution has been to look to  
19 the -- look to define a reasonable hypothetical capital  
20 structure looking first to that of the parents, and for  
21 whatever reason they believe that's not appropriate,  
22 looking to alternatives.

23 The alternatives they would typically look to  
24 are the oil pipeline proxy group companies, or something  
25 in between.

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1           Q    Is there a reason that this oil pipeline  
2 industry grew up with parents owning oil pipeline  
3 companies?

4           MR. BRENA:  Objection; there was no cross  
5 examination on these points.  He's trying to get in  
6 additional direct.

7           MR. MARSHALL:  This goes to the nature of why  
8 FERC is doing what it's doing.  And there has been a  
9 question by the Commission Chair, and others, about why  
10 does this rationale hold true.

11           This goes to the rationale of why, historically  
12 and regulatorily, this has been the character of having  
13 a capital structure based on the parents' capital  
14 structure.

15           MR. BRENA:  And, again, I think the Chair even  
16 corrected her question to say -- to paraphrase that  
17 we're not concerned with what FERC did.  We're concerned  
18 with the logic behind it, and redirected her question to  
19 the logic.

20           His question went to what FERC does.  If he  
21 wants to explore this witness's knowledge with regard to  
22 the logic behind the positions he's taken, be happy to.  
23 But it's beyond the scope of the direct for him to be  
24 exploring what FERC has done.

25           MR. MARSHALL:  The question does go to the

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1 logic behind it in terms of how this industry was  
2 developed and why, as the situation where the parents  
3 owning pipeline companies --

4 MR. BRENA: But does the question --

5 MR. MARSHALL: -- integrated oil companies  
6 have a history of having created oil pipeline delivery  
7 companies. And therefore, it's the exploration of the  
8 reasons why that we're trying to get at here.

9 It's on an arbitrary situation where people  
10 just happen to come in and create an oil pipeline  
11 company with a joint venture. There's a history behind  
12 this, and there's a regulatory history, a history  
13 relating to the oil pipeline industry behind this.  
14 That's what we're trying to explore.

15 JUDGE WALLIS: I am going to sustain the  
16 objection.

17 Q BY MR. MARSHALL: The Commission asked a  
18 question as to why the situation is the way it is, why  
19 you would recommend the capital structure.

20 Is there any historical or other industry  
21 reasons why the oil pipeline industry would have a  
22 different type of arrangement than other regulated  
23 companies?

24 A Yes. The industry and the oil pipeline  
25 industry was created by the integrated oil pipeline

2489

1 companies. And they, at one point, I think, owned it  
2 all. Most of the independent companies were created as  
3 a result of the integrated selling off the assets to  
4 independent companies.

5 Over the years, the situation and the logic, I  
6 think, is that this is an integrated industry, and that  
7 the parents and the pipelines are linked in an  
8 operational sense, as well as a financial sense. And it  
9 makes sense to look at the capital structure of the  
10 parents, because of that operational link.

11 Q Now, with regard to water-borne competition,  
12 are there pipeline companies in the United States that  
13 are landlocked and have no water-borne competition  
14 whatsoever?

15 A Yes. You can -- water-borne competition occurs  
16 on the coast. It occurs up and down the Mississippi  
17 River, and up and down the Ohio River, and beyond that  
18 there isn't much.

19 Q Are you familiar with companies like Explorer,  
20 Colonial, and other large oil pipeline companies that  
21 were owned by parents where there is 100 percent debt  
22 structure for the pipeline company?

23 A Yeah -- go ahead.

24 MR. BRENA: Go ahead. I am sorry.

25 THE WITNESS: Yes. I have worked essentially

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1 for all of them over the years.

2 Q BY MR. MARSHALL: Is this an unusual  
3 arrangement, in your view, to have oil pipeline  
4 companies owned by parents with 100 percent debt  
5 structure owed to the parents?

6 MR. TROTTER: I object to the question. All  
7 we're getting now is a rehash of the direct testimony.  
8 It's not proper redirect.

9 MR. BRENA: I join the objection. Nobody asked  
10 these questions on cross.

11 MR. TROTTER: It's basically asked and  
12 answered, this topic is addressed.

13 MR. MARSHALL: Fair enough.

14 Q BY MR. MARSHALL: There was a T&D agreement  
15 that you mentioned yesterday in response to questions to  
16 Mr. Brena. Have you been able to find that agreement  
17 and review it?

18 A Yes, I have.

19 Q Can you explain what that agreement covers, and  
20 how it covers the arrangement there?

21 A Yes. It's -- I assumed, without having studied  
22 it carefully, that it was a conventional T&D agreement  
23 where Olympic had secured contracts with its shippers,  
24 some of which were bids, some of which might not be.  
25 And the revenues from that -- or those contracts were

2491

1 the backing for the loan, because it's called that,  
2 would be the normal procedure on a T&D agreement.

3 This T&D agreement is nothing more than a loan  
4 guarantee by the parents. The T&D agreement specifies  
5 that the guarantors are going to be the owners of the  
6 pipeline, and their share of the guarantee is exactly  
7 equal to their ownership percentage of the pipeline.  
8 And there have been amendments to that over time as the  
9 ownership of the pipeline is shifted.

10 And the rule on the change is that whoever buys  
11 a share of the pipeline assumes this responsibility. So  
12 this so-called T&D agreement is nothing more than a flat  
13 guarantee by the parents of the loan.

14 MR. BRENA: Excuse me, Your Honor. Could I ask  
15 for clarification on the record whether that question  
16 and answer went to the through-put and deficiency  
17 agreement related to the parent company loans, or to the  
18 Prudential loans?

19 THE WITNESS: This went to the agreement with  
20 Prudential.

21 Q BY MR. MARSHALL: I think Mr. Brena's  
22 clarification may have unclarified something.

23 Is there any through-put and deficiency  
24 agreement that the parents have for their direct loans  
25 to Olympic?



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1           A    No.  The only through-put and deficiency  
2           agreement is with Prudential.  And as I described, it  
3           turns out to be nothing more than a loan guarantee by  
4           the parents.

5           Q    So does that make all of the debt that Olympic  
6           has, either directly or indirectly, and supported by the  
7           parents?

8           A    Either direct loan by the parents or guaranteed  
9           by the parents in proportion to their ownership shares.

10          Q    In other words, the entire financial profile of  
11          this company leans on the capital structure of the  
12          parents?

13          A    Yes.

14          Q    Under those circumstances, does it make sense  
15          to look at the capital structure of the parents?

16          A    Yes.

17               MR. TROTTER:  Your Honor, can we go off the  
18          record for a scheduling discussion?

19               JUDGE WALLIS:  Yes.

20   (Brief recess taken.)

21               JUDGE WALLIS:  Let's be back on the record  
22          following an afternoon recess.

23               Mr. Marshall, are you prepared to quantify the  
24          remaining estimate of your time on redirect?

25               MR. MARSHALL:  Five or six minutes.

2493

1 JUDGE WALLIS: Very well. Please proceed.

2 Q BY MR. MARSHALL: Dr. Schink, the individual  
3 who owned the company in the American Water Resources  
4 case, was the capital structure, his capital structure  
5 as a parent, used in that case?

6 MR. BRENA: Objection, Your Honor. There was  
7 no question asked about that case at all in cross  
8 examination. And for the similar reasons I have already  
9 argued with regard to another case, it's beyond the  
10 scope of examination.

11 MR. MARSHALL: Let me rephrase the question.

12 Q BY MR. MARSHALL: Looking at the rationale for  
13 using the capital structure of the parent, is the only  
14 case you are aware of in Washington state the case  
15 involving American Water Resources?

16 MR. BRENA: Your Honor, I restate the  
17 objection. He simply should not be asking the witness  
18 questions that direct the witness to the American Water  
19 case. There was no cross examination on that case.

20 MR. MARSHALL: I think this would be helpful  
21 to the Commission to draw the distinction between that  
22 situation and this situation. The Commission will find  
23 that useful.

24 And it does respond to the issue about what  
25 rationale do we have for use of a parent structure in a

1 wholly owned subsidiary position.

2 MR. BRENA: If he felt that, he should have put  
3 it in his rebuttal testimony, not on redirect when there  
4 was no cross.

5 JUDGE WALLIS: The topic has been addressed,  
6 and because I believe you are citing to a Washington  
7 state published case, you are free to cite it and argue  
8 it on brief. And I think the better approach would be  
9 to sustain the objection.

10 MR. MARSHALL: But Mr. Trotter specifically  
11 asked about that case in his examination.

12 MR. TROTTER: Your Honor, I did ask the  
13 question whether the Commission was punishing American  
14 Water in that case. That was my question.

15 JUDGE WALLIS: Very well. I will reverse my  
16 ruling, and the witness may respond to the question.

17 THE WITNESS: That was a case where you had  
18 a company owned by a single individual who, as I  
19 understand the history of the case, had been -- had been  
20 admonished over the years by the Commission to invest  
21 more of his personal capital into the company, and had  
22 been unwilling to do so.

23 I think that's the case where the Commission,  
24 out of frustration for a lack of commitment on the part  
25 of an owner of supporting his company, installed a

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1 capital structure that, in fact, had a higher ratio of  
2 debt than it might otherwise have done.

3 I think the circumstances are entirely  
4 different. We're not dealing with an individual, a  
5 recalcitrant individual who is unwilling to support the  
6 company he owns. We're dealing with two major  
7 integrated oil companies who have amply demonstrated  
8 their willingness to support the company that they own.

9 Q Was that individual's capital structure taken  
10 into account at all? Was that even a factor?

11 A Well, an individual -- I don't know how -- I  
12 don't know what my capital structure is, so I don't know  
13 how you would do that.

14 Q Now I am going to turn to --

15 JUDGE WALLIS: Is your microphone on, Mr.  
16 Marshall?

17 MR. MARSHALL: I believe it is. I will get  
18 closer.

19 Q BY MR. MARSHALL: -- to discounted cash flow.  
20 There were a number of questions about discounted cash  
21 flow. And the question arose about how the FERC did  
22 cash flow analysis. And there were questions asked you  
23 about other approaches, and also about the WUTC  
24 approach.

25 I am going to try to collapse all the questions

1 together, and ask you whether the FERC approach to  
2 discounted cash flow analysis for setting a rate of  
3 return of equity is similar to the WUTC's approach, and  
4 give an explanation as to why you used the approach you  
5 did in comparison to the other witnesses that you have  
6 reviewed.

7 MR. TROTTER: I object, Your Honor. It's been  
8 asked and answered. It's in his direct testimony. He  
9 had a specific opportunity to address methodologies of  
10 all witnesses, and he gave that testimony. So this is  
11 asked and answered.

12 MR. MARSHALL: Let me back up and try to unpack  
13 the question.

14 Q BY MR. MARSHALL: There were questions asked to  
15 you about the validity of the discounted cash flow  
16 methodology at the FERC. Do you remember those  
17 questions?

18 A Yes.

19 Q Did you attempt to apply the FERC discounted  
20 cash flow analysis in coming up with your  
21 recommendations, and also a modification if the  
22 modification were to be adopted?

23 A Yes, I did. I applied both the strict FERC  
24 methodology, and the method and modifications to it. My  
25 recommendation is based on the modified approach.

2497

1           Q    And there were a number of questions asked by  
2   Mr. Brena about your testimony in other cases, where you  
3   had brought to bear CAPM and other approaches for  
4   setting rate of return on equity. Do you remember those  
5   questions of Mr. Brena?

6           A    Yes.

7           Q    Why is it you chose to use the discounted cash  
8   flow approach of the FERC instead of some other  
9   approach?

10          A    I have been following the FERC's decisions in a  
11   number of cases. And the approach it has taken, and the  
12   Commission -- the FERC has made it clear that, in fact,  
13   it expects this methodology to be followed. And that in  
14   fact it tends to rely on this methodology until and  
15   unless facts arise which make it believe that it's  
16   inappropriate.

17                    And I don't think any such facts have arisen.  
18   And I think also I discovered in doing my rebuttal as I  
19   report there that this methodology is quite similar to  
20   that employed by -- or has been relied on in previous  
21   decisions by the WUTC.

22          Q    In your testimony do you have an exhibit that  
23   does a comparison of the cash flow analysis by yourself  
24   and by other witnesses?

25          A    Yes, I do, in my rebuttal testimony make that

1 contrast, and also report my view or my thinking or  
2 interpretation of what -- of the methods they followed  
3 that have been -- most closely approximates that, that  
4 has been relied on in the past by the WUTC of this  
5 Commission.

6 Q Is this blow-up an exhibit from your testimony?

7 MR. BRENA: Objection; this is just --

8 MR. MARSHALL: I am not going to ask  
9 questions, but I want to refer the witness to that and  
10 ask for that particular exhibit number.

11 JUDGE WALLIS: What was the exhibit number?

12 THE WITNESS: This specific exhibit is not in  
13 my testimony. All the numbers come from, as documented  
14 in the notes, either from my testimony and the numbers  
15 are all repeated in my testimony. But this particular  
16 document wasn't in there.

17 Q BY MR. MARSHALL: If you use the discounted  
18 cash flow calculation most consistent with the WUTC  
19 methodology, do you reduce the comparisons that you had  
20 with the other witnesses in this case?

21 A The numbers represented are, in fact, presented  
22 in my testimony.

23 Q What are those numbers?

24 MR. BRENA: Objection --

25 MR. TROTTER: I object. He just said it's in

2499

1 his testimony.

2 JUDGE WALLIS: It is contained in the  
3 testimony, Mr. Marshall. If you wish to cite on brief  
4 you may cite to the original document. This document is  
5 not in the record. At this point the witness has  
6 indicated it's a compilation of information that is in  
7 his testimony, and you would be able to present that  
8 information on brief. So I will sustain the objections.

9 MR. MARSHALL: Very well. I -- again, we just  
10 thought this might be helpful with Dr. Schink here to be  
11 able to review that, since the issue about discounted  
12 cash flow has come up in the comparisons with witnesses  
13 to follow will also come up. But if that's the way you  
14 wish to proceed, that would be fine.

15 JUDGE WALLIS: Thank you.

16 MR. MARSHALL: We then have no further  
17 questions of this witness.

18 JUDGE WALLIS: Very well. Anything further of  
19 the witness?

20 (No response.)

21 JUDGE WALLIS: Let the record show there's no  
22 response.

23 Dr. Schink, we appreciate you sharing your day  
24 with us yesterday and today, and wish you well as you  
25 complete your California adventure. And let's be off



2500

1 the record while John W. Wilson, our next witness, steps  
2 forward.

3 (Brief recess.)

4 JUDGE WALLIS: Let's be back on the record.  
5 The Commission Staff witness John W. Wilson has stepped  
6 forward.

7 Mr. Wilson, would you please stand and raise  
8 your right hand?

9

10 JOHN W. WILSON,  
11 produced as a witness in behalf of the Commission Staff,  
12 having been first duly sworn, was examined and testified as  
13 follows:

14

15 JUDGE WALLIS: Please be seated. In  
16 conjunction with Dr. Wilson's appearance at the  
17 administrative conference on Thursday June 13, a number  
18 of documents were marked for identification. And those  
19 documents are shown on the exhibit list for this  
20 proceeding as Exhibits 301-T through 309. And I will  
21 not identify them for the record at this time, but refer  
22 to the record made on June 13.

23 Mr. Trotter, you may proceed.

24

25 DIRECT EXAMINATION

2501

1 BY MR. TROTTER:

2 Q Would you please state your name for the  
3 record?

4 A John W. Wilson.

5 Q Dr. Wilson, what is your business address?

6 A 1601 North Kent Street, Arlington, Virginia.

7 Q And what is your present position?

8 A I am the president of J.W. Wilson and  
9 Associates, which is an economic consulting firm.

10 Q And you are testifying on behalf of Commission  
11 Staff in this case?

12 A Yes, I am.

13 Q And in the course of your duties and in  
14 response to that role, did you have cause to prepare  
15 Exhibit 301-T through 309?

16 A Yes, I did.

17 Q If I ask you the questions in 301-T, would you  
18 give the answers that appear there?

19 A Yes, I would.

20 Q And are Exhibits 302 to 309 correct, to the  
21 best of your knowledge?

22 A Yes.

23 MR. TROTTER: I move for admission of Exhibits  
24 301-T to 309.

25 JUDGE WALLIS: Is there objection?

2502

1 (No response.)

2 JUDGE WALLIS: Let the record reflect there is  
3 no objection. 301-T through 309 are received in  
4 evidence.

5 (EXHIBIT ADMITTED)

6 MR. MARSHALL: The only thing I would add on  
7 that, Your Honor, is this witness quotes from a number  
8 of newspaper articles. And while I don't object to  
9 having them in there to show the state of mind of the  
10 witness, or whoever wrote the articles, I would object  
11 to the introduction of newspaper articles for the truth  
12 of the matter asserted in those. They are hearsay, and  
13 otherwise -- in fact, some of them contain hearsay  
14 within hearsay.

15 MR. TROTTER: Well, Mr. Schink had quotes from  
16 various publications. They are not offered for the  
17 truth, but they are offered for this witness' reliance  
18 on what was said, and in forming his opinion.

19 JUDGE WALLIS: Very well. On that basis the  
20 objection is overruled.

21 MR. TROTTER: Witness is available for cross  
22 examination.

23 JUDGE WALLIS: Mr. Marshall, you may proceed.

24 CROSS EXAMINATION

25 BY MR. MARSHALL:

2503

1 Q Dr. Wilson, have you made a systematic study of  
2 risk for the oil pipeline industry?

3 A I have looked at the risk of the oil pipeline  
4 industry, and I have done some things in this  
5 presentation that look at it pretty systematically.

6 Q And is it your conclusion that Olympic faces no  
7 greater risk than the proxy group at the FERC?

8 A Actually, I would say Olympic is probably  
9 somewhat less risky than the proxy group. The proxy  
10 group, as you know, is not a group of pipeline  
11 companies. It's a group of limited partnerships. And  
12 they don't have risk protection advantages of vertical  
13 integration to the extent that Olympic does.

14 So if you compared them with those limited  
15 partnerships, I would say that Olympic, because of the  
16 vertically integrated nature of Olympic with the  
17 refiners, and also with the marketing end of the  
18 business, is somewhat less risky than that particular  
19 group.

20 Q What is your knowledge of Olympic compared to  
21 other oil pipeline companies in terms of size? Is  
22 Olympic smaller, same size, bigger than the oil pipeline  
23 group companies in the proxy group?

24 A Well, it's certainly smaller than the proxy  
25 group, which doesn't consist of an enterprise that has a

2504

1 single pipeline. They are also small compared to the  
2 bigger interstate petroleum pipeline, like Colonial and  
3 some of the others that have been mentioned. So I would  
4 say, compared to most of the companies that have been  
5 mentioned as comparable, it's smaller.

6 Q Quite a bit smaller?

7 A It's a lot smaller than Kinder Morgan, a lot  
8 smaller than Colonial. A lot smaller than a lot of  
9 these companies.

10 Q Do you know what size, the number of miles  
11 Buckeye has? That's the first one in your proxy group.

12 A Let me see if I have that information. 3,900  
13 miles, serves ten states, mostly in the Northeast and  
14 Upper Midwest.

15 Q So that's also quite a bit larger than Olympic,  
16 correct?

17 A Yes. Again, it's a limited partnership that  
18 has interest in multiple pipelines.

19 Q Olympic only has one pipeline?

20 A One facility, right, running in two states,  
21 right, Washington and Oregon.

22 Q Is diversification a way of trying to reduce  
23 risk in general terms, general economic terms?

24 A It's a way of reducing what is referred to as  
25 nonsystematic risk -- nonsystemic risk. It's one of the

2505

1 foundations of beta analysis, as I've discussed in my  
2 testimony.

3 Q Turn to page 30, line 7. The testimony is  
4 301-T.

5 A (Complies.) I have that.

6 Q Do you see where most of these companies have  
7 substantial business diversification, in addition to  
8 their pipeline enterprise? Do you see that?

9 A The reference there is to the gas pipelines,  
10 and to the vertically integrated oil companies. There  
11 also is substantial diversification with respect to  
12 the -- some of the members of the proxy group, that is,  
13 the limited partnerships.

14 Q Kinder Morgan, for example, has 10,000 miles of  
15 natural gas pipeline in additional to oil pipeline; is  
16 that correct?

17 A Yeah, it has about the same amount of gas  
18 pipelines as it does oil pipelines. It has some  
19 interests in carbon dioxide in Colorado, West Texas.

20 Q Does Olympic have any diversification?

21 A Olympic is purely an oil products pipeline,  
22 runs from the four oil refineries in Washington to  
23 Portland, Seattle, and places in between.

24 Q So is it fair to say Olympic is a small,  
25 undiversified, single product type of pipeline?

2506

1           A    Yes.  But you are talking about a different  
2   type of diversification than I had in mind when we spoke  
3   a moment ago about capitalizing the pricing models.  But  
4   it is smaller, and it does not have as many different  
5   enterprises in different parts of the country as some of  
6   these limited partnerships do.

7           Q    It doesn't have any other enterprises in other  
8   parts of the country, does it?

9           A    Olympic does not, no.

10          Q    It doesn't have any other products other than  
11   shipping petroleum oil products, correct?

12          A    Well --

13          Q    Does it ship gas, for example?

14                   MR. TROTTER:  Excuse me, Your Honor.  The  
15   witness needs to be permitted to answer the question and  
16   not have this rapid-fire questioning for which he's not  
17   allowed to respond.

18                   JUDGE WALLIS:  Mr. Marshall.

19                   MR. MARSHALL:  I will stop rapid-fire.

20                   THE WITNESS:  It ships various types of refined  
21   products.  And obviously its parents, in terms of their  
22   marketing, have some diversification that transfers  
23   through to the pipeline.  But it in itself simply ships  
24   refined products.  It doesn't ship natural gas.

25                   JUDGE WALLIS:  Off the record for a moment.

2507

1 (Discussion off the record.)

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

4 Q BY MR. MARSHALL: Excluding any flow through  
5 that you had in mind from the parents, Olympic itself is  
6 a small, undiversified, single geographic area oil  
7 product pipeline, correct?

8 A It's relatively small compared to the other  
9 companies we have talked about. It does gain its  
10 diversification benefits from its parents, rather than  
11 on a stand-alone basis. And it is limited in terms of  
12 its geographic scope, yes.

13 Q Now, this pipeline is characterized, as  
14 Mr. Elgin has indicated, by high fixed costs; is that  
15 correct?

16 A All pipelines are. And that's true of this  
17 pipeline, too, yes.

18 Q By high fixed costs, it means basically if you  
19 lose through-put, those costs remain there for the most  
20 part, with some adjustments for power, and DRA. But for  
21 the most part those costs don't disappear if the demand  
22 is down, or if the pipeline is interrupted. Is that  
23 true?

24 A Well, there's several questions there. That is  
25 not what high fixed costs means, but I think that some



2508

1 of the things you said about fixed costs are true. And  
2 I will be glad to break it apart if you would like me  
3 to.

4 Q Let me try if I can. Let's assume that the  
5 cost is \$10, and you ship 10 barrels of oil on a system.  
6 There's a dollar a barrel, right?

7 A Okay.

8 Q And then let's assume that the through-put  
9 drops to five barrels, but your costs remain at \$10.  
10 Now your cost per barrel is \$2, correct?

11 A If all of the \$10 are fixed costs, that is  
12 right.

13 Q And if you have high fixed costs, and a small  
14 percentage of variable costs, that would be more or less  
15 true?

16 A If fixed costs were the preponderance of your  
17 costs, and your volume falls, you will have a  
18 substantial increase in cost per unit. And I think  
19 we've seen that for Olympic as a result of the outage  
20 because of Whatcom Creek, and because of the reduction  
21 in through-put attributable to the seam project.

22 Q Now, what -- among the risks that an oil  
23 pipeline faces and the character of Olympic, is the risk  
24 in interruption or a decline in through-put one of the  
25 biggest risks that a pipeline faces?

2509

1           A    I will agree that the risk of interruption  
2           would be a major risk that a pipeline faces.

3           Q    Apart from competition, is there any bigger  
4           risk that you think a pipeline faces?  Can you think of  
5           offhand --

6           A    I don't think Olympic faces much risk from  
7           competition.  I think that a major risk that Olympic  
8           faces is the type of interruption that has occurred,  
9           which is the essence of its cash flow problem.

10          Q    But my question, can you think of, on the stand  
11          here today, any risk bigger than that of interruption?

12          A    Well, most things that I can think of as major  
13          risks would probably involve some type of interruption,  
14          such as a shutdown for environmental reasons, safety  
15          concerns.  All of these things could result in  
16          interruption of flows.

17                    It wouldn't have to be a physical interruption,  
18          like an explosion, but, yes, I think most of the  
19          risks -- most of the big risks that this type of  
20          enterprise faces would involve some type of curtailment  
21          of its operations.

22          Q    Okay.  Again, can you think of, outside of  
23          interruption of flow, decline in through-put, can you  
24          think of any other bigger risk?

25          A    That's the type of risk that every enterprise

2510

1 faces, a loss of sales, decline in demand for its  
2 product. That's uniform to every type of enterprise,  
3 whether a law firm like yours, or whether it's Olympic.

4 Q So the answer is, you can't think of any bigger  
5 risk than the risk of interruption?

6 A The risk of not being able to operate is the  
7 biggest risk that any type of business faces, and there  
8 are a variety of things that can lead to that.

9 Q Correct. Let's explore those for a minute.  
10 Interruption can occur for a number of reasons on  
11 Olympic's system, including earthquakes, third-party  
12 damage, sabotage, poorly manufactured pipe, regulatory  
13 decisions on safety, regulatory decisions on  
14 environment, accidents. Are all of those ways in which  
15 you can have an interruption?

16 A Sure.

17 Q Are you familiar with the high consequence area  
18 regulations that have been adopted by the Federal  
19 Government Department of Transportation?

20 A Generally, yes.

21 Q When did those finally go into effect?

22 A I don't know the effective date.

23 Q Do you assume January 2002, subject to check?

24 A I will accept that.

25 Q Can you define what a high consequence area is?

2511

1           A    Not with specificity, but it's generally areas  
2    in which an accident would cause substantial collateral  
3    damage.  It's typically populated areas where property  
4    or life would be particularly threatened by an accident.

5           Q    Are you aware that the definition of that  
6    regulation also includes unusually sensitive areas, and  
7    navigable waters.  Those are the other two --

8           A    Environmentally sensitive areas, sure.

9           Q    Now, do you know whether the risk of earthquake  
10   is higher for Olympic than it is for other pipeline  
11   companies, because of its location in Western  
12   Washington?

13          A    It is an area that is susceptible to  
14   earthquake.  There are areas that are less susceptible,  
15   probably New England.  There are areas more susceptible,  
16   perhaps California, the Memphis area in the Midwest.  I  
17   would say the Southeast is probably less.  So I would  
18   say it's more susceptible than a lot of areas in the  
19   Eastern United States.

20          Q    Do you know if this pipeline goes through more  
21   heavily populated areas as defined under the high  
22   consequence area regulations than other pipelines that  
23   you may be thinking about?

24          A    It goes through the Seattle Metropolitan Area,  
25   Seattle SMSA, and through the Portland SMSA.  And as you

2512

1 already pointed out, it's not a very long pipeline.  
2 There are pipelines that go through Washington,  
3 Baltimore, New York. So there are some that go through  
4 more densely populated areas. But this is a populated  
5 area that Olympic goes through.

6 Q Is virtually all of Olympic's pipeline located  
7 in a high consequence area as defined by the Federal  
8 government?

9 A A large portion is -- meaning more --

10 Q Large, meaning more than 80 or 90 percent, or  
11 do you know?

12 A It's up there. It probably is in that range,  
13 yes.

14 Q Do you know if -- do you know of any other part  
15 of the HCA, such as the integrity management program?  
16 Are you familiar with that?

17 JUDGE WALLIS: Could you define that acronym?

18 MR. MARSHALL: Integrity management program,  
19 HCA, high consequence area --

20 THE WITNESS: HCA, high --

21 Q BY MR. MARSHALL: Mr. Wilson, it is actually  
22 HCA, high consequence area.

23 JUDGE WALLIS: Very well. And I am going to  
24 ask, Dr. Wilson, if you would please remember the court  
25 reporter's admonition and take at least a short breath

2513

1 before you respond to Mr. Marshall's questioning. It  
2 sounds like we're putting a brake on you, but it really  
3 does make things go faster in the long run.

4 THE WITNESS: Thank you. I will do that.

5 Q BY MR. MARSHALL: Are you familiar with the  
6 Integrity Management Program, and the Federal  
7 regulations that went into effect January 2002?

8 A No, I am not.

9 Q Do you know what ERW pipe is?

10 A Yes. It's an electronic resistance welding, I  
11 think that's what is referred to. That's what ERW  
12 means.

13 Q Have you made a study as to how much pipe  
14 Olympic has that is ERW origin?

15 A I have not made a study. I have seen  
16 information, but I've not made a study of that.

17 Q What percentage of Olympic pipe is ERW type  
18 pipe?

19 A I don't know the percentage. There's a lot of  
20 it.

21 Q Are you aware of anything in the Federal  
22 regulations that requires special attention to ERW pipe,  
23 pre-1970 ERW pipe?

24 A There may be, but I am not familiar in detail  
25 with those regulations, no.

2514

1           Q    Do you know when Olympic was first in  
2           operation, what year?

3           A    It goes back before the 1970's.  It's been in  
4           operation a long time, but I don't know the year of its  
5           inception.  I made a study of the oil pipeline industry  
6           back in the 1970s when I ran these special -- the  
7           Senate's Special Subcommittee on Integrated Oil  
8           Operations for Senator Jackson, and Olympic was one of  
9           the pipelines that we analyzed.  But I don't know how  
10          far back before that it goes.

11          Q    Would you say, based on that knowledge, that  
12          virtually all -- or at least a very large percentage of  
13          Olympic's pipe would be pre-1970 ERW type pipe?

14          A    I think it would be.

15          Q    Is the pipeline system with that type of pipe  
16          riskier than other kinds of pipeline systems with other  
17          kinds of pipe, or do you know?

18          A    There are risks associated with various types  
19          of pipe.  You may recall a couple of years ago that  
20          there were major problems with regard to gas pipelines  
21          in the Phoenix area.  They were not this type of pipe,  
22          but they were also susceptible to explosions and  
23          rupture.

24                    I would say generally that an older ERW pipe of  
25          this nature is probably a bigger maintenance problem and

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1 potentially more risk than new modern equipment that is  
2 being installed.

3 Q Would you know if the proxy group, for example,  
4 just to take Buckeye because it's the first one, what  
5 percentage of pipe Buckeye has in operation that is  
6 pre-1970 ERW pipe?

7 A I don't know.

8 Q For any of the proxy group, would you have any  
9 idea?

10 A What the percentage was, no, I wouldn't.

11 Q Now, there was, in September of 1999, a hydro  
12 test of a segment of Olympic's pipe in which an ERW seam  
13 failed. Do you recall that?

14 A Right. I think these were tests subsequent to  
15 the Whatcom Creek incident.

16 Q The Whatcom creek incident was not caused by an  
17 ERW weld seam failure, was it?

18 A I know that Olympic has made that statement.  
19 All I said is the tests were conducted, in part, as a  
20 consequence.

21 Q Well, you know that the Whatcom Creek incident  
22 was not caused by an ERW weld seam failure?

23 A I don't know that. I have seen that asserted  
24 by Olympic in this case, and that may well be the case,  
25 but I don't know it.



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1           Q    You know of no evidence that you have heard of  
2   in your background that would show that the Whatcom  
3   Creek accident was caused in any way, shape or form by  
4   the weld seam failure of an ERW pipe; is that correct?

5           A    I don't know that one way or the other.  That  
6   is correct.

7           Q    And you have never seen anything from anybody  
8   else that suggested that the Whatcom Creek was caused by  
9   a weld seam failure?

10          A    That's true.  But I haven't investigated the  
11   causes of Whatcom Creek.

12          Q    Now, after the September 1999 weld seam  
13   failure, was there a restriction placed on Olympic  
14   because of its use of ERW weld seam pipe?

15               MR. BRENA:  Your Honor, at this point I am  
16   going to object to this line of cross examination.

17               Mr. Wilson is a capital structure and rate of  
18   return witness, and I haven't heard a single question  
19   with regard to either.

20               He's been asked about high consequence area  
21   regulation, and different types of welding, but I don't  
22   recall any of that being in the scope of his testimony.  
23   The scope of the cross is beyond the scope of this  
24   witness' answering case.

25               And besides that, it's also not relevant to

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1 Olympic's presentation of the case. They have not put  
2 on any evidence whatsoever that Olympic is more or less  
3 risky, or has more or less ERW pipe in their case,  
4 either.

5 So, I mean, we're exploring areas -- we're  
6 exploring engineering issues with a capital structure  
7 and rate of return witness with regard to comparing  
8 Olympic with other industry pipelines, when they have  
9 not -- when there's no underlying comparative  
10 information in the record, or in the case.

11 So I object, because it can't be relevant  
12 absent them putting on a showing of that. And I object  
13 to that, because it's beyond the scope of the witness.

14 Are we going to ask our engineers capital  
15 structure questions, and capital structure people  
16 engineering questions? We're going to be here forever.

17 MR. TROTTER: I join the objection to the  
18 extent that if the company truly thought that analysis  
19 of ERW pipe percentages for the proxy group or for  
20 Olympic was relevant to cost of capital and capital  
21 structure issues, Mr. Schink would have testified to it  
22 and he didn't.

23 So I think this line of questioning -- if the  
24 company thought it was probative, they would have put  
25 direct evidence in on it from their cost of capital

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1 witness.

2 MR. MARSHALL: We did. Mr. Schink quite  
3 clearly testified that Olympic was much riskier than the  
4 proxy group, and he said that not only on direct, but on  
5 rebuttal the reasons why. In fact, there's a whole  
6 section of common sense for why this pipeline is riskier  
7 than the proxy group. This witness has said that he  
8 does not believe that Olympic is any riskier than the  
9 proxy group, and there are a number of different kinds  
10 of risk.

11 And we have identified the biggest risk is the  
12 risk of interruption, and the risk of interruption is  
13 significantly higher for Olympic because of where it's  
14 located, its size, its use of the type of pipe. All of  
15 the witnesses have testified to the kinds of pipe they  
16 have used, the kinds of interruptions it's had, the  
17 consequences of the interruptions, the area through  
18 which this pipeline goes.

19 This goes to the essence of why this pipeline  
20 is riskier than any other comparable pipeline company  
21 that this witness is trying to say bears the same kind  
22 of risk.

23 MR. BRENA: Your Honor, if I may respond to  
24 those questions, what Mr. Schink does or does not say on  
25 the stand doesn't determine what is proper cross for

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1       this witness.  What determines what is proper cross for  
2       this witness is this witness's testimony, and whether or  
3       not the line of questioning is in it or not.

4               He didn't put testimony in on this, and it's  
5       not helpful to be asking him questions on high  
6       consequence area, and ERW pipe.  He didn't put any  
7       testimony in on that.

8               Secondly, I went through great efforts with  
9       Mr. Schink to -- great efforts with him to get him to  
10      identify why he added his risk additer in his direct  
11      case.  And he identified that he had one single reason,  
12      which was the reason he identified the risk additer in  
13      his direct case.  And that single reason was water-borne  
14      competition.

15              Now, that's their case.  Now he doesn't -- and  
16      nowhere, nowhere in Mr. Schink's testimony or in any  
17      witness' testimony is there anything that will allow  
18      this Commission to compare the comparative risks.  I  
19      mean, we have no information on these pipelines, whether  
20      they go through high populated areas -- they go through  
21      Chicago, Seattle, LA, New York.  We have no information  
22      whether they are all ERW pipe or non-ERW pipe.  They  
23      simply do not have a factual basis in their case from  
24      which to make this relevant to rate of return matter.  
25      They just don't have it.

2520

1 JUDGE WALLIS: The objection is sustained.

2 Mr. Marshall.

3 MR. MARSHALL: May I respond briefly. This  
4 witness has opened up this area himself by saying this  
5 pipeline is no riskier than the proxy group, regardless  
6 of what any other witness has testified to.

7 We're entitled to explore the basis for his  
8 conclusion that this is no riskier than the pipeline  
9 proxy group that he makes the comparison.

10 JUDGE WALLIS: You are entitled to explore the  
11 basis for his analysis, and he has testified that he  
12 does not know the degree that other pipelines use ERW  
13 pipe, or the specific proportions of their lines that  
14 are in highly sensitive areas or other factors you are  
15 seeking to inquire into.

16 So his having stated that he did not consider  
17 that kind of information in preparing his testimony  
18 would seem to indicate that these questions are beyond  
19 the scope of the witness' direct, and not proper areas  
20 for you to inquire into.

21 MR. MARSHALL: But, again, in order to make  
22 the statement that he has the conclusion that he's drawn  
23 that Olympic is no riskier than the other pipeline proxy  
24 group members, he would have to have a basis for that.

25 JUDGE WALLIS: And you are entitled to inquire

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1 into that basis.

2 MR. MARSHALL: Again, I think we have  
3 identified the salient ways for interruption, and this  
4 witness is now saying he doesn't have the basis for  
5 making that comparison.

6 JUDGE WALLIS: That's a matter for you to argue  
7 based on the responses to the questions you have asked  
8 that are within the scope of his testimony.

9 Q BY MR. MARSHALL: Mr. Wilson, in making your  
10 conclusion that Olympic was no riskier than any of the  
11 other proxy companies, did you look at any of these  
12 risks of interruption that we have been talking about?

13 A Actually, you misstate my testimony. I think  
14 that what I said was that with regard to the proxy group  
15 itself, which is not a vertically integrated pipeline  
16 that is tied to refineries that are owned by its  
17 affiliates and to marketing operations that are owned by  
18 its affiliates, I believe Olympic is less risky as an  
19 economic proposition. And I certainly think of risk  
20 from a financial and economic proposition in making this  
21 statement.

22 Q So let me explore that. In making a statement  
23 about risk, you meant just financial risk and not an  
24 operational risk; is that correct?

25 A I did mean financial risk, and of course,

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1 operating characteristics do feed into operational risk.

2 Q So explain how operational characteristics feed  
3 into financial risk.

4 A Well, along the lines you have suggested to the  
5 extent that there are the possibilities of shutdown, and  
6 because of accidents, because of earthquakes, because of  
7 explosions, because of environmental concerns, these are  
8 all the types of risks that this Commission is very  
9 familiar with in terms of its conventional regulation of  
10 pipelines, as well as other types of enterprises such as  
11 utilities.

12 It's the same type of risk that this Commission  
13 dealt with extensively in the era of nuclear  
14 construction where there were risks associated with  
15 shutdowns, nonoperation, cost overruns, so on with  
16 nuclear power plants we had not experienced with other  
17 types of generation.

18 Q So how do those operational risks facing  
19 Olympic compare to the operational risk of the companies  
20 that you have compared Olympic to?

21 A On the whole I think that those risks, those  
22 operational risks are similar to pipeline companies.  
23 And I would say that's true both with respect to gas  
24 pipelines. And with respect to oil pipelines, both  
25 crude and petroleum product pipelines, I would say that

2523

1 the risks are lower than they were historically with  
2 respect to nuclear plant construction in the Pacific  
3 Northwest. So there's a spectrum. But I would say  
4 similar to risks associated with other types of oil and  
5 gas pipelines.

6 Q So the operational risks facing Olympic, you  
7 believe, are similar to the risks facing other oil  
8 pipeline companies?

9 A Yes.

10 Q And the basis for that is knowledge about the  
11 particular operating risks of Olympic compared to those,  
12 or just some in-general theory?

13 A Not in terms of all of the details, but the  
14 companies that own and operate Olympic have familiarity  
15 and expertise that's associated with ownership and  
16 operation of other types of pipelines, and other similar  
17 pipelines in other parts of the country.

18 There are some features of Olympic that you  
19 have pointed out that may make it, on one hand, slightly  
20 more risky than another pipeline. I don't think that I  
21 would consider the earthquake risk that you talk about  
22 as a dramatic risk factor that separates Olympic in a  
23 significant way from other pipelines in other parts of  
24 the country.

25 Q When you say there were some risk factors that



2524

1 may make Olympic slightly more risky than the others,  
2 which ones did you have in mind?

3 A Well, earthquake is one. I agreed with you  
4 that the probability of earthquake, although certainly  
5 less in this part of the country than in Alaska, or  
6 California, or maybe the Memphis trend is higher than it  
7 is in the Northeast or the Southeast for the most part.  
8 And so on that basis, I would say if you were going to  
9 place the odds of Olympic being disrupted by an  
10 earthquake, whereas the odds would be long, it would be  
11 higher than a pipeline in New England.

12 Q Please turn to page 34, again, line 8.

13 JUDGE WALLIS: Exhibit 201 -- or 301?

14 MR. MARSHALL: Yes, 301-T.

15 Q BY MR. MARSHALL: A risk free investment such  
16 as US Treasury Security have no operational risk. Is  
17 that fair to say --

18 A We're talking about financial risk. This is  
19 different than operational risk. But treasury security  
20 has, I think, a financial analyst would tell you it's  
21 got very little risk of either failure to pay the  
22 interest, or failure to recoup the investment. It's not  
23 likely to default or fail to pay the anticipated return.

24 Q Will an investor looking at risk of a  
25 particular company, look at the operational risk

2525

1 characteristics of that company compared to other  
2 potential investments in that same industry?

3 A Depends on what type of investor he is. If  
4 he's an investor with a highly diversified portfolio,  
5 most modern financial theorists, most professors of  
6 finance would tell you that that is a consideration, but  
7 that a lot of that can be diversified away.

8 Q Let's assume an investor that has to choose  
9 between Olympic and Buckeye, isn't it true that that  
10 investor would look at the operational risk  
11 characteristics of Olympic compared to Buckeye if that  
12 investor only had that one decision to make?

13 A You are not talking about apples and apples,  
14 you are talking about apples and oranges. Somebody  
15 looking at the investment in a single pipeline versus  
16 investment in a limited partnership with multiple  
17 pipelines is probably not going to go out and gather  
18 information on electronic resistance welding in the  
19 pipelines.

20 He's going to be looking at other things. I  
21 think that one of the things you would look at would be  
22 the relative security of an enterprise like Olympic,  
23 because of its tie-in to the refining industry and its  
24 tie-in to the marketing industry, and the imperative on  
25 the part of its parents to utilize it to get their

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1 product to market and protect and gain revenues and  
2 profits from the more expensive and important parts of  
3 their business, which is the refining business.

4 Q So you are now stating that somehow there's an  
5 integration between the parents and the pipeline that  
6 have an effect on risk?

7 A Yes.

8 Q At page 2 of your testimony, line 21, you  
9 indicated that you were on the NAIC's advisory committee  
10 on nuclear risks. Do you see that?

11 A Yes.

12 Q NAIC stands for what?

13 A National Association of Insurance  
14 Commissioners.

15 Q What kinds of nuclear risks were you talking  
16 about related to insurance?

17 A Well, there's a Federal standard statute that  
18 limits insurance, limits liability in the event of a  
19 nuclear accident, and this is something that has been  
20 under study by the NAIC, as well as the nuclear  
21 industry.

22 Q Are risks insurable?

23 A Yes.

24 Q And did Olympic have insurance for risks, or do  
25 you know?

2527

1           A    I am sure that they have insurance for some of  
2           their risks.  They are required to by law.  I am not  
3           sure that they are insured for all of the risks.  There  
4           are some things they are obliged to do, and some things  
5           that are voluntary.

6           Q    Would one measure of riskiness have to do with  
7           the availability of insurance and the price of  
8           insurance?

9           A    The availability and price of insurance affects  
10          your ability to lay off risks, your ability to limit  
11          your risk exposure.  I would agree with that.

12          Q    Turn to your Exhibit JWW-4, page 1 of 4, and I  
13          think that must be the next one in sequence here.

14          A    That's Exhibit 304?

15          Q    Yes, I do believe that is.  It's the one that  
16          has your DCF cost of equity indications?

17          A    For the oil pipeline limited partnerships, look  
18          at page 1 or page 2?

19          Q    I am looking at page 1 of 4 DCF cost of equity  
20          indications.

21          A    I have that.

22          Q    Here you have used three industries, three  
23          groups of industries; is that correct?

24          A    I think you can call it three industries, three  
25          industry groups.

2528

1           Q    And the oil pipeline limited partnerships you  
2    have as an indicated DCF range of 13.3 to 17.2 percent;  
3    is that correct?

4           A    Yes.

5           Q    And then for all of -- the other two  
6    industries, integrated petroleum and natural gas  
7    pipeline, you have much lower DCF changes; is that  
8    correct?

9           A    Yes.

10          Q    Does that indicate to you that oil pipelines  
11    should be treated differently than the other two,  
12    because of the range of -- because the range is so much  
13    higher?

14          A    Well, it would indicate a higher rate of return  
15    allowance was applicable if that was the only  
16    information that you had.  And I, of course, commented  
17    on that in my direct testimony, and I presented a lot of  
18    additional information that shed, shall we say, a  
19    broader light on that question.

20          Q    You were asked, were you not, to review  
21    Dr. Schink's testimony?

22          A    I was, yes.

23          Q    And have you also reviewed Dr. Schink's  
24    rebuttal testimony in this case?

25          A    Yes, I have.

2529

1 Q And have you reviewed his quotations on the DCF  
2 methodology that you have commented on in your  
3 testimony?

4 A I don't believe I commented on any quotations  
5 that he made with respect to DCF methodology.

6 Q Did you review Dr. Schink's 201-T beginning at  
7 page 43?

8 A Yes, I did.

9 Q Look at line 14, where it says the  
10 Commission --

11 A Are you referring to, on Dr. Schink's 201-T,  
12 page 43?

13 Q Yes.

14 A Then you are talking about the WUTC quote at  
15 the bottom of the page?

16 Q Right. Up at the top it says, The WUTC  
17 methodology. Do you see that on the top of 43?

18 A I do see that.

19 Q At line 14, do you see the statement, The  
20 Commission appears to rely on a forward looking DCF  
21 analysis; is that correct?

22 A I saw that statement, yes.

23 Q And did you read that particular case, the GTE  
24 case?

25 A I did not read that case, no.

2530

1           Q    Do you know whether this Commission has  
2           indicated it will, quote, continue to rely on the  
3           discounted cash flow analysis as the most satisfactory  
4           method of measuring investor expectation?

5           A    I did talk with Mr. Trotter about that very  
6           subject.  I observe here that this is a case that is  
7           eight years old.  If you are asking me whether I dispute  
8           what is said here in the quote, I don't at all.

9                    If you are asking me whether I would agree with  
10           Mr. Schink's characterization of this as a current  
11           specification of limited methodology, I think I do  
12           disagree with that based upon the briefing that I have  
13           had, and my understanding of the Commission's  
14           orientation.

15           Q    Actually, the only question I have pending is  
16           whether you actually reviewed that case, and your answer  
17           was you had not; is that correct?

18           A    I think that's a question you asked me a  
19           question or two ago, yes.

20           Q    And do you see on page 45 and 46 of his  
21           testimony, a quotation from the Avista case of September  
22           29, 2000?

23           A    Yes, I see that.

24           Q    You used a combination of different approaches  
25           on establishing a rate of return on equity; is that

2531

1 correct?

2 A I have shown the results of a number of  
3 different approaches, several DCF approaches, capital  
4 assets pricing model approaches, which are certainly the  
5 ones that are most prominent in the academic community  
6 today. And also I presented some comparable earnings  
7 information.

8 So I presented information from a number of  
9 different approaches, and those are summarized in  
10 Exhibit 309.

11 Q Have you then tried to apply the three  
12 different industries and the four different approaches  
13 that you have just discussed to come up with that  
14 comparison?

15 A I have shown the results of each of these  
16 approaches for the limited oil partnerships, as well as  
17 for the natural gas and integrated petroleum industries.  
18 I've shown it for each of them, for each of the methods.

19 Q What would the result be if you used only the  
20 DCF approach, and only applied to the integrated -- or  
21 the oil pipeline companies as the one industry and not  
22 the other two?

23 A If that's the only thing that I did, it would  
24 be a very short presentation. And it would just be the  
25 range that you refer to, the 13.3 to 17.2.



2532

1           Q    So if you were limited to that, to the DCF  
2    approach, and you were limited to proxy group of oil  
3    pipeline companies that you compared to, your result  
4    would be what?

5           A    Well, if I was told I was limited to that, I  
6    wouldn't be here today. That would be a ludicrous  
7    exercise. But if that was the only information that the  
8    Commission decided that it wanted to consider, then the  
9    only thing they would have for me would be that 13.3 to  
10   17.2 range if that's all they wish to consider.

11          Q    And how would you pick a number in that range?

12          A    Based upon what I know, I would go to the  
13   bottom of the range because that range is considerably  
14   higher than the -- than the cost of capital today.

15          Q    And that range, would you consider it at all  
16   risky in that range?

17          A    I don't understand the question.

18          Q    The pipeline industry, I believe that you  
19   testified at the very outset, is different in terms of  
20   risk than other industries, such as integrated oil  
21   companies themselves. Is that a fair statement?

22          A    Every industry has some unique risk  
23   characteristics, and the oil pipeline industry is no  
24   exception in that regard.

25          Q    And I believe you said earlier that, for

2533

1 example, a nuclear power industry was a particularly  
2 risky industry, and maybe still is?

3 A Nuclear power generation investments proved to  
4 be more risky than other types of investments in the  
5 power generation business. That's true.

6 Q And is oil pipeline riskier than two or three  
7 years ago?

8 A In the sense of having costs of money, no. In  
9 terms of their comparison with other industries, I am  
10 not aware that they are, no.

11 Q How did you choose 50 percent as the upper  
12 limit for Olympic's actual equity share?

13 A I didn't choose 50 percent as a limit for  
14 Olympic's actual equity share. I chose it as an upper  
15 limit of a deemed equity share, recognizing that  
16 Olympic's actual equity percentages for the foreseeable  
17 future are likely to be substantially less than that.

18 Q If Olympic's parents characterized the capital  
19 that they put into Olympic as all equity, 100 percent  
20 equity, would you agree that the capital structure for  
21 Olympic should be set on that basis or on the  
22 characterization on that investment, or would you put --

23 A I would --

24 JUDGE WALLIS: Dr. Schink, please let Mr.  
25 Marshall conclude the question -- Dr. Wilson, I'm sorry.

1                   MR. TROTTER:    And I object to the question as  
2   it was about to be compound.   So if we could have it  
3   rephrased, Counsel, that would be great.

4                   JUDGE WALLIS:   Mr. Marshall.

5                   Q   BY MR. MARSHALL:   If Olympic parents  
6   characterized the financial risk that they have in  
7   Olympic as all equity, would you accept 100 percent  
8   equity capital structure for Olympic for purposes of  
9   rate making?

10                  A   If they characterized it, no, I wouldn't.   I  
11   wouldn't recognize it as all equity for rate making.  
12   And if it was 100 percent equity in reality, as opposed  
13   to simply a characterization, I don't think I would use  
14   100 percent equity ratio either, because that wouldn't  
15   be an efficient way in which to fund a pipeline.

16                  Q   So you would put an upper limit on rate of  
17   return on equity in a capital structure, even if it has  
18   one 100 percent equity?

19                  A   I think that would be my recommendation to the  
20   Commission.   If they had a company who had an excessive  
21   amount of equity in their capital structure such that it  
22   resulted in a higher cost indication than would be  
23   achievable in the marketplace, I would recommend that  
24   they use a reasonable deemed capital structure instead  
25   of the actual capital structure that was excessively

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1 financed with equity, yes.

2 Q What upper limit would you place on that, or  
3 do you have an opinion?

4 A I would have to look at the circumstances of  
5 the company in question. I would say that for most  
6 companies like Olympic, and indeed, for most companies  
7 that this Commission regulates, equity ratios much above  
8 the 50 percent level would tend to be excessively  
9 costly.

10 Q So you would put a 50 percent limit on the  
11 equity portion of capital structure, even if the actual  
12 equity structure were 100 percent --

13 A I would look at the --

14 JUDGE WALLIS: Dr. Wilson -- did you complete  
15 the question?

16 MR. MARSHALL: Yes. Yes.

17 THE WITNESS: Before I could say what the exact  
18 deemed capital structure should be, or what the  
19 appropriate range would be, I would want to look at the  
20 circumstances of the case.

21 But, for example, if Avista or Puget Sound came  
22 in here with an electricity rate case with an 80 percent  
23 equity ratio, it is likely that if I reviewed the  
24 circumstances in those cases I would say to the  
25 Commission this is an excessively thick equity ratio,

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1 and an electric utility doesn't need this much equity in  
2 its capital structure.

3 I would recommend you used a deemed capital  
4 structure that more closely represents efficient  
5 operation. I think commissions are obliged to look at  
6 efficiency and prudent costs when it comes to capital  
7 cost, much the way they do when they look at other types  
8 of expenses.

9 So, yes, I would recommend some limits on the  
10 amount of equity to be used in a capital structure, not  
11 only because equity typically costs more than debt,  
12 because it has a big tax burden that it takes with it.

13 Q Do you know why Olympic's parents have a  
14 combined equity percentage of 86 percent?

15 A I have a pretty good idea. Would you like me  
16 to tell you why I think they do?

17 Q Are they operating, would you imagine, in a  
18 prudent way using market signals on setting their  
19 capital structure?

20 A No, I don't think their capital structure has  
21 anything to do at all with market signals. You are  
22 looking at a capital structure in which the measurement  
23 is book equity. It's an accounting concept. If you  
24 were looking at a market measure, such as the  
25 capitalized value of the equity, the market value, now

1 the capitalization of the company in the marketplace,  
2 that would be a market measure of sorts.

3 But to take the book value of a company is  
4 simply taking the accounting entries that have occurred  
5 over time as a result of mergers, acquisitions, the  
6 capitalization of goodwill.

7 For example, if you had two companies worth a  
8 billion dollars each that merged together as equals,  
9 they may come out of that merger with 2 billion dollars  
10 worth of equity.

11 On the other hand, if you had two companies, a  
12 billion dollars each, one of which acquired the other at  
13 a market book ratio of two to one, which is a typical  
14 range these days, you create a billion dollars or two  
15 billion dollars worth of goodwill, and you come up with  
16 a capital ratio of -- equity ratio of a third or a  
17 quarter. Simply a result of an accounting process  
18 that's attributable to the merger and acquisition  
19 business, and having nothing to do with risk  
20 characteristics that would differentiate those two  
21 companies.

22 So I think it's a complete mischaracterization  
23 when you look at book equity ratios, and then compare  
24 that with debt and arrive at the conclusion that this is  
25 some sort of a market perfection or the result of market

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1 mechanisms that's creating these ratios. It's not. You  
2 would have to go to a completely different measure,  
3 which is the capitalization of the firm, the value that  
4 the market puts on the firm's stock, not the book value.

5 Q Have you done that for BP?

6 A Have I done what for BP?

7 Q Done that capitalization?

8 A I have looked, and I can tell you what it is,  
9 yes.

10 Q What is their capitalization?

11 A Market cap for BP is 195 billion dollars. It's  
12 a very large cap company.

13 Q Please explain in layman's terms why Olympic's  
14 own capital structure matters when it's wholly owned by  
15 BP and Equilon.

16 A Thank you. It matters for the following  
17 reason. It matters because of the way that the company  
18 has been managed and operated.

19 Under certain circumstances it would be  
20 appropriate to argue, as Dr. Schink has argued, that  
21 high debt ratios and high payout ratios for vertically  
22 integrated enterprises of this nature are not  
23 particularly important if the quid pro quo is that the  
24 parents of the company are standing by and providing the  
25 contingency, and providing the equity backing that an

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1 enterprise needed.

2 I think it's been described that for many  
3 vertically integrated pipelines that pay out all or most  
4 of their earnings, there are regular determinations as  
5 capital needs occur on the part of the owners to inject,  
6 infuse equity capital into the enterprise. Many  
7 companies do operate that way.

8 In this case, that's not happened. Going back  
9 12 years there's not been a single instance in which any  
10 of the owners of Olympic Pipeline have infused any  
11 equity capital into the enterprise during a period of  
12 time in which they regularly received as dividends all  
13 of the earnings of the enterprise.

14 Now we have a situation in the last couple of  
15 years where some fairly extreme cash flow problems have  
16 developed, because of very understandable and  
17 describable incidents. A couple of investments that  
18 didn't turn out to be revenue producing, Cross Cascades  
19 and Bayview, the Whatcom Creek accident that we talked  
20 about earlier, and the seam rupture problem, all of  
21 which require equity backing that required the  
22 contingency of either retained earnings or the infusion  
23 by the parent.

24 In this case, because the retained earnings  
25 have not been acquired over time, it would have been



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1 appropriate for there to be equity infusions by the  
2 parents to resolve these problems. That's not happened.

3 So you sort of can't have it both ways. You  
4 can either say capital structure doesn't make any  
5 difference. We can pay out all of our earnings, because  
6 the other pipeline companies do. We can maintain the  
7 type of equity ratios that the other pipeline companies  
8 do. But you can't turn around when the time for equity  
9 infusions comes about and say, well, we're going to  
10 provide safety investments only if rates increase to  
11 provide the cash flow that has been interrupted by  
12 virtue of these accidents.

13 So in a nutshell, I think that's where I would  
14 come down. And I think that the panel certainly  
15 understands it, too. I think that's very close to the  
16 questions that the Chairman was asking the last witness,  
17 which I think is hitting the nail right on the head.

18 Q Let me give you an example. If I want to buy a  
19 house for \$200,000, and I put \$50,000 down, and I loan  
20 myself \$50,000 so I have \$100,000 in this house --

21 A You loan yourself \$50,000?

22 Q It does sound strange, doesn't it?

23 A Why don't you borrow it from me?

24 Q In the situation of Olympic, the owners have  
25 done essentially that. They have put in capital when

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1       they bought that.  Maybe the capital is gone, but they  
2       have also put in loans; is that correct?

3             A     They have put in loans.  And I think one of  
4       your witnesses -- one of your witnesses, your assistant  
5       treasurer, what is his name?

6             Q     Mr. Howard Fox.

7             A     Mr. Fox, that's right.  I think has come close  
8       in his rebuttal testimony to at least outlining a  
9       solution to the cash flow problem, and a solution to the  
10      regulatory problem here.

11            And that is, characterize the investments that  
12      have been put in recently properly; that is, as equity  
13      capital.  Put a moratorium on dividend payments.  That  
14      would not be unique.  There was a proposal in Oregon  
15      recently on the part of Northwest Gas, and probably  
16      here, too, I don't know if it was made in Washington, to  
17      put a moratorium on dividend payments in order to fix  
18      the capital structure problem they were going to have if  
19      they acquired Portland General.

20            But you could put a moratorium on dividends  
21      until some sort of an acceptable target was reached.  
22      The owners of the pipeline have not made capital  
23      contributions to the extent that BP has made loans, or  
24      should make equivalent contributions.

25            I think those actions, if taken, would

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1 essentially solve all or nearly all of the cash flow  
2 problems. Your own evidence indicates that your cash  
3 flow is adequate before the Whatcom Creek accident, and  
4 the difficulties that you are trying to run through the  
5 rate payer here would largely be resolved -- and really  
6 without any cash flow problem of a major nature to the  
7 parents of Olympic. I think it can be done.

8 Q The question related to the character of the  
9 loans in equity in this hypothetical. Your question  
10 back to me is why would you loan yourself money to  
11 invest in a home. The character of a loan from a parent  
12 is different than the character of a loan from a third  
13 party. Is that true or not true?

14 A It depends upon the nature of the legal  
15 agreement that exists. I think that's a legal question.

16 Q If I loan --

17 A Oftentimes parent corporations that make loans  
18 to affiliates have superior claims to borrowings that  
19 have been done from third parties. It depends upon the  
20 nature of the loan.

21 Q In this case, do Olympic's parents have any  
22 superior borrowing right to any third-party loans  
23 whatsoever?

24 A I don't think so.

25 Q In fact, you know that's not true, correct?

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1           A    I don't know of any.

2           Q    So as far as you know, all of the loans that  
3   Olympic has are either guaranteed by the parents, or  
4   made directly by the parents; is that correct?

5           A    I think there are a couple of smaller loans  
6   that -- or interest payments that are associated with  
7   nonparents, but the bulk of the borrowing is from the  
8   parents.

9           Q    And the bulk of the loans are from the parents,  
10   and all of the loans are either made by the parents or  
11   guaranteed in some fashion by the parents, correct?

12          A    In some fashion, I think it was indicated that  
13   there was certain through-put arrangements that backed  
14   certain loans.  But I will agree with you that the loans  
15   by -- the loans are either by the parents or secured by  
16   them in some way.

17          Q    And the through-put agreement is with the  
18   parents?

19          A    Yes.

20          Q    And you recognize through-put and deficiency  
21   agreements.  Are you familiar with them?

22          A    To some extent.

23          Q    Are you familiar with the ones in this case?

24          A    Not in detail, no.

25          Q    Have you seen the through-put and deficiency

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1 agreement in this case?

2 A No, I don't believe I have.

3 Q Was this officially financed with a through-put  
4 and deficiency agreement in 1965?

5 A Was that the essence of the financing in '65?  
6 I don't know whether that was the full financing or not,  
7 no.

8 Q Now, you mentioned Avista debt a little while  
9 ago. Does Avista debt, is that owed to third parties,  
10 or is it owed to any of the shareholders of Avista?

11 A I can -- I don't think I mentioned Avista debt.  
12 Avista clearly has first mortgage bonds that are payable  
13 to unrelated parties. Whether they have any debt  
14 associated with affiliates, I don't know.

15 Q So as far as you know, they don't owe any debt  
16 to any parties. They don't rely on any parents, lean on  
17 their parents' capital structure in any way; is that  
18 correct?

19 A Avista doesn't have corporate parents, I don't  
20 believe.

21 Q Can you think of any regulated company  
22 regulated by the WUTC that has a capital structure where  
23 the company being regulated must rely on or lean on the  
24 debt of the corporate parents?

25 A Well, that certainly existed in the past with

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1       respect to Pacific Northwest Bell when it was part of  
2       the AT&T system. I don't know at the present time to  
3       what extent. You do have GTE affiliates that rely upon,  
4       in some way, parent debt. There may be some.

5             Q     When you said a moment ago that the character  
6       of the debt was a legal question -- do you remember  
7       that?

8             A     Yes.

9             Q     What do you mean, it's a legal question?

10            A     What the debt instruments, the contract calls  
11       for.

12            Q     Now, the character of capital placed at risk,  
13       the essence of what we're trying to do here is to try to  
14       find out how to attract sufficient capital on reasonable  
15       terms. Would you agree that that is the end product of  
16       regulatory practice?

17            A     That's one regulatory objective that's usually  
18       a consequence in determining a fair rate of return.

19            Q     And with a capital structure such as this,  
20       where the capital at risk is all parent loans directly  
21       to the subsidiary, or guaranteed by the subsidiary, what  
22       is the way to attract capital on reasonable terms?

23            A     On a going forward basis, as I indicated  
24       earlier, I think you can have it one way or the other.  
25       You can set up a process under which a capital structure

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1 would be achieved so that independent financing can be  
2 done.

3 Or you can set up a mechanism under which, in  
4 essence, the financing is done by the -- directly by the  
5 parent companies. But you would have to have, in that  
6 arrangement, a quid pro quo in which the parent  
7 companies would pony up the equity infusions that were  
8 necessary at the time that they became necessary, which  
9 is, to a significant extent, what has not happened here.

10 Q But do you agree that in order to attract  
11 capital on reasonable terms from the parents you are  
12 going to have to look at what the cash flow will be? In  
13 other words, will new capital come in in this situation  
14 where the odds are that it will not recover the new  
15 investment?

16 A I think that there's several things that are  
17 important. I think you would want to look at what the  
18 parents' cost of capital was. I have actually done  
19 that. You have not in your case. I think you would  
20 want to -- yeah, I think you would be concerned about  
21 cash flow, but you can't be concerned about cash flow  
22 only without looking to the causes of the cash flow  
23 problem.

24 You can't say, gee, cash flow is not adequate.  
25 We need higher rates, if the cash flow problem is

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1       attributable to outages or limited operations without  
2       going into the reasons for those operations and those  
3       outages, or without considering the recovery period.  
4       You don't provide for capital investments out of current  
5       cash flow. Capital investments, they are useful over  
6       a long period of time, or typically funded not only in  
7       this industry, but all industries by the equity owner  
8       and recovered through prices and charges and rates over  
9       time.

10                They are not expensed at the time that they are  
11       incurred. It would be completely unreasonable to set  
12       rates here so as to provide all of the cash flow  
13       currently that's necessary to solve Whatcom Creek,  
14       that's necessary to provide for the safety investments  
15       that must be made to take care of the seam problems, to  
16       overcome the lack of revenue from Bayview and Cross  
17       Cascades.

18                Those are all matters in which equity capital  
19       should be advanced by the entrepreneur, the owner of the  
20       company. And then to the extent that those costs are  
21       just and reasonable, be recovered over time through  
22       rates.

23                Q     So it's your testimony that setting a rate that  
24       you have recommended here will attract capital from the  
25       parents of Olympic?



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1           A    It should.  It certainly reflects adequately  
2   cost of capital in the marketplace today.  I believe it  
3   exceeds the cost of capital that those parent companies  
4   face at the present time, and I think that they -- that  
5   there will be a basis for fair and reasonable and  
6   adequate attraction of capital.

7           Q    Do you know how much capital Olympic needs over  
8   the next three years?

9           A    I think it's been indicated by Olympic -- I  
10  don't have any independent knowledge of this -- that  
11  they need something in excess of 61 million dollars.

12          Q    The rate of return on this investment that you  
13  wish Olympic's parents to make is what percentage?

14          A    I have indicated a range, and the range, I  
15  think, is 7.4 to 8 percent overall.

16          Q    So for the 66 million dollars you want Olympic  
17  to put in over the next three years, assuming it's a  
18  correct figure, you want to allow a return of 7 to 8  
19  percent overall; is that correct?

20          A    7.4 to 8 percent on rate base.

21          Q    That's --

22          A    That's a pretty attractive return in today's  
23  market.  It would not have been an attractive return  
24  when cost of capital was 10 or 12 percent.  But an 8  
25  percent return in today's market, there aren't a lot of

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1 places you can go and get an 8 percent return today.

2 It's -- keep in mind, here, we're talking about  
3 6 or 7 percent above the short-term rate. You are not  
4 going to find any finance professors that are going to  
5 come in and argue with support from the financial  
6 literature that the spread over the risk free rate is  
7 more than 7 percent. That's really the top end of their  
8 range.

9 Q And you think with all of Olympic's risk, with  
10 all of its challenges, with all of the things it must do  
11 over the next three years, considering all of the  
12 situations it has with new Federal regulations, with all  
13 of the risks that we went into, that 7 to 8 percent will  
14 be sufficient to attract 66 million dollars in  
15 additional capital?

16 A The answer is yes. And I would also say that  
17 it's important to take into consideration how we got to  
18 where we are.

19 Q If we take into consideration, going back, how  
20 we got to where we are, would you agree that past  
21 returns on equity haven't taken into account a risk that  
22 actually came to pass -- in fact, several risks that  
23 have come to pass, including Whatcom Creek, the ERW seam  
24 failure, and so on?

25 MR. TROTTER: Excuse me, Your Honor. That was

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1 one question, and he's onto another one. I am going to  
2 object to questions that have five or ten prepositional  
3 phrases in them, so if Mr. Marshall --

4 JUDGE WALLIS: If you could improve your grammar, Mr.  
5 Marshall, so the witness may respond.

6 Let's take a five-minute break.

7 (Brief recess taken.)

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

9 Mr. Marshall.

10 Q BY MR. MARSHALL: Dr. Wilson, I asked the  
11 question before the break, but we didn't actually get to  
12 the answer. And you are thinking back in time as to  
13 certain decisions that were made, and I was wondering if  
14 you could go back in time and look at the actual risks  
15 faced by Olympic.

16 In light of what actually happened, would you  
17 say that the rate of return allowed was commensurate  
18 with the actual risk, as it turned out?

19 A It was commensurate with the actual risks that  
20 were perceived, and were relevant. I won't say that  
21 Whatcom Creek was foreseen, or that the seam rupture  
22 problem was foreseen, or that it was known that these  
23 investments in Cross Cascades and Bayview were not going  
24 to pan out and produce revenue. If that was foreseen,  
25 it wouldn't have been made.

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1           So if you are -- your point is that the events  
2           that occurred were not foreseen. I will agree with  
3           that, and I don't know whether the amount of money  
4           obtained through rate of return allowances was  
5           sufficient to compensate for them. You would have to do  
6           a present value calculation to answer that question. I  
7           haven't done it.

8           Q    Now, if -- assume for a moment that we create  
9           Olympic as a stand-alone entity, and it has plant in  
10          service of 92 to 95 million dollars. Are you with me so  
11          far?

12          A    I can assume Olympic as a stand-alone entity.  
13          I don't know what you mean to create it, if you have  
14          something in particular in mind.

15          Q    Let's assume they have a 50 percent equity and  
16          50 percent debt capital structure for this company with  
17          that amount of plant in service. Are you with me there?

18          A    Uh-huh.

19          Q    Would that company be riskier as a stand-alone  
20          company than it is currently being owned by the parents  
21          that have ownership interest?

22          A    I think so, yes, because it would lose the risk  
23          reducing benefits of vertical integration.

24          Q    So if you had a 50 percent equity in a  
25          stand-alone company that we have hypothesized, you would

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1 have approximately 47 to 48 million dollars of equity,  
2 and the rest would be debt, correct?

3 A Sure, half and a half.

4 Q And 47 million dollars of equity, Olympic has  
5 gone through that just in the decline of through-put  
6 since 1999, hasn't it?

7 A I don't know that they have as a result of  
8 decline in through-put.

9 Q Well, if you went back and looked at what the  
10 amount of the through-put was before -- before, let's  
11 take the ERW seam failure in September 1999, and then  
12 look at what the through-put levels are following that,  
13 the through-put levels have declined dramatically,  
14 haven't they?

15 A Through-put levels were very low as a result of  
16 Whatcom Creek, and even since the pipeline went back  
17 into operation because of the limitations on pressure,  
18 they have been lower than normal. That's also water  
19 over the dam.

20 Q And as we have discussed before, the decline in  
21 through-put is the biggest risk, and the decline in  
22 through-put -- will you accept subject to check, since  
23 September of '99 through December 2001, was in the range  
24 of 48 to 53 million dollars, depending on what you do  
25 with the variable costs like power and DRA?

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1           A    I can't verify those numbers.  They are not  
2           something I have studied.  But I will agree it's like  
3           having an electric generating plant that is shut down  
4           and not able to produce kilowatt hours, or produce no  
5           revenue for some time.  It is a risk that is common to  
6           the types of businesses that this Commission regulates,  
7           but it's a serious risk.

8           Q    So if you assume a company, a stand-alone  
9           company in the beginning of 1999 with 95 million dollars  
10          plant in service and a 50/50 capital structure, just the  
11          through-put decline alone and the loss of revenues would  
12          more than eat up all of the equity, is that correct,  
13          everything else being the same?

14          A    As I said, I can't verify your numbers for you.  
15          But if you had a 50 million dollar reduction in  
16          through-put, it would certainly be a significant hit on  
17          equity.  I think the thing that you are potentially  
18          forgetting to take into account is there would be some  
19          reduction in operating costs as well.

20          Q    At the same time Olympic had to face putting  
21          millions, tens of millions of dollars of additional  
22          capital, improvements, safety replacement, and so forth  
23          in that same period of time, correct?

24          A    Yes.

25          Q    So if Olympic were a stand-alone company, it

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1 would not have had the dollars to do that, assuming the  
2 capital structure you have assumed, right?

3 A Again, I think I cannot verify your numbers for  
4 you. And in your hypothetical you haven't taken into  
5 account expense reductions, and maybe tax  
6 considerations. But you could create a hypothetical in  
7 which a bankruptcy would occur.

8 Q And for that reason, your testimony has been  
9 that Olympic is a less risky business, because it is  
10 owned by two large oil companies, right?

11 A Yes. The fact that it is tied to the  
12 refineries and the marketing does reduce its risk.

13 Q And because of that, Olympic continues to rely  
14 on and lean on the credit, the capital structure of  
15 those two large entities to reduce its risk and to  
16 provide capital to it?

17 A Did you say because of that, or simply are you  
18 making the statement that they do rely upon their  
19 parents?

20 Q Let me make this clear. You said Olympic is  
21 less risky because it has ownership by two large oil  
22 companies; is that correct?

23 A Well, historically it's been more than that,  
24 but the tie-in to the refining and to the marketing, the  
25 vertical integration that ties the pipeline investment

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1 to a self interest in the refining and the marketing  
2 does tend to reduce the risk.

3 Q It's the backing of two large oil companies  
4 that reduces the risk, whether it's tied into something  
5 that doesn't have any financial wherewithal, doesn't  
6 matter. It's because entities like BP and Equilon are  
7 there that reduces the risk. It's their capital being  
8 leaned on, correct?

9 MR. TROTTER: I will object to the question.  
10 There's three in one -- compound question. I object.

11 JUDGE WALLIS: Mr. Marshall, do you want to  
12 parse that up, please?

13 Q BY MR. MARSHALL: If something tied into an  
14 entity that had no money, it wouldn't matter whether  
15 they could lean on that entity. It's only because  
16 Olympic has two large, solvent companies standing behind  
17 it that reduces its risk, correct?

18 A No, I don't -- I don't agree with that. You  
19 are trying to make a different type of argument.

20 My observations didn't have so much to do with  
21 the size and the financial capabilities of BP and Shell  
22 as it did with the functional integration of the  
23 pipeline with the refining and the marketing interests  
24 of the same owner.

25 So you are actually -- you are making a



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1 different point when you talk about the -- simply the  
2 financial size. In other words, if Microsoft owned  
3 pipeline, I wouldn't make the same statements about  
4 reduced risk that I make, because it is tied to the  
5 refining and the marketing. The ownership by Microsoft  
6 wouldn't provide that advantage, even though Bill Gates  
7 has got lots of money.

8 Q By the same token, if Olympic were owned by  
9 Enron, it wouldn't provide much mitigation of risk,  
10 would it?

11 A It would be worse than that.

12 Q It sure would. So it does matter?

13 A Could be contingent liabilities.

14 Q That's right. Contingent liabilities are a big  
15 part of risk?

16 A That certainly would be a problem if Enron were  
17 there, yes.

18 Q Now, what you are really saying is the capital  
19 structure, the solvency, the power of being able to  
20 stand behind a child, a parent that has the wherewithal  
21 is an important factor in trying to figure out what the  
22 risk is for Olympic Pipeline?

23 A Didn't much like the child analogy. But,  
24 again, I think you are trying to make a different point  
25 than I did. You are saying that a big rich company

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1 Microsoft or BP, or any other big corporation that you  
2 could name, that had great financial capability would do  
3 the same thing. And I don't think that's my point.

4 My point is the functional relationship between  
5 the pipeline and the refining and the marketing creates  
6 an assurance of revenue treatment for the pipeline,  
7 assuming it can operate, that you wouldn't have with  
8 independent ownership.

9 Q But the thing that you are suggesting is that  
10 we ought to try to find a method to look at Olympic as  
11 though it were a stand-alone company without the backing  
12 of BP or Equilon, to look at that risk profile of 95  
13 million dollars of plant, and 50/50 equity without any  
14 stand-by parent to help them out?

15 A No. I think it's appropriate for the  
16 Commission to take the affiliation into consideration.

17 Q And that results, then, in two refineries  
18 subsidizing two other refineries, the other two that are  
19 here; isn't that correct?

20 A That's not my testimony, no.

21 Q But isn't that the logical outcome? If you  
22 insist on two refineries that rely on the pipeline to  
23 come up with the capital, and absorb all the risk, and  
24 two other refineries by operation of Federal law that  
25 must be treated without any discrimination are able to

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1 benefit, isn't it inevitable that you have a subsidy?

2 A No, I don't -- I am not seeing your subsidiary  
3 argument. I think that the risks are what they are.  
4 And they affect the cost of capital for the pipeline,  
5 and certainly the cost of capital that ought to be used  
6 for regulatory purposes.

7 But I am certainly not arguing that there ought  
8 to be different rates for different classes of shippers  
9 that are unrelated to cost of service.

10 Q Well, under your approach, wouldn't it be  
11 better for BP and Equilon to sell Olympic to a third  
12 party and make it a stand-alone company?

13 A I doubt from a corporate point of view that BP  
14 and Equilon would agree with you. I have reviewed  
15 enough investment decisions by oil companies with  
16 respect to vertically integrated facilities to believe  
17 that they see value in that existing relationship. I  
18 don't think that they would be as comfortable about  
19 their refining operations or their marketing operations  
20 without control of the pipeline.

21 MR. MARSHALL: I don't have any further  
22 questions.

23 JUDGE WALLIS: Mr. Brena.

24 MR. BRENA: I have no questions.

25 JUDGE WALLIS: Mr. Finklea.

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1                   MR. FINKLEA:    Your Honor, there is one  
2                   question that is sparked by the colloquy with  
3                   Mr. Marshall, and it is not friendly cross, actually.

4

5

CROSS EXAMINATION

6

7

BY MR. FINKLEA:

8

Q    Dr. Wilson, if Olympic has a through-put  
9                   adjustment mechanism as suggested by Dr. Means, does  
10                  that lower the risk of this venture compared to the risk  
11                  that Mr. Marshall was describing during the time of the  
12                  outages?

13

A    Yes.

14

MR. FINKLEA:    Nothing further.

15

JUDGE WALLIS:   Commissioner questions?

16

17

EXAMINATION

18

19

BY CHAIRWOMAN SHOWALTER:

20

Q    Well, as a follow-up to the last question that  
21                  Mr. Marshall asked you, he raised the scenario of let's  
22                  say, for simplified purposes, four shippers, two of  
23                  which are owners of the company, and he asked you  
24                  questions about subsidy from the shipper owners to the  
25                  "shipper onlys," let's call them.

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1           But isn't it correct that if this Commission  
2 sets an appropriate rate, setting aside all the disputes  
3 of whatever that is, that then the shipper owners as  
4 owners will get an appropriate return on their  
5 investment, and the shippers, including the shipper  
6 onlys, will get an appropriate rate for the service they  
7 are receiving?

8           A    I believe that follows.  Yes.

9           Q    So the debate really is over what is the  
10 appropriate revenue requirement or risk in order to give  
11 the shipper owners -- really the owners, as owners, the  
12 appropriate opportunity for return?

13          A    I agree.

14          Q    So then, I guess, the next step down of detail  
15 is whether, recognizing in any way that the owners are  
16 who they are, in this case two large oil companies, is  
17 impermissible, because just to recognize the parents as  
18 potential backers is to treat them unfairly, and thereby  
19 consequently treat the shipper only shippers  
20 preferentially?

21          A    I think it's appropriate.  And in this case,  
22 actually, significant.  And it is also traditional  
23 regulatory practice to recognize in context like this  
24 who the parties are.  For example, this Commission and  
25 commissions throughout the country, and the Federal

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1       Communications Commission always recognized who Western  
2       Electric was when they were owned by AT&T, and were  
3       vertically integrated, and made all the telephone  
4       equipment that AT&T installed in their central offices  
5       and customers' premises.

6               And so it is significant, in regulating  
7       electric utilities in many states, to recognize whether  
8       those electric utilities purchase their coal from  
9       affiliated coal companies. The type of vertical  
10      integration here that reduces revenue risk and creates  
11      an incentive to provide revenues and sales to the  
12      regulated entity is the type of consideration that  
13      regulatory commissions have always taken into account.

14             I don't think that that ought to dominate your  
15      thinking, but it's a relevant consideration, especially  
16      if you are thinking about risk, just like whether or not  
17      there's an automatic adjustment clause would affect your  
18      consideration of the risk of a gas utility or electric  
19      utility, or whether a through-put adjustment mechanism  
20      would affect your consideration of risk to this type of  
21      pipeline.

22             Q     Then Mr. Marshall asked you to compare a  
23      stand-alone company to a parent owned company, when both  
24      had 50/50 equity ratios. I am interested in a different  
25      comparison.

1           Compare two companies, each owned by their  
2           parents, and the parents look identical. In fact, maybe  
3           it is the same parents. Let's say the parents have two  
4           children and --

5           A    Somehow it sounds better when you say it.

6           Q    And one child has zero percent equity and the  
7           other has 50 percent equity.

8                    Is there a difference in those two scenarios  
9           vis-a-vis either risk cost of capital, the various  
10          elements that you have been talking about this  
11          afternoon?

12          A    I think there could be. In other words, you  
13          wouldn't simply look to the fact that BP was the owner  
14          of pipeline "X" and pipeline "Y". If the underlying  
15          financial circumstances of the two pipeline companies  
16          differed, it wouldn't be the fact that they are  
17          necessarily the same in terms of their rate of return  
18          characteristics, cost of the capital characteristics  
19          simply because they had the same parent.

20          Q    You mentioned the quid pro quo, and this is in  
21          a discussion of why is equity different than debt. And  
22          I thought I heard you say, well, it wouldn't be, or it  
23          might not be if -- there was a big if -- the parents  
24          were ready to stand behind the child or infuse capital  
25          when needed.

1           Is that a rough characterization of what you  
2       said, and maybe you were characterizing Dr. Schink?

3           A    I really wasn't saying that it doesn't make any  
4       difference whether it's equity or debt, because I think  
5       it does make a difference whether it's equity or debt.  
6       Certainly it would make a bigger difference to the  
7       accountant and the financial statements would look  
8       different depending on whether it was characterized as  
9       equity or debt.

10           What I was saying was the argument has been  
11       made that Olympic is very much like other pipelines.  
12       Not this proxy group, by the way, because it's not very  
13       much like this proxy group, but it does have some  
14       characteristics that are similar to other oil pipelines.

15           For example, thin equity ratios, it is true  
16       that there are other pipelines with 10 to 15 percent  
17       equity ratios. And it is true that there are other  
18       pipelines that pay out a large portion of their  
19       earnings, 100 percent in some cases.

20           But in order to function as a financially  
21       viable entity, if you are going to have a 90 percent  
22       debt ratio, or if you are going to pay out all of your  
23       earnings, in order to function as a viable financial  
24       equity, then the equity infusion must come at times when  
25       equity infusions are needed.



1           And as I said, we have had at least four, maybe  
2 five things that have happened here in recent years. I  
3 guess the one I forgot to mention was the decision on  
4 the part of this company not to come in for rate  
5 increase at some earlier time when they may have thought  
6 that was justified.

7           If you are going to do those kinds of things,  
8 and even unforeseen events occur, and you have elected  
9 to operate in this manner, then it's necessary to have  
10 the equity infusion directly in the alternative way, and  
11 not to say we behaved just like other pipeline companies  
12 up until now, except we're not going to do the equity  
13 infusion when the equity infusion is necessary.

14           Q    But it seems to me that the lack of guarantee  
15 of that quid pro quo is the difference. If you don't  
16 know that the quid pro quo exists, because nothing  
17 guarantees it, then you don't know it exists. Whereas  
18 if a company actually has equity in it, and something  
19 goes wrong, there is the possibility of -- eating into  
20 the equity, there's the possibility of a third party  
21 financing.

22           There are possibilities that exist that don't  
23 exist with the zero percent equity, and the only other  
24 possibility is simply the hope that the parent will  
25 infuse the capital when history may have demonstrated

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1 that it hasn't happened very often.

2 A That makes a lot of sense, what you are saying.  
3 And as a conceptual matter you are exactly right. As a  
4 practical matter, I think you need to take with a grain  
5 of salt some of the representations that lawyers make in  
6 argument.

7 You may not have a contractual guarantee that  
8 the funds that are necessary to operate this pipeline  
9 will occur. On the other hand, BP and Shell have not 50  
10 or 60 million dollars invested, they have a lot more  
11 invested in those refineries, and to some extent in  
12 their marketing operations, that are very dependent upon  
13 this pipeline.

14 And I think that you have more than a loose  
15 hope that the investments will be made to make sure that  
16 the pipeline does operate and operate efficiently, and  
17 in conformance with safety requirements.

18 That's not to say that in any way lessens the  
19 need of the Commission to provide a fair and equitable  
20 rate of return, and provide rates that permit the  
21 company to recover reasonable costs and expenditures.  
22 But it also undermines the argument that you better do  
23 what they want you to do, otherwise they are going to  
24 leave you without a pipeline. I don't think that's  
25 going to happen.

1           Q    So you are saying take with a grain of salt the  
2           threat that if we don't give the company the rate  
3           increase it has requested, it will not, for example,  
4           invest in safety equipment and therefore won't be able  
5           to run?

6           A    They will invest in safety equipment and it's  
7           incumbent upon you to give them a fair rate of return  
8           and adequate rate of return.  If you don't do that, they  
9           have a Constitutional entitlement to challenge that in  
10          the court, and I am sure they will.

11                    But there is a strong, strong economic  
12          motivation that they have independent of this regulatory  
13          forum to operate that pipeline, and operate it  
14          efficiently.  And I think that is likely to occur.  And  
15          I don't think any super normal bail-outs are necessary  
16          in order for that to occur.

17                    I think if you make a fair and reasonable  
18          decision, even though that is likely to mean some  
19          write-offs and nonrecovery of costs, as happens in the  
20          regulatory context many times when accidents happen --  
21          or even accidents that don't involve imprudence, even  
22          though there will be some cost write-offs, there will be  
23          an incentive to move forward and look at things in a  
24          going forward or incremental basis, instead of sitting  
25          around and spending all of the time that is being spent

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1 here trying to recover some costs that are, as an  
2 economic proposition, a matter of past history.

3 CHAIRWOMAN SHOWALTER: Thank you.

4 COMMISSIONER HEMSTAD: I don't have any  
5 questions.

6 COMMISSIONER OSHIE: I have no questions.

7 JUDGE WALLIS: Mr. Trotter.

8 MR. TROTTER: Just two.

9

10 REDIRECT EXAMINATION

11

12 BY MR. TROTTER:

13 Q Dr. Wilson, you said, I believe --

14 MR. BRENA: Excuse me, was there an opportunity  
15 after the Commissioners' questions to ask questions? I  
16 am just asking.

17 JUDGE WALLIS: Do you want to follow up with  
18 questions based on the Commissioners' questions?

19 CHAIRWOMAN SHOWALTER: It's a yes or no.

20 MR. BRENA: No, I was just -- never mind.

21 JUDGE WALLIS: Mr. Trotter.

22 Q BY MR. TROTTER: Dr. Wilson, in response to a  
23 question from Mr. Marshall you indicated that in your  
24 opinion it was not reasonable to limit the analysis of  
25 cost of equity capital in this case to only the DCF

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1 results, or oil pipeline limited partnerships. Do you  
2 recall that testimony?

3 A Yes.

4 Q Can you explain why, please?

5 A Well, several reasons. I wouldn't limit it to  
6 DCF analysis, because other information is available and  
7 valuable. And certainly in terms of financial theory on  
8 cost of money today, the CAPM evidence is likely to be a  
9 more intellectually compelling basis for rate of return  
10 determination.

11 I say that knowing that regulatory commissions  
12 do, by and large, give heavy weight to discounted cash  
13 flow. And I am fairly happy with that, but I think they  
14 should consider the other evidence, including CAPM and  
15 comparable earnings information as well.

16 Aside from methodology, I certainly wouldn't  
17 limit it to these limited oil partnerships -- limited  
18 oil pipeline partnerships. They are not an  
19 exceptionally good fit to an individual oil pipeline.  
20 The dividends that you use, and the dividends yield plus  
21 growth formula are not the same as dividends that are  
22 paid by corporations.

23 A significant part of these dividends for many  
24 of these companies is a return of capital, not a return  
25 on capital. And you will see for some of these

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1 companies in the comparable group, they are paying  
2 distributions, that we're calling dividends here, of \$3  
3 when they only have earnings of a dollar and a half, or  
4 \$2.

5 Now, regular corporations over a long haul  
6 can't do that. So these limited partnerships are in the  
7 business of returning capital, and not just making  
8 earnings and paying dividends out of earnings.

9 They are also, as business enterprises, as I've  
10 discussed with Olympic's counsel, rather different than  
11 Olympic itself. And we have only got five of them, and  
12 limited information on some of those five. So you would  
13 be dealing with a very small and limited universe.

14 Consequently both methodologically and in terms  
15 of what you are looking at, you would be really  
16 excessively restricting yourself in terms of what is  
17 available in order to create the type of information  
18 within which the Commission can exercise its discretion  
19 and good judgment on the rate of return.

20 And I would like to stress a proper  
21 determination on rate of return in this or any over  
22 proceeding, must necessarily involve the exercise of  
23 good judgment, common sense, and discretion on the part  
24 of the Commission. There is no magic bullet in terms of  
25 formula or methodology that will crank out a right

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1 answer.

2 That's one of the problems that FERC has had  
3 ever since the mid 1980s in its efforts to generate  
4 generic approaches that are applicable in all  
5 circumstances. It doesn't work very well. And it's a  
6 mistake that FERC has made. It may take time to reverse  
7 their ground on it.

8 But usually they start moving on the directions  
9 that are right, but it doesn't mean everybody else has  
10 to wait until they do.

11 Q Mr. Marshall used the phrase, capital at risk.  
12 Do you recall that?

13 A Yes. And he indicated that the debt is at  
14 risk, as is equity at risk.

15 Q Is there a difference between Olympic issuing a  
16 note to its parents, a debt instrument, as opposed to  
17 receiving an equity infusion from its parents in terms  
18 of capital at risk?

19 A The only thing that is the same is cash flow.  
20 The cash flow is going to be, in essence, the same you  
21 are going to get whether it's a million dollars of  
22 borrowing, or whether it's a million dollars of equity.  
23 You have a million dollars that you can apply to the  
24 needs of the business.

25 But there are many ways in which equity and

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1 debt are different, and indeed, do make a difference.  
2 Equity capital is reflected on the balance sheet of  
3 companies only to the extent that assets exceed  
4 liabilities. So if you have a large amount of debt, you  
5 may reflect negative equity. If you have a large amount  
6 of equity investment and unforeseen events like this  
7 take place, that equity investment, as an accounting  
8 matter, tends to be written out -- written off, and  
9 losses are recognized. The losses to the owners of  
10 enterprises when revenues fail to cover expenses.

11 So it's certainly a much cleaner way. It will  
12 produce a different type of balance sheet and a  
13 different and clearer basis for regulation and revenue  
14 determination by this Commission if, following Mr. Fox's  
15 suggestion, the recent debt infusions are recognized as  
16 they should be recognized, as equity infusions, and  
17 equivalent participation is obtained from the other  
18 owners of the pipeline.

19 MR. TROTTER: Those are all my questions.

20 Thank you.

21 JUDGE WALLIS: Are there further questions of  
22 the witness?

23 MR. MARSHALL: No.

24 JUDGE WALLIS: Very well. The witness is  
25 excused from the stand.



1           Mr. Brena has indicated that at this point he  
2 has a procedural matter he wants to raise.

3           MR. TROTTER:    Before we do that, I want to  
4 thank the Commission and parties in their courtesy in  
5 letting Dr. Wilson finish tonight.

6           JUDGE WALLIS:  Yes.  And let us extend our  
7 appreciation for your appearance here today.

8           Mr. Brena.

9           MR. BRENA:  Thank you, Your Honor.  We had had  
10 a conversation earlier, and I had asked for the  
11 workpapers so that we could understand what it is that  
12 they changed.  We have been served with their  
13 workpapers.

14           In their workpapers they say, Please see the  
15 attached workpapers of Dan Cummings, George Schink, and  
16 Brent Collins.  And this is the package that we got.  
17 And so it looks like it's thick enough.

18           Honestly, we don't care about Dan Cummings and  
19 George Schink.  I was very specific about what we  
20 wanted, so that part of the package -- and they go on  
21 to -- doesn't matter to me.  They go on to say, "All  
22 other rebuttal witnesses either do not have workpapers  
23 or such workpapers were submitted with each witness'  
24 rebuttal testimony."

25           So this is it.  They are saying that is all

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1       there is. This is what they produced for Brent Collins.  
2       He did three major cost of service studies in his  
3       rebuttal case; one where he revised everything based on  
4       corrections, one where he updated and changed things,  
5       and one DOC.

6               His AFDUC calculations workpaper isn't here,  
7       the financial statements he used aren't here, the CWIP  
8       workpapers aren't here, the miscellaneous expense  
9       workpapers isn't in here, outside services workpaper  
10      isn't indicated, his capital expenses aren't here, the  
11      oil loss allowance isn't here, all the adjustments -- I  
12      mean, this cannot be Mr. Collins' workpapers.

13              Now, you will notice that this is what I got  
14      for Cynthia Hammer, the most important update witness in  
15      this proceeding --

16              JUDGE WALLIS: For the purposes of the record,  
17      would you vocalize what you are indicating,        Mr.  
18      Brena.

19              MR. BRENA: I am holding up an empty hand. I  
20      want to read to you, because these are the problems we  
21      have been having. Let me read you what she said she did  
22      in her testimony. What she said she did was --

23              JUDGE WALLIS: Can you also cite us to an  
24      exhibit number? That is recognizing it hasn't been  
25      moved, but a number has been designated and that will

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1 assist us in following.

2 MR. BRENA: I am reading from 801-T, her  
3 testimony on page 2 of 5.

4 She says, "First I have reviewed base year data  
5 for accuracy and made corrections as required. Second,  
6 I have replaced the projections with actual data through  
7 April 2002. I have also revised the fuel and power  
8 costs to reflect lower than expected through-put."

9 And going on from page two to three,  
10 "Mr. Collins requested that I review certain suggested  
11 adjustments to data proposed by the WUTC Staff."

12 Turning forward to page 4, Are there other data  
13 corrections made, is the question on line 8. The answer  
14 is, "Yes, the final corrections involves the exclusion  
15 of 10.1 million in additions to carrier property and  
16 service, and was erroneously added to the rate payer.  
17 Consequently the base period additions to CPIS changes  
18 from 10.5 million to .4 million."

19 Turning to page five of her testimony, lines  
20 two through ten, the question states, Why did you make  
21 these data updates, and she points out that "The test  
22 period data relied upon was extracted from Olympic's  
23 most recently prepared 2002 budget, which was the best  
24 available information. I have replaced the projections  
25 with actual data from April 2002 in order to align with

1 the known and published standards set for test period  
2 data. I have annualized the updated nine-month test  
3 period expenses with the exception of oil losses,  
4 shortages, fuel and power, and remediation."

5 Turning to page 6 of her testimony, "How has  
6 the oil and loss shortages expense changed?" "The oil  
7 loss and shortages previously relied on were this  
8 number. I calculated a four-year average from 1995  
9 through 1998."

10 Page seven of her testimony, she said, "The  
11 test period additions of CPIS of 16.3 million used in  
12 BAC 3 have been updated. The revised test period  
13 projections include projections completed and closed  
14 through 2002."

15 Mr. Collins, in his testimony, which is 701, he  
16 acknowledges his use of this material. On page 4, lines  
17 9 and 10 he points out also, "Ms. Hammer has conducted a  
18 careful review of input data and corrected for anomalies  
19 in her data."

20 On page 6 of 701, several of the data that were  
21 provided by Ms. Hammer have changed.

22 Page 7, he goes into the data for carrier  
23 property and services, construction work in progress,  
24 working capital, operating expenses, volumes and  
25 revenues have been updated as described by Ms. Hammer.

1 And he points out that he asked Ms. Hammer to take the  
2 multi-year average of oil losses and shortages.

3 Finally, on page 8, in response to the  
4 question, "Do these updated data from Ms. Hammer cause  
5 any other data to change?" He says, "Yes, the test  
6 period depreciation expense is estimated based on the  
7 balance of the test period depreciation of property and  
8 service," and he goes on to indicate changes.

9 The entire backbone of their rebuttal case was  
10 the workpapers of Cynthia Hammer. We asked for them as  
11 clearly as we could have. We said we wanted to  
12 understand why the outside services account changed. We  
13 wanted to understand about the other services  
14 categories. We pointed out that we wanted to see the  
15 workpapers with regard to the test period adjustments  
16 that have been made, because they are just numbers.

17 Ms. Hammer does not divine numbers out of her  
18 head, and they appear in testimony. That isn't how it's  
19 done. People sit down and work up worksheets, and  
20 calculations. They even provided them to Mr. Collins.  
21 He acknowledged that they provided them in his  
22 testimony.

23 I would ask the Commission to compel the  
24 production of the complete workpapers of Mr. Collins and  
25 Ms. Hammer by tomorrow, or I will renew my motion to

1 dismiss, because I think at this point we need those  
2 numbers. We asked for them. I tried to do this as  
3 fairly as I could. I have no other choice. I can't sit  
4 and ask a witness questions on a number that they are  
5 representing was divined from her head, and put in  
6 testimony that we have had no opportunity to do  
7 discovery on.

8           And this is the problem we have had throughout  
9 this proceeding, and it's been consistent, and it's  
10 just -- you know, all I can do is give you the best  
11 record that I can. And I can't do it if they are not  
12 going to give us how they got -- how they got the  
13 numbers that they put in their entire rebuttal case.

14           If you are going to characterize them as  
15 updates, and update that, we will deal with it. But  
16 this does not allow it.

17           JUDGE WALLIS: Let me ask for comments from  
18 other counsel. Mr. Finklea.

19           MR. FINKLEA: Your Honor, Tosco joins in the  
20 same objection and would support everything that  
21 Mr. Brena has said. And will add that we don't believe  
22 that simply having Ms. Hammer available for a deposition  
23 on Monday without workpapers to have our people go  
24 through between now and then is going to do us any good.  
25 If we simply go into a room on Monday with no numbers,

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1 the fact she's available for a deposition without having  
2 the information, isn't going to make up for the fact  
3 that we don't have the information that Mr. Brena has  
4 identified.

5 JUDGE WALLIS: Mr. Trotter.

6 MR. TROTTER: I am advised by Staff we did  
7 receive no workpapers for Ms. Hammer. We also asked the  
8 same data request, all workpapers of all witnesses.

9 Mr. Brena is essentially correct. In my  
10 experience workpapers are essential. They give the  
11 starting point, and reflect the calculations of how you  
12 get from the starting point to the ending point.  
13 Sometimes that is summarized in the exhibit, sometimes  
14 it isn't.

15 In this particular case we were, frankly,  
16 looking for workpapers, given our understanding of the  
17 rebuttal case. And we don't have them.

18 MR. BRENA: And Your Honor, if I could go an  
19 additional step, I would like to not have the response  
20 be from a witness in this proceeding, Mr. Beaver. I  
21 would like to have counsel for Tesoro (sic). Mr. Beaver  
22 does not represent this company in this proceeding, and  
23 is a witness.

24 MR. BEAVER: I do believe I am counsel of  
25 record, even though I am providing some basic

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1 information about my job as general counsel for Olympic  
2 concerning the contingencies that Olympic faces. But I  
3 would suggest that I am, and have been identified  
4 throughout this proceeding, as counsel for Olympic.

5 It's the first time it's ever been raised, but  
6 if you will look at all of the orders and everything  
7 else from this Commission, I am identified as counsel  
8 for Olympic.

9 MR. BRENA: I would like that clarified. My  
10 understanding was that he was not counsel of record for  
11 this proceeding. He was a witness.

12 JUDGE WALLIS: My recollection is that Mr.  
13 Beaver has appeared as counsel of record. He has acted  
14 as counsel in this proceeding, and that his appearance  
15 as counsel is not new.

16 MR. BRENA: So he is both counsel of record,  
17 and a witness in this proceeding?

18 JUDGE WALLIS: At this point he has submitted  
19 prefiled testimony. He has not been sworn as a witness,  
20 and his proposed exhibit has not been received in  
21 evidence.

22 MR. BRENA: We will discuss it when he takes  
23 the stand.

24 MR. BEAVER: Your Honor, with regard to the  
25 discovery issue, it was my understanding this morning



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1       that we were to provide those particular workpapers  
2       tomorrow.  And I believe we talked about that, and we  
3       are attempting to accumulate those.

4                The responses that we have here, which we  
5       indicated we would provide, were the workpapers of all  
6       the rebuttal witnesses which we were able to accumulate.  
7       And the fact that it includes Dan Cummings, I mean, it  
8       was requested by Staff.  This was a response to the UTC  
9       Staff discovery request.

10               But I believe this morning we had this  
11       discussion about providing workpapers for Ms. Hammer,  
12       and tomorrow was the date we indicated we would be  
13       providing those.

14               MR. TROTTER:  Your Honor, this is Don Trotter.  
15       And pardon me, I do recall a conversation with -- it  
16       could have been Mr. Beaver or Mr. Marshall.  Again, my  
17       memory from this morning is not good, and I do recall  
18       them saying the remaining workpapers would be provided  
19       tomorrow.

20               MR. BRENA:  Your Honor, what prompted this  
21       entire thing was the representation -- and I will just  
22       quote you directly from their response to Staff data  
23       request 417.  The request was, "Please provide the  
24       workpapers of all Olympic rebuttal witnesses."  That was  
25       the request.

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1           The response, and I quote, "Please see the  
2 attached workpapers of Dan Cummings, George Schink, and  
3 Brent Collins." New paragraph. "All other rebuttal  
4 witnesses either do not have workpapers or such  
5 workpapers were submitted with each witness's rebuttal  
6 testimony."

7           They affirmatively represent that what they are  
8 gathering doesn't exist. If it does exist, we want it  
9 tomorrow. So if I understood counsel for Olympic  
10 correctly, their response to the Staff's data request  
11 was false; is that correct? Could I ask for  
12 confirmation of that?

13           JUDGE WALLIS: Mr. Beaver.

14           MR. BEAVER: As we indicated, we are attempting  
15 to put together workpapers, as we understand that term  
16 to be, of Ms. Hammer. And I believe we indicated we  
17 were going to try to provide those tomorrow.

18           MR. BRENA: And what of Mr. Collins?

19           MR. BEAVER: I frankly don't know if, other  
20 than the papers you have for Mr. Collins, if any  
21 additional ones are being prepared.

22           COMMISSIONER HEMSTAD: So I take it you are  
23 conceding the response to the Staff data request is  
24 incorrect?

25           MR. MARSHALL: What we agreed to do --

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1                   COMMISSIONER HEMSTAD: No. No. I am asking  
2 the written response to the data request, is it correct  
3 or not?

4                   MR. BEAVER: As we indicated to Mr. Trotter  
5 this morning, we are trying to put together the  
6 additional workpapers.

7                   COMMISSIONER HEMSTAD: I am not asking that  
8 question. I am asking you to look at the response to  
9 the data request, and tell us if it is correct.

10                  MR. BEAVER: Not having written it, I honestly  
11 don't know.

12                  CHAIRWOMAN SHOWALTER: Well, do you acknowledge  
13 that the answer given there is inconsistent with a  
14 representation that you are gathering workpapers from  
15 any other rebuttal witness?

16                  MR. BEAVER: It is.

17                  CHAIRWOMAN SHOWALTER: So what are the facts?  
18 Are you expecting to produce workpapers from Ms. Hammer?

19                  MR. BEAVER: I am, yes.

20                  CHAIRWOMAN SHOWALTER: By tomorrow morning?

21                  MR. BEAVER: I don't know if it's tomorrow  
22 morning, but I thought it was tomorrow.

23                  COMMISSIONER HEMSTAD: I take it on the record  
24 that you are conceding that your answer to the data  
25 request was not correct?

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1                   MR. MARSHALL:    What we tried to do and  
2                   promised to do was to provide all the materials as we  
3                   got them.  And what we may have done here is to provide  
4                   the cover sheet for part of the materials.  But what we  
5                   did is, even before lunch, we tried to provide as much  
6                   as we could.  That was the commitment we made.  We said  
7                   we will provide them tomorrow, but we will try to gather  
8                   up as much as we could in the meantime.

9                   This will be the cover sheet to the completed  
10                  set.  It was a mistake to have the cover sheet before  
11                  lunch on top of a partial thing, but what we were trying  
12                  to do -- we thought we were trying to do the right thing  
13                  by trying to provide all that we had gathered up before  
14                  lunch.  After lunch we were in these sessions and it  
15                  doesn't help out --

16                  COMMISSIONER HEMSTAD:  We're just trying to get  
17                  to the facts.

18                  MR. MARSHALL:  And I believe that's what  
19                  occurred.  This is an incorrect cover sheet.  But  
20                  there's nothing but an attempt to get as much as we  
21                  could before tomorrow.

22                  MR. BRENA:  Let me just make the point that  
23                  this is factually wrong, whether it's after they produce  
24                  it tomorrow and attach it, or before.

25                  They affirmatively represent that there are no

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1 workpapers for Cynthia Hammer or Mr. Collins. So, you  
2 know, it can't be correct no matter when you read it.

3 Secondly, I am very concerned with the  
4 statement that we're focusing on Ms. Hammer only. And  
5 what I heard was Mr. Collins' are being prepared.  
6 Workpapers aren't prepared. Workpapers are. They are  
7 what you prepare before you file your case, before you  
8 prepare your case. They are your work product that goes  
9 into what you prepare and file with this Commission.  
10 They should not be preparing anything. They should be  
11 gathering the information that was previously prepared  
12 in support of their rebuttal case.

13 But specifically the core of the changes in  
14 their case are Collins and Hammer. And I haven't heard  
15 a representation yet that they are going to produce  
16 anything with regard to Collins. And this cannot be  
17 Collins.

18 So I would ask -- I don't think this issue is  
19 going to go away any time soon. I would ask their  
20 responses be tomorrow by noon, so we have the  
21 opportunity to review those responses, and renew this  
22 issue if they are not adequate.

23 If we get them at the end of the day on Friday,  
24 and I am down in my hotel room all weekend with not the  
25 information I need to work on, that's not a happy

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1 scenario for me. And it really interferes with my  
2 ability to conduct Ms. Hammer's deposition Monday at  
3 9:00. And I mean, this is the three-day time that we  
4 have to get caught up to their rebuttal case. So please  
5 help me.

6 COMMISSIONER HEMSTAD: I would make the  
7 comment, perhaps we can give counsel the benefit of the  
8 doubt. When they said "prepare," they probably meant  
9 "produced."

10 MR. BEAVER: Again, I have tried to express, I  
11 believe it was made to Mr. Trotter, that there was  
12 more -- going to be more stuff tomorrow in addition to  
13 this. And I admit that now that I have read the first  
14 page, it's not accurate.

15 JUDGE WALLIS: Is there any doubt at all on the  
16 part of the company what is meant by the term  
17 "workpapers"?

18 MR. BEAVER: Well, with regard to Cynthia  
19 Hammer, this is somebody who is simply taking data and  
20 updating data. So in my mind, workpapers is -- where  
21 that information came from, that data came from. And  
22 that seemed to be a little different than what I heard.

23 MR. BRENA: The source data she drew them from,  
24 and then she not only drew it from them, but she  
25 compiled it and transferred it to Mr. Collins, and he

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1 incorporated it in his cost of service case.

2 We should be able to start with the number she  
3 looked at, and we should be able to end at Mr. Collins'  
4 cost of service. If we can't start with what she  
5 started with, and if that's invoices it's invoices -- if  
6 we can't start where she started and ended and where  
7 Collins ends, it's not workpapers.

8 MR. TROTTER: I would add that the testimony  
9 that was read did refer to certain analysis of certain  
10 numbers, so certainly that is prime workpaper material.

11 JUDGE WALLIS: Very well. The Commission has  
12 considered the statements and the arguments of the  
13 parties and directs that and compels the company to  
14 produce the workpapers as defined by noon tomorrow here  
15 in this hearing room.

16 In addition, the Commission asks for and  
17 directs the Company to report, at the start of the  
18 hearing at 9:30 tomorrow morning, the status of the  
19 preparations, and directs and compels the presence of  
20 the witnesses, Collins and Hammer, on the conference  
21 bridge or in person at 1:30, so that the sufficiency of  
22 the workpapers and the completeness may be inquired into  
23 directly by questions of the witnesses.

24 The Company understands this; is that correct?

25 MR. MARSHALL: Yes, that's correct. Although

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1 I want to make a footnote on the idea that invoices are  
2 workpapers. If we had invoices for everything to start  
3 out the case, you would have invoices everywhere.

4 JUDGE WALLIS: I think the request was that the  
5 Company's witnesses produce the workpapers that  
6 demonstrate where they started from and where they ended  
7 up, and how he got there. And if the witnesses used  
8 invoices, then they are requested; if they used other  
9 information, then that is what is requested.

10 Is that right, Mr. Brena?

11 MR. BRENA: That's correct.

12 MR. FINKLEA: That's my understanding as well,  
13 Your Honor.

14 JUDGE WALLIS: Very well. Is there anything  
15 further this evening?

16 MR. BRENA: No, Your Honor.

17 JUDGE WALLIS: We will convene for the  
18 scheduling discussion at 8:30 tomorrow morning, and  
19 resume the evidentiary hearing at 9:30. Thank you all.

20 ENDING TIME: 6:35 P.M.

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